

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2006

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2006

INDEX

	<u>Page No.</u>
INDEPENDENT AUDITORS' REPORT, BASIC FINANCIAL STATEMENTS AND ADDITIONAL INFORMATION	1 - 63
INDEPENDENT AUDITORS' REPORTS ON INTERNAL CONTROL AND ON COMPLIANCE	64 - 93

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Table of Contents
Year Ended September 30, 2006

	<u>Page No.</u>
I. Independent Auditors' Report	1
II. Basic Financial Statements:	
Management's Discussion and Analysis	3
Government-Wide Financial Statements:	
Statement of Net Assets	10
Statement of Activities	11
Governmental Fund Financial Statements:	
Balance Sheet	12
Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficits)	13
Reconciliation of Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities	14
Discretely Presented Component Unit Financial Statements:	
Combining Statement of Net Assets	15
Combining Statement of Revenues, Expenses and Changes in Net Assets	16
Notes to the Basic Financial Statements	17
III. Required Supplementary Information - Other than Management's Discussion and Analysis	40
Schedule of Revenues, Expenditures and Changes in Fund Balance (Deficit) – Budget and Actual - General Fund	41
Note to Required Supplementary Information - Budgetary Reporting	42
IV. Other Supplementary Information	43
Combining Schedule of Expenditures by Account - Governmental Funds	44
General Fund:	
Statement of Revenues, Expenditures by Function and Changes in Fund Balance	45
Statement of Revenues, Expenditures by Function and Changes in Fund Balance (Deficit) – Budget and Actual	47

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Table of Contents, Continued
Year Ended September 30, 2006

	<u>Page No.</u>
IV. Other Supplementary Information, Continued	
Nonmajor Governmental Funds:	
Combined Balance Sheet	49
Combined Statement of Revenues, Expenditures by Function, and Changes in Fund Balances	50
Combined Statement of Revenues, Expenditures by Account, and Changes in Fund Balances	51
Nonmajor Governmental Funds - Special Revenue Funds:	
Combining Balance Sheet	52
Combining Statement of Revenues, Expenditures by Function, and Changes in Fund Balances (Deficit)	54
Combining Statement of Revenues, Expenditures by Account, and Changes in Fund Balances (Deficit)	56
Nonmajor Governmental Funds - Capital Project Funds:	
Combining Balance Sheet	58
Combining Statement of Expenditures by Function, and Changes in Fund Balances (Deficit)	59
Combining Statement of Expenditures by Account, and Changes in Fund Balances (Deficit)	60
Section 211 Compact Sector Funds:	
Combining Balance Sheet	61
Combining Statement of Expenditures by Account and Changes in Fund Balance	62
V. Independent Auditors' Reports on Compliance and Internal Control	
Independent Auditors' Report on Compliance and on Internal Control Over Financial Reporting Based Upon the Audit Performed in Accordance with Government Auditing Standards	64
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	66
Schedule of Expenditures of Federal Awards	68
Notes to Schedule of Expenditures of Federal Awards	75
Schedule of Programs Selected for Audit in Accordance with OMB Circular A-33	78
Schedule of Findings and Questioned Costs	79
Summary Schedule of Prior Audit Findings and Questioned Costs	93

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2006

INDEPENDENT AUDITORS' REPORT

Honorable Johnny P. David
Governor, State of Pohnpei
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 Pohnpei (the State), as of and for the year ended September 30, 2006, 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 Pohnpei Transportation Authority, the Small Business Guarantee and Finance Corporation, and the Economic Development Authority, which represent 6% and 10%, respectively, of the assets and revenues of the State's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us and our opinion, insofar as it relates to the amounts included for the Pohnpei Transportation Authority, the Small Business Guarantee and Finance Corporation, and the Economic Development Authority are based solely on the reports of the other auditors.

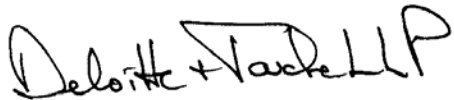
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 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 reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the reports of other auditors, such financial statements, as set forth in Section II of the foregoing table of contents, present fairly, in all material respects, the respective financial position of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Pohnpei as of September 30, 2006, 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 Unreserved Fund Balance - Budget and Actual - General Fund and notes thereto, on pages 41 and 42, 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, 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 15, 2007, on our consideration of the State's (Primary Government only) internal control over financial reporting and on 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 + Tuck LLP". The signature is stylized and appears to be written in a cursive or semi-cursive font.

June 15, 2007

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2006

This section of Pohnpei State's financial report presents our Management's Discussion and Analysis (MD&A) for the fiscal year ended September 30, 2006. This MD&A is prepared in compliance with the GASB-34 requirement. Readers are requested to read this MD&A in conjunction with the State's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The Pohnpei State's primary government's total net assets for this year are \$54,787,998.
- The net change in governmental fund balance is \$1,670,628. The total revenues reported are \$31,846,948 with the total expenditures of \$30,497,387.
- Actual revenues for the general fund were \$3,019,285 higher than budgeted revenues. The total expenditures, budgetary basis showed favorable variance of \$1,353,268. The general fund reported an unreserved fund balance of \$8,451,379 for the fiscal year.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of four parts-management's discussion and analysis (this section), the basic financial statements, required supplementary information and the notes to the financial statements.

The basic financial statements include two kinds of statements that present different views of the State:

Government-Wide Financial Statements

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

The statement of net assets includes all of the government's assets and liabilities. The difference between the two is called net assets. Over time, increases or decreases in the State's net assets serve as an indicator to measure the State's financial position.

The statement of activities on the other hand, account for the State's current year's revenues and expenses regardless of when cash is received or paid.

The government-wide financial statements of the State consist of its governmental activities, which include public works, health, education and general administration. Sales taxes, revenue sharing, federal grants and Compact II/Sector grants are the major sources of these activities. Compact II/Sector grants replace the Compact I funding in fiscal year 2004.

Fund Financial Statements

The fund financial statements provide more detailed information about the State's significant funds. The State uses fund accounting to comply with financial related legal requirements.

- Governmental funds. Most of the State's basic services are included in governmental funds which focus on how cash and other financial assets that can readily be converted to cash flow in and out and the balances left at year-end that are available for spending. Unlike the government-wide financial statements, the governmental funds statements focus on the short-term financial requirements of the State. Because this information does not encompass the additional long-term focus of the government wide statements, we provide a reconciliation at the bottom of the

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2006

governmental funds statement, or on the subsequent page to explain the relationship between them. The State maintains individual governmental funds, which are categorized as major and non-major. The major fund includes the General Fund. The other major funds are consisting of the Compact II/Sector Grants, Federal Grants and Compact CIP.

FINANCIAL ANALYSIS OF THE STATE AS A WHOLE (GOVERNMENT-WIDE)

The following is a summary of the State's net assets as of September 30:

	<u>Governmental Activities</u>	
	<u>2006</u>	<u>2005</u>
Current and other assets	\$ 21,013,192	\$ 18,423,640
Capital assets	28,489,651	18,542,156
Other non current assets	<u>15,495,330</u>	<u>15,548,791</u>
Total assets	<u>64,998,173</u>	<u>52,514,587</u>
Current liabilities	3,562,854	2,695,575
Long-term debt	4,521,067	4,200,000
Other liabilities	<u>2,126,254</u>	<u>1,921,030</u>
Total liabilities	<u>10,210,175</u>	<u>8,816,605</u>
Net Assets:		
Invested in capital assets, net of related debt	28,489,651	18,542,156
Restricted	18,199,990	18,498,826
Unrestricted	<u>8,098,357</u>	<u>6,657,000</u>
Total net assets	\$ <u>54,787,998</u>	\$ <u>43,697,982</u>

Changes in net assets. The State's Statement of Changes in Net Assets for the fiscal year ended September 30 follows:

	<u>Governmental Activities</u>	
	<u>2006</u>	<u>2005</u>
Program revenues:		
Charges for services	\$ 887,785	\$ 633,934
Operating grants and contributions	3,619,486	3,509,463
Compact related	16,601,682	15,962,149
Capital grants and contributions	157,667	354,778
General revenues:		
Taxes	8,507,190	8,155,747
Investment earnings	815,446	1,550,495
Other	<u>1,257,692</u>	<u>323,337</u>
Total revenues	<u>31,846,948</u>	<u>30,489,903</u>

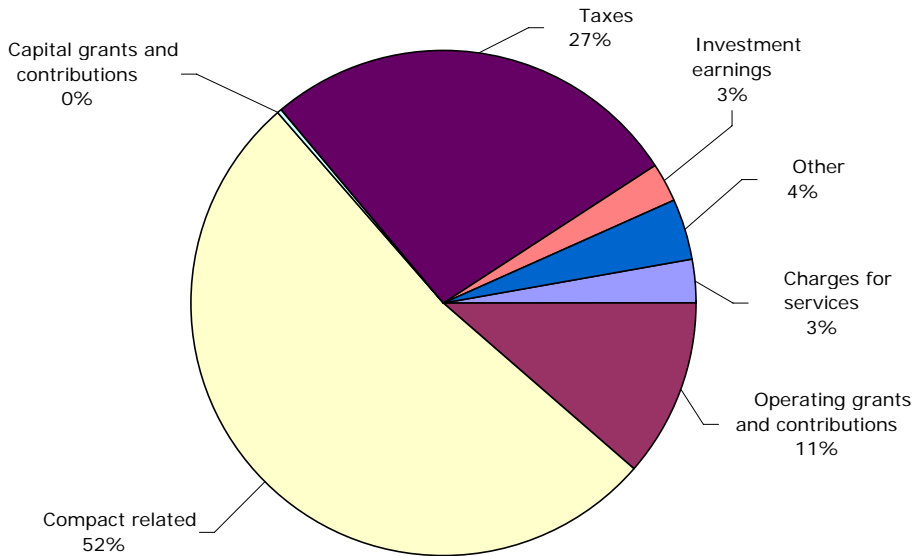
**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2006

	<u>Governmental Activities</u>	
	<u>2006</u>	<u>2005</u>
Expenses:		
General Government	6,755,381	5,859,081
Education	11,166,703	10,299,719
Health services	6,417,038	6,766,282
Land and natural resources	442,512	403,758
Public works and others	4,183,498	4,652,816
Public safety	1,132,077	1,153,324
Boards, Commission and other appropriations	2,145,923	2,165,763
Other Miscellaneous	<u>86,575</u>	<u>140,400</u>
 Total expenses	 <u>32,631,247</u>	 <u>31,441,143</u>
 Increase (decrease) in net assets	 \$ <u>(990,065)</u>	 \$ <u>(951,240)</u>

Exhibit I below, showed that 52% of the State's revenues were derived from Compact II while 27% come from taxes and licenses. The least source of revenues is capital grants and contribution. For expenses the State encompass a range of services. Exhibit II illustrated that education got 34% of the State's total expenses while health represented 20%.

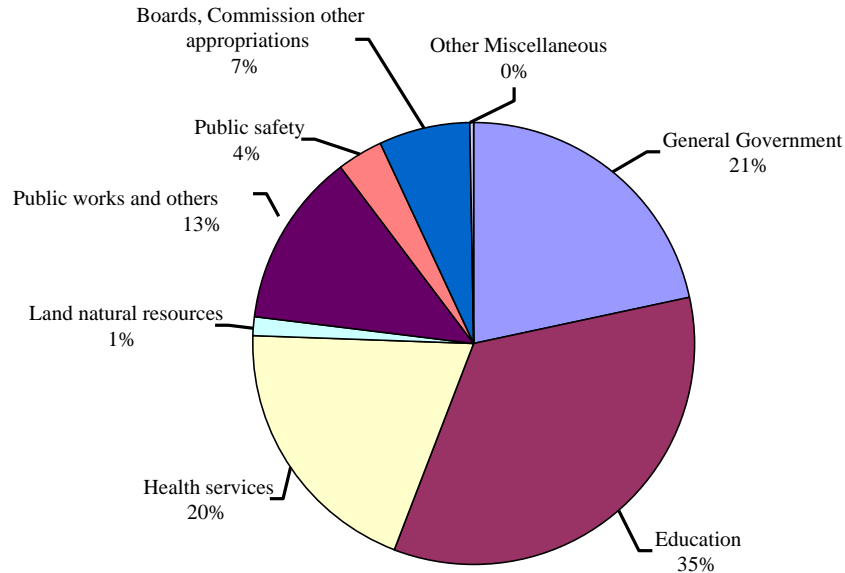
**Pohnpei State Government
Sources of Revenues for Fiscal Year 2006
Exhibit I**



**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2006

**Pohnpei State Government
Expenses by Function for Fiscal Year 2006
Exhibit II**



Governmental Activities:

General Fund

The revenues increased by \$1,357,045 compared from fiscal year 2005. The total expenditures however, also increased by \$1,190,104 or 3.79% more than last year. The increase in revenues is due to the positive result of the investment earnings. The government also received donation from other source and collected the prior year accounts from National Government which were previously written off. On the other hand, funding out of some Capacity Sector grant for fiscal year 2005 was now being funded by the general fund; hence explained the increase in expenditures.

Special Revenue

As mentioned in the preceding paragraph, Compact II/Sector Grants were the major sources of Pohnpei State's operating grants for fiscal year 2006. The total revenues equals to the expenditures in the amount of \$16,601,682 which are discussed below:

- The education sector grant that shall support and improve the educational system of the Federated States of Micronesia, including, without limitation, the systems for primary, secondary, and post-secondary education. The total expenditures for the grant are \$ 6,748,108.
- The health sector grant that shall support and improve the delivery of preventive, curative and environmental care, and develop the human and material resources necessary for the Federated States of Micronesia to perform these services. The total funding for the year is \$ 5,104,320.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2006

- The sector grant for private sector development shall support the efforts of the Federated of Micronesia to attract new foreign investment and increase indigenous business activity. Priorities will be in advancing the private development of fisheries, tourism and agriculture; employing new telecommunications technologies; and analyzing and developing new systems, laws, and policies to foster private sector development, to facilitate investment by potential private investors, and develop business and entrepreneurial skills. The total of \$ 858,753 was expended for this activity.
- The sector for capacity building shall support the efforts of the Federated States of Micronesia to build effective, accountable and transparent national and local government and other public sector institutions and systems. The total grant expenditures are \$ 744,965.
- The environment sector shall support the efforts of the Federated States of Micronesia to protect the Nation's land and marine environment and to conserve and achieve sustainable use of its natural resources. The amount of \$ 716,280 was expended for the fiscal year.
- Public Infrastructure grant shall give priority to primary and secondary education capital projects and programs that directly affect health and safety including water and wastewater projects, solid waste disposal projects and health care facilities. The State did not receive funding for this activity for the fiscal year.
- The Supplemental Education Grant (SEG) is considered the seventh-sector grant. SEG has been offered in lieu of grants that were formerly available from various federal agencies. The federal programs that were incorporated into SEG are Territories & Freely Associated States Education Grant (T&FASEG), Adult Education & Family Literacy, Workforce Investment Act, Pacific Vocational Education Improvement Program and Early Childhood Program (formerly Head Start). For the year, the total expenses incurred were \$ 2,429,256.

Another major source of funding under Special Revenue funds is the US Federal Grants, which supported \$ 2,940,984 expenditures of the State.

Capital Projects

The fund for the Capital projects decreased dramatically because of the termination of Compact I funding.

Other Governmental Funds

All the non-major funds from the Special revenue and CIP funds were grouped under this category.

FINANCIAL ANALYSIS OF THE STATE GOVERNMENT'S FUNDS

The State's governmental fund changes in fund balances for the year ended September 30, 2006 are shown below.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2006

	<u>General Fund</u>	<u>Other Funds</u>	<u>Total</u>
Revenues:			
Taxes	\$ 8,213,147	\$ 294,043	\$ 8,507,190
Compact	-	16,601,682	16,601,682
Other	<u>2,073,138</u>	<u>4,986,005</u>	<u>7,059,143</u>
Total revenues	<u>10,286,285</u>	<u>21,881,730</u>	<u>32,168,015</u>
Expenditures	<u>8,736,134</u>	<u>21,761,253</u>	<u>30,497,387</u>
Net change in fund balance	\$ <u>1,550,151</u>	\$ <u>120,477</u>	\$ <u>1,670,628</u>

General Fund Budgetary Highlights

During the year, the State revised its budget several times to accommodate supplemental funding for departments and offices requiring increases in appropriations to avoid budget overruns.

The State's general fund balance increase of \$1,550,151 comes mainly from investment income which registers at \$ 815,446 for the year, donation from other sources, and bad debts recovery.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The State's capital assets at the end of fiscal years 2006 and 2005 consist basically of equipment, buildings, roads and bridges. The summary of capital assets at the end of September 30 is shown below:

	<u>Primary Government Governmental Activities</u>	
	<u>2006</u>	<u>2005</u>
Buildings	\$ 6,294,579	\$ 6,294,579
Infrastructure	52,241,781	20,870,910
Machinery	<u>6,474,918</u>	<u>5,985,609</u>
	65,011,278	33,151,098
Additional prior year assets reported	<u>-</u>	<u>30,348,002</u>
Total as restated	\$ <u>65,011,278</u>	\$ <u>63,499,100</u>

The notes to the financial statements present more information about the State's capital assets.

Long-Term Debt

At September 30 the State had long-term debt as shown below:

	<u>Primary Government Governmental Activities</u>	
	<u>2006</u>	<u>2005</u>
Early Retirement & Private Sector Development	\$ 4,521,067	\$ 4,200,000
Compensated absences	676,254	587,030
Claims and litigation	<u>1,450,000</u>	<u>1,334,000</u>
Total	\$ <u>6,647,321</u>	\$ <u>6,121,030</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2006

Economic Factors and Next Year's Budget

Funding for the operations of most of the government services in fiscal year 2007 will still come from the Compact II.

Fiscal year 2007 is the fourth year of the implementation of the economic assistance under the Compact II/ Sector Grant. Sector funding replaces the funding sources from the old Compact I. Under the Compact II/Sector grant, the annual budget approved by JEMCO for fiscal year 2007 is as follows:

- For education sector grant, which continues to be the funding priority, the annual budget is \$ 7,187,007.
- The health sector grant's budget is \$ 4,945,959.
- The sector grant funding for private sector development is \$ 499,854.
- The capacity building sector grant budget for fiscal year 2007 is \$ 729,991.
- The environment sector grant is \$ 630,544.
- The total grants for the Public Infrastructure for three years amounted to \$ 11,000,000. Priority projects are education, health related and private sector development. It is also required that 5% of the total grant be allocated to the Infrastructure Maintenance fund for the maintenance of the existing and new projects. Local matching of the same amount is required.
- In the case of the Supplemental Education Grant (SEG), the total funding from September 1, 2005 from March 31, 2007 is \$3,352,563. The programs covered in the funding are Early Childhood Education, Education Improvement Programs, Workforce Development/Skill Training, Vocational Education and Staff Development.

For fiscal year 2007, the locally generated revenues and the revenue shares from the National Government are projected at a range of \$ 7,000,000 or less due to the implementation of FSM Public law no 14-90. FSM Public law no. 14-90 allows taxpayers to deduct the wages and benefits paid to their employees from the taxable revenues; hence reducing the amount of gross revenue taxes. For Pohnpei State; the annual amount of expected reduction in gross revenue taxes is more than \$ 400,000. The Department of Treasury and Administration will however continue to intensify its collection effort to raise more revenues in the ensuing years. In addition, the final carry-over balances from the Compact II may be authorized to be used to fund other operations of the government.

FINANCIAL CONTACT

This financial report is designed to provide all interested users with a general overview of the State of Pohnpei's finances. If you have questions about this report or need additional financial information, please contact the Office of the Director of Treasury and Administration, P.O. Box 1567 Kolonia, Pohnpei FM 96941.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Statement of Net Assets
September 30, 2006

	Primary Government	Component Units
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 1,571,189	\$ 2,186,311
Investments	10,066,182	1,139,906
Receivables, net of allowance for uncollectibles	7,740,006	5,865,480
Advances	477,963	-
Inventories	31,700	1,680,551
Other current assets	-	169,924
Restricted assets:		
Cash and cash equivalents	1,126,152	1,741,706
Total current assets	21,013,192	12,783,878
Noncurrent assets:		
Capital assets, net of accumulated depreciation	28,489,651	35,518,286
Due from component units	3,355,288	-
Investments	-	132,505
Other	-	586,355
Restricted assets:		
Investments	12,140,042	-
Total noncurrent assets	43,984,981	36,237,146
Total assets	\$ 64,998,173	\$ 49,021,024
<u>LIABILITIES</u>		
Current liabilities:		
Current portion of long-term obligations	\$ -	\$ 243,518
Notes payable	-	683,647
Bank overdraft	1,369,322	-
Accounts payable	348,659	2,494,631
Current portion of compensated absences payable	196,113	-
Due to primary government	-	136,000
Other liabilities and accruals	1,004,096	767,446
Deferred revenue	644,664	804,307
Total current liabilities	3,562,854	5,129,549
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	4,521,067	2,700,682
Compensated absences payable	676,254	-
Due to primary government	-	3,355,288
Other noncurrent liabilities	1,450,000	-
Total noncurrent liabilities	6,647,321	6,055,970
Total liabilities	10,210,175	11,185,519
Contingencies and commitments		
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	28,489,651	32,300,421
Restricted for:		
Nonexpendable:		
Future operations	8,256,948	-
Expendable:		
Compact related	5,589,177	-
Capital projects	889,470	-
Other purposes	3,464,395	3,991,668
Unrestricted	8,098,357	1,543,416
Total net assets	54,787,998	37,835,505
Total liabilities and net assets	\$ 64,998,173	\$ 49,021,024

See accompanying notes to basic financial statements.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Statement of Activities
Year Ended September 30, 2006

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	\$ 6,755,381	\$ 782,843	\$ 2,647,296	\$ 146,183	\$ (3,179,059)	\$ -
Land and natural resources	442,512	-	142,387	-	(300,125)	-
Education	11,166,703	-	10,751,671	-	(415,032)	-
Health services	6,417,038	-	5,972,085	-	(444,953)	-
Public safety	1,132,077	-	11,542	-	(1,120,535)	-
Attorney-general	301,540	-	-	-	(301,540)	-
Public works and transportation	661,278	-	-	-	(661,278)	-
Municipal governments	2,145,923	-	-	-	(2,145,923)	-
Debt service	86,575	-	179,571	-	92,996	-
Future operations	-	-	539,201	-	539,201	-
Capital projects	680,375	-	-	11,484	(668,891)	-
Other appropriations	2,841,845	104,942	(22,585)	-	(2,759,488)	-
Total primary government	\$ 32,631,247	\$ 887,785	\$ 20,221,168	\$ 157,667	(11,364,627)	-
Component units:						
Pohnpei Utilities Corporation	\$ 11,920,059	\$ 9,990,600	\$ -	\$ 2,445,371	-	515,912
Pohnpei Port Authority	1,409,588	2,245,357	-	75,033	-	910,802
Pohnpei Fisheries Corporation	790,012	436,567	-	-	-	(353,445)
Pohnpei Transportation Authority	1,905,752	1,313,419	-	-	-	(592,333)
Small Business Guarantee and Finance Corporation	105,957	8,908	70,530	-	-	(26,519)
Economic Development Authority	251,873	210,412	-	-	-	(41,461)
Pohnpei State Housing Authority	186,359	142,105	90,912	-	-	46,658
Total component units	\$ 16,569,600	\$ 14,347,368	\$ 161,442	\$ 2,520,404	-	459,614
General revenues:						
Taxes:						
Revenue sharing					5,697,612	-
Excise taxes					2,809,578	-
Unrestricted investment earnings					815,446	22,982
Other					1,257,692	1,440,515
Total general revenues and transfers					10,580,328	1,463,497
Special item:						
Bad debts					205,766	-
Change in net assets					(990,065)	1,923,111
Net assets at the beginning of the year as restated					55,778,063	35,912,394
Net assets at the end of the year					\$ 54,787,998	\$ 37,835,505

See accompanying notes to basic financial statements.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Balance Sheet
Governmental Funds
September 30, 2006

	General	Special Revenue		Capital Projects	Permanent	Other Governmental Funds	Total
		U.S Federal Grants	Compact Sector Grants	Compact Capital Projects	Compact Trust		
ASSETS							
Cash and cash equivalents	\$ 1,571,189	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,571,189
Investments	5,257,201	-	-	2,989,324	-	1,819,657	10,066,182
Receivables, net:							
FSM National Government	720	1,223,186	541,192	-	-	423,460	2,188,558
Taxes	1,649,810	-	-	-	-	-	1,649,810
Other	3,889,000	-	-	1,664	-	10,974	3,901,638
Due from component units	905,288	-	-	2,450,000	-	-	3,355,288
Due from other funds	4,516,520	-	665,107	-	-	4,624,916	9,806,543
Advances	167,028	179,624	87,739	-	-	43,572	477,963
Inventories	985	-	-	-	-	30,715	31,700
Restricted assets:							
Cash and cash equivalents	479,020	-	-	647,132	-	-	1,126,152
Investments	-	-	-	-	8,256,948	3,883,094	12,140,042
Total assets	\$ 18,436,761	\$ 1,402,810	\$ 1,294,038	\$ 6,088,120	\$ 8,256,948	\$ 10,836,388	\$ 46,315,065
LIABILITIES AND FUND BALANCES							
Liabilities:							
Bank Overdraft	\$ 1,369,322	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,369,322
Accounts payable	62,212	63,747	166,444	6,097	-	50,159	348,659
Other liabilities and accruals	893,349	-	-	-	-	110,747	1,004,096
Deferred revenue	-	-	593,847	-	-	50,817	644,664
Due to other funds	5,290,023	1,339,063	519,805	1,149,809	-	1,507,843	9,806,543
Total liabilities	7,614,906	1,402,810	1,280,096	1,155,906	-	1,719,566	13,173,284
Fund balances:							
Reserved for:							
Related assets	1,973,690	-	-	4,242,600	8,256,948	30,715	14,503,953
Encumbrances	181,079	678,718	964,758	379,120	-	351,538	2,555,213
Continuing appropriations	215,707	-	-	1,057,226	-	1,033,246	2,306,179
Debt service fund	-	-	-	-	-	3,883,094	3,883,094
Special projects	-	-	-	-	-	321,067	321,067
Unreserved:							
General fund	8,451,379	-	-	-	-	-	8,451,379
Special revenue funds	-	(678,718)	(950,816)	-	-	2,964,790	1,335,256
Debt service fund	-	-	-	-	-	(91,337)	(91,337)
Capital projects funds	-	-	-	(746,732)	-	623,709	(123,023)
Total fund balances	10,821,855	-	13,942	4,932,214	8,256,948	9,116,822	33,141,781
Total liabilities and fund balances	\$ 18,436,761	\$ 1,402,810	\$ 1,294,038	\$ 6,088,120	\$ 8,256,948	\$ 10,836,388	
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							
28,489,651							
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 (4,521,067)							
Compensated absences payable (872,367)							
Claims payable (1,450,000)							
(6,843,434)							
Net assets of governmental activities							
\$ 54,787,998							

See accompanying notes to basic financial statements.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficits)
Governmental Funds
Year Ended September 30, 2006

	Special Revenue			Capital Projects	Permanent	Other Governmental	Total
	General	U.S Federal Grants	Compact Sector Grants	Compact Capital Projects	Compact Trust	Funds	
Revenues:							
Compact funding	\$ -	\$ -	\$ 16,601,682	\$ -	\$ -	\$ -	\$ 16,601,682
Investment income	815,446	-	4,363	11,484	539,201	179,571	1,550,065
Federal contributions	-	1,570,558	-	-	-	-	1,570,558
FSM revenue sharing	5,697,612	-	-	-	-	-	5,697,612
State taxes	2,515,535	-	-	-	-	294,043	2,809,578
CFSM grants	-	-	-	-	-	76,626	76,626
Other grants	-	53,815	-	-	-	19,048	72,863
Fees and charges	104,942	-	-	-	-	782,843	887,785
Other	1,152,750	1,316,611	-	-	-	110,818	2,580,179
Total revenues	10,286,285	2,940,984	16,606,045	11,484	539,201	1,462,949	31,846,948
Expenditures:							
Current:							
General government	3,223,542	266,989	2,319,998	-	-	683,650	6,494,179
Land and natural resources	267,465	142,387	-	-	-	25,000	434,852
Education	-	1,574,307	9,177,364	-	-	59,105	10,810,776
Health services	-	867,765	5,104,320	-	-	335,453	6,307,538
Public safety	1,078,623	11,542	-	-	-	-	1,090,165
Office of the Attorney-General	301,540	-	-	-	-	-	301,540
Public works	624,428	-	-	-	-	36,850	661,278
Payments to non-governmental agencies	185,672	-	-	-	-	-	185,672
Boards, commissions and other	703,175	77,994	-	-	-	311,579	1,092,748
Grants to local governments	2,145,923	-	-	-	-	-	2,145,923
Debt service	-	-	-	-	-	86,575	86,575
Capital projects	-	-	-	551,444	-	128,931	680,375
Total expenditures	8,530,368	2,940,984	16,601,682	551,444	-	1,667,143	30,291,621
Excess (deficiency) of revenues over expenditures	1,755,917	-	4,363	(539,960)	539,201	(204,194)	1,555,327
Other financing sources (uses):							
Proceeds from long-term debt	-	-	-	-	-	321,067	321,067
Special item (expense):							
Bad debts	(205,766)	-	-	-	-	-	(205,766)
Net change in fund balances	1,550,151	-	4,363	(539,960)	539,201	116,873	1,670,628
Fund balances at the beginning of the year	9,271,704	-	9,579	5,472,174	7,717,747	8,999,949	31,471,153
Fund balances at the end of the year	\$ 10,821,855	\$ -	\$ 13,942	\$ 4,932,214	\$ 8,256,948	\$ 9,116,822	\$ 33,141,781

See accompanying notes to basic financial statements.

**STATE OF POHNPEI
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, 2006

Amounts reported for governmental activities in the statement of activities on page 11 are different than the net change in fund balances because:

Net change in fund balances - total governmental funds from page 13	\$ 1,670,628
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 depreciation exceeded capital outlays in the current period	(2,132,586)
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore, are not reported as expenditures in governmental funds. These expenses include accrued annual leave and claims and judgments payable that are reported in the statement of activities, but not in funds	<u>(528,107)</u>
Change in net assets of governmental activities as presented on page 11.	\$ <u>(990,065)</u>

See accompanying notes to basic financial statements.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Combining Statement of Net Assets
Component Units
September 30, 2006

	Pohnpei Utilities Corporation	Pohnpei Port Authority	Pohnpei Fisheries Corporation	Pohnpei Transportation Authority	Small Business Guarantee and Finance Corporation	Economic Development Authority	Pohnpei Housing Authority	Total
ASSETS								
Current assets:								
Cash and cash equivalents	\$ 521,763	\$ 1,355,411	\$ 234,631	\$ -	\$ 14,731	\$ 10,543	\$ 49,232	\$ 2,186,311
Investments	637,506	-	-	-	-	502,400	-	1,139,906
Receivables, net:								
General	2,605,737	385,135	-	293,570	4,924	191,489	-	3,480,855
Other	232,950	87,118	-	14,201	6,627	-	2,043,729	2,384,625
Inventories	1,604,871	-	-	75,565	-	-	115	1,680,551
Other current assets	-	-	-	12,639	-	18,951	138,334	169,924
Restricted assets:								
Cash and cash equivalents	-	333,450	-	-	1,408,256	-	-	1,741,706
Total current assets	<u>5,602,827</u>	<u>2,161,114</u>	<u>234,631</u>	<u>395,975</u>	<u>1,434,538</u>	<u>723,383</u>	<u>2,231,410</u>	<u>12,783,878</u>
Noncurrent assets:								
Capital assets, net of accumulated depreciation	29,912,393	4,873,347	548,339	133,077	6,560	35,206	9,364	35,518,286
Investments	132,505	-	-	-	-	-	-	132,505
Other	355,011	-	-	-	231,344	-	-	586,355
Total noncurrent assets	<u>30,399,909</u>	<u>4,873,347</u>	<u>548,339</u>	<u>133,077</u>	<u>237,904</u>	<u>35,206</u>	<u>9,364</u>	<u>36,237,146</u>
Total assets	<u>\$36,002,736</u>	<u>\$ 7,034,461</u>	<u>\$ 782,970</u>	<u>\$ 529,052</u>	<u>\$ 1,672,442</u>	<u>\$ 758,589</u>	<u>\$ 2,240,774</u>	<u>\$ 49,021,024</u>
LIABILITIES								
Current liabilities:								
Current portion of long-term debt	\$ 118,536	\$ -	\$ 124,982	\$ -	\$ -	\$ -	\$ -	\$ 243,518
Notes payable	643,647	-	-	-	-	40,000	-	683,647
Accounts payable	713,049	100,232	1,122,151	34,108	4,790	520,301	-	2,494,631
Due to primary government	-	-	-	-	-	136,000	-	136,000
Other liabilities and accruals	254,323	191,724	-	8,686	2,336	298,530	11,847	767,446
Deferred revenue	318,636	308,499	166,667	10,505	-	-	-	804,307
Total current liabilities	<u>2,048,191</u>	<u>600,455</u>	<u>1,413,800</u>	<u>53,299</u>	<u>7,126</u>	<u>994,831</u>	<u>11,847</u>	<u>5,129,549</u>
Noncurrent liabilities:								
Due to primary government	-	-	2,450,000	905,288	-	-	-	3,355,288
Noncurrent portion of long-term debt	2,645,682	-	55,000	-	-	-	-	2,700,682
Total liabilities	<u>4,693,873</u>	<u>600,455</u>	<u>3,918,800</u>	<u>958,587</u>	<u>7,126</u>	<u>994,831</u>	<u>11,847</u>	<u>11,185,519</u>
NET ASSETS								
Invested in capital assets, net of related debt	26,694,528	4,873,347	548,339	133,077	6,560	35,206	9,364	32,300,421
Restricted	132,505	-	-	-	1,639,600	-	2,219,563	3,991,668
Unrestricted	4,481,830	1,560,659	(3,684,169)	(562,612)	19,156	(271,448)	-	1,543,416
Total net assets	<u>31,308,863</u>	<u>6,434,006</u>	<u>(3,135,830)</u>	<u>(429,535)</u>	<u>1,665,316</u>	<u>(236,242)</u>	<u>2,228,927</u>	<u>37,835,505</u>
	<u>\$36,002,736</u>	<u>\$ 7,034,461</u>	<u>\$ 782,970</u>	<u>\$ 529,052</u>	<u>\$ 1,672,442</u>	<u>\$ 758,589</u>	<u>\$ 2,240,774</u>	<u>\$ 49,021,024</u>

See accompanying notes to basic financial statements.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Combining Statement of Revenues, Expenses, and Changes in Net Assets
Component Units
Year Ended September 30, 2006

	Pohnpei Utilities Corporation	Pohnpei Port Authority	Pohnpei Fisheries Corporation	Pohnpei Transportation Authority	Small Business Guarantee and Finance Corporation	Economic Development Authority	Pohnpei Housing Authority	Total
Operating revenues:								
Charges for services	\$ 9,990,600	\$ 2,245,357	\$ 436,567	\$ 1,313,419	\$ 8,908	\$ 137,250	\$ -	\$14,132,101
Sales	-	-	-	-	-	73,162	142,105	215,267
Total operating revenues	<u>9,990,600</u>	<u>2,245,357</u>	<u>436,567</u>	<u>1,313,419</u>	<u>8,908</u>	<u>210,412</u>	<u>142,105</u>	<u>14,347,368</u>
Operating expenses:								
Cost of services	9,910,725	1,180,406	668,635	1,834,230	103,637	182,849	178,645	14,059,127
Administration costs	-	-	121,377	-	-	65,203	7,714	194,294
Depreciation and amortization	<u>2,009,334</u>	<u>229,182</u>	<u>-</u>	<u>71,522</u>	<u>2,320</u>	<u>3,821</u>	<u>-</u>	<u>2,316,179</u>
Total operating expenses	<u>11,920,059</u>	<u>1,409,588</u>	<u>790,012</u>	<u>1,905,752</u>	<u>105,957</u>	<u>251,873</u>	<u>186,359</u>	<u>16,569,600</u>
Operating income (loss)	<u>(1,929,459)</u>	<u>835,769</u>	<u>(353,445)</u>	<u>(592,333)</u>	<u>(97,049)</u>	<u>(41,461)</u>	<u>(44,254)</u>	<u>(2,222,232)</u>
Nonoperating revenues (expenses):								
Contributions from the primary government	-	-	-	-	70,530	-	90,912	161,442
Interest income	(57,926)	6,963	-	-	42,942	-	31,003	22,982
Other	<u>284,013</u>	<u>3,647</u>	<u>1,011,561</u>	<u>123,487</u>	<u>7,152</u>	<u>10,655</u>	<u>-</u>	<u>1,440,515</u>
Total nonoperating revenues (expenses), net	<u>226,087</u>	<u>10,610</u>	<u>1,011,561</u>	<u>123,487</u>	<u>120,624</u>	<u>10,655</u>	<u>121,915</u>	<u>1,624,939</u>
Capital contributions	<u>2,445,371</u>	<u>75,033</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,520,404</u>
Change in net assets	741,999	921,412	658,116	(468,846)	23,575	(30,806)	77,661	1,923,111
Net assets at the beginning of the year, as restated	<u>30,566,864</u>	<u>5,512,594</u>	<u>(3,793,946)</u>	<u>39,311</u>	<u>1,641,741</u>	<u>(205,436)</u>	<u>2,151,266</u>	<u>35,912,394</u>
Net assets at the end of the year	<u>\$31,308,863</u>	<u>\$ 6,434,006</u>	<u>\$ (3,135,830)</u>	<u>\$ (429,535)</u>	<u>\$ 1,665,316</u>	<u>\$ (236,242)</u>	<u>\$ 2,228,927</u>	<u>\$37,835,505</u>

See accompanying notes to basic financial statements.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies

The accompanying financial statements of the State of Pohnpei (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, Kosrae and Yap. The State is a constitutional government comprised of three branches: the Legislative Branch, consisting of 23 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 net assets and results of operations of the following legally separate entities are presented as part of the State's operations:

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(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:

Pohnpei Utilities Corporation (PUC): PUC was created by Pohnpei State Public Law (PSPL) No. 2L-179-91 and is responsible for providing electrical, water and sewer services to the people of Pohnpei through the operation of the electric power, water and sewer systems. PUC is governed by a seven-member Board of Directors appointed by the Governor with the advice and consent of the Legislature.

Pohnpei Port Authority (PPA): PPA was created by PSPL No. 2L-224-91 and is responsible for overseeing the use and maintenance of the State's sea and air ports. PPA is governed by a seven-member Board of Directors, consisting of representatives of the State appointed by the Governor with the advice and consent of the Legislature.

Pohnpei Fisheries Corporation (PFC): PFC was created by PSPL No. 3L-28-93 and is responsible for the operation and management of the fish processing plant, boats owned by the plant and the cold storage facility. PFC is governed by a seven-member Board of Directors, consisting of representatives of the State appointed by the Governor with the advice and consent of the Legislature.

Pohnpei Transportation Authority (PTA): PTA was created by PSPL No. 169-69 and is responsible for promotion, development, and improving transportation facilities of the State. PTA is governed by a seven-member Board of Directors, consisting of representatives of the State appointed by the Governor with the advice and consent of the Legislature.

Small Business Guarantee and Finance Corporation (SBGFC): SBGFC was created by PSPL No. 3L-86-95 to provide, promote, develop and widen in both scope and services reach various alternative modes of financing for small enterprises, including, but not limited to, direct and indirect project lending, venture capital, financial leasing, secondary mortgage and rediscounting of loan papers to small businesses. SBGFC is governed by a seven-member Board of Directors, consisting of four representatives of the State and three representatives from the private sector appointed by the Governor with the advice and consent of the Legislature.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

i. Discretely Presented Component Units, Continued

Pohnpei Economic Development Authority (PEDA): PEDA was created by PSPL No. 4L-159-78 for the purpose of promoting economic development through expansion of agriculture, marine resources, tourism, industry, energy development, banking, transportation and community development in Pohnpei. PEDA is also designated to succeed the Ponape District Fishing Authority as the sole entity to promote, develop, and support commercial utilization of living marine resources as provided in Public Law No. 7-110 of the Trust Territory Code. PEDA is governed by a seven-member Board of Developers appointed by the Governor with the advice and consent of the Legislature.

Pohnpei State Housing Authority (PSHA): PSHA was created by PSPL No. 2L-81-88 for the purpose of facilitating, through low-interest loans, the construction of safe and sanitary residential housing for low income families of the State, and for monitoring the Housing Preservation Grant (HPG) loan funds extended by United States Department of Agriculture Rural Development. PSHA is governed by a five-member Board of Directors appointed by the Governor with the advice and consent of the Legislature.

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.

P.O. Box 370
Kolonia, Pohnpei, FSM 96941

B. Government-Wide Financial Statements

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

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.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

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 - nonexpendable consists of permanent funds in which donors or other outside sources have stipulated that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to the principal.
- Restricted net assets - expendable consists of resources in which the State is legally or contractually obligated to spend resources in accordance with restrictions 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 \$18,199,990 of restricted net assets, of which \$3,464,395 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.

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.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

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.

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 Governmental Fund fund types:

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.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

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. Debt Service Fund

This fund accounts for the accumulation of resources for the retirement of long-term debt.

iv. Capital Projects Funds

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

v. Permanent Fund

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:

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 Pohnpei State Government, as well as other direct federal grants that the Pohnpei State Government received from the United States government.

Compact Sector Grants Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for United States Congress appropriations under United States Public Law 99-239, as amended, Title II, Article I, Section 211(a) and approved by FSM Congress to support and improve the education, health, private sector development, public sector capacity building, and environment sectors of the Federated States of Micronesia.

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.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Compact Trust Fund, a Governmental Fund Type - Permanent Fund. This fund accounts for United States Congress appropriations under United States Public Law 99-239, as amended, Title II, Article I, Section 215 and approved by FSM Congress 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. Earnings from funds invested would not be available for distribution until October 2023.

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

Cash and cash equivalents include cash held in demand accounts as well as short-term investments with maturity dates 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.

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

Amounts due from other governments include those funds which are earned and have yet to be reimbursed by the FSM National Government in its role as the primary grant recipient of U.S. federal assistance programs, Congress of the Federated States of Micronesia public project grants, U.S. Department of the Interior capital project grants through the Trust Territory Government and amounts due to the State under the FSM tax revenue sharing program.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

I. Inventories and Prepaid Items

Inventories of materials and supplies are determined by physical count and are valued at the lower of cost (principally average cost) or market. Certain payments made to vendors or persons for services reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

J. Interfund Receivables/Payables

During the course of its operations, the 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 lags between the dates that 1) interfund goods and services are provided or reimbursable expenditures occur, 2) transactions are recorded in the accounting system, and 3) payments between funds are made, and are scheduled to be collected in the subsequent year.

K. Restricted Assets

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through enabling legislation and loan agreements. As of September 30, 2006, investments of \$8,256,948 recorded in the Section 215 Compact Trust Fund are restricted in that they are not available to be used in current operations. In addition, investments of \$3,883,094 recorded in the Debt Service Fund are restricted for future repayment of the Early Retirement Program loan. Furthermore, cash and cash equivalents were restricted for the following uses:

Deposit with a local bank restricted for the purchase of medical supplies for the State hospital.	\$ 470,924
Deposit with a local bank as remaining loan proceeds of the \$4,200,000 Early Retirement loan with Asian Development Bank.	8,096
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 Pohnpei State Housing Authority, the trustee of the Loan Guarantee Escrow Account.	<u>647,132</u>
	\$ <u>1,126,152</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

L. Capital Assets

Capital assets, which include property, plant, equipment and infrastructure assets (e.g. roads, bridges, ramps and other similar items), are reported in the governmental activity column of the government-wide financial statements. Such assets, whether purchased or constructed, are recorded at historical cost or estimated historical cost. Donated capital assets are recorded at fair market value at the date of donation.

The State currently holds no title to land. Machinery and equipment, other than vehicles and boats, are capitalized when the cost of individual items exceed \$50,000. Vehicles and boats, along with significant repair and maintenance qualifying as a betterment of such, are capitalized regardless of cost and depreciated. Building and infrastructure projects, along with significant improvements or reconstruction qualifying as a betterment of such, are capitalized when the cost of individual items or projects exceed \$100,000. The costs of normal maintenance and repairs that do not add to the value of the capital asset or materially extend capital asset lives are not capitalized. Additionally, as of fiscal year 2004, the State chose to capitalize assets acquired with U.S. federal funds that have an acquisition cost of \$5,000 or more.

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	40-50 years
Infrastructure	25-50 years
Facilities	3 - 40 years
Machinery and equipment	3 - 25 years
Furniture and fixtures	3 - 10 years

M. 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.

N. Compensated Absences

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

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

O. 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.

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, 2006, is represented by the following assets:

	<u>General</u>	U.S. Federal <u>Grants</u>	Section 211 Sector <u>Grant</u>	Compact Capital <u>Projects</u>	Compact <u>Trust</u>	Other Governmental <u>Funds</u>	<u>Total</u>
Investments	\$ 308,810	\$ -	\$ -	\$ 1,792,600	\$ -	\$ -	\$ 2,101,410
Due from component units	905,288	-	-	2,450,000	-	-	3,355,288
Advances and grants receivable	750,511	-	-	-	-	-	750,511
Inventories	985	-	-	-	-	30,715	31,700
Restricted assets:							
Cash and cash equivalents	8,096	-	-	-	-	-	8,096
Investments	-	-	-	-	8,256,948	-	8,256,948
	<u>\$ 1,973,690</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,242,600</u>	<u>\$ 8,256,948</u>	<u>\$ 30,715</u>	<u>\$ 14,503,953</u>

The reserve for related assets within the General Fund and the reserve for the Debt Service Fund include the amount of \$4,200,000 set aside for future repayment of the Early Retirement Program Loan.

P. 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.

Q. New Accounting Standards

During fiscal year 2006, the State implemented the following pronouncements:

- 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 its 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.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(1) Organization and Summary of Significant Accounting Policies, Continued

Q. New Accounting Standards, Continued

- 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.

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 June 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 September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*. GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. The Statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. The provisions of this Statement are effective for periods beginning after December 15, 2006. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of the State.

R. Estimates

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

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

S. Restatement of Primary Government Governmental Activities Net Assets

Net assets, as previously reported September 30, 2005	\$ 43,697,982
Understatement of capital assets, net of accumulated depreciation, previously reported for governmental activities	<u>12,080,081</u>
Net assets, as restated September 30, 2005	\$ <u>55,778,063</u>

T. Restatement of Component Unit Activities Net Assets

Small Business Guarantee and Finance Corporation:	
Net assets, as previously reported September 30, 2005	\$ 1,708,839
Less prior year adjustment	<u>(67,098)</u>
Net assets, as restated September 30, 2005	\$ <u>1,671,741</u>
Pohnpei State Housing Authority:	
Net assets, as previously reported September 30, 2005	\$ 3,519,740
Less prior year adjustment	<u>(1,368,474)</u>
Net assets, as restated September 30, 2005	\$ <u>2,151,266</u>
Economic Development Authority:	
Net assets, as previously reported September 30, 2005	\$ (10,450)
Less prior year adjustment	<u>(194,986)</u>
Net assets, as restated September 30, 2005	\$ <u>(205,436)</u>

U. Deferred Revenue

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

(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.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(2) Deposits and Investments, Continued

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%.
- 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.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(2) Deposits and Investments, Continued

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.

As of September 30, 2006, the carrying amount of the primary government's total cash and cash equivalents were \$2,697,341 and the corresponding bank balances were \$2,843,349. Of the bank balance amounts, \$2,843,349 is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2006, bank deposits in the amount of \$200,000 were FDIC insured. The State does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to 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

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, 2006, the State's investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ <u>2,518,677</u>
Other investments:	
Domestic equities	9,130,511
Money market funds	571,256
Cash management account	<u>9,985,780</u>
	<u>19,687,547</u>
	\$ <u>22,206,224</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(2) Deposits and Investments, Continued

B. Investments, Continued

As of September 30, 2006, 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	\$ 14,506	\$ 162,271	\$ 126,754	\$ 154,882	\$ 458,413
U.S. government agency obligations	Aaa	49,380	211,923	20,233	1,011,136	1,292,672
Municipal bonds	Aaa	-	-	-	-	-
Corporate notes and bonds	Aaa	-	46,311	-	11,485	57,796
Corporate notes and bonds	Aa1	-	41,047	28,640	-	69,687
Corporate notes and bonds	Aa2	-	-	5,902	-	5,902
Corporate notes and bonds	Aa3	-	57,712	58,789	-	116,501
Corporate notes and bonds	A1	-	-	28,802	23,107	51,909
Corporate notes and bonds	A2	-	28,800	72,507	13,320	114,627
Corporate notes and bonds	A3	-	37,113	-	28,815	65,928
Corporate notes and bonds	Baa1	-	7,045	39,329	-	46,374
Corporate notes and bonds	Baa2	-	-	5,526	-	5,529
Corporate notes and bonds	Baa3	-	-	-	18,185	18,185
Corporate notes and bonds	Not rated	<u>29,480</u>	<u>15,122</u>	<u>29,246</u>	<u>141,309</u>	<u>215,157</u>
		<u>\$ 93,366</u>	<u>\$ 607,344</u>	<u>\$ 415,728</u>	<u>\$ 1,402,239</u>	<u>\$ 2,518,677</u>

As of September 30, 2006, the Compact Capital Projects Fund holds 19% of the shares of the Pacific Islands Development Bank, which is carried at a cost of \$1,000,000 as the market value of these shares is difficult to assess since they are not publicly traded. Additionally, the State acquired an interest in an airline during fiscal year 2004 and recorded an impairment of such investment in the same period. Financial statements from the investee are not currently available.

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.

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, 2006.

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, 2006, the State did not hold an investment in any one issuer that represented more than 5% of the State's total investments.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(2) Deposits and Investments, Continued

B. Investments, Continued

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.

(3) Receivables

Receivables as of September 30, 2006, for the primary government's individual major governmental funds, and nonmajor governmental funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	<u>General</u>	U.S. Federal <u>Grants</u>	Section 211 <u>Sector Grant</u>	Compact <u>Capital Projects</u>	Compact <u>Trust</u>	Other <u>Governmental Funds</u>	<u>Total</u>
Receivables:							
Loans	\$ 94,697	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 94,697
CFSM	720	1,511,064	541,192	-	-	420,648	2,473,624
Taxes	1,649,810	-	-	-	-	18,721	1,668,531
Other	<u>5,798,823</u>	<u>-</u>	<u>-</u>	<u>1,664</u>	<u>-</u>	<u>562,204</u>	<u>6,362,691</u>
	7,544,050	1,551,064	541,192	1,664	-	1,001,573	10,599,543
Less: allowance for uncollectibles	<u>(2,004,520)</u>	<u>(287,878)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(567,139)</u>	<u>(2,859,537)</u>
	<u>\$ 5,539,530</u>	<u>\$ 1,223,186</u>	<u>\$ 541,192</u>	<u>\$ 1,664</u>	<u>\$ -</u>	<u>\$ 434,434</u>	<u>\$ 7,740,006</u>

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

(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, 2006, are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	U.S. Federal Grants	\$ 1,339,063
General	Compact Sector Grants	519,805
General	Compact Capital Projects	1,149,809
General	Nonmajor government funds	1,507,843
Compact Sector Grants	General	665,107
Nonmajor governmental funds	General	<u>4,624,916</u>
		<u>\$ 9,806,543</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(4) Interfund Receivables and Payables, Continued

Receivables and payables between funds reflected as due to/from primary government in the statement of net assets at September 30, 2006, are summarized as follows:

<u>Discretely Presented Component Units</u>	<u>Due From</u>	<u>Due To</u>
Pohnpei Fisheries Corporation:		
Compact Capital Projects Fund	\$ -	\$ 2,450,000
Pohnpei Transportation Authority:		
General Fund	<u>-</u>	<u>905,288</u>
	\$ <u>-</u>	\$ <u>3,355,288</u>

Receivables and payables between funds reflected as due to/from component units in the governmental funds balance sheet at September 30, 2006, are summarized as follows:

<u>Primary Government</u>	<u>Due From</u>	<u>Due To</u>
General Fund:		
Pohnpei Transportation Authority	\$ 905,288	\$ -
Compact Capital Projects Fund:		
Pohnpei Fisheries Corporation	<u>2,450,000</u>	<u>-</u>
	\$ <u>3,355,288</u>	\$ <u>-</u>

(5) Fixed Assets

Capital asset activities for the year ended September 30, 2006, are as follows:

Primary Government

	Balance October 1, 2005	<u>Additions</u>	<u>Retirements</u>	Balance September 30, 2006
Governmental activities:				
Capital assets, being depreciated:				
Buildings	\$ 6,294,579	\$ -	\$ -	\$ 6,294,579
Machinery, equipment & others	5,985,609	582,643	(93,334)	6,474,918
Infrastructure	<u>52,112,209</u>	<u>129,572</u>	<u>-</u>	<u>52,241,781</u>
Total capital assets, being depreciated	<u>64,392,397</u>	<u>712,215</u>	<u>(93,334)</u>	<u>65,011,278</u>
Less accumulated depreciation for:				
Buildings	(1,609,114)	(125,892)	-	(1,735,006)
Machinery, equipment & others	(5,008,913)	(392,806)	93,334	(5,308,385)
Infrastructure	<u>(27,152,133)</u>	<u>(2,326,103)</u>	<u>-</u>	<u>(29,478,236)</u>
	<u>(33,770,160)</u>	<u>(2,844,801)</u>	<u>93,334</u>	<u>(36,521,627)</u>
Governmental activities capital assets, net	\$ <u>30,622,237</u>	\$ <u>(2,132,586)</u>	\$ <u>-</u>	\$ <u>28,489,651</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(5) Fixed Assets, Continued

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

General government	\$ 54,162
Department of Land and Natural Resources	7,660
Education	355,927
Health services	109,500
Public safety	41,912
Boards and commissions	<u>2,275,640</u>
	\$ <u>2,844,801</u>

Discretely Presented Component Units

	Balance October 1, 2005	<u>Additions</u>	<u>Retirements</u>	Balance September 30, 2006
Buildings and improvements	\$ 3,242,268	\$ 2,748	\$ -	\$ 3,245,016
Power plant facilities	49,659,974	109,692	-	49,769,666
Water and sewer plant facilities	14,716,959	3,369,452	-	18,086,411
Machinery and equipment	<u>21,686,757</u>	<u>233,034</u>	<u>(17,628)</u>	<u>21,902,163</u>
	<u>89,305,958</u>	<u>3,714,926</u>	<u>(17,628)</u>	<u>93,003,256</u>
Construction in progress	2,534,100	3,214,597	(3,431,094)	2,317,603
Less accumulated depreciation	<u>(57,205,381)</u>	<u>(2,614,559)</u>	<u>17,367</u>	<u>(59,802,573)</u>
	\$ <u>34,634,677</u>	\$ <u>4,314,964</u>	\$ <u>(3,431,355)</u>	\$ <u>35,518,286</u>

(6) Notes Payable and Long-term Obligations

Primary Government

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 \$4,200,000 loan from the ADB through the FSM National Government. The activities of the ERS Program are recorded in the General 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 2037. 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.

Asian Development Bank (ADB) Private Sector Development Program Loan

During the year ended September 30, 2003, the State entered into an agreement with the Federated States of Micronesia National Government (FSM) to borrow a portion of the proceeds of the FSM Program Loan with ADB, for the purpose of promoting private sector development in Pohnpei, with interest at 1 to 1½%.

As of September 30, 2006, two drawdowns totaling \$321,067 were received. The principal payments shall be made in 32 equal semi-annual payments beginning on May 15, 2011 and the last payment in November 15, 2026.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(6) Long-term Obligations, Continued

Primary Government, Continued

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>
2007	\$ -	\$ 5,708	\$ 5,708
2008	140,000	3,219	143,219
2009	140,000	3,219	143,219
2010	140,000	3,219	143,219
2011	160,153	5,542	165,695
2012 - 2016	792,910	19,475	812,385
2017 - 2021	800,118	12,267	812,385
2022 - 2026	807,886	4,500	812,386
2027 - 2031	700,000	-	700,000
2032 - 2036	700,000	-	700,000
2037	<u>140,000</u>	<u>-</u>	<u>140,000</u>
	<u>\$4,521,067</u>	<u>\$57,149</u>	<u>\$4,578,216</u>

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 appropriated funds into the ERS Trust Account. As of September 30, 2006, \$3,883,094 has been deposited to the Trust Account, which is restricted for the repayment of this debt, and the remaining amount of \$316,906 is included in the General Fund reserve for related assets.

Other long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2006, 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, 2005</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance September 30, 2006</u>	<u>Due Within One Year</u>
Loan payable:					
ADB loan	\$ 4,200,000	\$ 321,067	\$ -	\$ 4,521,067	\$ -
Other:					
Compensated absences	781,327	91,040	-	872,367	196,113
Claims and litigation payable	<u>1,334,000</u>	<u>116,000</u>	<u>-</u>	<u>1,450,000</u>	<u>-</u>
	<u>2,115,327</u>	<u>207,040</u>	<u>-</u>	<u>2,322,367</u>	<u>196,113</u>
	<u>\$ 6,315,327</u>	<u>\$ 528,107</u>	<u>\$ -</u>	<u>\$ 6,843,434</u>	<u>\$ 196,113</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(6) Notes Payable and Long-term Obligations, Continued

Discretely Presented Component Units

Pohnpei Utilities Corporation (PUC)

Notes payable consist of the following at September 30, 2006:

Notes payable drawn on a bank line of credit of \$190,000 (line expiry March 24, 2007), interest at time certificate of deposit (TCD) rate plus 2% (4.5% at September 30, 2006), collateralized by TCD, due on January 29, 2007. \$ 190,000

Note payable to an investment company, interest at 9.25% at September 30, 2006, collateralized by investments. 453,647

Total notes payable \$ 643,647

A summary of long-term debt as of September 30, 2006, is as follows:

Amount drawn on a note payable to the State of Pohnpei, facilitated by an Asian Development Bank loan to the FSM, due in semi-annual installments of \$33,500 commencing February 28, 2007. The State of Pohnpei has not imposed collateralization on PUC and has waived its rights to receive 6.82% in interest. The loan agreement includes a 1% service charge to be added to the principal until installment payments commence. This service charge may be paid by PUC or by the State of Pohnpei. \$ 2,118,767

Loan payable to United States Department of Agriculture, Rural Utilities Service, due in monthly installments of \$2,654 commencing October 28, 2006. The loan is collateralized by a revenue bond. The loan bears a fixed interest rate of 4.5%. 578,000

Loan payable to FSM Development Bank, 5 year term, interest at 9%, collateralized by a \$150,000 time certificate of deposit. Pursuant to a loan agreement dated October 26, 2001, PUC is required to make monthly payments of both principal and interest in the amount \$10,379. A member of the PUC Board is also a member of management of the FSM Development Bank. 67,451

Less current installments 2,764,218
118,536

\$ 2,645,682

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(6) Notes Payable and Long-term Obligations, Continued

Discretely Presented Component Units

Pohnpei Fisheries Corporation (PFC)

A summary of long-term debt as of September 30, 2006, is as follows:

Notes payable to Pohnpei Economic Development Corporation, uncollateralized and without interest, due in equal monthly installments beginning April 30, 1998 of \$20,000.	\$ 40,000
Notes payable to Federated States of Micronesia Development Bank (FSMDB), collateralized by the existing assets of the Corporation, due in monthly installments of \$4,655, with 9% interest and a term of 4 years beginning June 2004, ending May 2007.	124,982
Notes payable to FSM National Government for amounts received under a conditional grant award, interest at 9% with no specified repayment term.	<u>15,000</u>
	179,982
Less current installments	<u>124,982</u>
	<u>\$ 55,000</u>

Economic Development Authority

Notes payable as of September 30, 2006:

No details were provided on the financial statement report. \$ 40,000

Annual debt service requirements to maturity for principal and interest of discretely presented component units are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 243,518	\$ 167,963	\$ 411,481
2008	106,810	47,038	153,848
2009	52,552	46,296	98,848
2010	53,312	45,536	98,848
2011	54,090	44,758	98,848
2012 - 2016	282,812	211,428	494,240
2017 - 2021	305,445	188,795	494,240
2022 - 2026	331,300	162,940	494,240
2027 - 2031	361,062	133,178	494,240
2032 - 2036	395,581	98,659	494,240
2037 - 2041	435,917	58,323	494,240
2042 - 2046	<u>321,801</u>	<u>14,383</u>	<u>336,184</u>
	<u>\$2,944,200</u>	<u>\$1,219,297</u>	<u>\$4,163,497</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(7) 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, 2006 is \$3,045,001.

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.

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.

Loan Guarantees

As discussed in Note 1K, if after exhaustive efforts between PHA and Rural Development (parties to the MOU) have failed to collect from the defaulted borrowers, the State may be ultimately responsible for various USDA Rural Development loans. As of March 28, 2007, the State was notified that various loans in the program may be in default. No provision for any liability that may result from this matter has been provided for within the accompanying financial statements.

Litigation

The State is party to several legal proceedings arising from governmental operations. Claims are filed with the State's Attorney General. Approved claims are usually paid under general appropriations to the affected government agency. The State Attorney General is of the opinion that the probable outcome of suits existing at September 30, 2006, is not predictable but could have a material impact on the accompanying financial statements. Such impact has currently been estimated to approximate \$1,450,000.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2006

(8) Continuing Appropriations

Continuing appropriations as of September 30, 2006, are summarized as follows:

Major Governmental Funds

General Fund:

Each fiscal year, the Pohnpei State Legislature appropriates funds for various programs, municipal projects and other projects which are available until fully expended or project completion. \$ 215,707

Compact Capital Projects Fund:

Each fiscal year, the Pohnpei State Legislature appropriates funds for capital projects and economic development projects. \$ 1,057,226

Nonmajor Governmental Funds

Each fiscal year, the Pohnpei State Legislature appropriates funds for various programs and other projects. \$ 1,033,246

(9) Self-Insurance Fund - Component Units

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

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

Pohnpei Transportation Authority does not purchase commercial insurance covering potential risks. Management of this entity represents that no material losses have been sustained as a result of this practice during the last three years.

(10) FSM Development Bank Loan Funds

Compact Capital Account funds in an aggregate amount of \$1.7 million were transferred to the control of the FSM Development Bank (FSMDB) (a component unit of the FSM National Government) to be loaned out to borrowers from Pohnpei State mainly for economic development projects. The loan fund is administered by FSMDB in a Trust capacity. All loan decisions are made by management of the State. These loans are not controlled by the State and are not currently recorded in the accompanying financial statements. As of December 31, 2006 (FSMDB fiscal year end), the outstanding fund balance aggregated \$719,915.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2006

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual
General Fund
Year Ended September 30, 2006

	Budgeted Amounts		Actual - Budgetary	Variance with Final Budget -
	Original	Final	Basis (see Note 1)	
Revenues:				
FSM Revenue sharing	\$ 4,600,000	\$ 4,600,000	\$ 5,697,612	\$ 1,097,612
State taxes	2,315,000	2,315,000	2,515,535	200,535
Investment income	215,000	215,000	815,446	600,446
Other	137,000	137,000	1,257,692	1,120,692
Total revenues	<u>7,267,000</u>	<u>7,267,000</u>	<u>10,286,285</u>	<u>3,019,285</u>
Expenditures:				
Current:				
General government	3,554,867	3,526,659	3,223,542	303,117
Department of Land and Natural Resources	291,905	287,913	267,465	20,448
Department of Education	226,915	225,938	-	225,938
Department of Health Services	350,000	350,000	-	350,000
Department of Public Safety	1,125,921	1,083,238	1,078,623	4,615
Office of the Attorney-General	294,588	324,331	301,540	22,791
Other appropriations	1,238,208	1,874,960	1,327,603	547,357
Payments to Non-governmental Agencies	190,743	190,743	185,672	5,071
Grants to local governments	2,179,497	2,225,620	2,145,923	79,697
Total expenditures	<u>9,452,644</u>	<u>10,089,402</u>	<u>8,530,368</u>	<u>1,559,034</u>
Excess (deficiency) of revenues over expenditures	<u>(2,185,644)</u>	<u>(2,822,402)</u>	<u>1,755,917</u>	<u>4,578,319</u>
Special item (expense):				
Bad debts	-	-	(205,766)	(205,766)
Net change in unreserved fund balance	<u>(2,185,644)</u>	<u>(2,822,402)</u>	<u>1,550,151</u>	<u>4,372,553</u>
Other changes in unreserved fund balance:				
Increase in reserve for related assets	-	-	(330,778)	(330,778)
Increase in encumbrances	-	-	(126,135)	(126,135)
Decrease in reserve for Compact Programs	-	-	4,249,134	4,249,134
Increase in reserve for continuing appropriations	-	-	(48,132)	(48,132)
Unreserved fund balance at the beginning of the year	<u>3,157,139</u>	<u>3,157,139</u>	<u>3,157,139</u>	<u>-</u>
Unreserved fund balance at the end of the year	<u>\$ 971,495</u>	<u>\$ 334,737</u>	<u>\$ 8,451,379</u>	<u>\$ 8,116,642</u>

See accompanying notes to required supplementary information - budgetary reporting.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Required Supplementary Information – Budgetary Reporting
September 30, 2006

(1) Budgetary Information

The Governor presents to the Pohnpei 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 Pohnpei State Legislature reviews and approves these estimates making changes, as it deems appropriate. The Appropriation Committee of the Pohnpei State Legislature, during the regular session of the Pohnpei State Legislature, holds public hearings at which time Departments and Offices are required to justify their budget estimates. During the regular session of the Pohnpei State Legislature, an appropriation bill, as required by the Constitution, is introduced and budget estimates are then legally enacted by the Pohnpei State Legislature.

Formal budget integration is employed as a management control device during the year for all funds. The Pohnpei 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 Fund Balance - Budget and Actual - General Fund (which are presented on a non-GAAP budgetary basis) are reconciled to unreserved fund balance of the Governmental Fund Balance Sheet within the other changes in unreserved fund balance 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, 2006, 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>
Division of Police and Security	\$ 4,803
Health Care Plan Board	\$ 16,026

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2006

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Combining Schedule of Expenditures by Account
Governmental Funds
Year Ended September 30, 2006

	General	Special Revenue		Capital Projects	Permanent	Other Governmental Funds	Total
		U.S Federal Grants	Section 211 Sector Grant	Compact Capital Projects	Section 215 Compact Trust		
Expenditures:							
Salaries and wages	\$ 4,489,468	\$ 1,366,494	\$ 10,732,579	\$ (220)	\$ -	\$ 147,881	\$ 16,736,202
Grants and subsidies	2,225,607	-	195,530	-	-	-	2,421,137
Contractual services	120,747	658,557	605,376	463,083	-	300,311	2,148,074
Capital outlay	50,568	264,043	566,297	23,793	-	85,464	990,165
Utilities	148,054	23,291	698,532	2,475	-	213,863	1,086,215
Travel	422,474	255,223	406,595	11,470	-	13,590	1,109,352
Supplies and materials	264,072	250,164	803,974	47,004	-	174,355	1,539,569
Medical supplies	-	18,908	1,236,443	-	-	318,179	1,573,530
Medical referral	34,231	-	154,768	-	-	-	188,999
Scholarship and training	-	-	334,329	-	-	54,932	389,261
POL	57,487	34,865	70,744	2,034	-	251,072	416,202
Communications	91,543	20,451	131,157	-	-	16,019	259,170
Food stuffs	52,477	166	379,846	-	-	2,495	434,984
Rentals	8,023	9,335	7,700	70	-	33,489	58,617
Principal and interest payments	12,814	-	-	-	-	41,532	54,346
Repairs and maintenance	25,218	10,728	52,607	1,667	-	3,722	93,942
Printing and reproduction	19,955	8,678	41,654	-	-	2,667	72,954
Freight	2,804	6,407	64,171	(2)	-	14,607	87,987
Import tax	740	1,585	32,666	-	-	4,041	39,032
Official and housing allowance	167,240	9,015	31,800	-	-	1,590	209,645
Insurance	209,325	-	6,181	-	-	-	215,506
Other	127,521	3,074	48,733	70	-	(12,666)	166,732
	<u>\$ 8,530,368</u>	<u>\$ 2,940,984</u>	<u>\$ 16,601,682</u>	<u>\$ 551,444</u>	<u>\$ -</u>	<u>\$ 1,667,143</u>	<u>\$ 30,291,621</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function, and Changes in Fund Balances
General Fund

Year Ended September 30, 2006

(with comparative totals for the year ended September 30, 2005)

	2006	2005
Revenues:		
FSM Revenue sharing	\$ 5,697,612	\$ 4,635,134
State taxes:		
Sales tax	2,293,026	2,875,233
Hotel tax	77,452	58,847
Tax penalties	145,057	165,968
	2,515,535	3,100,048
Investment income	815,446	1,184,816
Other revenues	1,257,692	323,337
Total revenues	10,286,285	9,243,335
Expenditures:		
Current:		
General government:		
Governor and staff	528,717	411,094
Department of Treasury and Administration	741,723	432,440
Judiciary Branch	350,937	6,146
Legislative Branch	1,602,165	1,511,214
	3,223,542	2,360,894
Department of Land and Natural Resources:		
Office of the Director	57,908	57,418
Division of Public Land	51,799	51,449
Division of Surveying and Mapping	157,758	149,495
	267,465	258,362
Department of Education:		
Division of Pre-School and Primary Education	-	(1,026)
Post-secondary education	-	1,783
	-	757
Department of Public Safety:		
Division of Law and Litigation	87,803	93,310
Division of Police and Security	750,926	771,629
Division of Correction and Rehabilitation	234,894	-
Division of Search and Rescue	5,000	234,278
	1,078,623	1,099,217
Office of the Attorney-General	301,540	242,035
Boards, Commissions and Other:		
Social Affairs	176,682	190,822
Transportation and Infrastructure	624,428	625,086
Election Commissioner	54,740	53,331
Pohnpei Public Broadcasting Corporation	80,963	102,173
Public Land and Trustees	12,005	-
Pohnpei Housing Authority	90,912	120,215
Pohnpei Ethics Commission	120	-
Health Care Plan Board	61,886	-
Micronesian Games	225,517	-
Other	350	3,651
	1,327,603	1,095,278

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function, and Changes in Fund Balance, Continued
General Fund
Year Ended September 30, 2006
(with comparative totals for the year ended September 30, 2005)

	2006	2005
Expenditures, continued:		
Current, continued:		
Payments to Non-governmental Agencies:		
Pohnpei Public Library	52,463	-
Micronesian Legal Services Corporation	38,280	38,281
USDA Rural Development	94,929	97,485
	185,672	135,766
Grants to local governments	2,145,923	2,165,763
Total expenditures	8,530,368	7,358,072
Excess (deficiency) of revenues over expenditures	1,755,917	1,885,263
Special item (expense):		
Bad Debts	(205,766)	(158,828)
Net change in fund balance	1,550,151	1,726,435
Fund balance at the beginning of the year	9,271,704	7,545,269
Fund balance at the end of the year	\$ 10,821,855	\$ 9,271,704

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
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, 2006

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final		
Revenues:				
FSM Revenue sharing:	\$ 4,600,000	\$ 4,600,000	\$ 5,697,612	\$ 1,097,612
State taxes:				
Sales tax	2,315,000	2,315,000	2,293,026	(21,974)
Hotel tax	-	-	77,452	77,452
Tax penalties	-	-	145,057	145,057
	<u>2,315,000</u>	<u>2,315,000</u>	<u>2,515,535</u>	<u>200,535</u>
Investment income	215,000	215,000	815,446	600,446
Other revenues	137,000	137,000	1,257,692	1,120,692
Total revenues	<u>7,267,000</u>	<u>7,267,000</u>	<u>10,286,285</u>	<u>3,019,285</u>
Expenditures:				
Current:				
General government:				
Governor and staff	525,790	576,052	528,717	47,335
Department of Treasury and Administration	894,106	903,133	741,723	161,410
Judiciary Branch	438,546	438,546	350,937	87,609
Legislative Branch	1,696,425	1,608,928	1,602,165	6,763
	<u>3,554,867</u>	<u>3,526,659</u>	<u>3,223,542</u>	<u>303,117</u>
Department of Land and Natural Resources:				
Office of the Director	65,668	62,514	57,908	4,606
Division of Public Land	51,549	51,211	51,799	(588)
Division of Surveying and Mapping	174,688	174,188	157,758	16,430
	<u>291,905</u>	<u>287,913</u>	<u>267,465</u>	<u>20,448</u>
Department of Education:				
Office of the Director	19,000	19,000	-	19,000
Division of Pre-School and Primary Education	15,977	15,000	-	15,000
Secondary education	191,938	191,938	-	191,938
	<u>226,915</u>	<u>225,938</u>	<u>-</u>	<u>225,938</u>
Department of Health Services:				
Division of Medical Services	280,000	280,000	-	280,000
Division of Dental Services	35,000	35,000	-	35,000
Division of Primary Health Care	10,000	10,000	-	10,000
Administration and Health Development	10,000	10,000	-	10,000
Hospital Food	5,000	5,000	-	5,000
Hospital Buildings and Grounds	10,000	10,000	-	10,000
	<u>350,000</u>	<u>350,000</u>	<u>-</u>	<u>350,000</u>
Department of Public Safety:				
Division of Law and Litigation	96,368	90,436	87,803	2,633
Division of Police and Security	786,743	746,123	750,926	(4,803)
Division of Search and Rescue	-	5,000	5,000	-
Division of Correction and Rehabilitation	242,810	241,679	234,894	6,785
	<u>1,125,921</u>	<u>1,083,238</u>	<u>1,078,623</u>	<u>4,615</u>
Office of the Attorney-General	294,588	324,331	301,540	22,791

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
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, 2006

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final		
Expenditures, continued:				
Current, continued:				
Boards, Commissions and Other:				
Social Affairs	212,528	189,413	176,682	12,731
Transportation and Infrastructure	639,654	715,055	624,428	90,627
Election Commissioner	57,198	57,198	54,740	2,458
Pohnpei Public Broadcasting Corporation	145,330	87,117	80,963	6,154
Public Land and Trustees	11,803	11,803	12,005	(202)
Pohnpei Housing Authority	123,625	118,981	90,912	28,069
Pohnpei Ethics Commission	1,500	120	120	-
Health Care Plan Board	46,570	45,860	61,886	(16,026)
Micronesian Games	-	230,000	225,517	4,483
Bureau of Social Affairs	-	419,413	-	419,413
Other	-	-	350	(350)
	<u>1,238,208</u>	<u>1,874,960</u>	<u>1,327,603</u>	<u>547,357</u>
Payments to Non-governmental Agencies:				
Pohnpei Public Library	52,463	52,463	52,463	-
Micronesian Legal Services Corporation	38,280	38,280	38,280	-
USDA Rural Development	100,000	100,000	94,929	5,071
	<u>190,743</u>	<u>190,743</u>	<u>185,672</u>	<u>5,071</u>
Grants to local governments	<u>2,179,497</u>	<u>2,225,620</u>	<u>2,145,923</u>	<u>79,697</u>
Total expenditures	<u>9,452,644</u>	<u>10,089,402</u>	<u>8,530,368</u>	<u>1,559,034</u>
Excess (deficiency) of revenues over expenditures	(2,185,644)	(2,822,402)	1,755,917	4,578,319
Special item (expense):				
Bad debts	-	-	(205,766)	(205,766)
Net change in unreserved fund balance (deficit)	(2,185,644)	(2,822,402)	1,550,151	4,372,553
Other changes in unreserved fund balance (deficit):				
Increase in reserve for related assets	-	-	(330,778)	(330,778)
Increase in encumbrances	-	-	(126,135)	(126,135)
Decrease in reserve for Compact programs	-	-	4,249,134	4,249,134
Increase in reserve for continuing appropriations	-	-	(48,132)	(48,132)
Unreserved deficit at the beginning of the year	<u>3,157,139</u>	<u>3,157,139</u>	<u>3,157,139</u>	<u>-</u>
Unreserved fund balance (deficit) at the end of the year	<u>\$ 971,495</u>	<u>\$ 334,737</u>	<u>\$ 8,451,379</u>	<u>\$ 8,116,642</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Combined Balance Sheet
Nonmajor Governmental Funds
September 30, 2006

	Other Special Revenue	Other Debt Service	Other Capital Projects	Total
ASSETS				
Investments	\$ 1,819,657	\$ -	\$ -	\$ 1,819,657
Receivables, net:				
CFSM	411,785	-	11,675	423,460
Other	10,974	-	-	10,974
Due from other funds	3,481,531	265,590	877,795	4,624,916
Advances	43,572	-	-	43,572
Inventories	30,715	-	-	30,715
Restricted assets:				
Investments	-	3,883,094	-	3,883,094
Total assets	<u>\$ 5,798,234</u>	<u>\$ 4,148,684</u>	<u>\$ 889,470</u>	<u>\$ 10,836,388</u>
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts payable	\$ 50,159	\$ -	\$ -	\$ 50,159
Other liabilities and accruals	110,747	-	-	110,747
Deferred revenue	50,817	-	-	50,817
Due to other funds	1,507,843	-	-	1,507,843
Total liabilities	<u>1,719,566</u>	<u>-</u>	<u>-</u>	<u>1,719,566</u>
Fund balances:				
Reserved for:				
Related assets	30,715	-	-	30,715
Encumbrances	284,914	35,860	30,764	351,538
Continuing appropriations	798,249	-	234,997	1,033,246
Debt service	-	3,883,094	-	3,883,094
Special projects	-	321,067	-	321,067
Unreserved:				
Special revenue funds	2,964,790	-	-	2,964,790
Debt service fund	-	(91,337)	-	(91,337)
Capital projects funds	-	-	623,709	623,709
Total fund balances	<u>4,078,668</u>	<u>4,148,684</u>	<u>889,470</u>	<u>9,116,822</u>
Total liabilities and fund balances	<u>\$ 5,798,234</u>	<u>\$ 4,148,684</u>	<u>\$ 889,470</u>	<u>\$ 10,836,388</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Combined Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances
Nonmajor Governmental Funds
Year Ended September 30, 2006

	<u>Other Special Revenue</u>	<u>Other Debt Service</u>	<u>Other Capital Projects</u>	<u>Total</u>
Revenues:				
Investment income	\$ -	\$ 179,571	\$ -	\$ 179,571
CFSM grants	76,626	-	-	76,626
Other grants	19,048	-	-	19,048
Sales tax	294,043	-	-	294,043
Fees and charges	782,843	-	-	782,843
Other	110,818	-	-	110,818
	<hr/>	<hr/>	<hr/>	<hr/>
Total revenues	1,283,378	179,571	-	1,462,949
Expenditures by function:				
Current:				
General government	683,650	-	-	683,650
Land and Natural Resource	25,000	-	-	25,000
Education	59,105	-	-	59,105
Health services	335,453	-	-	335,453
Public safety	36,850	-	-	36,850
Boards, commissions and other	311,579	-	-	311,579
Debt service	-	86,575	-	86,575
Capital projects	-	-	128,931	128,931
	<hr/>	<hr/>	<hr/>	<hr/>
Total expenditures	1,451,637	86,575	128,931	1,667,143
Excess (deficiency) of revenues over expenditures				
	<hr/>	<hr/>	<hr/>	<hr/>
	(168,259)	92,996	(128,931)	(204,194)
Other financing sources (uses):				
Proceeds from long-term debt	-	321,067	-	321,067
	<hr/>	<hr/>	<hr/>	<hr/>
Net change in fund balances	(168,259)	414,063	(128,931)	116,873
Fund balances at the beginning of the year	<hr/>	<hr/>	<hr/>	<hr/>
	4,246,927	3,734,621	1,018,401	8,999,949
Fund balances at the end of the year	<hr/>	<hr/>	<hr/>	<hr/>
	\$ 4,078,668	\$ 4,148,684	\$ 889,470	\$ 9,116,822

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Combined Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances
Nonmajor Governmental Funds
Year Ended September 30, 2006

	Other Special Revenue	Other Debt Service	Other Capital Projects	Total
Revenues:				
Investment income	\$ -	\$ 179,571	\$ -	\$ 179,571
CFSM grants	76,626	-	-	76,626
Other grants	19,048	-	-	19,048
Sales tax	294,043	-	-	294,043
Fees and charges	782,843	-	-	782,843
Other	110,818	-	-	110,818
Total revenues	1,283,378	179,571	-	1,462,949
Expenditures by account:				
Salaries and wages	147,881	-	-	147,881
Contractual services	190,307	-	110,004	300,311
Utilities	213,863	-	-	213,863
Supplies and materials	174,355	-	-	174,355
POL	251,072	-	-	251,072
Medical supplies	318,179	-	-	318,179
Scholarship and training	54,932	-	-	54,932
Capital outlay	34,924	28,950	21,590	85,464
Travel	10,077	-	3,513	13,590
Communications	16,019	-	-	16,019
Repairs and maintenance	3,722	-	-	3,722
Printing and reproduction	2,667	-	-	2,667
Freight	6,375	-	8,232	14,607
Rent	33,489	-	-	33,489
Import tax	4,041	-	-	4,041
Official and housing allowance	1,590	-	-	1,590
Food stuffs	2,495	-	-	2,495
Principal and interest payments	-	41,532	-	41,532
Other	(14,351)	16,093	(14,408)	(12,666)
Total expenditures	1,451,637	86,575	128,931	1,667,143
Excess (deficiency) of revenues over expenditures	(168,259)	92,996	(128,931)	(204,194)
Other financing sources (uses):				
Proceeds from long-term debt	-	321,067	-	321,067
Net change in fund balances	(168,259)	414,063	(128,931)	116,873
Fund balances at the beginning of the year	4,246,927	3,734,621	1,018,401	8,999,949
Fund balances at the end of the year	\$ 4,078,668	\$ 4,148,684	\$ 889,470	\$ 9,116,822

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

Combining Balance Sheet
September 30, 2006

Section 211(b) Special Block Grant	Compact Other Grants	Non-U.S. Grants	CFSM Grants	Agriculture Revolving	SVAP Revolving	Airport Operations	Recycling Revolving	Pave Road Maintenance
ASSETS								
Investments	\$ 523,856	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Receivables, net:								
CFSM	-	-	64,336	-	-	-	-	-
Other	-	-	3,926	-	-	-	-	-
Due from other funds	-	50,817	-	11,097	4,909	22,273	22,899	1,107,675
Advances	-	-	603	4,991	-	-	-	-
Inventories	-	-	-	30,715	-	-	-	-
Total assets	\$ 523,856	\$ 50,817	\$ 68,865	\$ 46,803	\$ 4,909	\$ 22,273	\$ 22,899	\$ 1,107,675
LIABILITIES AND FUND BALANCES (DEFICITS)								
Liabilities:								
Accounts payable	\$ -	\$ -	\$ 3,108	\$ 11,306	\$ -	\$ -	\$ -	\$ -
Other liabilities and accruals	5,256	-	-	-	-	-	-	-
Deferred revenue	-	50,817	-	-	-	-	-	-
Due to other funds	286,977	-	65,758	-	-	-	-	-
Total liabilities	292,233	50,817	68,866	11,306	-	-	-	-
Fund balances (deficits):								
Reserved for:								
Related assets	-	-	-	30,715	-	-	-	-
Encumbrances	-	5,399	12,433	16,865	284	-	-	60,306
Continuing appropriations	-	-	-	-	-	-	-	695,753
Unreserved (deficit)	231,623	(5,399)	(12,434)	(12,083)	4,625	22,273	22,899	351,616
Total fund balances (deficits)	231,623	-	(1)	35,497	4,909	22,273	22,899	1,107,675
Total liabilities and fund balances (deficits)	\$ 523,856	\$ 50,817	\$ 68,865	\$ 46,803	\$ 4,909	\$ 22,273	\$ 22,899	\$ 1,107,675

See Accompanying Independent Auditors' Report.

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

Combining Balance Sheet, Continued
September 30, 2006

	Medical Supplies Revolving	Health Care Premiums	V6AH Revolving	Environmental Quality	Early Retirement	Special Police Fee	Fishing Fines	Public Lands Trust	Total
ASSETS									
Investments	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,819,657
Receivables, net:									
CFSM	-	-	-	-	-	-	-	-	411,785
Other	-	7,048	-	-	-	-	-	-	10,974
Due from other funds	411,642	1,083,160	-	1,126	-	43,402	546,944	175,587	3,481,531
Advances	37,978	-	-	-	-	-	-	-	43,572
Inventories	-	-	-	-	-	-	-	-	30,715
Total assets	\$ 449,620	\$ 1,090,208	\$ -	\$ 1,126	\$ -	\$ 43,402	\$ 546,944	\$ 175,587	\$ 5,798,234
LIABILITIES AND FUND BALANCES (DEFICITS)									
Liabilities:									
Accounts payable	\$ 35,745	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 50,159
Other liabilities and accruals	-	-	-	-	-	-	-	-	110,747
Deferred revenue	-	-	-	-	-	-	-	-	50,817
Due to other funds	-	-	28,747	-	-	-	-	-	1,507,843
Total liabilities	\$ 35,745	\$ -	\$ 28,747	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,719,566
Fund balances (deficits):									
Reserved for:									
Related assets	-	-	-	-	-	-	-	-	30,715
Encumbrances	158,883	-	878	-	-	266	480	-	284,914
Continuing appropriations	-	-	-	-	-	-	-	-	798,249
Unreserved (deficit)	254,992	1,090,208	(29,625)	1,126	-	43,136	546,464	175,587	2,964,790
Total fund balances (deficits)	\$ 413,875	\$ 1,090,208	\$ (28,747)	\$ 1,126	\$ -	\$ 43,402	\$ 546,944	\$ 175,587	\$ 4,078,668
Total liabilities and fund balances (deficits)	\$ 449,620	\$ 1,090,208	\$ -	\$ 1,126	\$ -	\$ 43,402	\$ 546,944	\$ 175,587	\$ 5,798,234

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)
 Year Ended September 30, 2006

	Section 211(b) Special Block Grant	Compact Other Grants	Non-U.S. Grants	CFSM Grants	Agriculture Revolving	SVAP Revolving	Airport Operations	Recycling Revolving	Pave Road Maintenance
Revenues:									
CFSM grants	\$ -	\$ -	\$ -	\$ 76,626	\$ -	\$ -	\$ -	\$ -	\$ -
Other grants	-	-	19,048	-	-	-	-	-	-
Sales tax	-	-	-	-	-	-	-	-	294,043
Fees and charges	-	-	50,509	-	60,005	284	-	-	-
Other	-	-	-	-	-	-	-	-	-
Total revenues	-	-	69,557	76,626	60,005	284	-	-	294,043
Expenditures by function:									
Current:									
General government	-	137,564	51,996	76,627	77,472	4,156	-	-	173,365
Land and Natural Resources	-	25,000	-	-	-	-	-	-	-
Education	-	57,252	1,853	-	-	-	-	-	-
Health services	-	-	15,708	-	-	-	-	-	-
Public safety	-	36,850	-	-	-	-	-	-	-
Boards, commissions and other	-	327,192	-	-	-	-	-	-	-
Total expenditures	-	583,858	69,557	76,627	77,472	4,156	-	-	173,365
Net change in fund balances (deficits)	-	(583,858)	-	(1)	(17,467)	(3,872)	-	-	120,678
Fund balances (deficits) at the beginning of the year	231,623	995,256	-	-	52,964	8,781	22,273	22,899	986,997
Fund balances (deficits) at the end of the year	\$ 231,623	\$ 411,398	\$ -	\$ (1)	\$ 35,497	\$ 4,909	\$ 22,273	\$ 22,899	\$ 1,107,675

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, 2006

	Medical Supplies Revolving	Health Care Premiums	V6AH Revolving	Environmental Quality	Early Retirement	Special Police Fee	Fishing Fines	Public Lands Trust	Total
Revenues:									
CFSM grants	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 76,626
Other grants	-	-	-	-	-	-	-	-	19,048
Sales tax	-	-	-	-	-	-	-	-	294,043
Fees and charges	456,068	145,548	19,060	1,100	-	50,269	-	-	782,843
Other	-	-	63	-	-	-	-	110,755	110,818
Total revenues	<u>456,068</u>	<u>145,548</u>	<u>19,123</u>	<u>1,100</u>	<u>-</u>	<u>50,269</u>	<u>-</u>	<u>110,755</u>	<u>1,283,378</u>
Expenditures by function:									
Current:									
General government	-	8,982	64,392	2,542	-	36,469	50,085	-	683,650
Land and Natural Resources	-	-	-	-	-	-	-	-	25,000
Education	-	-	-	-	-	-	-	-	59,105
Health services	319,745	-	-	-	-	-	-	-	335,453
Public safety	-	-	-	-	-	-	-	-	36,850
Boards, commissions and other	-	-	-	-	(15,613)	-	-	-	311,579
Total expenditures	<u>319,745</u>	<u>8,982</u>	<u>64,392</u>	<u>2,542</u>	<u>(15,613)</u>	<u>36,469</u>	<u>50,085</u>	<u>-</u>	<u>1,451,637</u>
Net change in fund balances (deficits)	136,323	136,566	(45,269)	(1,442)	15,613	13,800	(50,085)	110,755	(168,259)
Fund balances (deficits) at the beginning of the year	<u>277,552</u>	<u>953,642</u>	<u>16,522</u>	<u>2,568</u>	<u>(15,613)</u>	<u>29,602</u>	<u>597,029</u>	<u>64,832</u>	<u>4,246,927</u>
Fund balances (deficits) at the end of the year	\$ <u>413,875</u>	\$ <u>1,090,208</u>	\$ <u>(28,747)</u>	\$ <u>1,126</u>	\$ <u>-</u>	\$ <u>43,402</u>	\$ <u>546,944</u>	\$ <u>175,587</u>	\$ <u>4,078,668</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
 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, 2006

	Section 211(b) Special Block Grant	Compact Other Grants	Non-U.S. Grants	CFSM Grants	Agriculture Revolving	SVAP Revolving	Airport Operations	Recycling Revolving	Pave Road Maintenance
Revenues:									
CFSM grants	\$ -	\$ -	\$ -	\$ 76,626	\$ -	\$ -	\$ -	\$ -	\$ -
Other grants	-	-	19,048	-	-	-	-	-	-
Sales tax	-	-	-	-	-	-	-	-	294,043
Fees and charges	-	-	50,509	-	60,005	284	-	-	-
Other	-	-	-	-	-	-	-	-	-
Total revenues	-	-	69,557	76,626	60,005	284	-	-	294,043
Expenditures by account:									
Salaries and wages	-	-	9,987	35,213	-	-	-	-	37,465
Contractual services	-	98,794	14,667	-	300	-	-	-	49,878
Utilities	-	191,830	20,852	821	-	-	-	-	-
Supplies and materials	-	-	16,208	10,749	59,039	4,156	-	-	55,076
POL	-	238,102	597	10,300	-	-	-	-	-
Medical supplies	-	-	-	-	-	-	-	-	-
Scholarship and training	-	54,932	-	-	-	-	-	-	-
Capital outlay	-	-	2,965	(148)	12,402	-	-	-	-
Travel	-	-	1,853	4,661	-	-	-	-	-
Communications	-	200	-	11,609	362	-	-	-	-
Repairs and maintenance	-	-	-	740	1,237	-	-	-	-
Printing and reproduction	-	-	72	-	-	-	-	-	-
Freight	-	-	376	-	3,430	-	-	-	-
Rentals	-	-	-	1,190	-	-	-	-	490
Import tax	-	-	-	-	-	-	-	-	30,365
Official and housing allowance	-	-	750	-	462	-	-	-	91
Food stuffs	-	-	1,003	1,492	-	-	-	-	-
Other	-	-	227	-	240	-	-	-	-
Total expenditures	-	583,858	69,557	76,627	77,472	4,156	-	-	173,365
Net change in fund balances (deficits)	-	(583,858)	-	(1)	(17,467)	(3,872)	-	-	120,678
Fund balances (deficits) at the beginning of the year	231,623	995,256	-	-	52,964	8,781	22,273	22,899	986,997
Fund balances (deficits) at the end of the year	\$ 231,623	\$ 411,398	\$ -	\$ (1)	\$ 35,497	\$ 4,909	\$ 22,273	\$ 22,899	\$ 1,107,675

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
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, 2006

	Medical Supplies Revolving	Health Care Premiums	V6AH Revolving	Environmental Quality	Early Retirement	Special Police Fee	Fishing Fines	Public Lands Trust	Total
Revenues:									
CFSM grants	-	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	76,626
Other grants	-	-	-	-	-	-	-	-	19,048
Sales tax	-	-	-	-	-	-	-	-	294,043
Fees and charges	456,068	145,548	19,060	1,100	-	50,269	-	-	782,843
Other	-	-	63	-	-	-	-	110,755	110,818
Total revenues	456,068	145,548	19,123	1,100	-	50,269	-	110,755	1,283,378
Expenditures by account:									
Salaries and wages	-	3,121	58,201	2,402	-	-	1,492	-	147,881
Contractual services	-	439	-	-	-	-	26,229	-	190,307
Utilities	-	360	-	-	-	-	-	-	213,863
Supplies and materials	-	567	5,230	-	-	22,133	1,197	-	174,355
POL	-	40	-	-	-	1,450	583	-	251,072
Medical supplies	318,179	-	-	-	-	-	-	-	318,179
Scholarship and training	-	-	-	-	-	-	-	-	54,932
Capital outlay	-	1,587	-	-	-	8,815	9,303	-	34,924
Travel	-	-	-	-	-	-	3,563	-	10,077
Communications	-	40	-	-	-	-	3,808	-	16,019
Repairs and maintenance	-	-	-	-	-	-	-	-	3,722
Printing and reproduction	-	19	-	-	-	1,745	-	-	2,667
Freight	1,566	-	250	-	-	2,326	-	-	6,375
Rentals	-	1,944	513	-	-	-	-	-	33,489
Import tax	-	-	(10)	-	-	-	-	-	4,041
Official and housing allowance	-	188	20	-	-	-	3,300	-	1,590
Food stuffs	-	820	-	-	-	-	-	-	2,495
Other	-	45	-	140	-	-	610	-	(14,351)
Total expenditures	319,745	8,982	64,392	2,542	(15,613)	36,469	50,085	-	1,451,637
Net change in fund balances (deficits)	136,323	136,566	(45,269)	(1,442)	15,613	13,800	(50,085)	110,755	(168,259)
Fund balances (deficits) at the beginning of the year	277,552	953,642	16,522	2,568	(15,613)	29,602	597,029	64,832	4,246,927
Fund balances (deficits) at the end of the year	\$ 413,875	\$ 1,090,208	\$ (28,747)	\$ 1,126	\$ -	\$ 43,402	\$ 546,944	\$ 175,587	\$ 4,078,668

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
CAPITAL PROJECTS FUNDS

Combining Balance Sheet
September 30, 2006

	<u>Health and Education Projects</u>	<u>OIA Capital Projects</u>	<u>Total</u>
<u>ASSETS</u>			
Receivables, net:			
CFSM	\$ 11,675	\$ -	\$ 11,675
Due from other funds	<u>877,795</u>	<u>-</u>	<u>877,795</u>
	<u>\$ 889,470</u>	<u>\$ -</u>	<u>\$ 889,470</u>
 <u>FUND BALANCES</u>			
Fund balances:			
Reserved for:			
Encumbrances	\$ 30,764	\$ -	\$ 30,764
Continuing appropriations	234,997	-	234,997
Unreserved	<u>623,709</u>	<u>-</u>	<u>623,709</u>
Total fund balances	<u>889,470</u>	<u>-</u>	<u>889,470</u>
Total liabilities and fund balances	<u>\$ 889,470</u>	<u>\$ -</u>	<u>\$ 889,470</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
CAPITAL PROJECTS FUNDS

Combining Statement of Expenditures by Function,
and Changes in Fund Balances (Deficit)
Year Ended September 30, 2006

	Health and Education Projects	OIA Capital Projects	Total
Expenditures by function:			
Capital projects	\$ 147,316	\$ (18,385)	\$ 128,931
Total expenditures	147,316	(18,385)	128,931
Net change in fund balances (deficits)	(147,316)	18,385	(128,931)
Fund balances (deficit) at the beginning of the year	1,036,786	(18,385)	1,018,401
Fund balances (deficit) at the end of the year	\$ 889,470	\$ -	\$ 889,470

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
CAPITAL PROJECTS FUNDS

Combining Statement of Expenditures by Account,
and Changes in Fund Balances (Deficit)
Year Ended September 30, 2006

	Health and Education Projects	OIA Capital Projects	Total
Expenditures by account:			
Contractual services	\$ 110,004	\$ -	\$ 110,004
Capital outlays	21,590	-	21,590
Travel	3,513	-	3,513
Freight	8,232	-	8,232
Other	3,977	(18,385)	(14,408)
Total expenditures	147,316	(18,385)	128,931
Net change in fund balances (deficits)	(147,316)	18,385	(128,931)
Fund balances (deficit) at the beginning of the year	1,036,786	(18,385)	1,018,401
Fund balances at the end of the year	\$ 889,470	\$ -	\$ 889,470

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

SECTION 211 COMPACT SECTOR FUNDS

Combining Balance Sheet
September 30, 2006

	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)(5) Supplemental Ed	Total
<u>ASSETS</u>							
Grants receivable net:	\$ 331,317	\$ 166,088	\$ -	\$ -	\$ 43,787	\$ -	\$ 541,192
Due from other funds	-	-	30,421	45,471	-	589,215	665,107
Advances	450	72,320	-	-	14,969	-	87,739
	<u>\$ 331,767</u>	<u>\$ 238,408</u>	<u>\$ 30,421</u>	<u>\$ 45,471</u>	<u>\$ 58,756</u>	<u>\$ 589,215</u>	<u>\$ 1,294,038</u>
<u>LIABILITIES AND FUND BALANCES</u>							
Liabilities:							
Accounts payable	\$ 30,208	\$ 56,356	\$ 11,509	\$ 15,241	\$ 11,073	\$ 42,057	\$ 166,444
Deferred revenue	2	-	18,375	29,046	-	546,424	593,847
Due to other funds	295,421	177,265	-	-	47,119	-	519,805
Total liabilities	<u>325,631</u>	<u>233,621</u>	<u>29,884</u>	<u>44,287</u>	<u>58,192</u>	<u>588,481</u>	<u>1,280,096</u>
Fund balances:							
Reserved for:							
Encumbrances	380,039	207,554	33,079	44,102	45,345	254,639	964,758
Unreserved special revenue funds	(373,903)	(202,767)	(32,542)	(42,918)	(44,781)	(253,905)	(950,816)
Total fund balances	<u>6,136</u>	<u>4,787</u>	<u>537</u>	<u>1,184</u>	<u>564</u>	<u>734</u>	<u>13,942</u>
Total liabilities and fund balances	<u>\$ 331,767</u>	<u>\$ 238,408</u>	<u>\$ 30,421</u>	<u>\$ 45,471</u>	<u>\$ 58,756</u>	<u>\$ 589,215</u>	<u>\$ 1,294,038</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

SECTION 211 COMPACT SECTOR FUNDS

Combining Statement of Expenditures by Account,
and Changes in Fund Balances
Year Ended September 30, 2006

	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	Supplement Education Grant	Total
Revenues:							
Compact funding	\$ 6,748,108	\$ 5,104,320	\$ 858,753	\$ 744,965	\$ 716,280	\$ 2,429,256	\$ 16,601,682
Investment income	<u>1,785</u>	<u>1,253</u>	<u>227</u>	<u>194</u>	<u>170</u>	<u>734</u>	<u>4,363</u>
	<u>6,749,893</u>	<u>5,105,573</u>	<u>858,980</u>	<u>745,159</u>	<u>716,450</u>	<u>2,429,990</u>	<u>16,606,045</u>
Expenditures by function:							
Current:							
General government	-	-	858,753	744,965	716,280	-	2,319,998
Education	6,748,108	-	-	-	-	2,429,256	9,177,364
Health services	<u>-</u>	<u>5,104,320</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>5,104,320</u>
Total expenditures	<u>6,748,108</u>	<u>5,104,320</u>	<u>858,753</u>	<u>744,965</u>	<u>716,280</u>	<u>2,429,256</u>	<u>16,601,682</u>
Net change in fund balances	1,785	1,253	227	194	170	734	4,363
Fund balances at the beginning of the year	<u>4,351</u>	<u>3,534</u>	<u>310</u>	<u>990</u>	<u>394</u>	<u>-</u>	<u>9,579</u>
Fund balances at the end of the year	<u>\$ 6,136</u>	<u>\$ 4,787</u>	<u>\$ 537</u>	<u>\$ 1,184</u>	<u>\$ 564</u>	<u>\$ 734</u>	<u>\$ 13,942</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

SECTION 211 COMPACT SECTOR FUNDS

Combining Statement of Expenditures by Account,
and Changes in Fund Balances
Year Ended September 30, 2006

	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)(5) Supplemental Ed	Total
Revenues:							
Compact funding	\$ 6,748,108	\$ 5,104,320	\$ 858,753	\$ 744,965	\$ 716,280	\$ 2,429,256	\$ 16,601,682
Investment income	1,785	1,253	227	194	170	734	4,363
	<u>6,749,893</u>	<u>5,105,573</u>	<u>858,980</u>	<u>745,159</u>	<u>716,450</u>	<u>2,429,990</u>	<u>16,606,045</u>
Expenditures by account:							
Salaries and wages	5,689,521	2,496,980	530,788	391,480	395,643	1,228,167	10,732,579
Contractual services	17,267	131,902	8,653	92,812	125,867	228,875	605,376
Utilities	175,966	448,626	32,138	8,100	9,955	23,747	698,532
Supplies and materials	143,608	151,229	39,433	34,046	68,023	367,635	803,974
POL	31,166	9,962	3,252	-	10,864	15,500	70,744
Medical supplies	-	1,236,443	-	-	-	-	1,236,443
Scholarship and training	334,329	-	-	-	-	-	334,329
Capital outlay	-	218,471	28,932	29,297	74,235	215,362	566,297
Travel	10,993	80,967	28,055	140,715	3,440	142,425	406,595
Grants and subsidies	75,000	-	120,530	-	-	-	195,530
Communications	26,813	18,392	18,577	7,947	10,777	48,651	131,157
Medical referral	-	154,768	-	-	-	-	154,768
Repairs and maintenance	20,709	7,172	5,081	2,681	4,478	12,486	52,607
Printing and reproduction	-	14,310	11,639	6,600	5,241	3,864	41,654
Freight	14,344	24,832	6,169	1,174	1,922	15,730	64,171
Rentals	1,897	176	5,043	467	100	17	7,700
Import tax	7,093	15,979	-	140	891	8,563	32,666
Official and housing allowance	840	20,400	4,280	-	3,800	2,480	31,800
Insurance	-	2,293	-	-	-	3,888	6,181
Food stuffs	198,538	69,316	2,517	-	606	108,869	379,846
Other	24	2,102	13,666	29,506	438	2,997	48,733
Total expenditures	<u>6,748,108</u>	<u>5,104,320</u>	<u>858,753</u>	<u>744,965</u>	<u>716,280</u>	<u>2,429,256</u>	<u>16,601,682</u>
Net change in fund balances	1,785	1,253	227	194	170	734	4,363
Fund balances at the beginning of the year	4,351	3,534	310	990	394	-	9,579
Fund balances at the end of the year	<u>\$ 6,136</u>	<u>\$ 4,787</u>	<u>\$ 537</u>	<u>\$ 1,184</u>	<u>\$ 564</u>	<u>\$ 734</u>	<u>\$ 13,942</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 Johnny P. David
Governor, State of Pohnpei
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 Pohnpei as of and for the year ended September 30, 2006, which collectively comprise the State of Pohnpei's basic financial statements and have issued our report thereon dated June 15, 2007. Our report was modified to include a reference to other auditors. 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

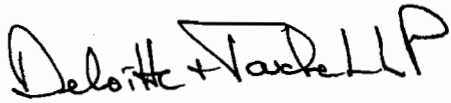
In planning and performing our audit, we considered the State of Pohnpei's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. 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 State of Pohnpei'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 certain matters that we reported to management of the State of Pohnpei in a separate letter dated June 15, 2007.

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

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

June 15, 2007

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

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

Compliance

We have audited the compliance of the State of Pohnpei with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2006. The State of Pohnpei's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (pages 79 and 80). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the State of Pohnpei's management. Our responsibility is to express an opinion on the State of Pohnpei's compliance based on our audit.

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

As described in items 2006-1 through 2006-6 in the accompanying Schedule of Findings and Questioned Costs, the State of Pohnpei did not comply with the requirements regarding procurement (Compact Sector Grants CFDA#15.875, Special Education CFDA#84.027), allowable costs/cost principles (Compact Sector Grants CFDA#15.875), period of availability (Compact Sector Grants CFDA#15.875), compliance for contract provisions (Compact Sector Grants CFDA#15.875, Special Education CFDA# 84.027) and compliance on the maintenance of fixed assets (Compact Sector Grants CFDA#15.875, Special Education CFDA#84.027) applicable to the Grants or Programs. Compliance with such requirements is necessary, in our opinion, for the State of Pohnpei to comply with requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the State of Pohnpei complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2006.

Internal Control Over Compliance

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

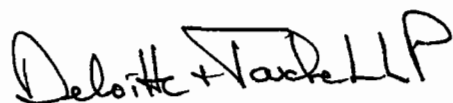
We noted certain matters involving the internal control over compliance and its operating that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgement, could adversely affect the State of Pohnpei's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 2006-1 through 2006-6.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Pohnpei as of and for the year ended September 30, 2006, and have issued our report thereon dated June 15, 2007. Our report was modified to include reference to other auditors. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the State of Pohnpei's basic financial statements. The accompanying schedule of expenditures of federal awards (pages 68 through 74) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the State of Pohnpei. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

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



June 15, 2007

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Summary Schedule of Expenditures of Federal Awards, by Grantor
Year Ended September 30, 2006

Agency/Program	Expenditures
U.S. Department of Agriculture	\$ 359,797
U.S. Department of the Interior	17,930,142
U.S. Department of Labor	215,345
U.S. Department of Homeland Security	56,485
U.S. Department of Education	1,358,962
U.S. Department of Health and Human Services	757,237
GRAND TOTAL	\$ 20,677,968

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

Direct from the U.S. Department of Education:

Freely Associated States Educational Grants	84.256A
Twenty-First Century Community Learning Center	84.287

Pass thru from the University of Hawaii:

Pacific Cancer Initiative (DHHS) U55/CCU923887.02

Reconciliation to the basic financial statements:

U.S. Federal Grants Fund (page 13)	\$ 2,940,984
Section 211 Compact Sector Grant (page 13)	16,601,682
Compact Capital Projects Fund (page 13)	551,444
Compact Other Grants Fund (page 52)	583,858
	\$ 20,677,968

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2006

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF AGRICULTURE		
Cooperative Forestry Assistance	10.664	\$ 14,657
Urban and Community Forestry Program	10.675	54,202
Forest Stewardship Program	10.678	218,732
Community Facility Loans and Grants	10.766	<u>72,206</u>
U.S. DEPARTMENT OF AGRICULTURE TOTAL		<u>\$ 359,797</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2006

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF THE INTERIOR		
Economic, Social and Political Development of the Territories:	15.875	
Compact Capital Improvement Projects		\$ 551,444
Compact Energy Grants		526,607
Compact Health and Medical Grants		-
Compact Scholarship Grants		57,251
Compact Special Block Grants		-
Compact II Capacity Build		744,965
Compact II Education Sector		6,748,108
Compact II Environment Sector		716,280
Compact II Health Sector		5,104,320
Compact II Private Sector		858,753
Compact II Supplemental Ed		2,429,256
Technical Assistance:		
Hospital Renovation		919
Survey and Mapping		20,867
PPA Computer System		37,994
Development of the Police Operations Manual		11,543
PPA Runway Mower Unit		35,000
Specialized equipment		5,000
Historic Preservation Fund Grants-In-Aid	15.904	81,835
U.S. DEPARTMENT OF THE INTERIOR TOTAL		<u>\$ 17,930,142</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2006

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF LABOR		
Job Training Partnership Act	17.250	\$ -
Workforce Investment Act	17.255	43,803
WIA Adult Program	17.258	69,404
WIA Youth Activities	17.259	789
WIA Dislocated Worker	17.260	<u>101,349</u>
U.S. DEPARTMENT OF LABOR TOTAL		<u>\$ 215,345</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2006

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF HOMELAND SECURITY		
Public Assistance Grants	83.544	\$ 38,696
Hazard Mitigation Grant	83.548	<u>17,789</u>
U.S. DEPARTMENT OF HOMELAND SECURITY		<u>\$ 56,485</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2006

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF EDUCATION		
Special Education - Grants to States	84.027	\$ 1,185,882
Vocation Education-Basic Grants to the States	84.048B	47,035
Freely Associated States - Educational Grant Program	84.256A	125,348
Twenty-First Century Community Learning Center	84.287B	<u>697</u>
U.S. DEPARTMENT OF EDUCATION TOTAL		<u>\$ 1,358,962</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2006

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES		
Public Health and Social Services Emergency Fund	93.003	\$ 28,427
Maternal and Child Health Federal Consolidated Programs	93.110	11,736
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	53,305
Family Planning - Services	93.217	84,401
Consolidated Health Centers (Community Health Centers, Migrant Health Centers, Health Care for the Homeless, Public Housing Primary Care, and School Based Health Centers)	93.224	157,269
Immunization Grants	93.268	93,556
CDC & Prevention-Investigations & Technical Assistance	93.283	19,571
National Bioterrorism Hospital Preparedness Program	93.889	-
HIV Care Formula Grants	93.917	40
HIV Prevention Activities-Health Department Based	93.940	30,568
Block Grants for Prevention and Treatment of Substance Abuse	93.959	125,093
Preventive Health Services - Sexually Transmitted Diseases Control Grants	93.977	8,022
Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	93.988	7,705
Preventive Health and Health Services Block Grant	93.991	7,842
Maternal and Child Health Services Block Grant to the States	93.994	98,256
Pacific Cancer Initiative	Note	<u>31,446</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES TOTAL		\$ <u>757,237</u>
GRAND TOTAL		\$ <u>20,677,968</u>

Note: The grant is received through the University of Hawaii and the grant number is U55/CCU923887.02.

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2006

1. Scope

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

A. Programs Subject to Single Audit

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

- U.S. Department of Agriculture
- U.S. Department of Education
- U.S. Department of Health and Human Services
- U.S. Department of Homeland Security
- 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 State of Pohnpei, for purposes of the basic financial statements, includes all of the funds of the primary government as defined by Governmental Accounting Standards Board (GASB) Statement 14, "The Financial Reporting Entity."

C. Subgrantees

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

D. Indirect Cost Allocation

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

E. CFDA #15.875

CFDA #15.875 represents the Office of Insular Affairs (OIA), U. S. Department of the Interior. Funding from this source is subject to varying rules and regulations since OIA administers the Compact of Free Association, which is a treaty, and is not a federal program. The Compact is comprised of various funded programs, each with separate compliance requirements. To maximize audit coverage of OIA funding, the OIG has recommended that programs administered under CFDA #15.875 be grouped by like compliance requirements and such groupings be separately evaluated as major programs.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2006

3. Discretely Presented Component Units

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

Pohnpei Utilities Corporation

The Pohnpei Utilities Corporation is the recipient of various pass-through funds from the State of Pohnpei. No material instances of noncompliance or questioned costs are presented in its audit reports. Following is the Schedule of Expenditures of Federal Awards for Pohnpei Utilities Corporation:

<u>Grantor/Program Title</u>	<u>CFDA #</u>	<u>Total Authorization</u>	<u>Receivable at Beginning of Year</u>	<u>Expenditures for the Year Ended Sept. 30, 2006</u>	<u>Cash Receipts for the Year Ended Sept. 30, 2006</u>	<u>Receivable at End of Year</u>
U.S. Department of the Interior:						
Office of Territorial and						
International Affairs:						
Operations and Maintenance						
Improvement Programs (OMIP):						
15.875						
Utility Development 2001		\$ 117,668	\$ 292	\$ 4,203	\$ 4,495	\$ -
OMIP Bench		562,500	-	4,388	4,388	-
OMIP Three Phase Prepaid Meter		75,000	-	43,000	43,000	-
OMIP LT Training		25,000	-	10,812	7,500	3,312
OMIP Power Study		50,000	-	23,835	23,835	-
OMIP Strategic		100,000	-	26,340	15,000	11,340
OMIP Tariff Study		50,000	-	50,000	11,350	38,650
OMIP Hydrologist for the Military wells		10,000	-	10,000	10,000	-
Nanpil Hydro Rehabilitation Project		<u>350,000</u>	<u>-</u>	<u>350,000</u>	<u>350,000</u>	<u>-</u>
		<u>1,340,168</u>	<u>292</u>	<u>522,578</u>	<u>469,568</u>	<u>53,302</u>
Infrastructure Sector:						
15.875						
Nanpil Hydro Rehabilitation Project		556,588	-	455,761	495,593	(39,832)
Pohnpei Water Well Drilling		<u>500,000</u>	<u>-</u>	<u>461,139</u>	<u>556,588</u>	<u>(95,499)</u>
		<u>1,056,588</u>	<u>-</u>	<u>916,900</u>	<u>1,052,181</u>	<u>(135,281)</u>
U.S. Department of Agriculture						
Rural Utilities Service						
Water and Waste Disposal Systems for						
Rural Communities Grant	10.760	<u>2,761,000</u>	<u>825,041</u>	<u>603,987</u>	<u>1,249,380</u>	<u>179,648</u>
		<u>\$ 5,157,756</u>	<u>\$ 825,333</u>	<u>\$ 2,043,465</u>	<u>\$ 2,771,129</u>	<u>\$ 97,669</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2006

- Note 1: The grant from RUS includes loan portion of \$578,000 and grant portion of \$2,183,000. Expenditures are first applied to the loan.
- Note 2: The schedule of expenditures of federal awards is prepared on the accrual basis of accounting.
- Note 3: The grants from U.S. DOI were received in a pass-through capacity. The grant from RUS was received in a direct recipient capacity.
- Note 4: During the year ended September 30, 2006, PUC received water wells valued at \$574,484 from the FSM National Government, which were originally funded by the U.S. Department of the Interior (15.875). These funds were audited for compliance at the FSM National Government level and are therefore not included as federal awards for purposes of this schedule.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Programs Selected For
Audit in Accordance with OMB Circular A-133
Year Ended September 30, 2006

<u>Grantor Program Title</u>	<u>CFDA No.</u>	<u>2006 Fiscal Year Expenditures</u>
<u>U.S. Department of the Interior</u>		
Compact of Free Association Compact II Sector Grants	15.875	\$ <u>16,601,682</u>
Total Major Programs Under CFDA #15.875		<u>16,601,682</u>
<u>U.S. Department of Education</u>		
Special Education – Grants to States	84.027	<u>1,185,882</u>
Total Major Programs Under U.S. Department of Education		<u>1,185,882</u>
Total U.S. Federal program expenditures selected		\$ <u>17,787,564</u>
Total U.S. Federal program expenditures		\$ <u>20,677,968</u>
% of total U.S. Federal expenditures covered by major programs		<u>86%</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2006

Part I - Summary of Auditors' Results

1. The Independent Auditor's Report on the financial statements, expressed an unqualified opinion.
2. Reportable conditions in internal control over financial reporting were identified, none of which are considered to be material weaknesses.
3. Instances of noncompliance considered material to the financial statements were not disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal award programs were identified, none 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 Compact II Sector Grants	15.875
U.S. Department of Education – Special Education – Grants to State	84.027

8. A threshold of \$604,716 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
9. The State did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

Part II - Financial Statement Findings Section

No matters are reportable.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

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

<u>Reference Number</u>	<u>CFDA Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
2006-1	15.875	Procurement	\$ -
2006-2	15.875	Allowable Costs/Cost Principles	\$ -
	10.678	Allowable Costs/Cost Principles	\$ -
2006-3	15.875	Period of Availability	\$ -
	84.287B	Period of Availability	\$ -
2006-4	15.875	Compliance: Contract Provision	\$ -
	84.027	Compliance: Contract Provision	\$ -
2006-5	15.875	Compliance: Maintenance of Fixed Assets	\$ -
	10.766	Compliance: Maintenance of Fixed Assets	\$ -
	15.875	Compliance: Maintenance of Fixed Assets	\$ -
	84.027	Compliance: Maintenance of Fixed Assets	\$ -
2006-6	15.875	Procurement-Travel	\$ -
	84.027	Procurement Travel	\$ -

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Federal Award Findings and Questioned Costs Section

Finding No.: 2006-1
CFDA No.: 15.875
Grantor Agency: U.S. Department of the Interior
Grant #: Compact II Sector Grants
Program Name: Pohnpei State Government
Requirement: Procurement
Questioned Costs: \$0

Criteria:

Procurements shall provide full and open competition among vendors, and any allowable exceptions should be approved and documented in the procurement file.

Condition:

1. CFDA 15.875 Compact Sector Grants: For two (3%) of 82 non-payroll expenditures tested (\$10,409 of the aggregate amount of \$1,667,704 tested), there was insufficient documentation to support competitive procurement requirements.

<u>Item</u>	<u>Org</u>	<u>Acct</u>	<u>Des</u>	<u>Des_2</u>	<u>Des_3</u>	<u>Date</u>	<u>Amount</u>	<u>Ck No.</u>
1	7220	8110	MADOLENIHMW MUN. GOV'T ADJUSTMENT/ GREGORIO		850200	09/29/06	\$ 3,409	199068
2	7312	8303	AGTAY	V60058	P50082	12/29/05	<u>7,000</u>	183704
							<u>\$10,409</u>	

- a. For item two, there was no detail description of the item being procured (i.e. model, type). Two vendors were price solicited locally stating no stock available, however no contact person and numbers noted for these vendors were indicated. The vendor selected was off island but appears to be an individual and not a company. Also, the acquisition cost of \$7,000 may be unreasonable for the purchase of an ambulance transmission.

No questioned costs result from the above items as the State transferred the expenditures to the general fund in its fiscal year 2006 financial statements.

Cause:

There appears to be a lack of controls over ensuring that competition is open among vendors and a lack of control in the maintenance and storage of relevant financial and program documentation.

Effect:

Noncompliance results from this condition due to insufficient competitive procurement documentation.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Federal Award Findings and Questioned Costs Section

Finding No.: 2006-1, Continued
CFDA No.: 15.875
Grantor Agency: U.S. Department of the Interior
Grant #: Compact II Sector Grants
Program Name: Pohnpei State Government
Requirement: Procurement
Questioned Costs: \$0

Recommendation:

We recommend that Pohnpei State Government comply with U.S. Federal program requirements and strengthen its internal controls to ensure that adequate competitive procurement documentation is on file. If there are any exceptions to the procurement regulations, they should be approved and documented.

Auditee Response:

We agree with your recommendation. Currently, all procurements are closely monitored to ensure that controls are effectively implemented. The attached memorandum to the Chief of Public Finance and Property Accountability addressed the documentation issue.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Federal Award Findings and Questioned Costs Section

Finding No.: 2006-2
CFDA No.: 15.875
Grantor Agency: U.S. Department of the Interior
Program Name: Compact Sector Grants
Requirement: Allowable Costs/Cost Principles
Questioned Cost: \$0

CFDA No.: 10.678
Grantor Agency: U.S. Department of Agriculture
Program Name: Forest Stewardship Program
Requirement: Allowable Costs/Cost Principles
Questioned Cost: \$0

Criteria:

Expenditures should be necessary, reasonable and in accordance with the program needs.

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

Condition:

1. CFDA 15.875 Compact Sector Grants: For two of eighty-two (3%) non-payroll expenditures tested (\$41,909 of the aggregate amount of \$1,667,704 tested), the expenditure was considered non-compliant to the allowable costs and cost principle requirements of the grant.

<u>Item</u>	<u>Org</u>	<u>Acct</u>	<u>Des</u>	<u>Des 2</u>	<u>Des 3</u>	<u>Date</u>	<u>Amount</u>	<u>Ck No.</u>
			MADOLENIHMW					
1	7220	8110	MUN. GOV'T		850200	9/29/2006	\$ 3,409	199068
2	7328	8210	MEDDHARM	L6245601	845602	7/24/06	38,500	196028
							<u>\$ 41,909</u>	

- a. For item one, there was insufficient documentation (i.e. accounts payable voucher and supporting invoices/contract) to support allowable requirements. No questioned costs result from this item as the State transferred the attendant expenditures to the general fund in its fiscal year 2006 financial statement presentation.
- b. For item two, the expenditure was a prepayment for purchase of an anesthesia machine that was received in fiscal year 2007; however this amount was expended in the fiscal year 2006 financial statements. No questioned costs result from this item as an audit adjustment was proposed to recognize an advance.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Federal Award Findings and Questioned Costs Section

Finding No.: 2006-2, Continued

Condition, Continued:

2. CFDA 10.678 Forest Stewardship Program: For one (4%) of twenty-seven non-payroll expenditures tested, invoices were for services or goods rendered or received in fiscal year 2007; however, the expenditure was recorded in fiscal year 2006.

<u>Org</u>	<u>Acct</u>	<u>Des</u>	<u>Des_2</u>	<u>Des_3</u>	<u>Process_date</u>	<u>Ck No.</u>	<u>Amount</u>	
2	3758	8303	TO CLOSE ALL PO ADVANCES/V60093	P60017	835915	02/24/06	189620	\$ 156,900

No questioned cost result from this finding, as an audit adjustment was proposed to reverse the expenditure and to recognize an advance. It has however been included as an insight due to the initial recordation.

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 allowable costs/costs principles results from the condition.

Recommendation:

We recommend that the State record expenditures when goods or services have been received or incurred. If disbursements have been advanced for these costs, they should be recorded as prepaid or advance payments.

We recommend that the State obtain approval from the grantor if goods or services are not anticipated to be received or incurred within 90 days after the period of availability. If such is not obtained, questioned costs may result in the following fiscal year.

The State has received verbal communication from the Office of Insular Affairs that indicated that such prepaid expenses may be classified in each respective Compact Sector Balance sheet and therefore, such classification appears to be authorized.

The State should exercise more stringent document policies in maintenance and storage of financial and programmatic records.

Auditee Response:

The Chief of Public Finance and Property Accountability is tasked to ensure that all incoming requisitions and payments are reviewed carefully so that the above findings will no longer exist in the ensuing transactions.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Federal Award Findings and Questioned Costs Section

Finding No.: 2006-3
CFDA No.: 15.875
Grantor Agency: U.S. Department of the Interior
Program Name: Compact Sector Grants
Requirement: Period of Availability
Questioned Cost: \$0

CFDA #: 84.287B
Grantor Agency: U. S. Department of Education
Grant #: S287B012146-03
Program Name: Twenty-First Century Community Learning Center
Requirement: Period of Availability
Questioned Cost: \$0

Criteria:

The obligation for the expenditure should occur during the period of availability.

Obligated funds have 90 days after grant award period for liquidation otherwise an approval from the grantor agency authorizing the extension of funds must be obtained.

Condition:

1. CFDA 15.875 Compact Sector Grants: For one (1%) of 82 non-payroll expenditures tested (\$34,231 of the aggregate amount of \$1,667,704 tested), the expenditure relates to services that were provided during fiscal year 2005 and are outside of the grant award period. No questioned costs result from this matter as the State transferred the attendant expenditures to the general fund in its fiscal year 2006 financial statement presentation.

<u>Org</u>	<u>Acct</u>	<u>Des</u>	<u>Des_3</u>	<u>Date</u>	<u>Amount</u>	<u>Ck No.</u>
7318	8460	MEDPHARM	836646	12/20/05	\$34,231	190103

2. CFDA 84.287 After School Learning Center: For one of 27 (4%) non-payroll expenditures tested (\$35,370 of the aggregate amount of \$666,664 tested), the expenditure was not incurred within the period of availability.

<u>Org</u>	<u>Acct</u>	<u>Des</u>	<u>Des_2</u>	<u>Des_3</u>	<u>Date</u>	<u>Amount</u>	<u>Ck No.</u>
3834	8313	ADJUSTMENTS	V60102	P50107	02/28/06	\$35,370	186885

The expenditure was recorded as an expense in fiscal year 2006 even though the grant award expired on May 31, 2005. No questioned costs result from this matter as the State has transferred the attendant expenditure to the general fund in its fiscal year 2006 financial statement presentation.

Cause:

There appears to be a control deficiency over ensuring that expenditures are recorded in the appropriate period and within the period of availability.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Federal Award Findings and Questioned Costs Section

Finding No.: 2006-3, Continued

Effect:

Expenditures may be misstated and Pohnpei State Government appears to be in noncompliance with the period of availability requirements.

Recommendation:

The Pohnpei State Government should ensure that expenditures are accounted for in the fiscal year in which applicable goods and services were received and rendered.

Expenditures anticipated to occur beyond the period of availability of the grant should be supported with an authorization from the grantor for an extension.

Auditee Response:

The recommendation is well noted. The Deputy Chief of Public Finance is doing stringent reviews of all incoming requisitions to make sure that all government procurements are done within the period of availability.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Federal Award Findings and Questioned Costs Section

Finding No.: 2006-4
CFDA No.: 15.875
Grantor Agency: U.S. Department of the Interior
Program Name: Compact Sector Grants
Requirement: Compliance: Contract Provisions
Questioned Cost: \$0

CFDA No.: 84.027
Grantor Agency: U.S. Department of Education
Grant#: H027B030002
Program Name: Special Education
Requirement: Compliance: Contract Provisions
Questioned Cost: \$0

Criteria:

For all contracts, the following provisions should be included as applicable:

- (i) For contracts in excess of \$100,000, administrative, contractual, or legal remedies in instances where contractors violate or breach contract terms, and the provision of such sanctions and penalties as appropriate;
- (ii) For contracts in excess of \$100,000, termination for cause and for convenience by the Grantee or Sub-Grantee including the manner by which it will be effected and the basis for settlement;
- (iii) Compliance with local statutes regarding kickbacks and corrupt practices;
- (iv) Access by the Government of the Federated States of Micronesia and its Sub-Grantees, the Government of the United States, or any of their duly authorized representatives to any books, documents, papers, and records of the contractor which are directly pertinent to the contract for the purpose of making audit, examination, excerpts, and transcriptions;
- (v) Retention of all required records for three years after Grantees or Sub-Grantees make final payments and all other pending matters are closed; and
- (vi) Compliance with all applicable standards, orders, or requirements issued under local environmental laws.

Condition:

- 1. CFDA 15.875 Compact Sector Grants: For seven (9%) of 82 non-payroll expenditures tested (\$155,084 of the aggregate amount of \$1,667,704 tested), Fiscal Procedures contract provisions (iii) to (v) were not noted in the contract.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Federal Award Findings and Questioned Costs Section

Finding No.: 2006-4, Continued

	<u>Org</u>	<u>Acct</u>	<u>Des</u>	<u>Des_2</u>	<u>Des_3</u>	<u>Date</u>	<u>Amount</u>	<u>Ck No.</u>
1	7254	8405	PREL	C6011401	837618	01/19/06	\$ 10,000	190772
2	7254	8405	PREL	C6011401	842530	05/16/06	10,000	193995
3	7257	8405	WORLDTEACH, INC.	C6034101	845784	07/25/06	21,000	196160
4	7254	8408	DOROTHY KELLEY	C60141	839635	03/10/06	46,865	192043
5	7254	8408	PREL	C6015401	839779	03/14/06	52,725	192094
6	7259	8450	LIPERTO LINGE POHNPEI WASTE	C6014401	839044	02/28/06	900	191654
7	7520	8405	MANAGEMENT	C6014001	839242	03/02/06	<u>13,594</u>	191783
							<u>\$155,084</u>	

2. CFDA 84.027 Special Education: For seven (18%) of 39 non-payroll expenditures tested (\$119,229 of the aggregate amount of \$243,644 tested), Fiscal Procedures contract provisions (iii) to (v) were not noted in the contract.

<u>Item</u>	<u>Org</u>	<u>Acct</u>	<u>Des</u>	<u>Des_2</u>	<u>APV#</u>	<u>Date</u>	<u>Amount</u>	<u>Ck No.</u>
1	3124	8405	DOTTY KELLY	C5062101	840959	04/10/06	\$ 46,872	192917
2	3127	8405	MR. TIMONTHY HAGEN	C6012001	839984	03/16/06	14,625	192235
3	3127	8405	MR. TIMONTHY HAGEN	C6012001	848930	09/14/06	14,625	198322
4	3127	8408	HEIDI SAN NICOLAS	C6017901	843449	06/06/06	13,883	194586
5	3127	8408	HEIDI SAN NICOLAS	C6018101	843448	06/06/06	15,000	194586
6	3127	8408	HEIDI SAN NICOLAS	C6029101	843565	06/08/06	7,382	194676
7	3127	8408	HEIDI SAN NICOLAS	C6018001	843566	06/08/06	<u>6,842</u>	194676
							<u>\$ 119,229</u>	

Cause:

There appears to be lack of internal control in ensuring that Fiscal Procedures Agreement contract provisions are included as applicable in the contract.

Effect:

The Pohnpei State Government appears to be in noncompliance with Compact Sector program and the Department of Education program objectives.

The conditions cited relate to the provisions in the contracts and not to amounts incurred under contracts and therefore no questioned costs result from this finding.

Recommendation:

We recommend that the State strengthen its control in ensuring that Fiscal Procedures Agreement contract provision requirements are included as applicable in contracts.

Auditee Response:

The attached memorandum from the Director of Treasury and Administration will address the finding.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Federal Award Findings and Questioned Costs Section

Finding No.: 2006-5
CFDA No.: 15.875
Grantor Agency: U.S. Department of the Interior
Program Name: Compact Sector Grants
Requirement: Compliance: Maintenance of Fixed Assets
Questioned Cost: \$0

CFDA No.: 10.766
Grantor Agency: U.S. Department of Agriculture
Program Name: Community Facility Loans and Grants
Requirement: Compliance: Maintenance of Fixed Assets
Questioned Cost: \$0

CFDA No.: 15.875
Grantor Agency: U.S. Department of the Interior
Grant No.: OMIP PPA 2005-1
Program Name: Technical Assistance: PPA Computer Systems
Requirement: Compliance: Maintenance of Fixed Assets
Questioned Cost: \$0

CFDA No.: 84.027
Grantor Agency: U.S. Department of Education
Grant No.: H0278030002
Program Name: Special Education
Requirement: Compliance: Maintenance of Fixed Assets
Questioned Cost: \$0

Criteria:

Management should periodically review asset maintenance activities, to ensure compliance with program objectives and requirements.

Condition:

No documented procedures are in currently in place to ensure that fixed assets are periodically reviewed for asset maintenance.

Cause:

There appears to be a weakness in internal controls over ensuring that fixed assets are periodically maintained.

Effect:

The expected life of the fixed asset may be lessened. However, no questioned costs resulted from this finding as no specific instances came to our attention of unnecessary expenditures that occurred due to the condition.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Federal Award Findings and Questioned Costs Section

Finding No.: 2006-5, Continued

Recommendation:

We recommend that the State strengthen internal controls to ensure that there are periodic reviews to ensure that asset maintenance activities are documented, monitored and performed.

Auditee Responses:

The Public Infrastructure under the Sector Grant allows for the 50% funding of the infrastructure maintenance. The matching fund comes from the Paved Road Maintenance. For the fixed assets, maintenance costs will come from the annual operations budget.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Federal Award Findings and Questioned Costs Section

Finding No.: 2006-6
CFDA No.: 15.875
Grantor Agency: U.S. Department of the Interior
Program Name: Compact Sector Grants
Requirement: Procurement-Travel
Questioned Cost: \$0

CFDA No.: 84.027
Grantor Agency: U.S. Department of Education
Grant No.: H027B030002
Program Name: Special Education
Requirement: Procurement-Travel
Questioned Cost: \$0

Criteria:

Procurements shall provide full and open competition among vendors, and any allowable exceptions should be approved and documented in the procurement file.

Travel extending to destinations where multiple airlines are available should be competitively procured.

Condition:

- CFDA 15.875 Compact Sector Grants: For three (4%) of 82 non-payroll expenditures tested (\$10,216 of the aggregate amount of \$1,667,704 tested), there was insufficient documentation to support competitive procurement requirements for travel extending to destinations where multiple airlines are available.

<u>Item</u>	<u>Org</u>	<u>Acct</u>	<u>Des</u>	<u>Des_2</u>	<u>Des_3</u>	<u>Date</u>	<u>Amount</u>	<u>Ck No.</u>
1	4516	8110	THE VILLAGE TRAVEL CONTINENTAL	T60477	845482	07/17/06	\$ 3,220	195935
2	7324	8110	MICRONESIA	T60471	844867	07/06/06	3,217	195527
3	7607	8110	HOUSE OF TRAVEL	T60078	836457	12/15/05	<u>3,779</u>	190001
							<u>\$ 10,216</u>	

- CFDA 84.027 Special Education: For three (8%) of 39 non-payroll expenditures tested (\$8,043 of the aggregate amount of \$243,644 tested), there was insufficient documentation to support competitive procurement requirements for travel extending to destinations where multiple airlines are available.

<u>Item</u>	<u>Org</u>	<u>Acct</u>	<u>Des</u>	<u>Des_2</u>	<u>Des_3</u>	<u>Date</u>	<u>Amount</u>	<u>Ck No.</u>
1	3125	8110	THE VILLAGE TRAVEL	T60163	839768	03/13/06	\$ 2,257	192054
2	3125	8110	THE VILLAGE TRAVEL	T60173	840583	04/05/06	2,893	192721
3	3125	8110	THE VILLAGE TRAVEL	T60172	840582	04/05/06	<u>2,893</u>	192721
							<u>\$ 8,043</u>	

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Federal Award Findings and Questioned Costs Section

Finding No.: 2006-6, Continued

Cause:

There appears to be a lack of controls over ensuring that competition remains open among vendors and a lack of control in the maintenance and storage of relevant financial and program documentation. Please note that the above items are only questioning when travel continues on from Guam or Honolulu. At each of those destinations, the traveler has a choice of carriers. However, it appears that the travel is restricted to one airline. Therefore, while we understand that only one carrier serves the island of Pohnpei, multiple carriers service Guam and Honolulu. Therefore, this finding only pertains to travel that is subject to competitive pricing.

Effect:

Noncompliance with competitive procurement for travel extending beyond Guam or Hawaii could result from this condition due to insufficient competitive procurement documentation.

Questioned costs would be the difference for travel extending beyond Guam or Hawaii. Per review of travel invoices, this is undeterminable as the price is not broken down by destination.

Recommendation:

We recommend that Pohnpei State Government comply with U.S. Federal program requirements and strengthen its internal controls to ensure that adequate competitive procurement documentation is on file. If there are any exceptions to the procurement regulations, they should be approved and documented.

We recommend that the State meet competitive procurement requirements for travel extending to areas served by multiple airlines.

Auditee Response:

We recognized that competitive procurement on travel extending to destinations where multiple airlines are available is not being done. Our situation is unique because we rely heavily on the quotations being provided by the three travel agencies on the island and the only airline servicing Pohnpei State. The Government does not have credit cards that are required to book flights on line. Travel agencies on the other hand, can not compete with on line price of the travel. At this point, the Government's capability to competitively procure government travels is limited on what the travel agencies and the airline can afford to offer.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Summary Schedule of Prior Audits Findings and Questioned Costs
Year Ended September 30, 2006

The following is a summary of unresolved questioned costs of the State of Pohnpei as of September 30, 2006:

	Questioned Costs Set Forth in Prior Audit Report <u>2005</u>	Questioned Costs Resolved in Fiscal Year <u>2006</u>	<u>Questioned Costs at September 30, 2006</u>
Unresolved Questioned Costs FY 04	\$ 80,721	\$ 80,721 (a)	\$ -
Questioned Costs FY 06	<u>-</u>	<u>-</u>	<u>-</u>
	\$ <u>80,721</u>	\$ <u>80,721</u>	\$ <u>-</u>

- (a) The U.S. Department of Education resolved \$50,721 of these questioned costs in a determination letter dated June 2, 2006.

The U.S. Department of the Interior indicated in a letter dated September 29, 2005 that no questioned costs would be disallowed for the reported matter.