

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

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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, 2005**

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**YEAR ENDED SEPTEMBER 30, 2005**

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FEDERATED STATES OF MICRONESIA**

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**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

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

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**YEAR ENDED SEPTEMBER 30, 2005**

## INDEPENDENT AUDITORS' REPORT

Honorable Rensley A. Sigrav  
Governor, State of Kosrae  
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 State of Kosrae (the State), as of and for the year ended September 30, 2005, which collectively comprise the State'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 State. Our responsibility is to express an opinion on the respective financial statements based on our audit. We did not audit the financial statements of the Micronesia Petroleum Corporation, which represent 33% and 66%, respectively, of the assets and revenues of the State's discretely presented component units. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Micronesia Petroleum Corporation is based solely on the report of the other auditors.

Except as discussed in the following paragraphs, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 State'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 respective 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 and the report of other auditors provide a reasonable basis for our opinion.

As discussed in Note 2 to the financial statements, the Compact Capital Projects Fund reports its investment in SEMO-Micronesia, Inc., a 50%-owned corporation, at cost. In our opinion, the investment should be adjusted to reflect the Compact Capital Projects Fund's equity in the losses of that corporation to conform with accounting principles generally accepted in the United States of America, which would decrease the investment, decrease fund balance, and change the expenditures of the Compact Capital Projects Fund. Due to the lack of audited financial statements of SEMO-Micronesia, Inc., the amount by which this departure would affect investments, fund balance, and expenditures of the Compact Capital Projects Fund is not reasonably determinable.

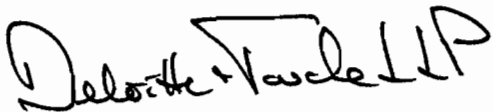
Because of inadequacies in the accounting records, we were unable to determine that advances recorded within the General Fund, the Compact Capital Projects Fund, and the aggregate remaining fund information; that receivables from federal agencies recorded within the Federal Grants Fund; and that loans receivable recorded within the aggregate remaining fund information were fairly stated as of September 30, 2005.

In our opinion, based on our audit and the report of other auditors, except for the effects of the matters discussed in the third, fourth and fifth paragraphs above, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae as of September 30, 2005, 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.

The Management's Discussion and Analysis, on pages 3 through 9, as well as the Schedule of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund and notes thereto, on pages 40 and 41, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the management of the State. 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 State's respective financial statements that collectively comprise the State'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 State, are presented for purposes of additional analysis and are not a required part of the basic financial statements of the State. 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 matters discussed in the fourth and fifth paragraphs 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 June 18, 2006 on our consideration of the State'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, appearing to read "Deloitte + Touche LLP", is written over a horizontal line.

June 18, 2006

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**Management's Discussion and Analysis  
September 30, 2005**

As management of Kosrae State Government, we offer readers of Kosrae State's financial statements this narrative overview and analysis of the financial activities of for the fiscal year ended September 30, 2005. We encourage readers to read the information presented here in conjunction with additional information that we have furnished in the State's financial statements, which follow this narrative.

**FINANCIAL HIGHLIGHTS**

- The assets of Kosrae State Government exceeded its liabilities at the close of fiscal year 2005 by \$39,622,907 (*net assets*) compared with net assets, as restated in 2004 of \$43,307,814, which is a decrease of \$3,684,907.
- The government's total net assets decreased by \$3,684,907 in 2005 when compared with 2004, primarily due to an increase in expenditures.
- Total revenues generated for fiscal year 2005 amounted to \$11,027,022 compared with total 2004 revenues of \$10,171,806, which is an increase of \$855,216, which is primarily attributed to greater revenues due to the increased receipt of Sector grants in 2005.
- Total expenditures amounted to \$14,711,929 in 2005 and \$12,939,005 in 2004, which is an increase of \$1,775,924.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This discussion and analysis are intended to serve as an introduction to Kosrae State's basic financial statements. The State's basic financial statements consist of three components; 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements (see Figure 1). The basic financial statements present two different views of the State through the use of government-wide statements and fund financial statements. In addition to the basic financial statements, this report contains other supplemental information that will enhance the reader's understanding of the financial condition of Kosrae State. The presentation of this financial report is from top level analysis down to detailed informative disclosures.



governmental activities, which works, safety and general major sources of these activities. fiscal year 2003 is the last year

most significant activities. A over resources that have been or states in the Federated States non-compliance) with finance-divided into three categories:

governmental activities in the services are accounted for in onverted into cash flow in and r spending in the next year. *ified accrual accounting*. This e governmental fund financial t determine if there are more or lationship between government f Activities) and governmental tements.

as major and non-major. The f Federal Grants and Compact

tanding of the data provided in

005 and 2004.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis  
September 30, 2005

	<u>Governmental Activities</u>	
	<u>2005</u>	<u>2004</u>
Current and other assets	\$ 5,134,419	\$ 5,877,466
Other non-current assets	<u>40,050,809</u>	<u>42,331,142</u>
Total assets	<u>45,185,228</u>	<u>48,208,608</u>
Current liabilities	3,226,511	2,563,297
Other liabilities	<u>2,335,810</u>	<u>2,337,497</u>
Total liabilities	<u>5,562,321</u>	<u>4,900,794</u>
Total net assets	\$ <u>39,622,907</u>	\$ <u>43,307,814</u>

The Summarized Statement of Net Assets of Kosrae State for the fiscal year ended September 30 2005 and 2004 are as follows:

	<u>Governmental Activities</u>	
	<u>2005</u>	<u>2004</u>
Revenues:		
Federal contributions	\$ 8,440,533	\$ 7,405,980
Charges for services	342,410	458,534
Revenue sharing	923,297	1,019,895
Investment earnings	237,446	207,516
Taxes	196,360	188,584
Other	<u>886,976</u>	<u>891,297</u>
Total revenues	<u>11,027,022</u>	<u>10,171,806</u>
Expenses:		
General government	4,685,687	3,809,287
Education	3,643,613	3,299,845
Health services	2,288,450	1,814,569
Capital projects	976,079	883,002
Public works	1,875,843	1,931,724
Economic development	87,963	-
Public safety	9,912	7,280
Other miscellaneous	<u>1,144,382</u>	<u>1,193,298</u>
Total expenses	<u>14,711,929</u>	<u>12,939,005</u>
Change in net assets	\$ <u>(3,684,907)</u>	\$ <u>(2,767,199)</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis  
September 30, 2005

Based on the summarized statement and on Figure 1 presented below, seventy-six percent (76%) of the States 2005 revenues came from Sector grants and Federal contributions.

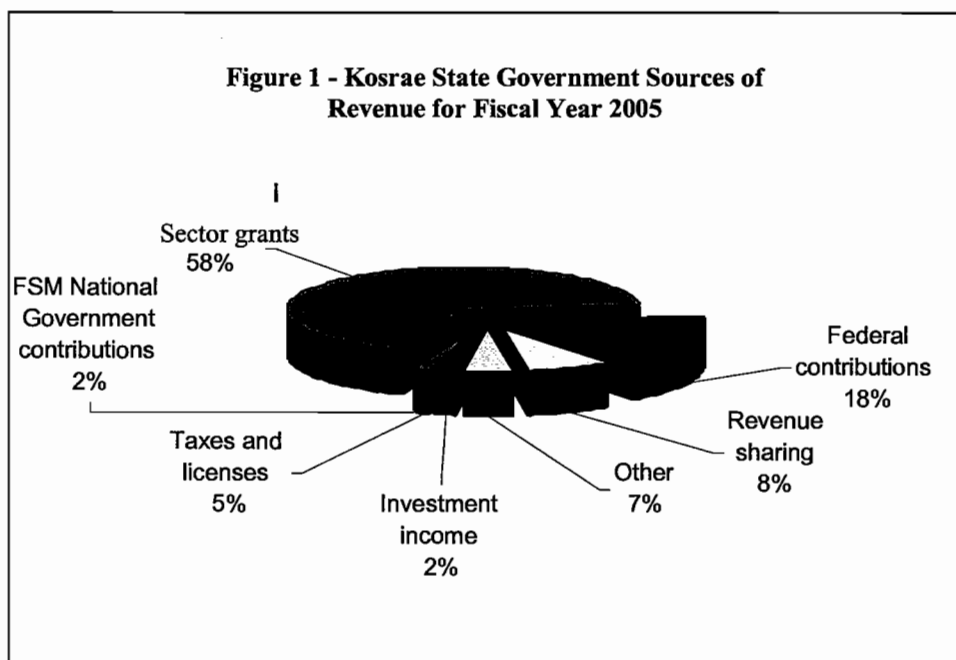
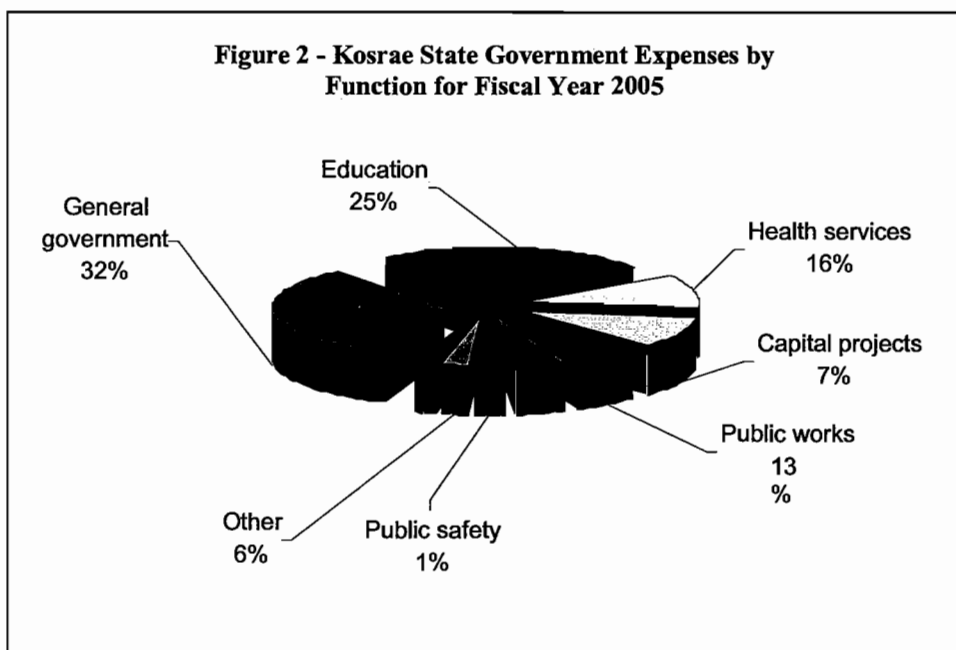


Figure 2 below shows that in 2005, the General Government and Education sector had the highest percentage which is 32% and 25% respectively, of the State's total expenditures.



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis  
September 30, 2005

**GOVERNMENTAL ACTIVITIES**

General Fund

The increase of \$455,216 or 4% of the total revenues compared to prior year was attributed to an increase in federal contributions due to the continued implementation of Sector grants. All other revenue categories remained relatively consistent.

The current year's General Government expenditures increased by \$876,400, which is almost 23% based on prior year amount, health services increased by \$478,881, which resulted in an increase of 26% compared with 2004 levels and education increased by \$343,768, which represents an increase of 10% over 2004 levels.

**REQUESTS FOR INFORMATION**

This report is designed to provide an overview of the State's finances for those with an interest in this area. Questions concerning any of the information found in this report or requests for additional information should be directed to the Director of Finance and Administration, P.O. BOX 878, Kosrae State, FM 96944.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

Statement of Net Assets  
September 30, 2005

	Primary Government	Component Units
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 63,281	\$ 279,105
Investments	820,058	1,796,163
Receivables, net of allowance for uncollectibles	3,946,924	823,470
Advances	272,229	-
Inventories	20,582	1,282,752
Other current assets	11,345	155,217
Total current assets	<u>5,134,419</u>	<u>4,336,707</u>
Noncurrent assets:		
Investments	2,682,000	-
Capital assets, net of accumulated depreciation	32,416,054	6,787,622
Restricted assets:		
Cash and cash equivalents	1,080,736	-
Investments	3,872,019	-
Total noncurrent assets	<u>40,050,809</u>	<u>6,787,622</u>
Total assets	<u>\$ 45,185,228</u>	<u>\$ 11,124,329</u>
<u>LIABILITIES</u>		
Current liabilities:		
Bank overdraft	\$ 520,098	\$ -
Current portion of long-term obligations	4,940	412,016
Short term line of credit	-	200,000
Accounts payable	1,570,242	273,555
Other liabilities and accruals	263,346	44,398
Deferred revenue	867,885	-
Total current liabilities	<u>3,226,511</u>	<u>929,969</u>
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	2,135,810	1,117,283
Due to primary government	-	62,278
Other noncurrent liabilities	200,000	-
Total noncurrent liabilities	<u>2,335,810</u>	<u>1,179,561</u>
Total liabilities	<u>5,562,321</u>	<u>2,109,530</u>
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	32,416,054	6,787,622
Restricted for:		
Compact related	4,859,828	-
Future operations	2,371,817	-
Other purposes	3,096,304	-
Unrestricted	<u>(3,121,096)</u>	<u>2,227,177</u>
Total net assets	<u>39,622,907</u>	<u>9,014,799</u>
Total liabilities and net assets	<u>\$ 45,185,228</u>	<u>\$ 11,124,329</u>

See accompanying notes to basic financial statements.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

Statement of Activities  
Year Ended September 30, 2005

Functions/Programs	Program Revenues				Net (Expenses) Revenues and Changes in Net Assets	
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government	Component Units
Primary government:						
Governmental activities:						
General government	\$ 4,685,687	\$ 132,126	\$ 3,087,248	\$ 7,218	\$ (1,459,095)	\$ -
Land and natural resources	87,963	-	66,809	-	(21,154)	-
Education	3,643,613	6,239	3,414,023	-	(223,351)	-
Health services	2,288,450	101,005	1,988,740	-	(198,705)	-
Public safety	9,912	-	-	-	(9,912)	-
Public works and transportation	1,875,843	103,040	-	-	(1,772,803)	-
Future operations	-	-	71,817	-	71,817	-
Capital projects	976,079	-	-	230,619	(745,460)	-
Other appropriations	1,144,382	-	70,674	-	(1,073,708)	-
Total primary government	<u>\$ 14,711,929</u>	<u>\$ 342,410</u>	<u>\$ 8,699,311</u>	<u>\$ 237,837</u>	<u>(5,432,371)</u>	<u>-</u>
Component units:						
Kosrae Utilities Authority	\$ 2,144,252	\$ 1,459,830	\$ -	\$ -	-	(684,422)
Micronesia Petroleum Corporation	3,182,806	3,055,470	-	-	-	(127,336)
Total component units	<u>\$ 5,327,058</u>	<u>\$ 4,515,300</u>	<u>\$ -</u>	<u>\$ -</u>	<u>-</u>	<u>(811,758)</u>
General revenues:						
Taxes:						
Revenue sharing					923,297	-
Excise taxes					196,360	-
Unrestricted investment earnings					237,446	68,488
Other					390,361	63,126
Total general revenues and transfers					<u>1,747,464</u>	<u>131,614</u>
Change in net assets					<u>(3,684,907)</u>	<u>(680,144)</u>
Net assets at the beginning of the year					<u>43,307,814</u>	<u>9,694,943</u>
Net assets at the end of the year					<u>\$ 39,622,907</u>	<u>\$ 9,014,799</u>

See accompanying notes to basic financial statements.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

Balance Sheet  
Governmental Funds  
September 30, 2005

	Special Revenue		Capital Projects	Permanent	Other Governmental Funds		Total
	General	U.S Federal Grants	Section 211 Sector Grants	Compact Capital Projects	Section 215 Compact Trust		
<b>ASSETS</b>							
Cash and cash equivalents	\$ 62,002	\$ -	\$ -	\$ -	\$ -	\$ 1,279	\$ 63,281
Equity in internal investment pool	155,556	-	-	664,502	-	-	820,058
Investments	150,000	-	-	2,532,000	-	-	2,682,000
Receivables, net:							
Loans	-	-	-	-	-	597,527	597,527
Federal agencies	1,124	1,994,843	237,083	-	-	-	2,233,050
CFSM	-	-	-	-	-	579,952	579,952
Other	462,586	-	35,827	-	-	37,982	536,395
Due from other funds	2,114,706	-	766,327	797,650	-	961,912	4,640,595
Advances	173,001	-	-	10,371	-	88,857	272,229
Prepaid items	-	11,345	-	-	-	-	11,345
Inventories	11,757	-	-	-	-	8,825	20,582
Restricted assets:							
Cash and cash equivalents	-	-	-	536,409	-	544,327	1,080,736
Pooled investments	-	-	-	-	-	1,500,202	1,500,202
Investments	-	-	-	-	2,371,817	-	2,371,817
Total assets	\$ 3,130,732	\$ 2,006,188	\$ 1,039,237	\$ 4,540,932	\$ 2,371,817	\$ 4,320,863	\$ 17,409,769
<b>LIABILITIES AND FUND BALANCES</b>							
<b>Liabilities:</b>							
Bank overdraft	\$ 520,082	\$ 16	\$ -	\$ -	\$ -	\$ -	\$ 520,098
Accounts payable	365,492	306,427	463,985	208,634	-	225,704	1,570,242
Other liabilities and accruals	112,214	4,059	148,833	(4,749)	-	2,989	263,346
Due to other funds	2,525,889	1,478,913	-	-	-	635,793	4,640,595
Deferred revenue	-	204,174	233,019	17,168	-	413,524	867,885
Total liabilities	3,523,677	1,993,589	845,837	221,053	-	1,278,010	7,862,166
<b>Fund balances:</b>							
<b>Reserved for:</b>							
Related assets	3,121,173	-	-	2,682,000	2,371,817	2,437,550	10,612,540
Encumbrances	87,031	357,086	328,506	259,052	-	164,009	1,195,684
Continuing appropriations	554,087	-	-	149,337	-	195,705	899,129
Compact programs	-	-	232,576	-	-	-	232,576
<b>Unreserved:</b>							
General fund	(4,155,236)	-	-	-	-	-	(4,155,236)
Special revenue funds	-	(344,487)	(367,682)	-	-	265,195	(446,974)
Capital projects funds	-	-	-	1,229,490	-	(19,606)	1,209,884
Total fund balances	(392,945)	12,599	193,400	4,319,879	2,371,817	3,042,853	9,547,603
Total liabilities and fund balances	\$ 3,130,732	\$ 2,006,188	\$ 1,039,237	\$ 4,540,932	\$ 2,371,817	\$ 4,320,863	

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

32,416,054

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:

Long-term debt payable

(2,140,750)

Claims payable

(200,000)

(2,340,750)

Net assets of governmental activities

\$ 39,622,907

See accompanying notes to basic financial statements.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficits)  
Governmental Funds  
Year Ended September 30, 2005

		Special Revenue		Capital Projects	Permanent	Other Governmental	Total
	General	U.S Federal Grants	Section 211 Sector Grants	Compact Capital Projects	Section 215 Compact Trust	Funds	
Revenues:							
Compact funding	\$ 9,269	\$ -	\$ 6,434,050	\$ -	\$ -	\$ -	\$ 6,443,319
Investment income	237,446	-	-	28,786	71,817	117,918	455,967
Federal contributions	-	1,997,214	-	-	-	-	1,997,214
FSM revenue sharing	923,297	-	-	-	-	-	923,297
State taxes	196,360	-	-	-	-	-	196,360
CFSM grants	-	-	-	-	-	201,833	201,833
Fees and charges	-	-	-	-	-	342,410	342,410
Other grants	-	-	-	-	-	76,261	76,261
Other	390,276	-	-	-	-	85	390,361
Total revenues	1,756,648	1,997,214	6,434,050	28,786	71,817	738,507	11,027,022
Expenditures:							
Current:							
General government	1,659,179	376,644	2,374,939	-	-	159,167	4,569,929
Land and Nautral Resources	30	66,809	-	-	-	-	66,839
Education	1,656	1,283,338	2,130,685	-	-	67,836	3,483,515
Health	45,093	257,824	1,733,916	-	-	126,391	2,163,224
Public Safety	2,412	-	-	-	-	-	2,412
Payments to non-governmental agencies	252,326	-	-	-	-	-	252,326
Boards, commissions and other	617,360	-	-	-	-	4,194	621,554
Capital projects	-	-	-	774,246	-	201,833	976,079
Total expenditures	2,578,056	1,984,615	6,239,540	774,246	-	559,421	12,135,878
Net change in fund balances	(821,408)	12,599	194,510	(745,460)	71,817	179,086	(1,108,856)
Fund balances (deficits) at the beginning of the year	428,463	-	(1,110)	5,065,339	2,300,000	2,863,767	10,656,459
Fund balances (deficits) at the end of the year	\$ (392,945)	\$ 12,599	\$ 193,400	\$ 4,319,879	\$ 2,371,817	\$ 3,042,853	\$ 9,547,603

See accompanying notes to basic financial statements.



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Reconciliation of the Statement of Revenues, Expenditure, and Changes in Fund  
Balances of Governmental Funds to the Statement of Activities  
Year Ended September 30, 2005

Amounts reported for governmental activities in the statement of activities on page 11 are different because:

Net change in fund balances - total governmental funds from page 13	\$ (1,108,856)
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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	(2,576,051)
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Change in net assets of governmental activities as presented on page 11.	\$ (3,684,907)
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**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**DISCRETELY PRESENTED COMPONENT UNITS  
Combining Statement of Net Assets  
September 30, 2005**

<u>ASSETS</u>	Kosrae Utilities Authority	Micronesia Petroleum Corporation	Total
Current assets:			
Cash and cash equivalents	\$ 248,597	\$ 30,508	\$ 279,105
Investments	1,764,339	31,824	1,796,163
Receivables, net:			
Federal agencies	7,785	-	7,785
General	202,195	613,490	815,685
Inventories	613,880	668,872	1,282,752
Prepayments	142,073	13,144	155,217
Total current assets	<u>2,978,869</u>	<u>1,357,838</u>	<u>4,336,707</u>
Noncurrent assets:			
Capital assets, net of accumulated depreciation	<u>4,509,386</u>	<u>2,278,236</u>	<u>6,787,622</u>
Total assets	<u>\$ 7,488,255</u>	<u>\$ 3,636,074</u>	<u>\$ 11,124,329</u>
 <u>LIABILITIES AND NET ASSETS</u>			
Current liabilities:			
Current portion of long-term debt	\$ -	\$ 412,016	\$ 412,016
Short term line of credit	200,000	-	200,000
Accounts payable	4,310	269,245	273,555
Accrued liabilities	33,906	10,492	44,398
Payable to Kosrae State Government	<u>-</u>	<u>62,278</u>	<u>62,278</u>
Total current liabilities	<u>238,216</u>	<u>754,031</u>	<u>992,247</u>
Noncurrent liabilities:			
Noncurrent portion of long-term debt	<u>-</u>	<u>1,117,283</u>	<u>1,117,283</u>
Total noncurrent liabilities	<u>-</u>	<u>1,117,283</u>	<u>1,117,283</u>
Total liabilities	<u>238,216</u>	<u>1,871,314</u>	<u>2,109,530</u>
Net assets:			
Invested in capital assets, net of related debt	4,509,386	2,278,236	6,787,622
Unrestricted	<u>2,740,653</u>	<u>(513,476)</u>	<u>2,227,177</u>
Total net assets	<u>7,250,039</u>	<u>1,764,760</u>	<u>9,014,799</u>
Total liabilities and net assets	<u>\$ 7,488,255</u>	<u>\$ 3,636,074</u>	<u>\$ 11,124,329</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**DISCRETELY PRESENTED COMPONENT UNITS  
Combining Statement of Revenues, Expenses, and Changes in Net Assets  
Year Ended September 30, 2005**

	Kosrae Utilities Authority	Micronesia Petroleum Corporation	Totals
Operating revenues:			
Charge for services	\$ 1,459,830	\$ 3,055,470	\$ 4,515,300
Operating expenses:			
Cost of goods sold	-	2,786,069	2,786,069
Personnel services	374,388	130,889	505,277
Fuel	1,119,340	7,299	1,126,639
Depreciation	461,378	34,037	495,415
Administration and general	128,343	-	128,343
Contractual services	-	24,049	24,049
Repair and maintenance	60,803	6,305	67,108
Taxes	-	124,578	124,578
Travel	-	12,905	12,905
Communications	-	6,435	6,435
Supplies and materials	-	8,187	8,187
Rent	-	5,400	5,400
Utilities	-	5,047	5,047
Others	-	31,606	31,606
Total operating expenses	<u>2,144,252</u>	<u>3,182,806</u>	<u>5,327,058</u>
Operating loss	<u>(684,422)</u>	<u>(127,336)</u>	<u>(811,758)</u>
Nonoperating revenues (expenses):			
Interest income	68,488	-	68,488
Other income (expense)	92,637	41,096	133,733
Interest expense	-	(70,607)	(70,607)
Total nonoperating revenues (expenses), net	<u>161,125</u>	<u>(29,511)</u>	<u>131,614</u>
Net loss	<u>(523,297)</u>	<u>(156,847)</u>	<u>(680,144)</u>
Net assets at beginning of year	<u>7,773,336</u>	<u>1,921,607</u>	<u>9,694,943</u>
Net assets at end of year	<u>\$ 7,250,039</u>	<u>\$ 1,764,760</u>	<u>\$ 9,014,799</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

(1) Summary of Significant Accounting Policies

The accompanying financial statements of the State of Kosrae (the State) 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 State's accounting policies are described below.

A. Reporting Entity

The State is one of the four states that make up the Federated States of Micronesia (FSM), along with the states of Chuuk, Pohnpei and Yap. The State is a constitutional government comprised of three branches: the Legislative Branch, consisting of 14 members elected for a term of four years by qualified voters of their respective election districts; the Executive Branch, headed by the Governor and Lt. Governor who are primarily responsible for executing the laws and administering state government services; and the Judiciary Branch made up of the State Supreme Court, which consists of a Chief Justice and up to four Associate Justices, and other courts that may be created by law.

For financial reporting purposes, the State has included all funds, organizations, agencies, boards, commissions and institutions. The State 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 State are such that exclusion would cause the State's financial statements to be misleading or incomplete. The criteria to be considered in determining financial accountability include whether the State, 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 State. 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 State has a September 30 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 State, are deemed to be related organizations. The nature and relationship of the State's component units and related organizations are disclosed in the following section.

Blended component units are entities that are legally separate from the State, but are so related to the State that they are, in substance, the same as the State or entities providing services entirely or almost entirely to the State. The State has not identified any entities that should be so blended.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

i. Discretely Presented Component Units

Discretely presented component units are entities which are legally separate from the State, but are financially accountable to the State, or whose relationships with the State are such that exclusion would cause the State'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:

Kosrae Utilities Authority (KUA): KUA was created by Kosrae State Law (KSL) No. 5-38 and is responsible for operating and maintaining, on a commercially accepted basis, the State's electric power. KUA is governed by a five-member Board of Directors, of which four members are appointed by the Governor subject to the advice and consent of the Legislature, and, ex-officio, the Director of the Department of Public Works.

Micronesian Petroleum Corporation (MPC): MPC was created by KSL No. 6-191 and is responsible for operating and managing the State's fuel storage facilities and to engage in the business of buying and selling petroleum products. MPC is governed by a five-member Board of Directors appointed by the Governor subject to the advice and consent of the Legislature.

Kosrae Port Authority (KPA): KPA was created by KSL No. 7-91 to operate, manage, equip, and maintain all ports of entry and to expand and improve upon services offered at the ports of entry. The official transfer of assets from the State to KPA has yet to occur; therefore, KPA's financial statements are not included in the accompanying financial statements.

The State'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 at the following address.

P.O. Box 727  
Tofol, Kosrae, FSM 96944

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.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

(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 \$10,327,949 of restricted net assets, of which \$3,096,304 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.

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.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

(1) Summary of Significant Accounting Policies, Continued

C. Fund Financial Statements, Continued

The State 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. 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 State 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 State 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.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

(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 State reports the following fund types:

1. Governmental Funds

i. General Fund

This fund is the primary operating fund of the State. 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 State capital facilities financed primarily from loans and federal reimbursements.

iv. Permanent Funds

This fund accounts for resources that are legally restricted to the extent that only earnings, and not principal, may be used to support programs for the benefit of the government.

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. 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 State reports the following major funds:



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

U.S. Federal Grants Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for all financial transactions of federally assisted funds, which are subgranted to the State, as well as other direct federal grants the State received from the U.S. government.

Section 215 Compact Trust, a Governmental Fund Type - Permanent Fund, accounts for the State's contributions to the Trust Fund established in accordance with Section 215 of the Compact of Free Association, as amended, to provide for an additional source of revenue for the government budget that will be needed to substitute for the absence of Compact of Free Association funding.

Compact Capital Projects Fund, a Governmental Fund Type - Capital Projects Fund. This fund accounts for United States Congress appropriations under United States Public Law 99-239, Title 2, Article 1, Section 211(a)(1) and approved by FSM Congress. The aforementioned section requires no less than 40% of the total amounts appropriated by the United States Congress to be applied to the capital account.

Section 211 Sector Grant Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for funds received under sector grants pursuant to the amended Compact of Free Association.

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 State'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 State 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 State. 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.

As of September 30, 2005, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit was \$1,144,017 and the corresponding bank balance was \$1,189,901, which is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2005, bank deposits in the amount of \$100,000 were FDIC insured. The State does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Therefore, these deposits are exposed to custodial credit risk.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

(1) Summary of Significant Accounting Policies, Continued

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

As of September 30, 2005, the carrying amount of the discretely presented component units' total cash and cash equivalents was \$279,105, which approximates the corresponding bank balance amount. All cash is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2005, bank deposits in the amount of \$300,000 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. Therefore, these deposits are exposed to custodial credit risk.

G. Investments

Investments 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. Investments in the equity of companies are carried at cost if less than twenty percent of the companies' total equity, on the equity method if greater than twenty percent and less than fifty percent and on a consolidated basis if greater than fifty percent.

H. Receivables

In general, tax revenue is recognized on the government-wide financial 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. Federal receivables include those funds which are earned, primarily from FSM National Government administered federal grants, which have yet to be reimbursed by the applicable grantor.

Receivables of the primary government are primarily due from businesses and individuals residing in the State. The State establishes an allowance for doubtful accounts receivable based on the credit risk of specific customers, historical trends and other information.

I. Prepaid Items

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 State 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.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

(1) Summary of Significant Accounting Policies, Continued

K. Inventories

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

Inventories of the discretely presented component units are valued at the lower of cost (FIFO) or market

L. Restricted Assets

As of September 30, 2005, cash and cash equivalents and time certificates of deposit of the primary government were restricted for the following uses:

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through loan agreements or enabling legislation. Specifically, the State has collateralized Asian Development Bank loan proceeds and earnings in the amount of \$1,500,202 for the Kosrae State Early Retirement Scheme. Furthermore, investments recorded in the Compact Trust Fund of \$2,371,817 are restricted in that they are not available to be used in current operations. As of September 30, 2005, cash and cash equivalents and time certificates of deposit of the primary government were restricted for the following uses:

Time certificate of deposit with a local bank as remaining loan proceeds of the \$2,000,000 Early Retirement loan with the Asian Development Bank.	\$ 166,540
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Time certificate of deposit of \$353,797 and demand deposit of \$23,990 with a local bank restricted for scholarships for post-secondary students.	377,787
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The State has restricted a time certificate of deposit that collateralizes a bank loan to Micronesian Petroleum Corporation, a component unit. (See Note 6)	210,672
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Time certificate of deposit of \$202,194 and demand deposit account of \$123,543 for the Loan Guarantee Escrow Account established for the sole purpose of loan collateralization made through the USDA Rural Development. The escrow account may be drawn down in the event of a borrower's default on the obligation under the terms of the promissory note and the deed of trust security instrument supporting such note and for which such note is guaranteed by the Kosrae State Housing Authority, the trustee of the Loan Guarantee Escrow Account.	<u>325,737</u>
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\$ 1,080,736

M. Capital Assets

Capital assets, which include property, plant, equipment and infrastructure (e.g. roads, bridges, ramps and other similar items), are reported in the governmental activity column of the government-wide financial statements.

Capital 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.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

(1) Summary of Significant Accounting Policies, Continued

M. Capital Assets, Continued

All land and non-depreciable land improvements are capitalized, regardless of cost. Singular pieces of machinery and equipment, other than vehicles, that equal or exceed \$50,000 are capitalized. Buildings and infrastructure projects with a cost that equals or exceeds \$100,000 are capitalized. The costs of normal maintenance and repairs that do not add to the value of assets or materially extend asset lives are not capitalized.

All vehicles have been grouped together regardless of cost and depreciated on a composite basis.

Capital assets 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	10 - 40 years
Infrastructure - roads, and bridges	5 - 50 years
Machinery, equipment and others	5 - 10 years

N. 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.

O. 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 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 one working day per bi-weekly pay period. All unused annual leave is cancelled at the end of each fiscal year. Accordingly, no liability is recorded for compensated absences in the accompanying statement of net assets.

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.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

**(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, 2005, is represented by the following assets:

	<u>General</u>	<u>U.S. Federal Grants</u>	<u>Section 211 Sector Grant</u>	<u>Compact Capital Projects</u>	<u>Section 215 Compact Trust</u>	<u>Other Governmental Funds</u>	<u>Totals</u>
Investments	\$ 164,617	\$ -	\$ -	\$ 2,682,000	\$ -	\$ -	\$ 2,846,617
Receivables:							
General	690,047	-	-	-	-	-	690,047
Loans	-	-	-	-	-	602,167	602,167
Federal agencies	2,266,509	-	-	-	-	-	2,266,509
Due from other funds	-	-	-	-	-	170,667	170,667
Restricted assets:							
Cash & cash equivalents	-	-	-	-	-	164,514	164,514
Investments	-	-	-	-	2,371,817	1,500,202	3,872,019
	<u>\$ 3,121,173</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,682,000</u>	<u>\$ 2,371,817</u>	<u>\$ 2,437,550</u>	<u>\$10,612,540</u>

The reserve for related assets within the General Fund includes the amount of \$164,617 set aside for future repayment of the Early Retirement Program Loan.

**Q. Risk Financing**

The State 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 State management believes it is more economical to manage its risks internally. In the event of claim settlements and judgments, the State 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. However, no material losses have been sustained from this practice in the last three years.

**R. New Accounting Standards**

During fiscal year 2005, the State implemented GASB 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.

For fiscal year 2006, the State will be implementing GASB Statement No. 42, Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries. The State does not believe that the implementation of this Statement will have a material effect on its financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

(1) Summary of Significant Accounting Policies, Continued

R. New Accounting Standards, Continued

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments. The provisions of this Statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In May 2004, GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment to NCGA Statement 1*. GASB Statement No. 44 improves the understandability and usefulness of statistical section information and adds information from the new financial reporting model for state and local governments required by GASB Statement No. 34. The provisions of this Statement are effective for periods beginning after June 15, 2005. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In July 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other post employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In December 2004, GASB issued Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefit Expenditures/Expense and Liabilities by cost-Sharing Employers*. GASB Technical Bulletin No. 2004-2 clarifies the requirements of GASB Statement Nos. 27 and 45 for recognition of pension and other postemployment benefit expenditures/expense and liabilities by cost-sharing employers. Management does not believe the implementation of this pronouncement will have a material effect on the financial statements of the State.

In June 2005, GASB issued Statement No. 47, *Accounting for Termination Benefits*. GASB Statement No. 47 establishes guidance for state and local governmental employers on accounting and financial reporting for termination benefits. These benefits include incentives for voluntary terminations (e.g., early retirement window programs) and severance payments with respect to involuntary terminations. The provisions of this Statement are effective for periods beginning after June 15, 2005. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

(1) Summary of Significant Accounting Policies, Continued

S. 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.

(2) Deposits and Investments

GASB Statement No. 40 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 rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

The State 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. The State has invested the majority of its excess Compact Funds in a pooled investment fund which is managed under the control of the Federated Development Authority, an entity comprised of the FSM National Government and its four component states. Investment income originating from the pool accrues to the General Fund.

The deposit and investment policies of the State are governed by State legislation. The Treasurer is responsible for ensuring that deposits of the General Fund are maintained in commercial checking or savings accounts of any financial institution whose assets are at least \$1 billion and whose deposits are subject to Federal Deposit Insurance Corporation (FDIC) insurance. The Governor is responsible for the investment of any monies of the State that are deemed not necessary for immediate use.

The Federated Development Authority has selected investment managers who are given authority to buy and sell securities. These investment managers may invest in stocks, bonds and cash equivalents, for which minimum standards of quality of such investments at the time of purchase shall be as follows:

- i. Cash equivalents - the investment manager may engage in all normally accepted short-term investment practices including, but not limited to U.S. Treasury and government agency securities, bankers acceptances, certificates of deposit, commercial paper and repurchase agreements using any of the foregoing as collateral. The following restrictions apply: (1) Commercial paper must be rated A-1/P-1 or higher by Standard & Poors Corporation and Moody's Investor Services; and (2) Certificates of deposit must be from FDIC insured banks or FSLIC insured savings and loan associations, both of which must have assets in excess of \$2 billion. Deposits in smaller institutions are acceptable, but must not exceed the amount of the insurance, unless collateralized by U.S. Treasury obligations at 102%.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

**(2) Deposits and Investments, Continued**

- ii. Stocks - A "B" rating by a national rating service. Non-rated stocks, such as banks or insurance companies, must be equal in quality or higher.
- iii. Bonds - Confined to issues rated "A" or higher by a national rating service, except in the case of U.S. Treasury or government agency obligations which are not rated.

The equity portfolio shall be diversified among issues and industry classifications. No more than 25% of the equity portfolio may be invested in any single classification, as described by the Standard and Poors 500 Index, unless prior approval is received from the Secretary of Finance.

No investment may be made in a single corporate entity which exceeds 5% of the total assets of the fund at the time of purchase without prior approval of the Secretary of Finance.

**A. Deposits**

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

Category 1      Deposits that are federally insured or collateralized with securities held by the State or its agent in the State's name;

Category 2      Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in the State's name; or

Category 3      Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in the State's name and non-collateralized deposits.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the State's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. The State does not have a deposit policy for custodial credit risk.

**B. Investments**

GASB Statement No. 3 previously required government entities to present investment risks in terms of whether the investments fell into the following categories:

Category 1      Investments that are insured or registered, or securities held by the State or its agent in the State's name;

Category 2      Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the State's name; or



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

**(2) Deposits and Investments, Continued**

**B. Investments**

Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the State's name.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for investments falling into categories 1 and 2, and provided for disclosure requirements addressing other common risks of investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. GASB Statement No. 40 did retain and expand the element of custodial credit risk in GASB Statement No. 3.

As of September 30, 2005, the State's investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ <u>485,283</u>
Other investments:	
Domestic equities	1,715,560
Money market funds	116,233
Cash management account	<u>2,375,001</u>
	<u>4,206,794</u>
	\$ <u>4,692,077</u>

As of September 30, 2005, the State's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

	Credit Ratings	Investment Maturities (In Years)				Fair Value
		Less Than 1	1 to 5	6 to 10	Greater Than 10	
U.S. government obligations	Aaa	\$ 4,696	\$ 41,099	\$ 15,291	\$ 49,297	\$ 110,383
U.S. government agency obligations	Aaa	55,693	78,131	48,357	25,379	199,560
Corporate notes and bonds	Aaa	4,701	26,608	12,231	4,644	48,184
Corporate notes and bonds	Aa1	-	4,522	-	-	4,522
Corporate notes and bonds	Aa2	-	15,322	9,723	-	25,045
Corporate notes and bonds	Aa3	-	11,824	9,814	100	21,738
Corporate notes and bonds	A1	4,707	-	4,962	10,107	19,776
Corporate notes and bonds	A2	-	19,246	10,099	7,272	36,617
Corporate notes and bonds	A3	-	3	-	-	3
Corporate notes and bonds	Baa1	-	1,171	492	5,582	7,245
Corporate notes and bonds	Baa2	-	689	1,290	1,388	3,367
Corporate notes and bonds	Baa3	-	-	1,181	461	1,642
Corporate notes and bonds	Not rated	-	1,199	483	5,519	7,201
		<u>\$ 69,797</u>	<u>\$ 199,814</u>	<u>\$ 105,923</u>	<u>\$ 109,749</u>	<u>\$ 485,283</u>

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. With the exception of investments in U.S. government securities, which are explicitly or implicitly guaranteed by the United States government, all other investments must be rated in accordance with the State's investment policy.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

(2) Deposits and Investments, Continued

B. Investments, Continued

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the State will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The State's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the State's name by the State's custodial financial institutions at September 30, 2005.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the State. As of September 30, 2005, the State did not hold an investment in any one issuer that represented more than 5% of the State's total investments.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. The State does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

As of September 30, 2005, the Compact Capital Projects Fund holds 5.4% of the shares of the Bank of the Federated States of Micronesia in the amount of \$500,000, 9% of the shares of the Pacific Islands Development Bank in the amount of \$450,000, and 50% of the shares in a joint venture with Semo Co., Ltd, a Korean Company, of Semo-Micronesia, Inc. in the amount of \$1,732,000. As the fair market value of these investments is not readily available, such have been recorded at cost.

In addition, as of September 30, 2005, the Compact Capital Projects Fund holds 100% of the shares of Pacific Tuna Ventures, Inc. and 50% of the shares in a joint venture with the National Fisheries Corporation of Kosrae Sea Ventures, Inc. These investments are accounted for using the equity method and, accordingly, the carrying values have been reduced to \$0.

Discretely Presented Component Units

Common Stock	\$ 31,824
Money market funds	<u>1,764,339</u>
	\$ <u>1,796,163</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

**(3) Receivables**

Receivables as of September 30, 2005, for the primary government's individual major funds and nonmajor funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	<u>General</u>	<u>U.S. Federal Grants</u>	<u>Section 211 Sector Grant</u>	<u>Compact Capital Projects</u>	<u>Section 215 Compact Trust</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Receivables:							
Federal Agencies	\$ -	\$ 2,217,801	237,083	\$ -	\$ -	\$ 173,144	\$ 2,628,028
Taxes	168,222	-	-	-	-	579,952	748,174
Loans	292,000	-	-	367,500	-	1,059,776	1,719,276
CFSM	9,461	728,828	-	-	-	-	738,289
Other	<u>34,027</u>	<u>54,798</u>	<u>35,827</u>	<u>-</u>	<u>-</u>	<u>367,278</u>	<u>491,930</u>
	503,710	3,001,427	272,910	367,500	-	2,180,150	6,325,697
Less: allowance for uncollectible accounts	<u>(40,000)</u>	<u>(1,006,584)</u>	<u>-</u>	<u>(367,500)</u>	<u>-</u>	<u>(964,689)</u>	<u>(2,378,773)</u>
Net receivables	<u>\$ 463,710</u>	<u>\$ 1,994,843</u>	<u>\$ 272,910</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,215,461</u>	<u>\$ 3,946,924</u>

Loans receivable of the primary government as of September 30, 2005 are as follows:

**Major Governmental Funds**

**Compact Capital Projects Fund:**

Note receivable due from Micronesian Petroleum Corporation, payable in monthly installments of \$2,628, uncollateralized, due February 1, 2009, interest at 1% per annum. This note has been fully provided for in the allowance for uncollectibles. \$ 272,500

Note receivable due from Pacific Tuna Ventures, Inc., payable in monthly installments of \$11,875, uncollateralized, due May 1996, interest at 3% per annum. This note has been fully provided for in the allowance for uncollectibles. 95,000

Less: Allowance for uncollectibles (367,500)

\$ -

**Nonmajor Governmental Funds**

Loans receivable from post-secondary students issued under a student financial assistance program to qualified Kosraean students, uncollateralized with interest at up to 6% per annum. These loans have been fully provided for in the allowance for uncollectibles. \$ 43,427

Low-income housing loans, details and terms of those loans have not been compiled and such have been provided for in the allowance for uncollectibles. 1,432,910

(1,476,337)

\$ -

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

**(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, 2004, are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	U.S. Federal Grants	\$ 1,478,913
General	Nonmajor governmental funds	961,912
Section 211 Sector Grant	General	766,327
Compact Capital Projects	General	797,650
Nonmajor governmental funds	General	<u>635,793</u>
		<u>\$ 4,640,595</u>

**(5) Fixed Assets**

Capital asset activities for the year ended September 30, 2005, are as follows:

**Primary Government**

	Balance October 1, 2004	Additions	Retirements	Balance September 30, 2005
Governmental activities:				
Buildings	\$ 13,251,456	\$ -	\$ -	\$ 13,251,456
Infrastructure	72,885,749	-	-	72,885,749
Machinery, equipment, others	<u>3,257,760</u>	<u>66,750</u>	<u>-</u>	<u>3,324,510</u>
	<u>89,394,965</u>	<u>66,750</u>	<u>-</u>	<u>9,461,715</u>
Less accumulated depreciation:				
Buildings	(9,757,400)	(367,851)	-	(10,125,251)
Infrastructure	(42,126,605)	(2,104,088)	-	(44,230,693)
Machinery, equipment, others	<u>(2,518,855)</u>	<u>(170,862)</u>	<u>-</u>	<u>(2,689,717)</u>
	<u>(54,402,860)</u>	<u>(2,642,801)</u>	<u>-</u>	<u>(57,045,661)</u>
	<u>\$ 34,992,105</u>	<u>\$ (2,576,051)</u>	<u>\$ -</u>	<u>\$ 32,416,054</u>

During the year ended September 30, 2005, depreciation expense was charged as follows:

General government	\$ 182,508
Land and natural resources	21,124
Education	160,098
Health services	125,226
Public safety	7,500
Public works and Transportation	1,875,843
Boards, Commissions and other	<u>270,502</u>
	<u>\$ 2,642,801</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

**(5) Fixed Assets, Continued**

**Discretely Presented Component Units**

	Balance October 1, 2004	Additions	Retirements	Balance September 30, 2005
Electrical plant in service	\$ 9,117,035	\$ 378,083	\$ (917)	\$ 9,494,201
Bulk plant	2,506,000	-	-	2,506,000
Building and improvements	207,346	-	-	207,346
Land	200,000	-	-	200,000
Machinery and equipment	417,384	32,712	(4,905)	445,191
Vehicles	295,664	-	-	295,664
Furniture and fixtures	61,521	-	-	61,521
	<u>12,804,950</u>	<u>410,795</u>	<u>(5,822)</u>	<u>13,209,923</u>
Less accumulated depreciation	<u>(6,062,846)</u>	<u>(569,118)</u>	<u>5,107</u>	<u>(6,626,857)</u>
	6,742,104	(158,413)	(715)	6,583,066
Construction in progress	<u>268,816</u>	<u>294,987</u>	<u>(359,247)</u>	<u>204,556</u>
	<u>\$ 7,010,920</u>	<u>\$ 136,664</u>	<u>\$ (359,962)</u>	<u>\$ 6,787,622</u>

**(6) Long-term Obligations**

**Primary Government**

**Malem Wastewater System Project (MWSP) Loan:**

During the year ended September 30, 1999, the State borrowed \$145,000 from the U.S. Department of Agriculture Rural Utilities Services for the Malem Wastewater System Project, payable in annual installments of \$8,199 commencing September 28, 2001, interest at 4.5% per annum, due September 28, 2041. As of September 30, 2005, the balance payable on this mortgage loan amounted to \$140,750.

**Asian Development Bank (ADB) Early Retirement Program Loan:**

During the year ended September 30, 1998, the State implemented an Early Retirement Scheme (ERS) in which employees holding certain nonessential positions as identified by the State were retired early with a payout of the equivalent of two-years' wages. This ERS program is funded by a \$2,000,000 loan from the ADB through the FSM National Government, non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The activities of the ERS Program are recorded in the Early Retirement Program Fund, a nonmajor governmental fund.

The ADB loan has a grace period of ten years with the first payment due in February 2008 and the last payment in August 2038. However, pursuant to the terms of the Financing Agreement between the State and the FSM National Government, the State is required to deposit into the ERS Trust account held in the name of the State within the FSM National Government investment portfolio, 100% of the outstanding principal balance by September 30, 2002.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

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

**Primary Government, Continued**

Funds for the repayment of the ADB loan are expected to be derived from the annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The Financing Agreement requires the State to continue to appropriate salaries for the abolished positions and deposit the appropriate funds into the ERS Trust Account. These funds had not been deposited to the Trust Account as of September 30, 2002. \$2,000,000 identified for future debt service payments is included in the General Fund and the Early Retirement Program Fund reserve for related assets of which \$1,500,202 is actually deposited in an investment account held jointly with the FSM National Government. That investment account is restricted for the repayment of this debt.

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 4,940	\$ 6,192	\$ 11,132
2007	1,764	6,116	7,880
2008	41,844	6,036	47,880
2009	41,927	5,953	47,880
2010	42,013	5,867	47,880
2011 - 2015	211,510	27,889	239,399
2016 - 2020	214,343	25,056	239,399
2021 - 2025	417,875	21,524	439,399
2026 - 2030	422,275	17,124	439,399
2031 - 2035	427,759	11,640	439,399
2036 - 2040	<u>314,500</u>	<u>4,806</u>	<u>319,306</u>
	\$ <u>2,140,750</u>	\$ <u>138,203</u>	\$ <u>2,278,953</u>

Other long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2005, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net assets:

	<u>Balance October 1, 2004</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance September 30, 2005</u>	<u>Due Within One Year</u>
Loans payable:					
ADB loan	\$ 2,000,000	\$ -	\$ -	\$ 2,000,000	-
MWSP loan	<u>140,750</u>	<u>-</u>	<u>-</u>	<u>140,750</u>	<u>4,940</u>
	<u>2,140,750</u>	<u>-</u>	<u>-</u>	<u>2,140,750</u>	<u>4,940</u>
Other:					
Claims	<u>200,000</u>	<u>-</u>	<u>-</u>	<u>200,000</u>	<u>-</u>
	<u>\$ 2,340,750</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,340,750</u>	<u>\$ 4,940</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

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

Discretely Presented Component Units

Micronesia Petroleum Corporation (MPC):

Loan payable to the State, due in monthly installments of \$2,628, uncollateralized, due February 1, 2009, interest at 1% per annum. \$ 272,500

Loan payable to the FSM Development Bank in the original amount of \$500,000 due in monthly installments of \$5,100, with a balloon payment of approximately \$264,000 due at maturity. Interest is at 9%, maturity in September 2008, collateralized by property and inventory of MPC 331,231

Loan payable to Kosrae State Government, primary government in the original amount of \$300,000 due in monthly installments of \$2,000. Commencing June 1, 2008 installments shall be increased to \$4,000 per month, interest at 1%. 292,000

Term loan payable to Bank of the FSM, interest at 2.75% greater than TCD rate pledged as collateral by Kosrae State Government, collateralized by a first security interest in essentially all MPC assets and a time certificate of deposit held by Kosrae State Government. 200,640

Loan payable to FSM Development Bank, ten year term, interest at 5%, monthly repayment of \$7,985. 432,928

Total debt 1,529,299  
Less current portion (412,016)

Long-term debt, net of current portion \$ 1,117,283

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 412,016	\$ 51,339	\$ 463,355
2007	136,038	17,818	153,856
2008	347,017	35,870	382,887
2009	366,594	37,319	403,913
2010	70,407	3,668	74,075
2011 - 2015	<u>197,227</u>	<u>9,861</u>	<u>207,088</u>
	<u>\$1,529,299</u>	<u>\$155,875</u>	<u>\$1,685,174</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

**(7) Short-Term Line of Credit**

**Discretely Presented Component Units**

Kosrae Utilities Authority (KUA):

From October 1, 2004 through August 2005, KUA maintained a \$200,000 bank line of credit that was not utilized. In August 2005, KUA increased the line to \$500,000. The notes are due in ninety day terms, interest is at 4%, and the line is collateralized by time certificates of deposit of \$632,848. Only one drawdown of \$200,000 occurred against the line, which drawdown is outstanding as of September 30, 2005.

**(8) Contingencies and Commitments**

**Sick Leave**

It is the policy of the State 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, 2005 is \$134,396.

**Insurance Coverage**

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

**Federal Grants**

The State 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 \$875,725 relating to fiscal years 1996 through 2005 have been set forth in the State's Single Audit Report for the year ended September 30, 2005. 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.

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

**Litigation**

The State is party to numerous legal proceedings, many of which are normal recurrences in governmental operations. The State's Attorney General is of the opinion that the probable outcome of suits existing at September 30, 2005, is not predictable but could have a material impact on the accompanying financial statements. Such impact has currently been estimated to approximate \$200,000, which has been recorded as a liability in the accompanying statement of net assets.



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2005

**(9) Individual Deficit Fund Balances**

Specific individual funds which had significant individual deficit fund balances as at September 30, 2005, are as follows:

**Nonmajor Governmental Funds**

General Fund	\$ <u>392,945</u>
Airport Trust Fund	\$ <u>93,368</u>
Scholarship Revolving Fund	\$ <u>85,351</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

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

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**YEAR ENDED SEPTEMBER 30, 2005**

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

Schedule of Revenues, Expenditures and Changes in Deficit - Budget and Actual  
General Fund  
Year Ended September 30, 2005

	Budgeted Amounts		Actual - Budgetary Basis (see Note 1)	Variance
	Original	Final		
Revenues:				
Compact funding	\$ 11,577,493	\$ 9,269	\$ 9,269	\$ -
FSM Revenue sharing	2,397,717	923,297	923,297	-
State taxes	-	196,360	196,360	-
Investment income	-	237,446	237,446	-
Other	1,916,639	390,276	390,276	-
Total revenues	15,891,849	1,756,648	1,756,648	-
Expenditures:				
Current:				
General government	2,269,180	1,869,742	1,659,179	210,563
Department of Land and Natural Resources	972,745	-	30	(30)
Department of Education	4,614,635	-	1,656	(1,656)
Department of Health Services	1,970,894	46,589	45,093	1,496
Department of Public Safety	-	2,500	2,412	88
Office of the Attorney-General	443,505	-	-	-
Other appropriations	1,484,197	1,096,339	617,360	478,979
Payments to Non-governmental Agencies	59,954	109,618	252,326	(142,708)
Grants to local governments	4,076,739	-	-	-
Total expenditures	15,891,849	3,124,788	2,578,056	546,732
Deficiency of revenues under expenditures	-	(1,368,140)	(821,408)	546,732
Other financing uses:				
Operating transfers out	-	-	-	-
Net change in unreserved deficit	-	(1,368,140)	(821,408)	546,732
Other changes in unreserved deficit:				
Increase in reserve for related assets	-	-	(58,276)	(58,276)
Decrease in encumbrances	-	-	83,152	83,152
Decrease in reserve for continuing appropriations	-	-	(341,302)	(341,302)
Unreserved deficit at the beginning of the year	(3,017,402)	(3,017,402)	(3,017,402)	-
Unreserved deficit at the end of the year	\$ (3,017,402)	\$ (4,385,542)	\$ (4,155,236)	\$ 230,306

See accompanying notes to required supplementary information - budgetary reporting.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Required Supplementary Information – Budgetary Reporting  
September 30, 2005

**(1) Budgetary Information**

The Governor presents to the Kosrae State Legislature, prior to September 30, proposed budget estimates for the fiscal year commencing October 1. The budget estimates include the overall and total proposed expenditures of the State and the means of financing those expenditures. The Kosrae State Legislature reviews and approves these estimates making changes, as it deems appropriate. The Appropriation Committee of the Kosrae State Legislature, during the regular session of the Kosrae State Legislature, holds public hearings at which time Departments and Offices are required to justify their budget estimates. During the regular session of the Kosrae State Legislature, an appropriation bill, as required by the Constitution, is introduced and budget estimates are then legally enacted by the Kosrae State Legislature.

Formal budget integration is employed as a management control device during the year for all funds. The Kosrae State Legislature 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. The State does not establish budgets for the operations of its other governmental funds.

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, 2005, 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>
USDA Rural Development	\$ 157,708

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

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**OTHER SUPPLEMENTARY INFORMATION**

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**YEAR ENDED SEPTEMBER 30, 2005**

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

Combining Schedule of Expenditures by Account  
Governmental Funds  
Year Ended September 30, 2005

		Special Revenue		Capital Projects	Permanent	Other	
		U.S Federal	Section 211	Compact	Section 215	Governmental	
	General	Grants	Sector Grant	Capital Projects	Compact Trust	Funds	Total
Expenditures:							
Salaries and wages	\$ 1,747,823	\$ 643,877	\$ 3,849,431	\$ 2,864	\$ -	\$ 91,120	\$ 6,335,115
Grants and subsidies	-	192,360	-	-	-	-	192,360
Contractual services	189,066	270,605	800,474	597,872	-	28	1,858,045
Capital outlay	45,425	243,343	203,221	151,099	-	153,193	796,281
Utilities	75,122	7,752	213,058	-	-	27,998	323,930
Travel	243,671	208,369	144,841	275	-	6,493	603,649
Supplies and materials	109,209	256,123	232,873	21,006	-	69,820	689,031
Medical supplies	-	8,339	218,758	-	-	95,814	322,911
Medical referral	-	-	43,705	-	-	-	43,705
Scholarship and training	22,828	-	292,486	-	-	67,836	383,150
POL	11,435	6,277	30,835	1,130	-	2,748	52,425
Communications	49,747	42,577	64,717	-	-	8,991	166,032
Food stuffs	17,591	-	15,615	-	-	2,698	35,904
Rentals	26,760	1,598	728	-	-	275	29,361
Repairs and maintenance	2,329	-	2,109	-	-	-	4,438
Printing and reproduction	2,663	6,450	13,694	-	-	899	23,706
Freight	582	231	1,335	-	-	-	2,148
Other	33,805	96,714	111,660	-	-	31,508	273,687
	<u>\$ 2,578,056</u>	<u>\$ 1,984,615</u>	<u>\$ 6,239,540</u>	<u>\$ 774,246</u>	<u>\$ -</u>	<u>\$ 559,421</u>	<u>\$ 12,135,878</u>

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function, and Changes in Fund Balance  
General Fund  
Year Ended September 30, 2005  
(with comparative totals for the year ended September 30, 2004)

	2005	2004
Revenues:		
Compact funds:		
Current Section 211(a) base grant	\$ 9,269	\$ -
	<u>9,269</u>	<u>-</u>
FSM Revenue sharing	923,297	1,019,895
State taxes:		
Sales tax	96,204	93,888
Alcohol and tobacco tax	75,747	66,716
Licenses and Fees	15,818	19,482
Tax penalties	8,591	8,498
	<u>196,360</u>	<u>188,584</u>
Investment income	237,446	207,516
Other revenues	390,276	1,041,632
Total revenues	<u>1,756,648</u>	<u>2,457,627</u>
Expenditures:		
Current:		
General government:		
Governor and staff	465,399	504,362
Department of Treasury and Administration	-	786,425
Judiciary Branch	383,857	380,622
Legislative Branch	809,923	761,314
Public Auditor	-	1,418
	<u>1,659,179</u>	<u>2,434,141</u>
Department of Land and Natural Resources:		
Office of the Director	30	804
	<u>30</u>	<u>804</u>
Department of Education:		
Office of the Director	1,656	44,941
Division of Instructional Services	-	3,550
Division of Curriculum Development	-	536
Facilities Special Services	-	(540)
	<u>1,656</u>	<u>48,487</u>
Department of Health Services:		
Division of Administration and Health Planning	45,093	174,440
Division of Hospital Services	-	667
	<u>45,093</u>	<u>175,107</u>
Department of Public Safety:		
Division of Law	2,412	(120)
	<u>2,412</u>	<u>(120)</u>
Office of the Attorney-General	-	(100)

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function, and Changes in Fund Balance, Continued  
General Fund  
Year Ended September 30, 2005

	2005	2004
Expenditures, continued:		
Current, continued:		
Boards, Commissions and Other:		
Transportation and Infrastructure	460,022	474,305
Community Affairs	-	137,365
Scholarship Board	-	99,027
Kosrae Utility Authority	-	70,000
Broadcast Authority	-	78,027
Economic Development Authority	-	60,336
Sports Operation	-	35,074
KSA Conservation and Safety Organization	-	10,000
KCAP Operations - legislative	-	5,000
Kosrae State Election Commission	-	4,442
Kosrae Port Authority	-	2,189
Parole Board	-	1,182
EPIC Conference	-	816
Other	157,338	-
Development Review Commission	-	(284)
	<u>617,360</u>	<u>977,479</u>
Payments to Non-governmental Agencies:		
Micronesian Legal Services Corporation	-	30,000
USDA Rural Development	252,326	51,911
Kosrea Visitors Bureau	-	44
	<u>252,326</u>	<u>81,955</u>
Total expenditures	<u>2,578,056</u>	<u>3,717,753</u>
Deficiency of revenues under expenditures	<u>(821,408)</u>	<u>(1,260,126)</u>
Other financing uses:		
Operating transfers out:		
U.S. Federal Grants Fund	-	(596,522)
Section 215 Compact Trust Fund	-	(288,760)
	<u>-</u>	<u>(885,282)</u>
Net change in fund balance	<u>(821,408)</u>	<u>(2,145,408)</u>
Fund balance at the beginning of the year	<u>428,463</u>	<u>2,573,871</u>
Fund balance (deficit) at the end of the year	<u>\$ (392,945)</u>	<u>\$ 428,463</u>

See Accompanying Independent Auditors' Report.



STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function and Changes in Fund Balance (Deficit)  
Budget and Actual - General Fund  
Year Ended September 30, 2005

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final		
Revenues:				
Compact funding:	\$ 11,577,493	\$ 9,269	\$ 9,269	\$ -
FSM Revenue sharing:	2,397,717	923,297	923,297	-
State taxes:				
Sales tax	-	96,204	96,204	-
Alcohol and tobacco tax	-	75,747	75,747	-
Licenses and Fees	-	15,818	15,818	-
Tax penalties	-	8,591	8,591	-
	-	196,360	196,360	-
Investment income	-	237,446	237,446	-
Other revenues	1,916,639	390,276	390,276	-
Total revenues	15,891,849	1,756,648	1,756,648	-
Expenditures:				
Current:				
General government:				
Governor and staff	264,529	579,729	465,399	114,330
Department of Treasury and Administration	589,591	78,000	-	78,000
Judiciary Branch	422,323	397,323	383,857	13,466
Legislative Branch	814,690	814,690	809,923	4,767
Public Auditor	178,047	-	-	-
	2,269,180	1,869,742	1,659,179	210,563
Department of Land and Natural Resources:				
Office of the Director	972,745	-	30	(30)
	972,745	-	30	(30)
Department of Education:				
Office of the Director	4,614,635	-	1,656	(1,656)
	4,614,635	-	1,656	(1,656)
Department of Health Services:				
Division of Administration and Health Planning	1,970,894	46,589	45,093	1,496
	1,970,894	46,589	45,093	1,496
Department of Public Safety:				
Division of Law	-	2,500	2,412	88
	-	2,500	2,412	88
Office of the Attorney-General	443,505	-	-	-

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function and Changes in Fund Balance (Deficit), Continued  
Budget and Actual - General Fund  
Year Ended September 30, 2005

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final		
Expenditures, continued:				
Current, continued:				
Boards, Commissions and Other:				
Transportation and Infrastructure	457,299	476,049	460,022	16,027
Commerce and Industry	219,712	59,145	-	59,145
Community Affairs	163,281	106,349	-	106,349
Scholarship Board	244,759	-	-	-
Broadcast Authority	87,645	87,645	-	87,645
Sports Operation	-	55,462	-	55,462
Kosrae State Election Commission	-	10,189	-	10,189
Kosrae Port Authority	190,525	-	-	-
Parole Board	1,500	1,500	-	1,500
Kosrae Island Resource Management Authority	119,476	-	-	-
Other	-	300,000	157,338	142,662
Development Review Commission	-	-	-	-
	<u>1,484,197</u>	<u>1,096,339</u>	<u>617,360</u>	<u>478,979</u>
Payments to Non-governmental Agencies:				
Micronesian Legal Services Corporation	-	15,000	-	15,000
USDA Rural Development	-	94,618	252,326	(157,708)
Kosrae Visitors Bureau	59,954	-	-	-
	<u>59,954</u>	<u>109,618</u>	<u>252,326</u>	<u>(142,708)</u>
Grants to local governments	<u>4,076,739</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total expenditures	<u>15,891,849</u>	<u>3,124,788</u>	<u>2,578,056</u>	<u>546,732</u>
Excess (deficiency) of revenues over (under) expenditures	<u>-</u>	<u>(1,368,140)</u>	<u>(821,408)</u>	<u>546,732</u>
Other financing uses:				
Operating transfers out				
U.S. Federal Grants Fund	-	-	-	-
Section 215 Compact Trust Fund	-	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net change in unreserved fund balance (deficit)	-	(1,368,140)	(821,408)	546,732
Other changes in unreserved fund balance (deficit):				
Decrease in reserve for related assets	-	-	(58,276)	(58,276)
Decrease in encumbrances	-	-	83,152	83,152
Increase in reserve for continuing appropriations	-	-	(341,302)	(341,302)
Unreserved deficit at the beginning of the year	<u>(3,017,402)</u>	<u>(3,017,402)</u>	<u>(3,017,402)</u>	<u>-</u>
Unreserved fund balance (deficit) at the end of the year	<u>\$ (3,017,402)</u>	<u>\$ (4,385,542)</u>	<u>\$ (4,155,236)</u>	<u>\$ 230,306</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

Combined Balance Sheet  
Nonmajor Governmental Funds  
September 30, 2005

	Other Special Revenue	Other Capital Projects	Total
<u>ASSETS</u>			
Cash and equivalents	\$ 1,279	\$ -	\$ 1,279
Receivables:			
CFSM	-	579,952	579,952
Other	37,982	-	37,982
Advances	78,610	10,247	88,857
Inventory	8,825	-	8,825
Loans receivable	597,527	-	597,527
Due from other funds	961,912	-	961,912
Restricted assets:			
Cash and equivalents	544,327	-	544,327
Pooled investments	1,500,202	-	1,500,202
Total assets	<u>\$ 3,730,664</u>	<u>\$ 590,199</u>	<u>\$ 4,320,863</u>
<u>LIABILITIES AND FUND BALANCES</u>			
Liabilities:			
Accounts payable	\$ 97,015	\$ 128,689	\$ 225,704
Other liabilities and accruals	3,088	(99)	2,989
Due to other funds	174,217	461,576	635,793
Deferred Revenue	413,491	33	413,524
Total liabilities	<u>687,811</u>	<u>590,166</u>	<u>1,278,010</u>
Fund balances:			
Reserved for:			
Related assets	2,437,550	-	2,437,550
Encumbrances	155,476	8,533	164,009
Continuing appropriations	184,632	11,073	195,705
Unreserved:			
Special revenue funds	265,195	-	265,195
Capital projects funds	-	(19,606)	(19,606)
Total fund balances	<u>3,042,853</u>	<u>-</u>	<u>3,042,853</u>
Total liabilities and fund balances	<u>\$ 3,730,664</u>	<u>\$ 590,166</u>	<u>\$ 4,320,863</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

Combined Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balances  
Nonmajor Governmental Funds  
Year Ended September 30, 2005

	<u>Other Special Revenue</u>	<u>Other Capital Projects</u>	<u>Total</u>
Revenues:			
Investment income	\$ 117,918	\$ -	\$ 117,918
CFSM grants	-	201,833	201,833
Other grants	76,261	-	76,261
Fees and charges	342,410	-	342,410
Other	85	-	85
Total revenues	<u>536,674</u>	<u>201,833</u>	<u>738,507</u>
Expenditures by function:			
Current:			
General government	159,167	-	159,167
Education	67,836	-	67,836
Health services	126,391	-	126,391
Boards, Commissions, others	4,194	-	4,194
Capital projects	-	201,833	201,833
Total expenditures	<u>357,588</u>	<u>201,833</u>	<u>559,421</u>
Excess of revenues over expenditures	179,086	-	179,086
Other financing sources:			
Operating transfer in	-	-	-
Net change in fund balances	<u>179,086</u>	<u>-</u>	<u>179,086</u>
Fund balances at the beginning of the year	<u>2,863,767</u>	<u>-</u>	<u>2,863,767</u>
Fund balances at the end of the year	<u>\$ 3,042,853</u>	<u>\$ -</u>	<u>\$ 3,042,853</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

Combined Statement of Revenues, Expenditures by Account,  
and Changes in Fund Balances  
Nonmajor Governmental Funds  
Year Ended September 30, 2005

	Other Special Revenue	Other Capital Projects	Total
Revenues:			
Investment income	\$ 117,918	\$ -	\$ 117,918
Fees and charges	342,410	-	342,410
CFSM grants	-	201,833	201,833
Other grants	76,261	-	76,261
Other	85	-	85
Total revenues	<u>536,674</u>	<u>201,833</u>	<u>738,507</u>
Expenditures by account:			
Salaries and wages	91,120	-	91,120
Contractual services	28	-	28
Capital outlay	13,193	140,000	153,193
Utilities	21,225	6,773	27,998
Travel	6,493	-	6,493
Supplies and materials	19,477	50,343	69,820
Medical supplies	95,814	-	95,814
Scholarship and training	67,836	-	67,836
POL	2,748	-	2,748
Communications	7,167	1,824	8,991
Food stuffs	-	2,698	2,698
Rentals	275	-	275
Printing and reproduction	704	195	899
Other	31,508	-	31,508
	<u>357,588</u>	<u>201,833</u>	<u>559,421</u>
Excess of revenues over expenditures	179,086	-	179,086
Other financing sources:			
Operating transfer in	-	-	-
Net change in fund balances	179,086	-	179,086
Fund balances at the beginning of the year	<u>2,863,767</u>	<u>-</u>	<u>2,863,767</u>
Fund balances at the end of the year	<u>\$ 3,042,853</u>	<u>\$ -</u>	<u>\$ 3,042,853</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA  
  
NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS

Combining Balance Sheet  
September 30, 2005

	Compact Special Block 211(b)	Compact Health & Medical 216(a)(2)	Compact Scholarship 216(a)(3)	Compact Energy Block Grant 214	Compact Special Development 212(b)	Foreign Assistance	Airport Revolving	Agriculture Revolving	Fisherman	Production Loan
ASSETS										
Cash and equivalents	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 407	\$ -	\$ -
Receivables, net:										
Other governments	-	-	-	-	-	14,599	4,640	18,743	-	-
General, net	-	-	-	-	-	-	-	-	-	-
Advances	-	78,635	-	-	-	-	(25)	-	-	-
Inventory	-	-	-	-	-	-	-	8,825	-	-
Loans receivable	-	-	-	-	-	-	-	-	-	-
Due from other funds	129,304	149,688	2,692	153	29,220	-	-	-	69	1,495
Restricted:										
Cash and equivalents	-	-	-	-	-	-	-	-	-	-
Pooled investments	-	-	-	-	-	-	-	-	-	-
Investments	-	-	-	-	-	-	-	-	-	-
Total assets	\$ 129,304	\$ 228,323	\$ 2,692	\$ 153	\$ 29,220	\$ 14,599	\$ 4,615	\$ 27,975	\$ 69	\$ 1,495
LIABILITIES AND FUND BALANCES (DEFICITS)										
Liabilities:										
Accounts payable	\$ 13,153	\$ 3,639	\$ 2,692	\$ 153	\$ 20,340	\$ 2,604	\$ 2,271	\$ -	\$ -	\$ -
Other liabilities and accruals	3,166	-	-	-	-	(78)	-	-	-	-
Due to other funds	-	-	-	-	-	-	95,712	-	-	-
Deferred Revenue	-	-	-	-	-	13,491	-	-	-	-
Total liabilities	16,319	3,639	2,692	153	20,340	16,017	97,983	-	-	-
Fund balances (deficits):										
Reserved for:										
Related assets	-	-	-	-	-	-	-	-	-	-
Encumbrances	-	6,370	373	-	53,166	1,494	3,691	-	-	-
Continuing appropriations	-	-	-	-	54,025	130,607	-	-	-	-
Unreserved (deficit)	112,985	218,314	(373)	-	(98,311)	(133,519)	(97,059)	27,975	69	1,495
Total fund balances (deficits)	112,985	224,684	-	-	8,880	(1,418)	(93,368)	27,975	69	1,495
Total liabilities and fund balances (deficits)	\$ 129,304	\$ 228,323	\$ 2,692	\$ 153	\$ 29,220	\$ 14,599	\$ 4,615	\$ 27,975	\$ 69	\$ 1,495

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS

Combining Balance Sheet, Continued  
September 30, 2005

	Scholarship Revolving Loan	Housing Revolving	Aluminum Recycling	Tourism Revolving	Health Care	Sports Council	Early Retirement Program	Broadcast Authority	Gifford Scholarship	Total
<b>ASSETS</b>										
Cash and equivalents	\$ -	\$ -	\$ -	872	\$ -	-	\$ -	\$ -	-	\$ 1,279
Receivables, net:										
Other governments	-	-	-	-	-	-	-	-	-	37,982
General, net	-	-	-	-	-	-	-	-	-	-
Advances	-	-	-	-	-	-	-	-	-	78,610
Inventory	-	-	-	-	-	-	-	-	-	8,825
Loans receivable	-	597,527	-	-	-	-	-	-	-	597,527
Due from other funds	-	188,518	136,137	-	148,624	502	170,667	4,843	-	961,912
Restricted:										
Cash and equivalents	-	-	-	-	-	-	166,540	-	377,787	544,327
Equity in internal investment pool	-	-	-	-	-	-	1,500,202	-	-	1,500,202
Investments	-	-	-	-	-	-	-	-	-	-
Total assets	\$ -	\$ 786,045	\$ 136,137	\$ 872	\$ 148,624	\$ 502	\$ 1,837,409	\$ 4,843	\$ 377,787	\$ 3,730,664
<b>LIABILITIES AND FUND BALANCES (DEFICITS)</b>										
Liabilities:										
Accounts payable	\$ 9,823	\$ 12,603	\$ -	\$ -	\$ 29,737	\$ -	\$ -	\$ -	\$ -	\$ 97,015
Other liabilities and accruals	-	-	-	-	-	-	-	-	-	3,088
Due to other funds	75,528	-	-	-	-	-	-	-	2,977	174,217
Deferred Revenue	-	-	-	-	-	-	400,000	-	-	413,491
Total liabilities	85,351	12,603	-	-	29,737	-	400,000	-	2,977	687,811
Fund balances (deficits):										
Reserved for:										
Related assets	-	602,167	-	-	-	-	1,835,383	-	-	2,437,550
Encumbrances	-	90,382	-	-	-	-	-	-	-	155,476
Continuing appropriations	-	-	-	-	-	-	-	-	-	184,632
Unreserved (deficit)	(85,351)	80,893	136,137	872	118,887	502	(397,974)	4,843	374,810	265,195
Total fund balances (deficits)	(85,351)	773,442	136,137	872	118,887	502	1,437,409	4,843	374,810	3,042,853
Total liabilities and fund balances (deficits)	\$ -	\$ 786,045	\$ 136,137	\$ 872	\$ 148,624	\$ 502	\$ 1,837,409	\$ 4,843	\$ 377,787	\$ 3,730,664

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures By Function,  
and Changes in Fund Balances (Deficits)  
Year Ended September 30, 2005

	Compact Special Block 211(b)	Compact Health & Medical 216(a)(2)	Compact Scholarship 216(a)(3)	Compact Energy Block Grant 214	Compact Special Development 212(b)	Foreign Assistance	Airport Revolving	Agriculture Revolving	Fisherman	Production Loan
Revenues:										
Compact funding	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Investment income	-	-	-	-	-	-	-	-	-	-
Fees and charges	-	-	-	-	-	-	103,040	-	-	-
Other grants	-	-	-	-	-	13,474	-	-	-	-
Other	-	85	-	-	-	-	-	-	-	-
Total revenues	-	85	-	-	-	13,474	103,040	-	-	-
Expenditures by function:										
Current:						-				
General government	-	-	-	-	19,780	5,587	129,979	-	-	-
Education	-	-	-	-	-	-	-	-	-	-
Health services	-	-	-	-	-	-	-	-	-	-
Resources and development	-	-	-	-	-	-	-	-	-	-
Boards, commissions and other	-	-	-	-	-	4,194	-	-	-	-
Total expenditures	-	-	-	-	19,780	9,781	129,979	-	-	-
Excess (deficiency) of revenues over (under) expenditures	-	85	-	-	(19,780)	3,693	(26,939)	-	-	-
Other financing sources (uses):										
Operating transfer in (out)	-	-	-	-	-	-	-	-	-	-
Net change in fund balances (deficits)	-	85	-	-	(19,780)	3,693	(26,939)	-	-	-
Fund balances (deficits) at the beginning of the year	112,985	224,599	-	-	28,660	(5,111)	(66,429)	27,975	69	1,495
Fund balances (deficits) at the end of the year	\$ 112,985	\$ 224,684	\$ -	\$ -	\$ 8,880	\$ (1,418)	\$ (93,368)	\$ 27,975	\$ 69	\$ 1,495

See Accompanying Independent Auditors' Report.



STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures By Function,  
and Changes in Fund Balances (Deficits), Continued  
Year Ended September 30, 2005

	Scholarship Revolving Loan	Housing Revolving	Aluminum Recycling	Tourism Revolving	Health Care	Sports Council	Early Retirement Program	Broadcast Authority	Gifford Scholarship	Total
Revenues:										
Compact funding	\$ -	\$ -	\$ -	\$ -	\$ -	-	\$ -	\$ -	\$ -	\$ -
Investment income	-	-	-	-	-	-	117,918	-	-	117,918
Fees and charges	6,239	43,791	84,410	-	101,005	-	-	3,925	-	342,410
Other grants	-	-	-	-	-	-	-	-	62,787	76,261
Other	-	-	-	-	-	-	-	-	-	85
Total revenues	6,239	43,791	84,410	-	101,005	-	117,918	3,925	62,787	536,674
Expenditures by function:										
Current:										
General government	-	-	1,800	-	-	80	-	1,941	-	159,167
Education	67,836	-	-	-	-	-	-	-	-	67,836
Health services	-	-	-	-	126,391	-	-	-	-	126,391
Resources and development	-	-	-	-	-	-	-	-	-	-
other	-	-	-	-	-	-	-	-	-	4,194
Total expenditures	67,836	-	1,800	-	126,391	80	-	1,941	-	357,588
Excess (deficiency) of revenues over (under) expenditures	(61,597)	43,791	82,610	-	(25,386)	(80)	117,918	1,984	62,787	179,086
Other financing sources (uses):										
Operating transfer in (out)	-	-	-	-	-	-	-	-	-	-
Net change in fund balances (deficits)	(61,597)	43,791	82,610	-	(25,386)	(80)	117,918	1,984	62,787	179,086
Fund balances (deficits) at the beginning of the year	(23,754)	729,651	53,527	872	144,273	582	1,319,491	2,859	312,023	2,863,767
Fund balances (deficits) at the end of the year	\$ (85,351)	\$ 773,442	\$ 136,137	\$ 872	\$ 118,887	\$ 502	\$ 1,437,409	\$ 4,843	\$ 374,810	\$ 3,042,853

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA  
  
NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures By Account,  
and Changes in Fund Balances (Deficits)  
Year Ended September 30, 2005

	Compact Special Block 211(b)	Compact Health & Medical 216(a)(2)	Compact Scholarship 216(a)(3)	Compact Energy Block Grant 214	Compact Special Development 212(b)	Foreign Assistance	Airport Revolving	Agriculture Revolving	Fisherman	Production Loan
Revenues:										
Compact funding	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Investment income	-	-	-	-	-	-	-	-	-	-
Fees and charges	-	-	-	-	-	-	103,040	-	-	-
Other grants	-	-	-	-	-	13,474	-	-	-	-
Other	-	85	-	-	-	-	-	-	-	-
Total revenues	-	85	-	-	-	13,474	103,040	-	-	-
Expenditures by account:										
Salaries and wages	-	-	-	-	-	-	86,371	-	-	-
Contractual services	-	-	-	-	-	4,749	28	-	-	-
Capital outlay	-	-	-	-	13,193	-	-	-	-	-
Utilities	-	-	-	-	-	-	21,225	-	-	-
Travel	-	-	-	-	-	-	4,552	-	-	-
Supplies and materials	-	-	-	-	6,587	4,122	5,859	-	-	-
Medical supplies	-	-	-	-	-	-	-	-	-	-
Medical referral	-	-	-	-	-	-	-	-	-	-
Scholarship and training	-	-	-	-	-	-	-	-	-	-
POL	-	-	-	-	-	435	2,313	-	-	-
Communications	-	-	-	-	-	-	7,167	-	-	-
Food stuffs	-	-	-	-	-	-	-	-	-	-
Rentals	-	-	-	-	-	275	-	-	-	-
Printing and reproduction	-	-	-	-	-	200	504	-	-	-
Other	-	-	-	-	-	-	1,960	-	-	-
	-	-	-	-	19,780	9,781	129,979	-	-	-
Excess (deficiency) of revenues over (under) expenditures	-	85	-	-	(19,780)	3,693	(26,939)	-	-	-
Other financing sources (uses):										
Operating transfer in (out)	-	-	-	-	-	-	-	-	-	-
Net change in fund balances (deficits)	-	85	-	-	(19,780)	3,693	(26,939)	-	-	-
Fund balances (deficits) at the beginning of the year	112,985	224,599	-	-	28,660	(5,111)	(66,429)	27,975	69	1,495
Fund balances (deficits) at the end of the year	\$ 112,985	\$ 224,684	\$ -	\$ -	\$ 8,880	\$ (1,418)	\$ (93,368)	\$ 27,975	\$ 69	\$ 1,495

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA  
NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures By Account,  
and Changes in Fund Balances (Deficits), Continued  
Year Ended September 30, 2005

	Scholarship Revolving Loan	Housing Revolving	Aluminum Recycling	Tourism Revolving	Health Care	Sports Council	Early Retirement Program	Broadcast Authority	Gifford Scholarship	Total
Revenues:										
Compact funding	\$ -	\$ -	\$ -	\$ -	\$ -	-	\$ -	\$ -	\$ -	\$ -
Investment income	-	-	-	-	-	-	117,918	-	-	117,918
Fees and charges	6,239	43,791	84,410	-	101,005	-	-	3,925	-	342,410
Other grants	-	-	-	-	-	-	-	-	62,787	76,261
Other	-	-	-	-	-	-	-	-	-	85
Total revenues	6,239	43,791	84,410	-	101,005	-	117,918	3,925	62,787	536,674
Expenditures by account:										
Salaries and wages	-	-	-	-	-	-	-	-	-	91,120
Contractual services	-	-	-	-	-	-	-	-	-	28
Capital outlay	-	-	-	-	-	-	-	-	-	13,193
Utilities	-	-	-	-	-	-	-	-	-	21,225
Travel	-	-	-	-	-	-	-	1,941	-	6,493
Supplies and materials	-	-	-	-	2,829	80	-	-	-	19,477
Medical supplies	-	-	-	-	95,814	-	-	-	-	95,814
Medical referral	-	-	-	-	-	-	-	-	-	-
Scholarship and training	67,836	-	-	-	-	-	-	-	-	67,836
POL	-	-	-	-	-	-	-	-	-	2,748
Communications	-	-	-	-	-	-	-	-	-	7,167
Food stuffs	-	-	-	-	-	-	-	-	-	-
Rentals	-	-	-	-	-	-	-	-	-	275
Printing and reproduction	-	-	-	-	-	-	-	-	-	704
Other	-	-	1,800	-	27,748	-	-	-	-	31,508
Total expenditures	67,836	-	1,800	-	126,391	80	-	1,941	-	357,588
Excess (deficiency) of revenues over (under) expenditures	(61,597)	43,791	82,610	-	(25,386)	(80)	117,918	1,984	62,787	179,086
Other financing sources (uses):										
Operating transfer in (out)	-	-	-	-	-	-	-	-	-	-
Net change in fund balances (deficits)	(61,597)	43,791	82,610	-	(25,386)	(80)	117,918	1,984	62,787	179,086
Fund balances (deficits) at the beginning of the year	(23,754)	729,651	53,527	872	144,273	582	1,319,491	2,859	312,023	2,863,767
Fund balances (deficits) at the end of the year	\$ (85,351)	\$ 773,442	\$ 136,137	\$ 872	\$ 118,887	\$ 502	\$ 1,437,409	\$ 4,843	\$ 374,810	\$ 3,042,853

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS  
CAPITAL PROJECTS FUNDS

Combining Balance Sheet  
September 30, 2005

	<u>TTG Capital Projects</u>	<u>CFSM Projects Fund</u>	<u>Total</u>
<u>ASSETS</u>			
Receivables, net:			
CFSM	\$ -	\$ 579,952	\$ 579,952
Advances	10,247	-	10,247
	<u>\$ 10,247</u>	<u>\$ 579,952</u>	<u>\$ 590,199</u>
 <u>LIABILITIES AND FUND BALANCES (DEFICITS)</u>			
Liabilities:			
Accounts payable	\$ -	\$ 128,689	\$ 128,689
Accrued payroll and others	(99)	-	(99)
Deferred Revenue	-	33	33
Due to other funds	10,346	451,230	461,576
Total liabilities	<u>10,247</u>	<u>579,952</u>	<u>590,199</u>
Fund balances (deficits):			
Reserved for:			
Encumbrances	-	8,533	8,533
Continuing appropriations	-	11,073	11,073
Unreserved	-	(19,606)	(19,606)
Total fund balances	<u>-</u>	<u>-</u>	<u>-</u>
Total liabilities and fund balances	<u>\$ 10,247</u>	<u>\$ 579,952</u>	<u>\$ 590,199</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA  
NONMAJOR GOVERNMENTAL FUNDS  
CAPITAL PROJECTS FUNDS

Combining Statement of Expenditures by Function,  
and Changes in Fund Balances  
Year Ended September 30, 2005

	TTG Capital Projects	CFSM Projects Fund	Total
Revenues:			
CFSM grants	\$ -	\$ 201,833	\$ 201,833
	<u>-</u>	<u>201,833</u>	<u>201,833</u>
Expenditures by function:			
Capital projects	-	201,833	201,833
Total expenditures	<u>-</u>	<u>201,833</u>	<u>201,833</u>
Excess of revenues over expenditures	-	-	-
Other financing sources:			
Operating transfer in	<u>-</u>	<u>-</u>	<u>-</u>
Net change in fund balances	-	-	-
Fund balances at the beginning of the year	<u>-</u>	<u>-</u>	<u>-</u>
Fund balances at the end of the year	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA  
NONMAJOR GOVERNMENTAL FUNDS  
CAPITAL PROJECTS FUNDS

Combining Statement of Expenditures by Account,  
and Changes in Fund Balances  
Year Ended September 30, 2005

	TTG Capital Projects	CFSM Projects Fund	Total
Revenues:			
CFSM grants	\$ -	\$ 201,833	\$ 201,833
	<u>-</u>	<u>201,833</u>	<u>201,833</u>
Expenditures by account:			
Salaries and wages	-	-	-
Equipment	-	140,000	140,000
Utilities	-	6,773	6,773
Travel	-	-	-
Supplies and materials	-	50,343	50,343
Printing and Reproduction		195	195
Food Consumption		2,698	2,698
POL	-	-	-
Communications	-	1,824	1,824
Total expenditures	<u>-</u>	<u>201,833</u>	<u>201,833</u>
Excess of revenues over expenditures	-	-	-
Other financing sources:			
Operating transfer in	<u>-</u>	<u>-</u>	<u>-</u>
Net change in fund balances	-	-	-
Fund balances at the beginning of the year	<u>-</u>	<u>-</u>	<u>-</u>
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA  
SECTION 211 COMPACT SECTOR FUNDS

Combining Balance Sheet  
September 30, 2005

	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Section 211(a)(5) Environment	Section 211(a)(6) Infrastructure	Section 211(a)(7) Supplemental Ed	Total
<b>ASSETS</b>								
Receivables, net:								
Federal agencies	\$ 61,038	\$ -	\$ -	\$ -	\$ -	\$ 9,394	\$ 166,651	\$ 237,083
Other	-	-	-	-	-	35,827	-	35,827
Due from other funds	<u>147,556</u>	<u>306,494</u>	<u>423,186</u>	<u>83,618</u>	<u>16,890</u>	<u>-</u>	<u>-</u>	<u>977,744</u>
	<u>\$ 208,594</u>	<u>\$ 306,494</u>	<u>\$ 423,186</u>	<u>\$ 83,618</u>	<u>\$ 16,890</u>	<u>\$ 45,221</u>	<u>\$ 166,651</u>	<u>\$ 1,250,654</u>
<b>LIABILITIES AND FUND BALANCES</b>								
Liabilities:								
Accounts payable	\$ 148,762	\$ 119,807	\$ 153,953	\$ 36,810	\$ 4,198	\$ 455	\$ -	\$ 463,985
Other liabilities and accruals	59,832	34,445	13,906	30,879	9,771	-	-	148,833
Due to other funds	-	-	-	-	-	44,766	166,651	211,417
Deferred revenue	-	-	230,098	-	2,921	-	-	233,019
Total liabilities	<u>208,594</u>	<u>154,252</u>	<u>397,957</u>	<u>67,689</u>	<u>16,890</u>	<u>45,221</u>	<u>166,651</u>	<u>1,057,254</u>
Fund balances:								
Reserved for:								
Encumbrances	25,477	12,097	232,575	57,441	916	-	-	328,506
Compact programs	-	-	232,576	-	-	-	-	232,576
Unreserved	<u>(25,477)</u>	<u>140,145</u>	<u>(439,922)</u>	<u>(41,512)</u>	<u>(916)</u>	<u>-</u>	<u>-</u>	<u>(367,682)</u>
Total fund balances	<u>-</u>	<u>152,242</u>	<u>25,229</u>	<u>15,929</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>193,400</u>
Total liabilities and fund balances	<u>\$ 208,594</u>	<u>\$ 306,494</u>	<u>\$ 423,186</u>	<u>\$ 83,618</u>	<u>\$ 16,890</u>	<u>\$ 45,221</u>	<u>\$ 166,651</u>	<u>\$ 1,250,654</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

SECTION 211 COMPACT SECTOR FUNDS

Combining Statement of Expenditures by Account,  
and Changes in Fund Balances (Deficit)  
Year Ended September 30, 2005

	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Section 211(a)(5) Environment	Section 211(a)(6) Infrastructure	Section 211(a)(7) Supplemental Ed	Total
Revenues:								
Compact funding	\$ 2,131,470	\$ 1,886,160	\$ 838,468	\$ 1,110,199	\$ 293,884	\$ 7,218	\$ 166,651	\$ 6,434,050
	<u>2,131,470</u>	<u>1,886,160</u>	<u>838,468</u>	<u>1,110,199</u>	<u>293,884</u>	<u>7,218</u>	<u>166,651</u>	<u>6,434,050</u>
Expenditures by function:								
Current:								
General government	-	-	813,239	1,093,947	293,884	7,218	166,651	2,374,939
Education	2,130,685	-	-	-	-	-	-	2,130,685
Health services	-	1,733,916	-	-	-	-	-	1,733,916
Total expenditures	<u>2,130,685</u>	<u>1,733,916</u>	<u>813,239</u>	<u>1,093,947</u>	<u>293,884</u>	<u>7,218</u>	<u>166,651</u>	<u>6,239,540</u>
Net change in fund balances	785	152,244	25,229	16,252	-	-	-	194,510
Fund balances at the beginning of the year	(785)	(2)	-	(323)	-	-	-	(1,110)
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ 152,242</u>	<u>\$ 25,229</u>	<u>\$ 15,929</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 193,400</u>

See Accompanying Independent Auditors' Report.



STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

SECTION 211 COMPACT SECTOR FUNDS

Combining Statement of Expenditures by Account,  
and Changes in Fund Balances (Deficit)  
Year Ended September 30, 2005

	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Section 211(a)(5) Environment	Section 211(a)(6) Infrastructure	Section 211(a)(7) Supplemental Ed	Total
Revenues:								
Compact funding	\$ 2,131,470	\$ 1,886,160	\$ 838,468	\$ 1,110,199	\$ 293,884	\$ 7,218	\$ 166,651	\$ 6,434,050
	<u>2,131,470</u>	<u>1,886,160</u>	<u>838,468</u>	<u>1,110,199</u>	<u>293,884</u>	<u>7,218</u>	<u>166,651</u>	<u>6,434,050</u>
Expenditures by account:								
Salaries and wages	1,625,866	765,324	362,821	808,589	257,681	(1)	29,151	3,849,431
Contractual services	51,800	325,329	346,634	75,485	1,131	95	-	800,474
Utilities	79,211	95,663	18,441	16,436	3,307	-	-	213,058
Supplies and materials	94,246	54,863	39,263	33,643	5,889	4,969	-	232,873
POL	12,155	3,802	4,032	7,186	3,660	-	-	30,835
Medical supplies	-	218,758	-	-	-	-	-	218,758
Scholarship and training	154,986	-	-	-	-	-	137,500	292,486
Capital outlay	74,497	113,206	7,218	8,300	-	-	-	203,221
Travel	853	64,384	6,848	65,359	6,384	1,013	-	144,841
Communications	7,570	18,811	13,603	20,226	4,313	194	-	64,717
Medical referral	-	43,705	-	-	-	-	-	43,705
Repairs and maintenance	75	175	1,124	367	368	-	-	2,109
Printing and reproduction	2,123	5,051	2,638	3,194	365	323	-	13,694
Freight	-	341	728	-	266	-	-	1,335
Rentals	468	75	60	125	-	-	-	728
Food stuffs	-	15,615	-	-	-	-	-	15,615
Leased housing/land	25,375	8,814	8,168	27,541	9,840	625	-	80,363
Training	-	-	1,030	16,666	-	-	-	17,696
Other	1,460	-	631	10,830	680	-	-	13,601
Total expenditures	<u>2,130,685</u>	<u>1,733,916</u>	<u>813,239</u>	<u>1,093,947</u>	<u>293,884</u>	<u>7,218</u>	<u>166,651</u>	<u>6,239,540</u>
Net change in fund balances	785	152,244	25,229	16,252	-	-	-	194,510
Fund balances at the beginning of the year	(785)	(2)	-	(323)	-	-	-	(1,110)
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ 152,242</u>	<u>\$ 25,229</u>	<u>\$ 15,929</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 193,400</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  
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Honorable Rensley A. Sigrav  
Governor, State of Kosrae  
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 State of Kosrae as of and for the year ended September 30, 2005, and have issued our report thereon dated June 18, 2006, which report was qualified due to our inability to: 1) examine evidence regarding the investments of the Compact Capital Projects Fund in SEMO-Micronesia, Inc.; and 2) assure ourselves as to the propriety of advances receivable of the General Fund, the Compact Capital Projects Fund, and the aggregate remaining fund information; receivables from federal agencies of the Federal Grants Fund; and loans receivable of the aggregate remaining fund information. 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**

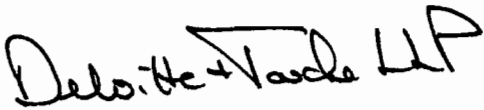
In planning and performing our audit, we considered the State of Kosrae's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operations of the internal control over financial reporting that, in our judgment, could adversely affect the State of Kosrae's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs (pages 76 through 100) as items 2005-04 and 2005-12 through 2005-22.

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 2005-21 and 2005-22 to be material weaknesses.

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Kosrae'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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

A handwritten signature in black ink, appearing to read "Deloitte + Touche LLP", is written over the printed name of the firm.

June 18, 2006

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

Honorable Rensley A. Sigrah  
Governor, State of Kosrae  
Federated States of Micronesia:

**Compliance**

We have audited the compliance of the State of Kosrae with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2005. The State of Kosrae's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (page 76 through 100). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the State of Kosrae's management. Our responsibility is to express an opinion on the State of Kosrae's compliance based on our audit.

We conducted our audit of compliance in accordance with 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 State of Kosrae's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the State of Kosrae's compliance with those requirements.

As described in items 2005-01 through 2005-11 in the accompanying Schedule of Findings and Questioned Costs, the State of Kosrae did not comply with requirements regarding allowable costs/cost principles, period of availability, procurement and suspension and debarment, cash management, and period of availability of funds that are applicable to its Freely Associated States-Education Grant Program (CFDA 84.256), Special Education-Grants to States (CFDA 84.027) and U.S. Department of the Interior Compact Sector Grants (CFDA 15.875), as described in the Federal Award Findings and Questioned Cost Section of the accompanying Schedule of Findings and Questioned Costs. Compliance with such requirements is necessary, in our opinion, for the State of Kosrae to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the State of Kosrae complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2005.

## Internal Control Over Compliance

The management of the State of Kosrae 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 State of Kosrae's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

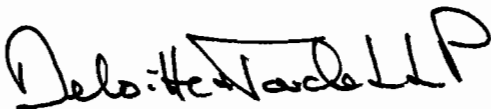
We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the State of Kosrae's ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 2005-01 through 2005-11.

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. We believe that the reportable conditions described above are 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 State of Kosrae as of and for the year ended September 30, 2005, and have issued our report thereon dated June 18, 2006, which report was qualified due to our inability to: 1) examine evidence regarding the investments of the Compact Capital Projects Fund in SEMO-Micronesia, Inc.; and 2) assure ourselves as to the propriety of advances receivable of the General Fund, the Compact Capital Projects Fund, and the aggregate remaining fund information; receivables from federal agencies of the Federal Grants Fund; and loans receivable of the aggregate remaining fund information. Our audit was performed for the purpose of forming an opinion on the financial statements that collectively comprise the State of Kosrae's basic financial statements. The accompanying schedule of expenditures of federal awards (pages 67 through 73) is presented for the purpose 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 State of Kosrae. 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 the propriety of receivables from federal agencies recorded within the Federal Grants Fund been determinable, is fairly stated, in all material respects when considered in relation to the basic financial statements taken as a whole.

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



June 18, 2006

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Summary Schedule of Expenditures of Federal Awards, by Grantor  
U.S. Federal and Other Assistance Fund  
Year Ended September 30, 2005

Grantor Program Title	Expenditures
U.S. Department of Agriculture	\$ 67,668
U.S. Department of the Interior	7,363,657
U.S. Department of Labor	99,207
U.S. Department of Education	1,214,037
U.S. Department of Health and Human Services	257,871
U.S. Department of Homeland Security	<u>13,414</u>
GRAND TOTAL	<u>\$ 9,015,854</u>
Note: All awards are received in a subgrantee capacity through the FSM National Government, except for the following, which are received directly from grantor agencies:	
US Department of Agriculture:	
Housing Preservation Grant	10.433
US Department of Education:	
Freely Associated States-Education Grant Program	84.256
Vocational Education Improvement Program	84.994
Reconciliation to the basic financial statements:	
U.S. Federal Grants Fund	\$ 1,984,615
Section 211 Compact Sector Grant	6,241,716
Compact Capital Projects Fund	774,246
Compact Other Grants Fund	19,780
Less amounts of non-federal awards included herein	<u>(4,503)</u>
	<u>\$ 9,015,854</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2005

Grantor Program Title	Federal CFDA Number	Expenditures
U.S. DEPARTMENT OF AGRICULTURE		
Cooperative Forestry Assistance	10.664	\$ 31,014
Rural Housing Preservation Grants	10.433	859
KIRMA Research/Capacity Bldg.	10.652	<u>35,795</u>
U.S. DEPARTMENT OF AGRICULTURE TOTAL		<u>\$ 67,668</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2005

Grantor Program Title	Federal CFDA Number	Expenditures
<b>U.S. DEPARTMENT OF THE INTERIOR</b>		
Economic, Social and Political Development of the Territories	15.875	
Compact Section 211(A) Capital Account		\$ 774,246
Compact II Capacity Building Sector		1,093,947
Compact II Education Sector		2,130,685
Compact II Environment Sector		293,884
Compact II Health Sector		1,733,916
Compact II Private Sector		813,239
Compact II Infrastructure Sector		7,218
Supplemental Education Grant Sector		166,651
Technical Assistance:		
Hospital Renovation		19,780
Road Maintenance Equipment		255,221
Survey and Mapping		74,870
<b>U.S. DEPARTMENT OF THE INTERIOR TOTAL</b>		<b>\$ 7,363,657</b>

See accompanying notes to schedule of expenditures of federal awards.



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2005

Grantor Program Title	Federal CFDA Number	Expenditures
U.S. DEPARTMENT OF LABOR		
WIA Administration	17.255	\$ 8,182
WIA Adult Program	17.258	16,076
WIA Youth Activities	17.259	20,733
WIA Dislocated Workers	17.260	<u>54,216</u>
U.S. DEPARTMENT OF LABOR TOTAL		<u>\$ 99,207</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2005

Grantor Program Title	Federal CFDA Number	Expenditures
U.S. DEPARTMENT OF EDUCATION		
Special Education - Grants to States	84.027	\$ 523,145
Freely Associated States-Education Grant Program	84.256	516,922
School to Work Opportunities	84.278	17,758
Vocational Education Improvement Program	84.994	<u>156,212</u>
U.S. DEPARTMENT OF EDUCATION TOTAL		<u>\$ 1,214,037</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2005

Grantor Program Title	Federal CFDA Number	Expenditures
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES		
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	\$ 11,988
Family Planning - Services	93.217	30,479
Immunization Grants	93.268	33,809
HIV Prevention Activities-Health Department Based	93.940	10,165
Block Grants for Prevention and Treatment of Substance Abuse	93.959	75,793
Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	93.988	14,978
National Bioterrorism Hospital Preparedness Program	93.889	12,084
Maternal and Child Health Services Block Grant to the States	93.994	55,186
Centers for Disease Control and Prevention-Investigations and Technical Assistance	93.283	13,389
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES TOTAL		\$ <u>257,871</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2005

Grantor Program Title	Federal CFDA Number	Expenditures
U.S. DEPARTMENT OF HOMELAND SECURITY		
Hazard Mitigation Grant	97.039	\$ <u>13,414</u>
U.S. DEPARTMENT OF HOMELAND SECURITY TOTAL		\$ <u><u>13,414</u></u>
GRAND TOTAL		\$ <u><u>9,015,854</u></u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2005

(1) Scope of Review

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

A. Programs Subject to Single Audit

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

(2) Summary of Significant Accounting Policies

A. Basis of Accounting

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

B. Reporting Entity

The Kosrae State Government, for purpose of the general purpose financial statements, includes all of the funds of the primary government as defined by Governmental Accounting Standards Board (GASB) Statement 14, "The Financial Reporting Entity."

(3) Component Units

The Kosrae Utilities Authority (KUA), a component unit - proprietary fund of the State of Kosrae separately satisfies the requirements of OMB Circular A-133. In fiscal year 2005, federal expenditures of KUA did not exceed the threshold.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Programs Selected for  
Audit In Accordance With OMB Circular A-133  
Year Ended September 30, 2005

<u>Grantor Program Title</u>	<u>CFDA No.</u>	<u>2005 Fiscal Year Expenditures</u>
<u>Major Programs</u>		
<u>U.S. Dept. of the Interior</u>		
Compact of Free Association:		
Compact Sector Grants	15.875	\$ 6,241,716
Compact Section 211(A) Capital	15.875	774,246
<u>U.S. Department of Education</u>		
Special Education – Grants to States	84.027	523,145
Freely Associated States-Education Grant Program	84.256	<u>516,922</u>
Total U.S. Federal program expenditures selected		\$ <u>8,056,029</u>
Total U.S. Federal program expenditures		\$ <u>9,018,030</u>
% of total U.S. Federal Program expenditures covered by Major Programs		<u>89%</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**Schedule of Findings and Questioned Costs  
Year Ended September 30, 2005**

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

1. The Independent Auditors' Report on the financial statements expressed a qualified opinion due to our inability to: 1) examine evidence regarding the investments of the Compact Capital Projects Fund in SEMO-Micronesia, Inc.; and 2) assure ourselves as to the propriety of advances receivable of the General Fund, the Compact Capital Projects Fund, and the aggregate remaining fund information; receivables from federal agencies of the Federal Grants Fund; and loans receivable of the aggregate remaining fund information.
2. Reportable conditions in internal control over financial reporting were identified, several of which are considered to be material weaknesses.
3. No instances of noncompliance considered material to the 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, all of which are considered to be material weaknesses.
5. The independent auditors' report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. The State's major programs were:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
U.S. Department of the Interior –	
Compact of Free Association –Capital Account	15.875
Compact of Free Association –Sector Grants	15.875
U.S. Department of Education –	
Special Education-Grants to States	84.027
Freely Associated States-Education Grant Program	84.256

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

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

**Part II - Financial Statement Findings Section**

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
2005-04	Allowable Costs/Cost Principles	\$ -
2005-12	Payroll Allotments	\$ -
2005-13	Journal Vouchers	\$ -
2005-14	Encumbrance	\$ -
2005-15	Accounts Receivable	\$ -
2005-16	Travel Expense	\$ -
2005-17	Continuing Appropriations	\$ -
2005-18	Payroll	\$ -
2005-19	Travel Advances	\$ -
2005-20	Due From Other Governments	\$ -
2005-21	Housing Renovation Loan Receivables	\$ -
2005-22	Equity Investments	\$ -

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

<u>Reference Number</u>	<u>CFDA#</u>	<u>Findings</u>	<u>Questioned Costs</u>
2005-01	15.875	Allowable Costs/Cost Principles and Period of Availability	\$ 129,462
2005-02	15.875	Allowable Costs/Cost Principles	\$ 104,515
2005-03	15.875	Allowable Costs/Cost Principles	Undeterminable
2005-04	15.875	Allowable Costs/Cost Principles	\$ -
2005-05	15.875	Procurement and Suspension and Debarment	\$ 88,821
2005-06	84.256	Period of Availability	\$ 98,480
2005-07	15.875	Allowable Costs/Cost Principles and Period of Availability	\$ -
2005-08	15.875	Period of Availability	\$ 16,935
2005-09	84.027	Period of Availability	\$ 24,246
2005-10	84.027	Cash Management	Undeterminable
2005-11	84.256	Cash Management	Undeterminable



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Federal Findings and Questioned Costs Section, Continued

Finding No.:	2005-01
CFDA:	15.875
Grant:	Section 211 Health Sector Grant
Grantor Agency:	U. S. Department of the Interior, Office of Insular Affairs
CFDA:	15.875
Grant:	Road Maintenance Equipment
Grantor Agency:	U.S. Department of the Interior
Area:	Allowable Costs/Cost Principles and Period of Availability
Questioned Cost:	\$129,462

Criteria: Expenditures should be recorded in the proper period and should be expended within ninety days of the grant year end, unless otherwise approved by the grantor agency.

Condition:

1. A fiscal year 2005 purchase order (P50207), totaling \$119,000, was issued to acquire an Olympus AU400e fully automated random access chemistry analyzer and a Water Feed System. Of this amount, \$107,700 was disbursed in fiscal year 2006, and the equipment has not been received as of the date of our report (Fund 73 Compact II Section 211 Health Sector Grant). However, this amount was expended in the 2005 financial statements.
2. Purchase order P40143, totaling \$43,524, was issued for the purchase of a Trailer. Of this amount, \$21,762 was paid in 2005, but the equipment was not received in fiscal year 2005. (Fund 37 Road Maintenance Equipment). However, the advance payment was expended in the 2005 financial statements.
3. Check number 17759, totaling \$1,250, for a scholarship award did not clear the bank within ninety days of the grant year end. As this is a subsequent event and not within the audit period, no questioned cost results from this condition.

Cause: There appears to be weak internal controls over ensuring that expenditures are recorded in the proper period and that advance payments are not recorded as expenditures.

Effect: Expenditures and prepayments are each misstated. A questioned cost exists.

Recommendation: Advance payments should be recorded as General Fund prepayments until applicable goods or services are received.

Auditee Response and Corrective Action Plan: We agree to this finding. Starting in fiscal year 2006 and onward instructions were given to the Chief Accountant to create and maintain a prepaid account to account for all advance payments. He was also instructed to make sure the procedures of obligations and disbursements of funds followed. The Director of Administration & Finance will monitor monthly.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Federal Findings and Questioned Costs Section, Continued

Finding No.: 2005-02  
CFDA: 15.875  
Grant: Section 211 Health Sector Grant  
Grantor Agency: U.S. Department of the Interior, Office of Insular Affairs  
Area: Allowable Costs/Cost Principles  
Questioned Cost: \$104,515

Criteria: Expenditures should be properly supported by a vendor invoice and, if applicable, by receiving reports.

Condition: The following checks were not properly supported:

1. Check number 13190, totaling \$6,000, was for the purchase of medical supplies; however, no invoice or receiving report was on file.
2. Check number 18118, totaling \$89,515, was for a payment charged to a mangrove crab hatchery expense account; however, no invoice or contract was provided to support this payment.
3. Check number 19002, totaling \$9,000, for curative medicine, was not substantiated by an invoice to support the payment basis.

Cause: There appears to be a weakness in internal controls over ensuring that expenditures are properly supported.

Effect: Expenditures may not be valid. A questioned cost exists.

Recommendation: We recommend that the State ensures that expenditures are properly supported.

Auditee Response and Corrective Action Plan: We agree with the finding. Kosrae State Government will be complying with the criteria.

**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Federal Findings and Questioned Costs Section, Continued

Finding No.: 2005-03  
CFDA: 15.875  
Grant: Section 211 Health Sector Grant and Education Sector Grant  
Agency: U.S. Department of the Interior, Office of Insular Affairs  
Area: Allowable Costs/Cost Principles  
Questioned Costs: Undeterminable

Criteria: Expenditures should be necessary and reasonable for program needs and should be in accordance with program objectives. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

Condition: For 5 of 75 (7%) payroll expenditures tested, the employee hourly pay rate per the payroll report did not agree with the personnel action form.

<u>Fund No</u>	<u>PP</u>	<u>Employee Number</u>	<u>Position</u>	<u>Net Pay</u>	<u>Hourly Rate</u>
	19	42964	Classroom Teacher I	\$198.86	\$4.84
	19	65799	Classroom Teacher I	301.50	5.74
73	5	29422	Staff Physician	657.39	13.46
72	4	75872	Classroom Teacher II	19.49	4.14
72	13	67656	Scholarship Administrator	212.01	7.26

Cause: Personnel Action Forms, which have been updated in FY 2005, have yet to be filed within individual employee files.

Effect: Noncompliance with allowable costs/cost principles requirements results from the condition. It is not possible to determine if questioned costs exist due to the lack of available information.

Recommendation: All applicable personnel action forms should be filed within individual employee files to substantiate expenditures.

Auditee Response and Corrective Action Plan:

Kosrae State Government is following the independent auditors' recommendation to ensure all current PAF forms are filed within individual employee files. We agree to this finding. In 2006, a review has been conducted for all PAF forms to be file in individual jackets by social security numbers. Payroll Officer will be responsible for compliance with designated staff assigned to complete filing of all personnel actions.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005**

Federal Findings and Questioned Costs Section, Continued

Finding No.: 2005-04  
CFDA: 15.875  
Grant: Section 211 Health Sector Grant  
Grantor Agency: U.S. Department of the Interior, Office of Insular Affairs  
Area: Allowable Costs/Cost Principles  
Questioned Cost: \$0

Criteria: Personnel costs should be appropriately categorized and should not be classified as contractual services.

Condition:

1. JV5M0030 was recorded to transfer salaries expense to contractual expense. Total salaries transferred amounted to \$42,875, excluding \$3,573 of employee benefits paid and charged to the Sector Grant. This transfer relates to doctors hired under contract, who appear to be treated as employees, since the State bears responsibility for all withholdings and deducts taxes from the contractor payments at individual tax rates. As a result, these contractors actually appear to be employees. Hence, the basis of the transfer appears to be inappropriate.
2. JV5M0047 was recorded to transfer salaries expense to contractual expense. Total salaries transferred amounted to \$34,028, excluding \$3,072 of employee benefits paid and charged to the Sector Grant. This transfer relates to individuals hired under contract, who appear to be treated as employees, since the State bears responsibility for all withholdings and deducts taxes from the contractor payments at individual tax rates. As a result, these contractors actually appear to be employees. Hence, the basis of the transfer appears to be inappropriate. In addition, upon review of this transaction, one contractor's contract was unavailable for review.
3. Two similar issues were noted in general fund tests aggregating \$22,072. No questioned cost results from this condition as this matter does not relate to the expenditure of federal funds.

Cause: The State does not appear to be aware of the difference between a contractor and an employee.

Effect: Potential unallowable costs result from this condition as contractors should not be entitled to government benefits and the government should not withhold individual taxes from contractors.

Recommendation: We recommend that the State reexamines the distinction between a contractor and an employee and ensures that employee salaries are appropriately classified in the financial statements.

Auditee Response and Corrective Action Plan: We do not agree to this finding. It is a contractual obligation of the government to pay benefits when terms of individual contracts call for the government to pay benefits. The cited contracts are employment contracts for Doctors.

Auditor's Response: At issue is the appropriation classification of these expenditures. These are not contractual services. These are personnel costs and should be classified as such.

**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Federal Findings and Questioned Costs Section, Continued

Finding No.: 2005-05  
CFDA: 15.875  
Grant: Section 211 Health Sector Grant  
Grantor Agency: U. S. Department of the Interior, Office of Insular Affairs  
Area: Procurement  
Questioned Cost: \$88,821

Criteria: The Fiscal Procedures Agreement requires evidence of competitive procurement in support of procurement determinations.

Condition: The following expenditure packages did not contain competitive procurement documents:

<u>Fund</u>	<u>Description</u>	<u>Expense</u>	<u>Ck#</u>
73	Administrative Support Service	\$ 45,089	14908
73	Curative Medicine	5,000	17351
73	Curative Medicine	4,000	16231
73	Administrative Support Service	12,600	14908
73	Medical Referral	<u>22,132</u>	17707
		<u>\$ 88,821</u>	

Cause: There appears to be weak internal controls over ensuring that proper competitive procurement documentation is maintained to substantiate compliance.

Effect: Noncompliance with procurement requirements results from this condition. Additionally, questioned costs result due to the absence of competitive procurement documentation.

Recommendation: We recommend that Kosrae State Government strengthens internal controls to ensure that adequate competitive procurement documentation is on file

Auditee Response and Corrective Action Plan: We do agree with the finding, however item #1 was received (supporting documentations are submitted for review). For item # 2, this is the only vendor providing this service on island.

Kosrae State Government has implemented internal controls to ensure that adequate competitive procurement documentations are on file.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Federal Findings and Questioned Costs Section, Continued

Finding No.: 2005-06  
CFDA: 84.256  
Grant: Freely Associated States-Education Grant Program  
Grant No.: S256A030009-04  
Grantor Agency: U.S. Department of Education  
Area: Period of Availability  
Questioned Costs: \$98,480

Criteria: Expenditures should be recorded in the appropriate period.

Condition: For 2 of 21 (10%) expenditures tested, (\$98,480 of the aggregate population of \$350,375), expenditures do not relate to FY2005.

<u>Check No</u>	<u>Account</u>	<u>Payee</u>	<u>APV #</u>	<u>Org #</u>	<u>Cost Center</u>	<u>Check Amt</u>
13966	8405	UNIVERSITY OF GUAM	5001824	461410	5911	\$48,480
13965	8303	DJ STORE	5001825	461410	5911	50,000
						<u>\$98,480</u>

In the instance of the University of Guam payment, services were received in fiscal year 2001 and earlier. For the DJ Store, this appears to be an advance payment that was recorded as an expenditure even though the applicable goods were not received in fiscal year 2005.

Cause: There appears to be a control deficiency over ensuring that expenditures are recorded in the appropriate period.

Effect: Expenditures appear to be misstated, and noncompliance with period of availability requirements results from the condition.

Recommendation: Expenditures should be correctly accounted for in the period in which underlying goods and services are received.

Auditee Response and Corrective Action Plan: We do agree to this finding. For the two payments the reason for the delay was due to the time lapsed between grant periods. The approval process for the FASEG program extension was delayed several months at the end of FY03 period pending the Supplemental Education Grant (SEG) finalization. The budget proposal process requires all FSM states to consolidate their budgets before submitting to Washington D.C. When the extension request was finally approved by the grantor, FY04 has already begun thus services were provided in the previous fiscal year were finally posted in FY04. The second part of our response is same as presented in finding no. 2005-1.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Federal Findings and Questioned Costs Section, Continued

Finding No.:	2005-07
CFDA:	15.875
Grant:	Section 211 Education Health Sector Grants
Grantor Agency:	U.S. Department of the Interior, Office of Insular affairs
Area:	Allowable Costs/Cost Principles and Period of Availability
Questioned Cost:	\$0

Criteria: Federal expenditures should be recognized within 90 days of the end of the grant period.

Condition:

1. Check number 21300, totaling \$51,522, to purchase textbooks was recorded as a fiscal year 2005 expenditure. The applicable check payment was actually disbursed in May 2006, which is beyond the period of availability. As the payment date occurred in fiscal year 2006, no questioned costs result from this condition in fiscal year 2005.
2. Check number 19002, totaling \$107,700, to purchase equipment, was recorded as a fiscal year 2005 expenditure; however, the payment date was December 31, 2005, and the applicable check has not cleared the bank as of June 10, 2006. This matter is reflected as a questioned cost at Finding 2005-1.
3. Check number 18204, totaling \$2,865, did not clear the bank within ninety days of the fiscal year end. As the check clearance date occurred subsequent to the fiscal year end, no questioned costs result, but such will be reflected as a questioned cost in the 2006 audit, unless corrective action occurs.
4. Check number, 12759, totaling \$9,235, was recorded as an expenditure in fiscal year 2005, but the underlying services were received in fiscal year 2004. This amount appears to be an eligible program expenditure, but is not recorded in the appropriate period.

Cause: There appears to be a weakness in internal controls over ensuring that federal funds are recorded in the appropriate period and within the period of availability.

Effect: No questioned costs are presented at this finding, but noncompliance with allowable costs/cost principles and period of availability requirements results from this condition.

Recommendation: Expenditures should be recorded in the period in which goods and services are received and within the period of availability.

Auditee Response and Corrective Action Plan: We agree with the finding. Kosrae State Government will have to comply with the recommendation.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Federal Findings and Questioned Costs Section, Continued

Finding No.: 2005-08  
CFDA: 15.875  
Grant: Section 211 Health Sector Grant  
Grantor Agency: U.S. Department of the Interior, Office of Insular Affairs  
Area: Period of Availability  
Questioned Costs: \$16,935

Criteria: Expenditures should be recorded in the appropriate period.

Condition: For one of 12 (8%) expenditures tested, (\$16,935 of the aggregate population tested of \$322,904), the invoices relate to services received during the period of 9/1/04 - 10/1/04. Of the payment of \$17,500, \$16,935 relates to FY 2004 and \$565 relates to FY 2005.

Org	Ccled	Acct_No	Payee	APV #	Amount	Check #	Questioned Costs
731213	KA200B	8307	Kosrae Utility Authority	5000088	17,500	12486	\$16,935

Cause: There appears to be a control deficiency over ensuring that expenditures are recorded in the appropriate period.

Effect: Expenditures are misstated in both FY 2004 and in FY 2005. A questioned cost exists.

Recommendation: Expenditures should be correctly accounted for in the appropriate period in which goods or services have been received.

Auditee Response and Corrective Action Plan: We agree with this finding. Kosrae State Government will comply with the auditors recommendation. In fiscal year 2006 internal control has been established to correct this finding. Chief Accountant will make sure procedures are followed.



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Federal Findings and Questioned Costs Section, Continued

Finding No.: 2005-09  
CFDA: 84.027  
Grant: Special Education-Grants to States  
Grant Number: H027B030002-04  
Grantor Agency: U.S. Department of Education  
Area: Period of Availability  
Questioned Costs: \$24,246

Criteria: Expenditures should be recorded in the appropriate period underlying the receipt of applicable goods or services.

Condition: For 1 of 30 (3%) expenditures tested, (\$25,028 of the aggregate population of \$80,498), amounts were not recorded in the proper period.

The expenditure relates to services that were provided during FY2004 and are outside of the grant's period of availability.

<u>Org #</u>	<u>Cost Center</u>	<u>Check No</u>	<u>APV #</u>	<u>Payee</u>	<u>Check Amt</u>
301410	KA4091	15629	5003360	UNIVERSITY OF GUAM	\$24,246

Cause: There appears to be a control deficiency over ensuring that expenditures are recorded in the appropriate period.

Effect: Expenditures have been misstated in both FY 2004 and FY 2005. A questioned cost exists.

Recommendation: Expenditures should be recorded in the fiscal year in which applicable goods and services are received.

Auditee Response and Corrective Action Plan: We agree with this finding.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Federal Findings and Questioned Costs Section, Continued

Finding No.:	2005-10
CFDA:	84.027
Grant:	Special Education-Grants to States
Grant Number:	H027B030002-04
Grantor Agency:	U.S. Department of Education
Area:	Cash Management
Questioned Costs:	Undeterminable

Criteria: In accordance with applicable cash management requirements, the time elapsed between the receipt of Federal funds and the disbursement of checks should be minimized.

Condition: The Kosrae State Government could not provide documented details of expenditure drawdowns per GAPS for the program.

Cause: There appears to be a lack of internal controls over cash management.

Effect: The Kosrae State Government appears to be in noncompliance with applicable cash management requirements. Due to lack of information available and provided by the grantee, the amount of questioned costs is undeterminable.

Recommendation: The Kosrae State Government should establish a system to identify detailed expenditures per drawdown. In addition, the State should strengthen internal controls over cash management.

Auditee Response and Corrective Action Plan: Kosrae State Government (KSG) agree with this finding. KSG will ensure establishment of internal control over cash management requirement. Administrator of Division of Finance & Budget will be responsible to make sure procedures are followed. The Director of Administration & Finance will conduct monthly review to ensure full compliance.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Federal Findings and Questioned Costs Section, Continued

Finding No.:	2005-11
CFDA:	84.256
Grant:	Freely Associated States-Education Grant Program
Grant No.:	S256A030009-04
Grantor Agency:	U.S. Department of Education
Area:	Cash Management
Questioned Costs:	Undeterminable

Criteria: In accordance with applicable cash management requirements, the time elapsed between the receipt of Federal funds and the disbursement of check should be minimized.

Condition: The Kosrae State Government could not provide documented details of expenditure drawdowns per GAPS for the program.

Cause: There appears to be a lack of internal controls over cash management.

Effect: The Kosrae State Government appears to be in noncompliance with applicable cash management requirements. Due to lack of information available and provided by the grantee, the amount of questioned costs is undeterminable.

Recommendation: The Kosrae State Government should establish a system to identify detailed expenditures per drawdown. In addition, the State should strengthen internal controls over cash management.

Auditee Response and Corrective Action Plan:

Kosrae State Government is following the Independent Auditor's recommendation to establish internal controls over cash management. Expenditures are recorded and reported in GAPS to trigger drawdowns by the Project manager with the Finance Administrator as an internal policy by the Department of Administration & Finance.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Financial Statements Findings Section

Finding No.: 2005-12  
Area: Payroll Allotments

Criteria: Financial and programmatic records should be maintained on file for at least three years.

Condition: For 63 payroll expenditures tested, allotment forms to substantiate allotments deducted from employee biweekly payroll were not on file.

Cause: Allotment forms for fiscal year 2005 have not been filed within individual employee files and, therefore, allotment deductions could not be verified.

Effect: There does not appear to be a financial statement effect that results from this condition. However, inadequate documentation exists to substantiate withholdings.

Recommendation: The Kosrae State Government should ensure that allotment forms are filed within individual employee files.

Auditee Response and Corrective Action Plan: We agree to this finding. Kosrae State Government is updating its employee files to ensure that allotment forms are all filed within individual file. On a monthly basis, the Finance Administrator will review payroll deductions with authorizations to insure procedural compliance. The Payroll Officer will be responsible for compliance.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Financial Statements Findings Section, Continued

Finding No.: 2005-13  
Area: Journal Vouchers

Criteria:

1. Journal vouchers should be prepared and be approved by two different personnel to ensure an adequate segregation of duties.
2. Journal vouchers should be properly supported.

Condition:

1. The following journal vouchers were signed by only one person.

JV5D0068  
JV5D0065  
JV5D0060  
JV5D0041  
JV5M0062  
JV5M0088  
JV5D0040  
JV5D0033  
JV5D0023  
JV5M0102  
JV5M0051

2. The following journal vouchers have no supporting documentation attached:

JV5D0065 \$40,687  
JV5D0041 \$200,000

3. Journal voucher JV5M0072, totaling \$56,532, was recorded to transfer expenditures from one account to another. The amount transferred was determined based on the budget availability and did not specify which transactions were included within the transfer or their relationship to the recipient account.
4. Journal voucher JV5M0063, totaling \$33,700, was recorded to transfer expenditures from one account to another. The amount transferred was determined based on budget availability and the journal voucher did not specify which transactions were included in this transfer or their relationship to the recipient account.

Cause: The rationale for the transfer was not documented, and the specific expenditures transferred were not identified.

Effect: Incorrect transfers could occur if the rationale for such transfers is not documented and if the specific expenditures being transferred are not identified.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Financial Statements Findings Section, Continued

Finding No.: 2005-13, Continued  
Area: Journal Vouchers

Recommendation: We recommend that all journal vouchers adequately document the reason for their use and that specific detail be provided in support of expenditure transfers.

Auditee Response and Corrective Action Plan: Kosrae State Government (KSG) does agree with this finding. KSG is following the auditors' recommendation that all journal voucher must document the reasons and provide detail supporting documentations.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Financial Statements Findings Section, Continued

Finding No.: 2005-14  
Area: Encumbrances

Criteria: Encumbrances should be properly recorded and be supported by proper documentation.

Condition:

1. For one (2%) of 46 encumbrances tested, the amount of the encumbrance was understated.

PO#	FUND	FORG	CCLED	ACCT	PVNDR	POAMT.	POPAID.	PREMBAL
P50207	73	731211	KA220A	8405	5937	\$9,779	\$0	\$9,779

2. In four (8%) of 46 instances tested, Division of Planning & Statistics, which acts as the contract administrator, indicates that its records show that some liquidations have been made to the following contracts, but such data does not agree with the official accounting system and records.

C00234	11	111060	002403	8405	579	\$10,000	\$0	\$10,000
C00234	11	111010	012627	8405	579	\$25,000	\$0	\$25,000
C00235	11	111010	012627	8405	1152	\$25,000	\$0	\$25,000
C00235	11	111060	002402	8405	1152	\$10,000	\$0	\$10,000

3. In six (13%) of 46 instances tested, we were unable to determine the validity of the encumbrance due to insufficient supporting documents provided for review. In these instances, the underlying agreement was within the State and merely constituted a memo from one department to another indicating that services would be performed for a certain dollar amount.

C30160	60	601310	K0169	8303	6927	\$ 52,100	\$37,602	\$14,498
C30160	60	601310	K03006	8405	6927	\$111,941	\$41,004	\$70,937
C30160	60	601310	K0169	8001	6927	\$ 8,718	\$ 2,864	\$ 5,854
C30124	60	601310	K03006	8210	4,683	\$ 41,941	\$20,293	\$21,648
C30124	60	601310	K03006	8303	4683	\$ 14,525	\$ 7,682	\$ 6,843
C30124	60	601310	K03006	8419	4683	\$ 3,920	\$ 41	\$ 3,879

4. In one (2%) of 46 encumbrances tested, no supporting document was provided for review.

C23922	60	601510	6822	8405	1052	\$4,337	\$0	\$4,337
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5. For one (2%) of 46 encumbrances tested, the supporting document does not agree to the purchase order total and liquidation was not recorded in the proper account.

C00261	82	828201		8405	3462	\$18,689	\$14,538	\$4,151
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6. In one instance, two contracts from two different vendors were assigned the same contract number.

C20320	60	601101	K0145	8401	4,545	\$10,750	\$0	\$10,750
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**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Financial Statements Findings Section, Continued

Finding No.: 2005-14, Continued  
Area: Encumbrances

Condition, Continued:

7. In one instance, the reviewed purchase order and amount does not agree with the purchase order amount in the system.

L51732	72	721413	KA116A	8210	3,080	\$25,000	\$0	\$25,000
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8. In one instance, the stated vendor per the purchase order does not agree with the vendor stated per the system.

L52043	74	741611	KA433A	8210	6,314	\$15,250	\$0	\$15,250
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9. The following contract was fully paid , but the system indicates a remaining balance of \$1,000. This matter was corrected in fiscal year 2006.

C40025	46	461410	5910	8405	4,032	\$47,100	\$23,550	\$23,550
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10. Seventeen contracts from different vendors were issued under one contract number (C50104). This creates difficulty in tracking the actual outstanding encumbrances against this contract.

Cause: There seems to be weak internal controls over ensuring that encumbrances are well supported and are accurately reported in the system

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

Recommendation: Encumbrances should be periodically reviewed and reconciled to underlying support.

Auditee Response and Corrective Action Plan: We agree with the finding. Monthly reconciliation of encumbrances is a requirement that is implemented in fiscal year 2006. According to Kosrae State Constitution Code, Title 10, Section 10.203, the Director has the authority and full responsibility for the Treasury therefore is entitled to obligate funds for the State Government Recommend removal of this finding.

We agree with the finding; however, the assignment of contract number was due to a Directive established under this account. This said Directive was assigned a contract number, C50104, in which all contracts obligated against it thereafter was also issued or assigned the same contract number (C50104).

We do not agree with this finding. The Division of Planning & Statistics keeps a computerized financial tracking and monitoring system on all projects. Monthly reconciliation of this tracking system is conducted with Finance Office.

Auditors' Response: While we concur that a separate system is maintained, the above difference resulted.



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Financial Statements Findings Section, Continued

Finding No.: 2005-15  
Area: Accounts Receivable

Criteria: Accounts receivable should be collected in a timely manner and should be supported by subsidiary ledgers.

Condition:

- For the following accounts, the subsidiary ledger does not reconcile with the general ledger.

Fund	Account	Account Description	Balance @ 09/30/06 per GL	Per KSG Schedule	Variance
10	260	TRAVEL ADVANCES	\$173,001	\$171,930	\$ 1,071
19	280	compact SBG 221b Health & Educ	\$ 0	\$ 39,175	\$ (39,175)
26	203	ADVANCE ON MEDICAL FUND	\$ 31,132	\$ 0	\$ 31,132
26	267	ADVANCE - MEDICAL REFFERAL RP	\$ 47,503	\$ 0	\$ 47,503
30	262	A/R FROM U	\$866,567	\$ 0	\$ 866,567
30	280	A/R FSMNG	\$458,940	\$404,438	\$ 54,502
32	262	A/R FROM U	\$ 61,742	\$ 0	\$ 61,742
33	262	A/R FROM U	\$ 20,568	\$ 0	\$ 20,568
33	302	A/R HPG HO	\$ 20,694	\$ 0	\$ 20,694
34	262	A/R FROM U	\$ 5,624	\$ 0	\$ 5,624
37	280	A/R FSMNG	\$130,779	\$343,005	\$(212,226)
41	262	A/R FROM US GOVT	\$149,627	\$ 0	\$ 149,627
41	280	A/R FSMNG	\$ 39,230	\$ 41,515	\$ (2,285)
44	262	A/R FROM U	\$ 14,239	\$ 0	\$ 14,239
46	262	A/R FROM US GOVT	\$103,943	\$ 0	\$ 103,943
47	262	A/R FROM US GOVT	\$ 14,599	\$ 0	\$ 14,599
60	250	A/R GENERAL	\$(14,956)	\$ 0	\$(14,956)
60	298	A/R LOANS	\$ 95,000	\$ 0	\$ 95,000
77	262	A/R FROM US GOVT	\$166,651	\$ 0	\$ 166,651
82	207	A/R LANDING FEE/AIR MIKE	\$ 4,640	\$ 0	\$ 4,640
91	280	Receivables Fund	\$ 0	\$ 2,861	\$ (2,861)

- For the following accounts, receivables have been outstanding for in excess of one year:

Fund	Account	Balances > 1 year
10	200	\$401,482
10	202	\$ 817
10	204	\$ 5,963
10	208	\$ 21,715
10	209	\$ 1,761
10	210	\$ 46,247

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Financial Statements Findings Section, Continued

Finding No.: 2005-15, Continued  
Area: Accounts Receivable

Condition, Continued:

Fund	Account	Balances > 1 year
10	212	\$ 3,182
10	213	\$ 122
10	214	\$ 240
10	214	\$ 6,101
10	220	\$ 927
10	230	\$ 12,094
10	250	\$ 11,380
10	251	\$ 40,000
10	268	\$180,636
10	280	\$ 9,461
11	280	\$505,731
11	280	\$469,409
19	250	\$ 19,811
19	280	\$ 39,175
27	298	\$395,130
30	250	\$ 1,319
30	262	\$866,567
30	280	\$516,646
30	280	\$123,258)
32	280	\$ 89,630
32	280	\$ (66,733)
33	280	\$ 18,904
34	280	\$ 55,903
34	280	\$ (20,277)
37	262	\$546,755
37	280	\$388,128
37	280	\$ (45,124)
41	280	\$147,638
41	280	\$116,782)
44	280	\$ 9,689
46	280	\$ 202
46	283	\$246,895
46	284	\$161,632
46	285	\$ 37,268
46	286	\$123,059)
46	287	\$ 65,952
60	297	\$272,500
63	252	\$343,895
71	262	\$158,545

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Financial Statements Findings Section, Continued

Finding No.: 2005-15, Continued  
Area: Accounts Receivable

Condition, Continued:

Fund	Account	Balances > 1 year
82	250	\$ (23,692)
82	298	\$530,743
84	298	\$ 43,427
85	210	\$ 1,334
85	216	\$ 1,147
85	217	\$ 172
87	280	\$ 30,000
91	250	\$ 58,905
91	280	\$ 5,722
91	280	\$ 2,861

Cause: There appears to be a lack of reconciliation between subsidiary ledgers and the general ledger and non-timely collection of accounts receivable.

Effect: There may be a potential misstatement of the financial statements if subsidiary ledgers are not reconciled with the general ledger, and uncollected receivables affect the availability of cash.

Recommendation: Subsidiary ledgers should be routinely reconciled with the general ledger. In addition, standard collection efforts should be initiated.

Auditee Response and Corrective Action Plan: We agree with this finding. Kosrae State Government will comply with the criteria.

Finding No.: 2005-16  
Area: Travel Expenditures

Criteria: Travel expenditures should be supported with boarding passes or other evidence to ensure that travel actually occurred.

Condition: The following travel expenditures were not supported with boarding passes or other evidence that travel occurred.

T0502601  
T0533001

Cause: There appears to be a weakness in internal controls over ensuring that travel clearance is supported with boarding passes.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Financial Statements Findings Section, Continued

Finding No.: 2005-16, Continued  
Area: Travel Expenditures

Effect: Travel expenditures may not be adequately substantiated.

Recommendation: The State should consider requiring the submission of boarding passes to support travel occurrence.

Auditee Response and Corrective Action Plan: We agree with the finding. It is the state policy requiring submission of boarding passes or other evidence to support travel expenditures. Travel Personnel will ensure travel expenditures are properly supported.

Finding No.: 2005-17  
Area: Continuing Appropriations

Criteria: Continuing appropriations should be reconciled to applicable laws.

Condition:

1. Under the Micro Propagation/Mass Cultivation of Masa Troglodytarum Program, Kosrae State reflected a continuing appropriation of \$60,000. However, State Law 7-201 only allowed for an appropriation of \$50,000.
2. Under the Diabetes Today Pilot Program, Kosrae State reflected a continuing appropriation of \$18,840. State Law 7-129 only allows for an appropriation of \$7,670.

Cause: There appears to be weak internal controls over ensuring that continuing appropriations coincide with applicable Kosrae State Laws.

Effect: Continuing appropriations appear to be overstated by \$21,170.

Recommendation: We recommend that continuing appropriations be regularly reconciled to applicable State Laws.

Auditee Response and Corrective Action Plan: We agree to the finding that regular reconciliation of continuing appropriations be done, however for item 1, an original amount of \$10,000 was appropriated for the project under state law no. 7-109 (copy attached). For item 2, there were two appropriations for the project totaling up to \$11,170, under state laws 7-129 (\$7,670) and 7-218 (\$3,500). The allotment of the \$7,670 was double posted thereby created a total of \$18,840.

Recommended Action Plan: Monthly reconciliation of continuing appropriations is a requirement that was implemented in fiscal year 2006.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Financial Statements Findings Section, Continued

Finding No.: 2005-18  
Area: Payroll

Criteria: Payroll expenditures should be recorded in the proper period.

Condition: A portion of the pay period ended October 2, 2005, was not accrued for in fiscal year 2005.

Cause: There appears to be a control deficiency over ensuring that expenditures are recorded in the appropriate period.

Effect: Expenditures and accrued liabilities were misstated by approximately \$139K. However, this matter was corrected by a proposed audit adjustment.

Recommendation: Expenditures should be recorded in the period in which goods or services have been received.

Auditee Response and Corrective Action Plan: We agree with the finding, however, the condition has been corrected. Kosrae State will comply with the criteria.

Finding No.: 2005-19  
Area: Travel Advances

Criteria: Travel advances should be cleared in a timely manner.

Condition: Travel advances totaling \$136,218 appear to have been outstanding over a year, representing 79% of the total travel advances.

Cause: There appears to be weak internal controls over ensuring that travel is cleared in a timely manner.

Effect: Cash flows may be negatively impacted.

Prior Year Status: This finding is reiterative of conditions identified in the prior year Single Audit.

Recommendation: We recommend that the State enforce a collection policy for travel advances.

Auditee Response and Corrective Action Plan: We agree with the finding, however, enforcement for collection began in fiscal year 2006. Travel personnel will be responsible ensuring full compliance.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Financial Statements Findings Section, Continued

Finding No.: 2005-20  
Area: Due From Other Governments

Criteria: Due From Other Governments should be fairly stated at the end of each fiscal year.

Condition: Due From Other Governments has not been adjusted for uncollectible receivables.

Cause: The cause of this condition is that the necessary allowance for doubtful accounts has not been performed.

Effect: There is no effect of this condition on the financial statements by fund type as these receivable balances are already included as reserve for related assets in the fund balance.

Recommendation: We recommend that the Department of Administration ensures that Due From Other Governments is properly valued at the end of each fiscal year.

Auditee Response and Corrective Action Plan: We agree with this finding. Kosrae State Government will comply with the criteria.

Finding No.: 2005-21  
Area: Housing Renovation Loan Receivables

Criteria: The general ledger should reconcile with the subsidiary ledger.

Condition: The detailed schedule of loans receivable for the Expendable Trust Fund did not agree with the general ledger. The subsidiary ledger balance was greater than the general ledger balance by \$323,561.

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

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

Prior Year Status: This condition was reported as a finding in the Single Audit of Kosrae State Government for fiscal years 1999, 2000, 2001, 2002, 2003 and 2004.

Recommendation: We recommend that the Department of Administration ensures that loans receivable are reconciled at the end of each fiscal year.

Auditee Response and Corrective Action Plan: We agree with the finding. The condition was reported as a finding in the single audit report for the previous fiscal years, however, criteria will be corrected in fiscal year 2006.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2005

Financial Statements Findings Section, Continued

Finding No.: 2005-22  
Area: Equity Investments

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

Condition: Unaudited financial statements were submitted for KSVI and SEMO in support of Kosrae State equity investments. No financial statements for Pacific Tuna Industries were furnished in support of Kosrae State equity investments.

Cause: The cause of this condition is the lack of financial statements by investees.

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

Prior Year Status: The above condition was reported as a finding in the Single Audit of Kosrae State Government for fiscal years 1999, 2000, 2001, 2002, 2003 and 2004.

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

Auditee Response and Corrective Action Plan: We agree with this finding. Kosrae State Government will comply with the criteria.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Unresolved Prior Years' Findings and Questioned Costs  
Year Ended September 30, 2005

The following is a summary of unresolved questioned costs of the State of Kosrae as of September 30, 2005:

	Questioned Costs Set Forth in Prior Audit Report <u>2003</u>	Questioned Costs Resolved in Fiscal Year <u>2004</u>	Questioned Costs at <u>September 30, 2005</u>
Unresolved Questioned Costs FY 2002	\$ 72,138	\$ -	\$ 72,138
Unresolved Questioned Costs FY 2003	103,493	-	103,493
Unresolved Questioned Costs FY 2004	237,645	-	237,645
Questioned Costs FY 2005	<u>-</u>	<u>-</u>	<u>462,459</u>
	\$ <u>413,276</u>	\$ <u>-</u>	\$ <u>875,725</u>

The prior year status of findings is contained in the accompanying Schedule of Findings and Questioned Costs.