

POHNPEI PORT AUTHORITY

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2006 AND 2005

INDEPENDENT AUDITORS' REPORT

Board of Directors
Pohnpei Port Authority:

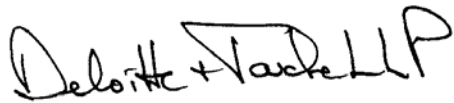
We have audited the accompanying statements of net assets of the Pohnpei Port Authority (the Authority), a component unit of the State of Pohnpei, as of September 30, 2006 and 2005, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Pohnpei Port Authority as of September 30, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 - 7 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the management of the Authority. 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 30, 2007, on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

January 30, 2007

POHNPEI PORT AUTHORITY

Management's Discussion and Analysis Year Ended September 30, 2006

Our discussion and analysis of the Pohnpei Port Authority's financial performance provides an overview of the Authority's financial activities for the fiscal year ended September 30, 2006. Please read it in conjunction with the Authority's financial statements, which follow this section.

Financial Highlights

- For the fiscal year ended September 30, 2006, the Authority's total operating revenues increased by \$805,001 or 49.67% from the prior year.
- During the year, the Authority's total operating expenses were \$1,409,588, which was \$213,765 or 17.88% higher than the prior year.
- For fiscal year 2006, the Authority's bad debt expense increased by \$48,754 or 37.04% from the prior year.
- The Authority reflected an increase in net assets of \$921,412 in fiscal year 2006 as compared to \$453,677 in fiscal year 2005.
- For fiscal year 2006, the Authority posted operating income of \$835,769 as compared to \$293,287 in fiscal year 2005.
- For fiscal year 2006, new sources of revenues such as pilotage service, boat transportation service, supplemental port service and seaport departure fees were implemented by the seaport division. As a result, additional seaport revenues of \$601,682 (49.87%) were generated, which led to a 32.99% increase in operating revenues for the seaport division.

Overview of the Financial Statements

The financial statements presented herein include all of the activities of the Pohnpei Port Authority (the "Authority"). Included in this report are the Statement of Net Assets and the Statements of Revenues, Expenses, and Changes in Net Assets. These financial statements present the complete financial picture of the Authority from the economic resources measurement focus using the accrual basis of accounting. These statements include all assets and liabilities of the Authority and current year's revenues and expenses are taken into account regardless of when cash is received or paid.

The accounts of the Authority are organized as a proprietary fund. Proprietary funds are used by governmental units that are operated in a manner similar to private business enterprises. The Authority prepares and submits a detailed statement of its proposed annual budget to the Governor on or before March 15th of each year. An annual budget may be amended at any time in the same manner as the adoption of the initial budget for that fiscal year. The Authority depends mainly on its generated revenues to sustain its operations. Seaport charges, departure fees, landing fees, land leases and space rentals are the major sources of revenues.

The Statement of Net Assets and the Statements of Revenues, Expenses and Changes in Net Assets

The Statement of Net Assets and Statements of Revenues, Expenses and Changes in Net Assets report the financial condition or position and results of operations of the Authority. They show the assets, liabilities and the difference between assets and liabilities. They report the information whether the Authority has sufficient resources to meet its current and long term obligations as well. They show whether the Authority's financial health is improving, deteriorating or remaining steady as prior year. They report the revenues earned and expenses incurred and whether the revenues are more or less than the expenses.

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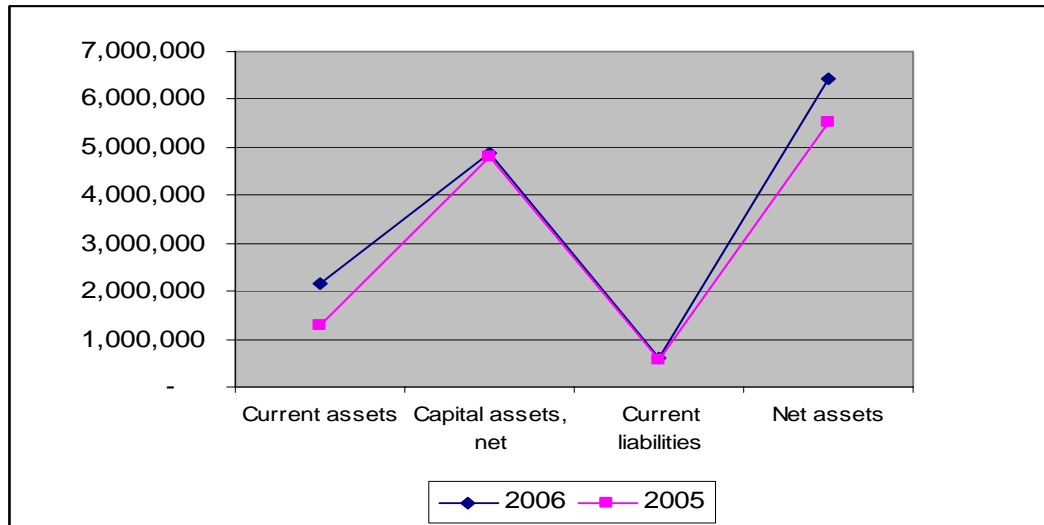
Management's Discussion and Analysis Year Ended September 30, 2006

A Financial Analysis of the Authority as a Whole

Net Assets

The Authority's net assets increased by \$921,412 or 16.71% during fiscal year 2006 as compared to fiscal year 2005. Current assets increased by \$891,711 or 70.25% while capital assets increased by \$53,204 or 1.10% and current and total liabilities increased by \$23,503 or 4.07%.

	2006	2005	2004
Current assets	\$ 2,161,114	\$ 1,269,403	\$ 959,754
Capital assets, net	4,873,347	4,820,143	4,858,755
Total assets	7,034,461	6,089,546	5,818,509
Current liabilities	600,455	576,952	759,59
Total liabilities	600,455	576,952	759,592
Net assets			
Invested in capital assets, net of related debt	4,873,347	4,820,143	4,858,755
Unrestricted	1,560,659	692,451	200,162
Total net assets	\$ 6,434,006	\$ 5,512,594	\$ 5,058,917



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Management's Discussion and Analysis Year Ended September 30, 2006

Changes in Net Assets

For the year ended September 30, 2006, net assets of the Authority changed as follows with comparison from prior year:

	2006	2005	2004
Operating revenues:			
Seaport charges	\$ 1,808,164	\$ 992,291	\$ 748,644
Land leases and space rentals	337,498	332,744	317,021
Departure fees	185,710	191,890	191,918
Landing fees	86,651	87,263	98,671
Other	7,712	16,546	69,845
Total operating revenues	2,425,735	1,620,734	1,426,099
Bad debt expense, net of recoveries	180,378	131,624	-
Net operation revenue	\$ 2,245,357	\$ 1,489,110	\$ 1,426,099
Operating expenses:			
Salaries and benefits	780,881	670,743	668,122
Depreciation	229,182	204,183	498,427
Utilities	76,706	72,324	58,882
Supplies and materials	54,568	48,293	39,336
Repairs and maintenance	73,893	45,296	41,137
Travel	56,834	44,687	58,878
Contractual services	46,508	46,237	27,472
Fuel	22,811	16,177	12,929
Communication	22,917	19,752	18,156
Training	4,562	4,256	-
Miscellaneous and others	40,726	23,875	20,849
Total operating expenses	1,409,588	1,195,823	1,444,188
Income (loss) from operations	835,769	293,287	(18,089)
Non- operating revenues (expenses):			
Federal grants	2,961	-	-
Interest income	6,963	6,267	1,707
Recovery of bad debts	-	-	37,262
Other income	686	154,123	26,881
Other non- operating expenses	-	-	(225)
Total non- operating revenues (expenses)	10,610	160,390	65,625
Capital contributions	75,033	-	-
Change in net assets	\$ 921,412	\$ 453,677	\$ 47,536

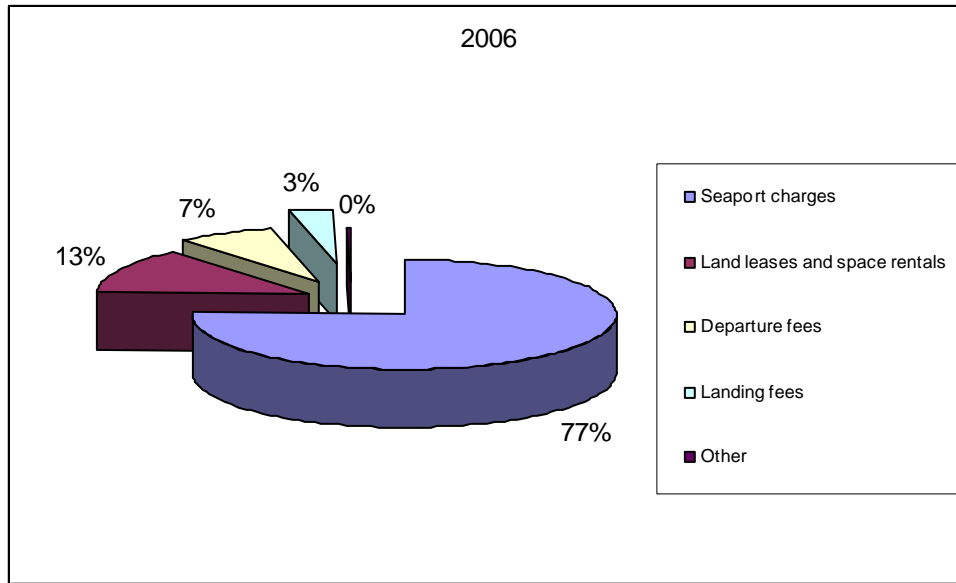
POHNPEI PORT AUTHORITY

Management's Discussion and Analysis Year Ended September 30, 2006

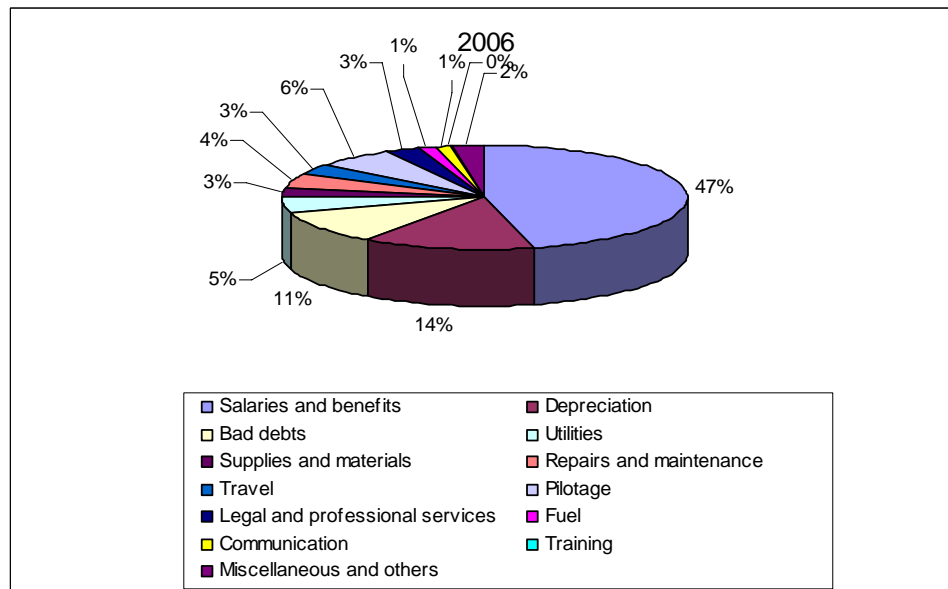
The Authority's operations for fiscal year 2006 reflected an increase in net assets of \$921,412 which is 203.10% higher from prior year and contributed to the continuous improvement of the Authority's financial condition.

For the year ended September 30, 2006, the Authority's operating revenues and expenses are as follow:

Operating Revenues



Operating Expenses



POHNPEI PORT AUTHORITY

Management's Discussion and Analysis Year Ended September 30, 2006

Of the total operating revenues of \$2,425,735 for fiscal year ended September 30, 2006, seaport activities contributed \$1,808,164 while land leases and space rentals was \$337,498 and departure and landing fees was \$272,361. The largest operating expenses were salaries and benefits, depreciation and bad debts, in the amount of \$780,881, \$229,182 and \$180,378, respectively.

Capital Assets

The Authority's investment in capital assets as of September 30, 2006 is \$4,873,347 (net of accumulated depreciation). This investment includes land, buildings and improvements, and machinery and equipment. The total increase in the Authority's investment in capital assets for the current year was 1.09% due to additions of \$282,647 (includes OMIP Grant in the amount of \$75,033) less depreciation expense of \$229,182. Refer to note 4 of the financial statements for further information.

Next Year's Projections and Budget

The construction of the Authority's new administration building will be started as soon as the bidding procedure is completed which is already in process. The construction of the building will be fully funded from the Authority's generated revenues. A five year strategic plan adopted by the Authority, lays out the goals and objectives to be achieved from fiscal years 2007 through 2011.

Contacting the Authority's Financial Management

This financial report is designed to provide our customers, creditors, board of directors and other interested parties with the general overview of the Authority's financial activities. Questions or additional financial information can be submitted and obtained from the Finance Division with the permission of the General Manager at P.O. Box 1150, Pohnpei, FM 96941.

Management's Discussion and Analysis for the year ended September 30, 2005 is set forth in the Company's report on the audit of financial statements, which is dated April 10, 2006. That Discussion and Analysis explains the major factors impacting the 2005 financial statements and can be viewed at the FSM Office of the Public Auditor's website at www.fsmpublicauditor.fm.

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Statements of Net Assets
September 30, 2006 and 2005

<u>ASSETS</u>	<u>2006</u>	<u>2005</u>
Current assets:		
Cash and equivalents	\$ 1,355,411	\$ 616,056
Restricted cash	333,450	326,413
Accounts receivable, net	385,135	322,666
Advances	9,124	4,268
Due from Pohnpei State	<u>77,994</u>	<u>-</u>
Total current assets	2,161,114	1,269,403
Property and equipment, net	<u>4,873,347</u>	<u>4,820,143</u>
	<u>\$ 7,034,461</u>	<u>\$ 6,089,546</u>
 <u>LIABILITIES AND NET ASSETS</u> 		
Current liabilities:		
Accounts payable	\$ 100,232	\$ 108,317
Accrued liabilities and others	126,831	114,953
Accrued annual leave	64,893	43,250
Deferred revenues	<u>308,499</u>	<u>310,432</u>
Total current liabilities	<u>600,455</u>	<u>576,952</u>
Commitments and contingencies		
Net assets:		
Invested in capital assets	4,873,347	4,820,143
Unrestricted	<u>1,560,659</u>	<u>692,451</u>
Total net assets	<u>6,434,006</u>	<u>5,512,594</u>
	<u>\$ 7,034,461</u>	<u>\$ 6,089,546</u>

See accompanying notes to financial statements.

POHNPEI PORT AUTHORITY

Statements of Revenue, Expenses, and Changes in Net Assets
Years Ended September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Operating revenues:		
Seaport charges	\$ 1,808,164	\$ 992,291
Land leases and space rentals	337,498	332,744
Departure fees	185,710	191,890
Landing fees	86,651	87,263
Other	<u>7,712</u>	<u>16,546</u>
Total operating revenues	2,425,735	1,620,734
Bad debt expense, net of recoveries	<u>180,378</u>	<u>131,624</u>
Net operating revenue	<u>2,245,357</u>	<u>1,489,110</u>
Operating expenses:		
Salaries and benefits	780,881	670,743
Depreciation	229,182	204,183
Utilities	76,706	72,324
Repairs	73,893	45,296
Travel	56,834	44,687
Supplies and materials	54,568	48,293
Contractual services	46,508	46,237
Communication	22,917	19,752
Fuel	22,811	16,177
Training	4,562	4,256
Miscellaneous and others	<u>40,726</u>	<u>23,875</u>
Total operating expenses	<u>1,409,588</u>	<u>1,195,823</u>
Earnings from operations	<u>835,769</u>	<u>293,287</u>
Nonoperating revenues (expenses):		
Federal grants	2,961	-
Interest income	6,963	6,267
Other nonoperating income	<u>686</u>	<u>154,123</u>
Total nonoperating revenues, net	<u>10,610</u>	<u>160,390</u>
Capital contributions	<u>75,033</u>	<u>-</u>
Change in net assets	921,412	453,677
Net assets at beginning of year	<u>5,512,594</u>	<u>5,058,917</u>
Net assets at end of year	<u>\$ 6,434,006</u>	<u>\$ 5,512,594</u>

See accompanying notes to financial statements.

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Statements of Cash Flows
Years Ended September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities		
Cash received from customers	\$ 2,180,955	\$ 1,496,396
Cash paid to suppliers for goods and service:	(395,732)	(378,571)
Cash paid to employees	<u>(764,094)</u>	<u>(674,306)</u>
Net cash provided by operating activities	<u>1,021,129</u>	<u>443,519</u>
Cash flows from capital and related financing activities:		
Net proceeds from disposal of property and equipment	947	-
Acquisition of property and equipment	<u>(282,647)</u>	<u>(165,571)</u>
Net cash used in capital and related financing activities	<u>(281,700)</u>	<u>(165,571)</u>
Cash flows from investing activities		
Interest income	6,963	6,267
Other income - insurance recovery	<u>-</u>	<u>83,977</u>
Net cash provided by investing activities	<u>6,963</u>	<u>90,244</u>
Net change in cash and equivalents:	746,392	368,192
Cash and equivalents at beginning of year	<u>942,469</u>	<u>574,277</u>
Cash and equivalents at end of year	\$ <u><u>1,688,861</u></u>	\$ <u><u>942,469</u></u>
Reconciliation of earnings from operations to net cash provided by operating activities		
Earnings from operations	\$ 835,769	\$ 293,287
Adjustments to reconcile earnings from operations to net cash provided by operating activities		
Depreciation	229,182	204,183
Bad debt expense, net	180,378	131,624
Changes in working capital		
Change in accounts receivable	(242,847)	(73,219)
Change in advances	(4,856)	(3,563)
Change in prepaid expenses	-	3,700
Change in accounts payable	(8,085)	(56,061)
Change in accrued liabilities	11,878	(5,312)
Change in accrued annual leave	21,643	-
Change in deferred revenue	<u>(1,933)</u>	<u>(51,120)</u>
Net cash provided by operating activities	\$ <u><u>1,021,129</u></u>	\$ <u><u>443,519</u></u>

Summary Schedule of Noncash Activity

In 2005, the Authority wrote off \$65,385 of previously recorded accounts payable

See accompanying notes to financial statements.

POHNPEI PORT AUTHORITY

Notes to Financial Statements
September 30, 2006 and 2005

(1) Summary of Significant Accounting Policies

A. Reporting Entity

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

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

The Authority is a discretely presented component unit of the Pohnpei State Government. The financial statements in this report do not represent the financial position, results of operations or cash flows of the State of Pohnpei as a whole.

B. New Accounting Standards

The Authority implemented the following pronouncements in the fiscal year 2006:

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes standards for impairment of capital assets when service utility has declined significantly and unexpectedly.
- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation (an amendment to GASB Statement No. 34)*, which requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets.
- GASB Statement No. 47, *Accounting for Termination Benefits*, which establishes guidance for state and local governmental employers on accounting and financial reporting for termination of benefits.
- GASB Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefit Expenditures/Expense and Liabilities by Cost-Sharing Employers*, which 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.

The implementation of these pronouncements did not have a material impact on the accompanying 2006 financial statements.

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Notes to Financial Statements
September 30, 2006 and 2005

(1) Summary of Significant Accounting Policies, Continued

C. Basis of Accounting

The accounting policies of the Authority conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting," requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989.

The Authority has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

GASB Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments" (GASB 34) as amended by GASB Statement No. 37, "Basic Financial Statements – Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Disclosures" establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following net asset categories:

- Invested in capital assets, net of related debt:

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

- Restricted:

- Nonexpendable – Net assets subject to externally imposed stipulations that require the Authority to maintain them permanently. For the years ended September 30, 2006 and 2005, the Authority does not have nonexpendable net assets.
- Expendable – Net assets whose use by the Authority is subject to externally imposed stipulations that can be fulfilled by actions of the Authority pursuant to those stipulations or that expire by the passage of time.

- Unrestricted:

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

D. Budget

A detailed statement of the Authority's proposed annual budget is required to be prepared and submitted to the Governor on or before March 15th of each year. The annual budget is adopted upon the Governor's approval. In the event of the Governor's disapproval of the proposed budget, the Authority and the Governor, or their representatives, shall within 10 days after notification by the Governor, meet and discuss the proposed budget in order to reach an agreement. If a satisfactory agreement is not reached within 10 days thereafter, the proposed budget shall be submitted for consideration and decision to a board of arbiters, whose decision shall be final.

POHNPEI PORT AUTHORITY

Notes to Financial Statements
September 30, 2006 and 2005

(1) Summary of Significant Accounting Policies, Continued

E. Cash and Equivalents

For the purposes of the statements of net assets and of cash flows, cash and equivalents are defined as cash in checking accounts, savings accounts, cash on hand, and time certificates of deposit with original maturity dates of less than ninety days. At September 30, 2006 and 2005, book balances approximated bank balances, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2006 and 2005, bank deposits in the amount of \$200,000 are FDIC insured. The Authority does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

The Authority has not experienced any losses in such accounts and management is of the opinion that it is not exposed to any significant credit risk on its deposits.

F. Receivables

The Authority's accounts receivable are with businesses and individuals based in Pohnpei State that relate to public land leases, space rentals, landing fees, port and handling charges, wharfage, gross receipts fees and other fees. The allowance for uncollectible accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts and prior collection experience. The allowance is established through a provision for bad debts charged to expense.

G. Property and Equipment

Property and equipment are stated at cost or at estimated appraised values as of the transfer date (note 4), less accumulated depreciation. Depreciation is based on the straight-line method over the estimated useful lives of the respective assets. The Authority utilizes a capitalization threshold of \$300.

H. Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and liability as the benefit accrues to employees. No liability is recorded for nonvesting accumulating rights to receive sick pay benefits. The related sick pay expense is recorded when the benefit is actually taken.

I. Estimates

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

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Notes to Financial Statements
September 30, 2006 and 2005

(1) Summary of Significant Accounting Policies, Continued

J. Deferred Revenue

Deferred revenues represent funds received from a grantor (the Federated States of Micronesia National Government and Pohnpei State Government) that will be used for capital projects. Therefore, this balance will ultimately be recorded as other income upon use of these funds for the intended purpose.

K. Reclassifications

Certain reclassifications have been made to the 2005 financial statements to conform with the 2006 presentation.

(2) Restricted Cash

Restricted cash represents a 1995 FSM Congress continuing appropriation of \$300,000 for the purpose of constructing an air strip for Kapingamarangi Municipal Government. As of September 30, 2006, cash advanced to the Authority was invested in time certificates of deposit.

(3) Accounts Receivable

The detail of accounts receivable, net of allowance for doubtful debts, at September 30, 2006 and 2005, is as follows:

	<u>2006</u>	<u>2005</u>
Accounts receivable	\$ 891,150	\$ 648,303
Less allowance for doubtful debts	<u>(506,015)</u>	<u>(325,637)</u>
	<u>\$ 385,135</u>	<u>\$ 322,666</u>

(4) Property and Equipment

A summary of the Authority's property and equipment at September 30, 2006 and 2005, is as follows:

	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2005</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Balance at September 30, 2006</u>
Non-depreciable:					
Land		\$ 2,776,034	\$ -	\$ -	\$ 2,776,034
Construction in progress		-	60,305	-	60,305
Depreciable:					
Buildings and improvements	7 to 70 years	13,646,798	-	-	13,646,798
Machinery and equipment	3 years	<u>583,199</u>	<u>222,342</u>	<u>(13,784)</u>	<u>791,757</u>
		17,006,031	282,647	(13,784)	17,274,894
Less accumulated depreciation		<u>(12,185,888)</u>	<u>(229,182)</u>	<u>13,523</u>	<u>(12,401,547)</u>
Net investment in property and equipment		<u>\$ 4,820,143</u>	<u>\$ 53,465</u>	<u>\$ (261)</u>	<u>\$ 4,873,347</u>

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Notes to Financial Statements
September 30, 2006 and 2005

(4) Property and Equipment, Continued

	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2003</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Balance at September 30, 2005</u>
Non-depreciable:					
Land		\$ 2,776,034	\$ -	\$ -	\$ 2,776,034
Depreciable:					
Buildings and improvements	7 to 70 years	13,518,064	128,734	-	13,646,798
Machinery and equipment	3 years	<u>567,196</u>	<u>36,837</u>	<u>(20,834)</u>	<u>583,199</u>
		14,085,260	165,571	(20,834)	14,229,997
Less accumulated depreciation		<u>(12,002,539)</u>	<u>(204,183)</u>	<u>20,834</u>	<u>(12,185,888)</u>
		<u>2,082,721</u>	<u>(38,612)</u>	<u>-</u>	<u>2,044,109</u>
Net investment in property and equipment		\$ <u>4,858,755</u>	\$ <u>(38,612)</u>	\$ <u>-</u>	\$ <u>4,820,143</u>

During fiscal year 1996, an appraisal of the Authority's facilities was made by an independent contractor and the resultant appraised values of the land are reflected in the accompanying financial statements.

(5) Commitments and Contingencies

The amount payable for a master plan is in dispute. In December 1997, the contractor filed suit against the Authority. The Authority filed a motion to dismiss the suit based on the statute of limitations. The motion is still pending in court. However, no provision for additional losses, other than the initial liability, that may result from resolution of this matter has been made in the accompanying financial statements.

The Authority is subject to certain legal complaints that have arisen in the normal course of business. Management is of the opinion that resolution of these matters will not have a material effect on the financial statements.

(6) Risk Management

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

(7) Future Rental Revenues

The approximate future minimum annual rental revenue receivable by the Authority for lease contracts currently held with certain private corporations is as follows:

<u>Fiscal year ending December 31,</u>	<u>Total</u>
2007	\$ 296,143
2008	233,555
2009	197,089
2010	196,072
2011	191,843
2012 – 2016	952,330
2017 – 2021	793,676
2022 – 2026	195,614

POHNPEI PORT AUTHORITY

Notes to Financial Statements
September 30, 2006 and 2005

(8) Other Income

In 2005, management undertook a comprehensive review of its liabilities and determined that such had previously been overstated. Other nonoperating income in 2005 substantially relates to non cash related reductions of previously recorded payables.

(9) Pension Plan

The Authority's retirement plan (the Plan) is a self-administered program established to pay retirement, disability and survivor income to employees and their survivors to supplement similar benefits that employees receive from the FSM Social Security System. The Plan is a contributory plan in which the Authority contributes a maximum of 5 percent of the participant's annual salary, and the participant contributes at least 3 percent from his or her annual salary. Participation is optional. Vesting occurs over a six year period. The Authority's controller is the designated Plan administrator. Contributions to the Plan during the years ended September 30, 2006 and 2005 were \$18,949 and \$19,008, respectively. Management is of the opinion that the Plan does not represent an asset or liability of the Authority. For the years ended September 30, 2006 and 2005, plan assets were \$158,573 and \$120,128, respectively.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Board of Directors
Pohnpei Port Authority:

We have audited the financial statements of the Pohnpei Port Authority (the Authority), as of and for the year ended September 30, 2006, and have issued our report thereon dated January 30, 2007. 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

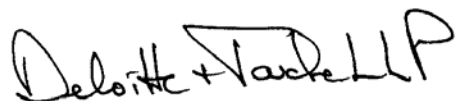
In planning and performing our audit, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and 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 that are required to be reported under *Government Auditing Standards*.

We noted other matters that we reported to management of the Authority in a separate letter dated January 30, 2007.

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



January 30, 2007