

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

YEAR ENDED SEPTEMBER 30, 2007

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

YEAR ENDED SEPTEMBER 30, 2007

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**FEDERATED STATES OF MICRONESIA
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**INDEPENDENT AUDITORS' REPORT
AND FINANCIAL STATEMENTS
AND ADDITIONAL INFORMATION**

YEAR ENDED SEPTEMBER 30, 2007

INDEPENDENT AUDITORS' REPORT

Honorable Emmanuel Mori
President
Federated States of Micronesia:

We have audited the accompanying financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Federated States of Micronesia (FSM) National Government as of and for the year ended September 30, 2007, which collectively comprise the FSM National Government's basic financial statements as set forth in Section II of the foregoing table of contents. These financial statements are the responsibility of the management of the FSM National Government. Our responsibility is to express an opinion on the respective financial statements based on our audit.

Except as discussed in the following paragraphs, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the FSM National Government's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates that our audit provides a reasonable basis for our opinions.

As discussed in Note 5 to the financial statements, the FSM National Government has not recorded a liability for retentions payable in the governmental activities and the Compact Sector Grants Fund and, accordingly, has not recorded an expenditure/expense for the current period change in that liability. Accounting principles generally accepted in the United States of America require that liabilities incurred attributable to services already rendered and that are not contingent upon a specific event that is outside of the control of the FSM National Government be accrued as liabilities and expenditures/expenses, which would increase the liabilities, decrease net assets, and change the expenses of the governmental activities and increase the liabilities, decrease fund balance, and change the expenditures of the Compact Sector Grants Fund. The amount by which this departure would affect the liabilities, net assets and expenses of the governmental activities and the liabilities, fund balance, and expenditures of the Compact Sector Grants Fund is not reasonably determinable.

As discussed in Note 5 to the financial statements, the FSM National Government has excluded from capital assets for governmental activities in the accompanying statement of net assets certain infrastructure assets that, in our opinion, should be included to conform with accounting principles generally accepted in the United States of America. The amount by which this departure would affect the assets, net assets and expenses of the governmental activities is not reasonably determinable.

Because of inadequacies in the accounting records, we were unable to form an opinion regarding the amount at which receivables, advances, amounts due to the FSM State Governments and deferred revenue are recorded for the governmental activities; the amount at which receivables, advances and amounts due to the FSM State Governments are recorded for the General Fund; the amount at which receivables and amounts due to the FSM State Governments are recorded for the U.S. Federal Grants Fund; and the amount at which deferred revenue is recorded for the aggregate remaining fund information. These amounts enter into the determination of revenues and expenditures/expenses for governmental activities, the General Fund, the U.S. Federal Grants Fund, and the aggregate remaining fund information for the year ended September 30, 2007.

The financial statements of the National Fisheries Corporation, a component unit of the FSM National Government, have historically consolidated its investment in Micronesia Longline Fishing Company, a 97%-owned corporation, and its investment in Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc., all 50%-owned corporations. Due to the lack of either audited or unaudited financial statements of Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc., the amount by which this departure would affect investments, net assets, and expenses of the aggregate discretely presented component units is not reasonably determinable.

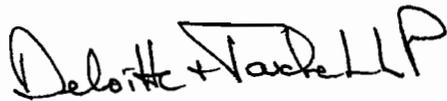
The financial statements of the National Fisheries Corporation have not been audited, and we were not engaged to audit these financial statements as part of our audit of the FSM National Government's basic financial statements. The financial activities of the National Fisheries Corporation are included in the FSM National Government's basic financial statements as a discretely presented component unit and represent 0.2% and 2% of the assets and revenues, respectively, of the FSM National Government's aggregate discretely presented component units.

In our opinion, except for the effects of not recording a liability for retentions payable in the governmental activities and the Compact Sector Grants Fund and not including certain capital assets in the governmental activities, as discussed in the third and fourth paragraphs above, and except for the effects on the financial statements of such adjustments, if any, as might have been determined to be necessary had accounting records regarding receivables, advances, amounts due to the FSM State Governments and deferred revenue for the governmental activities; receivables, advances and amounts due to the FSM State Governments for the General Fund; receivables and amounts due to the FSM State Governments for the U.S. Federal Grants Fund; and deferred revenue for the aggregate remaining fund information, and their effect on the determination of revenues and expenditures/expenses for governmental activities, the General Fund, the U.S. Federal Grants Fund, and the aggregate remaining fund information, been adequate, as discussed in the fifth paragraph above, the lack of audited financial statements of Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc., as discussed in the sixth paragraph above, and the lack of audited financial statements of the National Fisheries Corporation, as discussed in the seventh paragraph above, such financial statements, as set forth in Section II of the foregoing table of contents, present fairly, in all material respects, the respective financial position of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the FSM National Government as of September 30, 2007, 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 4 through 10, as well as the Schedule of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund and notes thereto, on pages 53 through 55, are not a required part of the basic financial statements but are supplementary information required by GASB. This supplementary information is the responsibility of the management of the FSM National Government. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated June 23, 2008, on our consideration of the FSM National Government's 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 + Tatchell LLP". The signature is written in a cursive, stylized font.

June 23, 2008

FEDERATED STATES OF MICRONESIA NATIONAL GOVERNMENT

Management's Discussion and Analysis September 30, 2007

This discussion and analysis of the FSM National Government's financial performance provides an overview of the financial activities of the FSM National Government for the year ended September 30, 2007 and of the financial position of the FSM National Government at September 30, 2007. This report is to be read in conjunction with the financial statements of the FSM National Government which begins on page 11. Fiscal Year 2007 comparative information has been provided where appropriate.

FINANCIAL HIGHLIGHTS

- For the fiscal year ended September 30, 2007, FSM National Government has total net assets of \$61,400,254 (FY06 \$61,113,385). The increase is primarily due to increase in revenue collection against the projected budget.
- During the year, FSM National Government expenses for governmental activities were \$58,420,979 (FY06 \$51,688,730) and were funded by program revenues of \$29,655,526 (FY06 \$20,920,954) and were further funded with taxes and other general revenues (excluding special items) that totaled \$29,996,855 (FY06 \$26,943,423).
- During the year, FSM National Government wrote-off receivable balances of \$944,533 (FY06 \$10,242,788).
- During the year, FSM National Government transferred the fund balance from the original compact to the general fund with a net balance of \$634,575.
- The net change in governmental funds increased by \$5,094,492 (FY06 decreased by \$10,565,892). Total revenues reported are \$59,652,381 with total expenditures of \$57,129,332. Total loan proceeds from ADB Loan are \$3,515,976.
- At September 30, 2007, the General Fund reported an unreserved surplus of \$6,124,246 (FY06 \$4,513,590). Of the total unreserved surplus, \$2.4 million came from excess of revenue against the projected/budgeted amounts, \$2.1 million came from unexpended appropriations in the budgetary expenditures, and \$1.6 million came from net transfers of the fund balance from the original Compact and decreases in related assets, net of others. The summary and details of these amounts can be found on page 53 and pages 59 to 61, respectively.

OVERVIEW OF THE FINANCIAL STATEMENTS

This Financial Statements for the Year Ended September 30, 2007 consists of four parts - management's discussion and analysis (this section), the basic financial statements, required supplementary information, and notes to financial statements.

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

The Government-Wide Financial Statements

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

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

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Management's Discussion and Analysis
September 30, 2007

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

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

- **Governmental Activities** - Most of the FSM National Government's basic services are reported here. These include the services provided by the Executive Branch such as health, education, foreign affairs, transportation, resources and development, finance, the Attorney General's office, and general administration; the Judicial Branch; the Legislative Branch; other National Government programs; Boards and Commissions; and other legislative appropriations. These services are funded by Compact of Association funds, US Federal grants, FSM tax revenues, licenses, fees and investment earnings.
- **Components Units** – The FSM National Government has seven (7) component units namely, College of Micronesia - FSM, National Fisheries Corporation, FSM Telecommunications Corporation, FSM Development Bank, FSM Social Security Administration, the FSM Coconut Development Authority, and the Mi Care Plan. These components units are entities which are legally separate from the FSM National Government, but are financially accountable to the FSM National Government, or whose relationships with the FSM National Government is such that exclusion would cause the FSM National Government's basic financial statements to be misleading or incomplete.

Fund Financial Statements

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

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

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THE NATIONAL GOVERNMENT AS A WHOLE

Net Assets may serve overtime as a useful indicator of government's financial position. At the end of FY07, National Government assets exceeded liabilities by \$61,400,254. Of the total net assets, \$37,858,632 is either restricted as to purposes for which they may be used or are invested in capital assets. National Government uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although National Government investments in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other source, since the capital assets themselves cannot be used to liquidate these liabilities.

Table 1 shows the schedule of National Government's net assets as of September 30, 2007.

Table 1
Net Assets
Governmental Activities

	<u>2007</u>	<u>2006</u>
Current assets	\$ 49,967,094	\$ 42,962,869
Other assets	43,905,103	46,534,623
Capital assets	<u>24,761,802</u>	<u>26,277,068</u>
Total assets	<u>118,633,999</u>	<u>115,774,560</u>
Current liabilities	15,543,229	15,992,186
Other liabilities	<u>41,690,516</u>	<u>38,668,989</u>
Total liabilities	<u>57,233,745</u>	<u>54,661,175</u>
Net assets:		
Invested in capital assets net of related debt	24,761,802	26,277,068
Restricted	13,096,830	28,208,866
Unrestricted	<u>23,541,622</u>	<u>6,627,451</u>
Net assets	<u>\$61,400,254</u>	<u>\$61,113,385</u>

At the end of FY07, the FSM National Government unrestricted assets show a surplus of \$23,541,622 compared to \$6,627,451 at the end of FY06.

Table 2 shows the changes in Net Assets of the National Government as of September 30, 2007.

Table 2
Changes in Net Assets
Governmental Activities

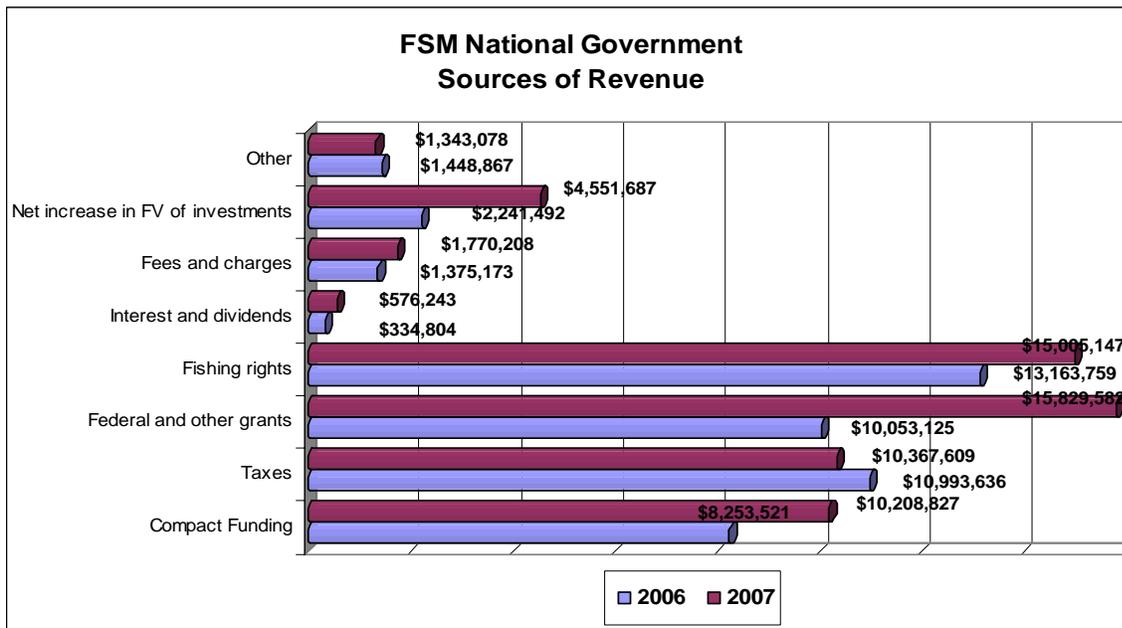
	<u>2007</u>	<u>2006</u>
Revenues:		
<i>Program Revenues:</i>		
Charges for services	\$ 1,628,040	\$ 1,792,101
Operating grants and contributions	14,750,180	18,393,366
Capital grants and contributions	13,277,306	735,487
<i>General Revenues:</i>		
Income tax	2,398,611	3,178,727
Fishing rights fees	15,005,147	13,163,759
Fuel	137,348	144,760
Import	4,186,072	4,270,936
Gross receipt	3,842,247	3,399,213

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Management's Discussion and Analysis
September 30, 2007

	<u>2007</u>	<u>2006</u>
Net increase in investment earnings	3,115,689	1,301,039
Other	<u>1,311,741</u>	<u>1,484,989</u>
Total revenues	<u>59,652,381</u>	<u>47,864,377</u>
Expenditures:		
Executive	41,008,896	32,312,261
Judicial	955,439	973,067
Legislative	3,221,718	3,376,796
Off of Public Auditor	806,761	715,357
Other National Government Program	4,878,679	4,582,373
Boards and commissions	1,864,426	1,571,629
Other appropriations	3,932,825	3,458,713
Payments to component units	1,248,428	4,648,293
Capital	37,255	50,241
Debt service	<u>466,552</u>	<u>-</u>
Total expenditures	<u>58,420,979</u>	<u>51,688,730</u>
Excess before special items	<u>1,231,402</u>	<u>(3,824,353)</u>
Special items	944,533	10,242,788
Change in net assets	<u>286,869</u>	<u>(14,067,141)</u>
Net assets, beginning of year	<u>61,113,385</u>	<u>75,180,526</u>
Net assets, end of year	<u>\$61,400,254</u>	<u>\$61,113,385</u>

National Government revenues from governmental activities, including local revenues, investment earnings increases, compact and other grants funding totaled \$59,652,381 (FY06 \$47,864,377). In FY07, the cost of governmental activities totaled \$59,365,512 (FY06 \$61,931,518); the difference between the two representing increased in net assets of \$286,869 (decrease in FY06 of \$14,067,141). To assist in appreciating the details of governmental activities, the above governmental activities information is shown in pictorial form in the following graph.



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Management's Discussion and Analysis
September 30, 2007

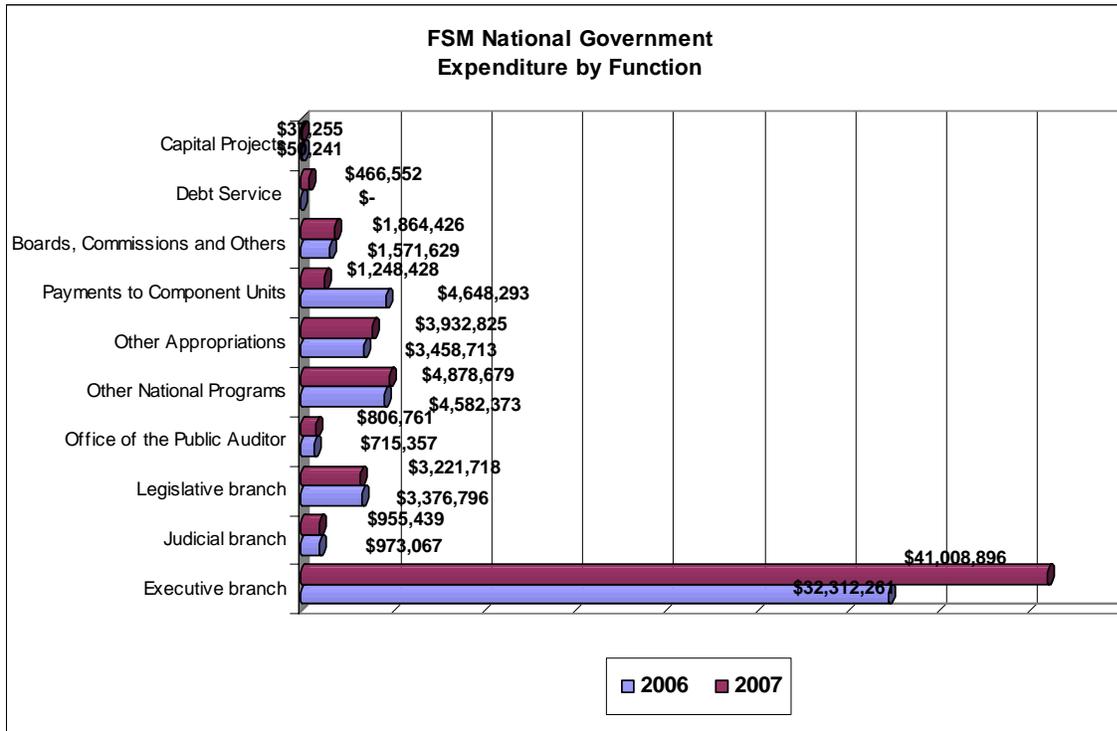


Table 3 shows the National Government governmental fund changes in fund balances for the year ended September 30, 2007.

**Table 3
Changes in Fund Balances**

	<u>General Fund</u>		<u>Other Funds</u>		<u>Total</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Revenues:						
Compact funding	\$ -	\$ -	\$10,208,827	\$ 8,253,521	\$10,208,827	\$ 8,253,521
Federal and other grants	-	-	15,829,582	10,053,125	15,829,582	10,053,125
Taxes	10,367,609	10,993,636	-	-	10,367,609	10,993,636
Fishing rights fees	15,005,147	13,163,759	-	-	15,005,147	13,163,759
Net increase in fair value of investments	2,921,999	1,301,039	2,205,931	1,275,257	5,127,930	2,576,296
Other	<u>1,706,323</u>	<u>1,864,003</u>	<u>1,406,963</u>	<u>960,037</u>	<u>3,113,286</u>	<u>2,824,040</u>
Total revenues	<u>30,001,078</u>	<u>27,322,437</u>	<u>29,651,303</u>	<u>20,541,940</u>	<u>59,652,381</u>	<u>47,864,377</u>
Expenditures	26,623,817	26,095,999	30,505,515	24,583,013	57,129,332	50,679,012
Excess (deficiency) of revenue over (under) expenditures	3,377,261	1,226,438	(854,212)	(4,041,073)	2,523,049	(2,814,635)
Net transfers	<u>(1,410,057)</u>	<u>(258,658)</u>	<u>4,926,033</u>	<u>2,750,189</u>	<u>3,515,976</u>	<u>2,491,531</u>
Special items	<u>944,533</u>	<u>10,242,788</u>	-	-	<u>944,533</u>	<u>10,242,788</u>
Net change in fund balance	<u>\$ 1,022,671</u>	<u>\$(9,275,008)</u>	<u>\$ 4,071,821</u>	<u>\$(1,290,884)</u>	<u>\$ 5,094,492</u>	<u>\$(10,565,892)</u>

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Management's Discussion and Analysis
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Analysis of budgetary Variations- General fund:

During the year, the FSM National Government revised its budget several times to accommodate supplemental funding for departments and offices requiring increases in appropriations. As can be seen in the following table, actual revenues exceeded projections by \$2,451,078 or 12.53% while expenditures were less than projections by \$2,164,459 or 6.81%. There were no material budget overruns at any level.

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget - Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
Revenues	\$24,675,000	\$27,550,000	\$30,001,078	\$2,451,078
Expenditures	<u>23,595,099</u>	<u>31,761,657</u>	<u>29,597,198</u>	<u>2,164,459</u>
Excess of revenues	<u>1,079,901</u>	<u>(4,211,657)</u>	<u>403,880</u>	<u>4,615,537</u>
Other financing sources (uses)	(619,858)	(827,180)	(1,410,057)	(462,074)
Special items	-	-	<u>944,533</u>	<u>(944,533)</u>
Net changed unreserved	460,043	(5,038,837)	(1,950,710)	3,208,930
Other changes in unreserved			3,561,366	3,561,366
Unreserved- beginning	<u>4,513,590</u>	<u>4,513,590</u>	<u>4,513,590</u>	-
Unreserved - ending	<u>\$ 4,973,633</u>	<u>\$ (525,247)</u>	<u>\$ 6,124,246</u>	<u>\$6,770,296</u>

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At the end of the September 30, 2007, FSM National Government had invested \$49,608,099 (FY06 \$49,093,983) in capital assets. These assets consist basically of office equipment and machinery, buildings, ship, and motor vehicles. The summary of capital assets of the year is shown below:

	<u>Primary Government Governmental Activities</u>	
	<u>2007</u>	<u>2006</u>
Buildings	\$14,248,976	\$14,248,976
Ships and Boats	23,322,100	23,319,942
Computer Equipment	3,653,760	3,296,202
Aircraft	709,207	709,207
Furniture, Equipment and Machinery	3,393,116	3,362,772
Motor Vehicles	<u>4,280,940</u>	<u>4,156,884</u>
	49,608,099	49,093,983
Less accumulated depreciation	<u>(24,846,297)</u>	<u>(22,816,915)</u>
Total	<u>\$24,761,802</u>	<u>\$26,277,068</u>

Further information on the FSM National Government's capital assets can be obtained from note 5 to the accompanying financial statements on page 46.

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Management's Discussion and Analysis
September 30, 2007

Long-Term Debt

At the end of fiscal year 2007, National Government had long term debt of \$42,448,974 (FY06 \$39,156,617) relating to Governmental Activities as shown below:

	<u>2007</u>	<u>2006</u>
ADB Loan -Early Retirement	\$17,682,020	\$17,682,020
-Fisheries and water project	13,658,034	13,942,923
-Private Sector Development	8,460,857	5,827,908
-Basic social Services	1,829,927	946,900
Compensated Absences (Annual Leave)	<u>818,136</u>	<u>756,866</u>
	<u>\$42,448,974</u>	<u>\$39,156,617</u>

Further information on the FSM National Government's long term obligations can be obtained from note 6 to the accompanying financial statements on page 47 and 48.

Economic Factors and Next year's Budget:

Fiscal year 2007 represents the fourth full year the FSM is implementing the economic assistance provisions available under the Amended compact. The total funds appropriated for the National Government operations and programs during the fiscal year amounted to \$38,157,201. Funding under the amended Compact and Compact 1 represents 24% of the National Government FY07 annual budget. The remaining 76% came from locally generated tax revenues, fishing access fees and related government services fees. The FSM National Government ended fiscal year 2007 with a positive unreserved general fund surplus.

The FSM economy has performed modestly in recent years. The economy continued to depend largely on external assistance, suggesting limited potential for development objectives of budgetary self-reliance and long-term economic advancement. The public sector expenditures continue to account for almost two-thirds of the FSM GDP and are funded largely by external assistance rather than domestic production. In the long term, real potential for economic growth will likely have to originate from the private sector.

In 2007, locally generated revenues provided an estimated \$27.5 million or 76% of the FSM National Government annual budget. The implementation of the Public Law No. 14-90, which allows the taxpayers to deduct amounts paid for social security and salaries and wages for their employees from Business Gross Receipts shows an effect of close to 10% reduction in the FSM National Government revenue share. It is anticipated that FY08 budget will reflect the same level or slightly increased level from FY07 budgetary level due to large amount of carry over in FY07, unless other revenue sources are identified.

In addition to receiving compact grant assistance, the FSM receives substantial program assistance from agencies of the United States Federal Government, Peoples Republic of China, Japan and other foreign governments. Grants and other technical assistance programs are also made available to the FSM from the international and regional organizations. In FY07, assistance received from these sources was estimated at approximately \$20.7 million.

FINANCIAL MANAGEMENT CONTACT –NATIONAL GOVERNMENT

This financial report is designed to provide all interested users with a general overview of the National Government's finances. Inquiries concerning this report, if any, may be directed to the Secretary of the Department of Finance and Administration, P.O. Box PS 158, Palikir, Pohnpei, FM 96941.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Statement of Net Assets
September 30, 2007

	Primary Government	Component Units
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 2,750,309	\$ 9,412,836
Time certificates of deposit	532,777	411,142
Investments	22,184,871	11,075,964
Receivables, net of allowance for uncollectibles	23,510,436	8,541,264
Due from primary government	-	616,042
Advances	978,701	12,501
Prepayments	10,000	1,150,340
Other current assets	-	1,042,946
Total current assets	49,967,094	32,263,035
Noncurrent assets:		
Investments	16,303,140	15,114,906
Loans receivable, net of current portion	23,626,559	19,165,324
Capital assets, net of accumulated depreciation	24,761,802	57,560,798
Deposits	1,149,850	-
Restricted assets - cash and cash equivalents	2,825,554	-
Total noncurrent assets	68,666,905	91,841,028
Total assets	\$ 118,633,999	\$ 124,104,063
<u>LIABILITIES</u>		
Current liabilities:		
Current portion of long-term obligations	\$ 639,001	\$ 4,444,084
Accounts payable	2,378,801	3,811,435
Due to component units	616,042	-
Compensated absences payable	119,457	-
Other liabilities and accruals	1,213,645	1,792,774
Tax refunds payable	493,828	-
Due to FSM State Governments	8,859,495	-
Due to primary government	-	801,169
Deferred revenue	1,222,960	3,076,794
Total current liabilities	15,543,229	13,926,256
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	40,991,837	22,824,013
Compensated absences payable, net of current portion	698,679	-
Total noncurrent liabilities	41,690,516	22,824,013
Total liabilities	57,233,745	36,750,269
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	24,761,802	33,176,111
Restricted for:		
Nonexpendable:		
Future operations	11,040,196	3,103,077
Expendable:		
Compact related	481,692	-
Other purposes	1,574,942	-
Unrestricted	23,541,622	51,074,606
Total net assets	61,400,254	87,353,794
Total liabilities and net assets	\$ 118,633,999	\$ 124,104,063

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Statement of Activities
Year Ended September 30, 2007

Functions/Programs	Expenses	Program Revenues		Net (Expenses) Revenues and Changes in Net Assets		
		Charges for Services	Grants and Contributions	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government
Primary government:						
Governmental activities:						
President's office	\$ 821,600	\$ -	\$ 99,545	\$ -	\$ (722,055)	\$ -
External affairs and LNOs	3,001,782	-	-	-	(3,001,782)	-
Health, education and social affairs	8,316,664	23,287	7,697,164	-	(596,213)	-
Economic affairs	2,638,978	119,233	347,744	-	(2,172,001)	-
Transportation, communication and infrastructure	16,431,610	118,319	776,006	-	(15,537,285)	-
Finance and administration	5,667,056	59,692	2,411,133	-	(3,196,231)	-
Justice	3,566,723	89,475	-	-	(3,477,248)	-
Office of the Public Defender	564,483	-	-	-	(564,483)	-
Judiciary	955,439	-	1,260	-	(954,179)	-
Legislature	3,221,718	-	-	-	(3,221,718)	-
Office of the Public Auditor	806,761	-	156,224	-	(650,537)	-
National government programs	4,878,679	4,600	1,096,129	-	(3,777,950)	-
Other appropriations	3,932,825	-	104,356	-	(3,828,469)	-
Payments to component units	1,248,428	-	414,780	-	(833,648)	-
Boards, commissions and other	1,864,426	817,146	-	-	(1,047,280)	-
Future operations	-	150,443	1,645,839	-	1,796,282	-
Capital projects	37,255	-	-	13,277,306	13,240,051	-
Debt Service	466,552	245,845	-	-	(220,707)	-
Total primary government	\$ 58,420,979	\$ 1,628,040	\$ 14,750,180	\$ 13,277,306	\$ (28,765,453)	-
Component units:						
FSM Telecommunications Corporation	\$ 14,165,471	\$ 12,823,174	\$ -	\$ -	-	(1,342,297)
FSM Development Bank	1,616,993	2,945,661	-	-	-	1,328,668
National Fisheries Corporation	1,255,463	98,415	100,000	-	-	(1,057,048)
College of Micronesia - FSM	18,967,513	17,675,214	-	-	-	(1,292,299)
FSM Coconut Development Authority	312,257	90,430	185,550	-	-	(36,277)
MiCare Plan, Inc.	5,259,806	5,687,809	300,000	-	-	728,003
Total component units	\$ 41,577,503	\$ 39,320,703	\$ 585,550	\$ -	-	(1,671,250)
General revenues:						
Taxes:						
Income					2,398,611	-
Import					4,186,072	-
Gross receipts					3,842,247	-
Fuel					137,348	-
Fishing rights					15,005,147	-
Unrestricted investment earnings					3,115,689	1,958,874
Other					1,311,741	877,428
Special items:						
Write-off of receivable balances					(944,533)	-
Total general revenues and special items					29,052,322	2,836,302
Change in net assets					286,869	1,165,052
Net assets at the beginning of the year					61,113,385	86,188,742
Net assets at the end of the year					\$ 61,400,254	\$ 87,353,794

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

**Balance Sheet
Governmental Funds
September 30, 2007**

	Special Revenue						Permanent	Other Governmental Funds	Total
	General	U.S Federal Grants	Section 111 Investment Development	Early Retirement Program	Asian Development Bank Loan	Compact Sector Grants	Compact Trust		
ASSETS									
Cash and cash equivalents	\$ 1,603,479	\$ 400	\$ -	\$ -	\$ 1,146,430	\$ -	\$ -	\$ -	\$ 2,750,309
Time certificates of deposit	-	-	532,777	-	-	-	-	-	532,777
Equity in internal investment pool	12,466,890	-	4,020,881	-	-	-	-	1,693,690	18,181,461
Investments	1,500,000	-	-	4,003,410	-	-	-	3,762,944	9,266,354
Receivables, net:									
General	273,109	-	279	-	85,381	-	-	-	358,769
Taxes	2,825,300	-	-	-	-	-	-	-	2,825,300
Federal agencies	645,149	3,905,217	-	-	-	-	-	-	4,550,366
Loans	1,500,000	-	7,850,258	-	29,501,285	-	-	103,011	38,954,554
Other governments and agencies	91,222	318,848	-	-	-	-	-	-	410,070
Accrued interest	31,937	-	2,896	-	-	-	-	-	34,833
Other	-	-	-	-	-	-	-	3,103	3,103
Due from other funds	4,930,481	445,978	-	-	-	734,044	-	3,106,569	9,217,072
Advances	978,701	-	-	-	-	-	-	-	978,701
Prepayments	10,000	-	-	-	-	-	-	-	10,000
Deposits and other assets	1,149,850	-	-	-	-	-	-	-	1,149,850
Restricted assets:									
Cash and cash equivalents	2,084,218	-	-	-	741,336	-	-	-	2,825,554
Investments	-	-	-	-	-	-	11,040,196	-	11,040,196
Total assets	<u>\$ 30,090,336</u>	<u>\$ 4,670,443</u>	<u>\$ 12,407,091</u>	<u>\$ 4,003,410</u>	<u>\$ 31,474,432</u>	<u>\$ 734,044</u>	<u>\$ 11,040,196</u>	<u>\$ 8,669,317</u>	<u>\$103,089,269</u>
LIABILITIES AND FUND BALANCES									
Liabilities:									
Accounts payable	\$ 1,634,599	\$ 384,165	\$ 87,951	\$ -	\$ 2,642	\$ 214,612	\$ -	\$ 54,832	\$ 2,378,801
Due to component units	546,748	69,294	-	-	-	-	-	-	616,042
Other liabilities and accruals	1,213,645	-	-	-	-	-	-	-	1,213,645
Tax refunds payable	493,828	-	-	-	-	-	-	-	493,828
Due to FSM State Governments	4,527,014	4,242,749	-	-	80,277	-	-	9,455	8,859,495
Due to other funds	4,286,591	-	-	4,142,955	227,453	37,740	-	522,333	9,217,072
Deferred revenue	-	-	-	-	2,184	-	-	1,220,776	1,222,960
Total liabilities	<u>12,702,425</u>	<u>4,696,208</u>	<u>87,951</u>	<u>4,142,955</u>	<u>312,556</u>	<u>252,352</u>	<u>-</u>	<u>1,807,396</u>	<u>24,001,843</u>
Fund balances (deficits):									
Reserved for:									
Related assets	5,173,547	-	7,850,258	4,003,410	31,389,051	-	11,040,196	3,865,955	63,322,417
Encumbrances	2,973,381	6,060,628	-	-	29,290	6,728,697	-	448,016	16,240,012
Continuing appropriations	3,116,737	-	-	-	20,000	44,950,760	-	1,003,362	49,090,859
Compact programs	-	-	4,468,882	-	-	-	-	-	4,468,882
Unreserved:									
General fund	6,124,246	-	-	-	-	-	-	-	6,124,246
Capital projects	-	-	-	-	-	-	-	(1,565,768)	(1,565,768)
Special revenue funds	-	(6,086,393)	-	(4,142,955)	(276,465)	(51,197,765)	-	3,110,356	(58,593,222)
Total fund balances (deficit)	<u>17,387,911</u>	<u>(25,765)</u>	<u>12,319,140</u>	<u>(139,545)</u>	<u>31,161,876</u>	<u>481,692</u>	<u>11,040,196</u>	<u>6,861,921</u>	<u>79,087,426</u>
Total liabilities and fund balances	<u>\$ 30,090,336</u>	<u>\$ 4,670,443</u>	<u>\$ 12,407,091</u>	<u>\$ 4,003,410</u>	<u>\$ 31,474,432</u>	<u>\$ 734,044</u>	<u>\$ 11,040,196</u>	<u>\$ 8,669,317</u>	
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									
24,761,802									
Long-term liabilities, including loans payable, are not due and payable in the current period and, therefore, are not reported in the funds. The liabilities include:									
Loans payable (41,630,838)									
Compensated absences payable (818,136)									
<u>(17,687,172)</u>									
Net assets of governmental activities <u>\$ 61,400,254</u>									

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficits)
Governmental Funds
Year Ended September 30, 2007

	Special Revenue					Permanent	Other Governmental Funds	Total	
	General	U.S Federal Grants	Section 111 Investment Development	Early Retirement Program	Asian Development Bank Loan	Compact Sector Grants			Compact Trust
Revenues:									
Compact funding	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 10,208,827	\$ -	\$ -	\$ 10,208,827
Taxes	10,367,609	-	-	-	-	-	-	-	10,367,609
Federal and other grants	-	15,333,263	-	-	-	-	-	496,319	15,829,582
Fishing rights	15,005,147	-	-	-	-	-	-	-	15,005,147
Interest and dividends	462,695	-	99,040	-	14,508	-	-	-	576,243
Fees and charges	595,882	-	-	-	-	-	-	1,174,326	1,770,208
Net increase in the fair value of investments	2,459,304	-	244,198	-	-	-	1,645,839	202,346	4,551,687
Other	1,110,441	-	1,300	-	231,337	-	-	-	1,343,078
Total revenues	30,001,078	15,333,263	344,538	-	245,845	10,208,827	1,645,839	1,872,991	59,652,381
Expenditures:									
Current:									
General government:									
President's office	721,443	99,545	-	-	-	-	-	-	820,988
External affairs and LNOs	2,958,372	-	-	-	-	-	-	-	2,958,372
Health, education and social affairs	247,949	5,334,748	-	-	-	1,920,796	-	605,927	8,109,420
Economic affairs	1,038,358	40,422	1,226,571	-	19,777	198,169	-	117,590	2,640,887
Transportation, communication and infrastructure	670,924	6,614,170	-	-	-	7,403,160	-	892,588	15,580,842
Finance and administration	2,575,878	2,108,458	-	-	975,872	302,675	-	-	5,962,883
Justice	3,165,860	-	-	-	-	-	-	-	3,165,860
Office of the Public Defender	554,836	-	-	-	-	-	-	-	554,836
Judiciary	978,198	-	-	-	-	1,260	-	-	979,458
Legislature	3,154,468	-	-	-	-	-	-	-	3,154,468
Office of the Public Auditor	669,013	39,791	-	-	-	116,433	-	-	825,237
National government programs	3,828,528	1,096,129	-	-	-	-	-	-	4,924,657
Other appropriations	3,871,555	-	-	-	-	-	-	-	3,871,555
Payments to component units	833,648	-	250,000	-	-	164,780	-	-	1,248,428
Boards, commissions and other	1,354,787	-	-	-	6,788	-	-	466,059	1,827,634
Capital projects	-	-	-	-	-	-	-	37,255	37,255
Debt Service:									
Principal and Interest payments	-	-	-	-	466,552	-	-	-	466,552
Total expenditures	26,623,817	15,333,263	1,476,571	-	1,468,989	10,107,273	-	2,119,419	57,129,332
Excess (deficiency) of revenues over (under) expenditures	3,377,261	-	(1,132,033)	-	(1,223,144)	101,554	1,645,839	(246,428)	2,523,049
Other financing sources (uses):									
Loan proceeds	-	-	-	-	3,515,976	-	-	-	3,515,976
Operating transfers in	1,204,672	-	-	-	-	-	-	2,614,729	3,819,401
Operating transfers out	(2,614,729)	-	-	-	-	-	-	(1,204,672)	(3,819,401)
Total other financing sources (uses), net	(1,410,057)	-	-	-	3,515,976	-	-	1,410,057	3,515,976
Special items:									
Write-off of receivable balances	944,533	-	-	-	-	-	-	-	944,533
Net change in fund balances (deficits)	1,022,671	-	(1,132,033)	-	2,292,832	101,554	1,645,839	1,163,629	5,094,492
Fund balances (deficit) at the beginning of the year	16,365,240	(25,765)	13,451,173	(139,545)	28,869,044	380,138	9,394,357	5,698,292	73,992,934
Fund balances (deficit) at the end of the year	\$ 17,387,911	\$ (25,765)	\$ 12,319,140	\$ (139,545)	\$ 31,161,876	\$ 481,692	\$ 11,040,196	\$ 6,861,921	\$ 79,087,426

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Reconciliation of the Statement of Revenues, Expenditure, and Changes in Fund
Balances of Governmental Funds to the Statement of Activities
Year Ended September 30, 2007

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

Net change in fund balances - total governmental funds from page 14	\$ 5,094,492
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, including increases to construction in progress	(1,515,266)
The issuance of long-term debt (e.g. bonds, leases) provides current financial resources to governmental funds, while the repayment of principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction has any effect on net assets. This amount is the net effect of these differences in the treatment of long - term debt and related items	(3,231,087)
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>(61,270)</u>
Change in net assets of governmental activities as presented on page 12.	\$ <u>286,869</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Combining Statement of Fiduciary Net Assets
Fiduciary Funds - Private Purpose Trusts
September 30, 2007

	FSM Social Security Administration	Pohnpei State Development Loan Fund	Yap State Development Loan Fund	Total
<u>ASSETS</u>				
Cash and cash equivalents	\$ 4,328,461	\$ 226,858	\$ 70,628	\$ 4,625,947
Time certificates of deposit	-	540,013	136,286	676,299
Receivables, net:				
Contributions	3,284,107	-	-	3,284,107
Accrued interest	151,056	9,988	377	161,421
Loans	-	67,002	122,555	189,557
Other	33,457	-	-	33,457
Investments	39,618,679	-	-	39,618,679
Capital assets, net of accumulated depreciation	85,352	-	-	85,352
Total assets	<u>47,501,112</u>	<u>843,861</u>	<u>329,846</u>	<u>48,674,819</u>
<u>LIABILITIES</u>				
Accounts payable	144,915			144,915
Other liabilities and accruals	24,699	-	2,074	26,773
Due to component units	14,282	123,946	94,111	232,339
Total liabilities	<u>183,896</u>	<u>123,946</u>	<u>96,185</u>	<u>404,027</u>
<u>NET ASSETS</u>				
Held in trust for:				
Social security benefits	47,317,216	-	-	47,317,216
Other purposes	-	719,915	233,661	953,576
Total net assets	<u>\$ 47,317,216</u>	<u>\$ 719,915</u>	<u>\$ 233,661</u>	<u>\$ 48,270,792</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Combining Statement of Changes in Fiduciary Net Assets
Fiduciary Funds - Private Purpose Trusts
Year Ended September 30, 2007

	<u>FSM Social Security Administration</u>	<u>Pohnpei State Development Loan Fund</u>	<u>Yap State Development Loan Fund</u>	<u>Total</u>
Additions:				
Contributions	\$ 12,783,551	\$ -	\$ -	\$ 12,783,551
	<u>12,783,551</u>	<u>-</u>	<u>-</u>	<u>12,783,551</u>
Investment earnings:				
Net increase in the fair value of investments	2,927,650	26,134	4,829	2,958,613
Interest and dividends	1,060,147	6,569	19,487	1,086,203
	<u>3,987,797</u>	<u>32,703</u>	<u>24,316</u>	<u>4,044,816</u>
Total investment earnings	3,987,797	32,703	24,316	4,044,816
Less investment expense	262,632	-	-	262,632
	<u>3,725,165</u>	<u>32,703</u>	<u>24,316</u>	<u>3,782,184</u>
Net investment earnings	3,725,165	32,703	24,316	3,782,184
Other	436,813	130	279	437,222
	<u>16,945,529</u>	<u>32,833</u>	<u>24,595</u>	<u>17,002,957</u>
Total additions	16,945,529	32,833	24,595	17,002,957
Deductions:				
Benefits	13,977,875	-	-	13,977,875
Refunds	20,088	-	-	20,088
Administrative expenses	1,037,987	32,833	12,297	1,083,117
	<u>15,035,950</u>	<u>32,833</u>	<u>12,297</u>	<u>15,081,080</u>
Total deductions	15,035,950	32,833	12,297	15,081,080
Change in net assets	1,909,579	-	12,298	1,921,877
Net assets at the beginning of the year	45,407,637	719,915	221,363	46,348,915
Net assets at the end of the year	<u>\$ 47,317,216</u>	<u>\$ 719,915</u>	<u>\$ 233,661</u>	<u>\$ 48,270,792</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Combining Statement of Net Assets
Component Units
September 30, 2007

	FSM Tele- Communications Corporation	FSM Development Bank	National Fisheries Corporation	College of Micronesia- FSM	FSM Coconut Development Authority	MiCare Plan, Inc.	Total
ASSETS							
Current assets:							
Cash and cash equivalents	\$ 1,260,460	\$ 1,890,029	\$ 24,674	\$ 6,053,088	\$ 73,804	\$ 110,781	\$ 9,412,836
Time certificates of deposit	111,142	300,000	-	-	-	-	411,142
Investments	10,197,514	-	-	-	-	878,450	11,075,964
Receivables, net:							
General	876,156	2,638	23,506	3,448,834	1,869	232,412	4,585,415
Loans	-	1,770,062	-	-	-	-	1,770,062
Interest	184,602	128,529	-	-	-	-	313,131
Other	465,586	306,008	-	1,059,993	-	41,069	1,872,656
Due from primary government	100,795	-	-	478,767	-	36,480	616,042
Advances	10,184	-	2,317	-	-	-	12,501
Inventories	642,886	-	80,944	406,204	20,306	-	1,150,340
Prepaid expenses	775,147	2,500	-	42,559	1,254	221,486	1,042,946
Total current assets	14,624,472	4,399,766	131,441	11,489,445	97,233	1,520,678	32,263,035
Noncurrent assets:							
Capital assets, net of accumulated depreciation	45,123,969	259,071	111,704	11,767,373	264,328	34,353	57,560,798
Investments	-	12,011,829	-	3,103,077	-	-	15,114,906
Loans receivable	-	19,165,324	-	-	-	-	19,165,324
Total noncurrent assets	45,123,969	31,436,224	111,704	14,870,450	264,328	34,353	91,841,028
Total assets	\$ 59,748,441	\$ 35,835,990	\$ 243,145	\$ 26,359,895	\$ 361,561	\$ 1,555,031	\$ 124,104,063
LIABILITIES							
Current liabilities:							
Current portion of long-term debt	\$ 844,084	\$ -	\$ 3,600,000	\$ -	\$ -	\$ -	\$ 4,444,084
Accounts payable	933,124	138,111	215,651	184,197	2,810	2,337,542	3,811,435
Other liabilities and accruals	-	8,546	48,324	1,734,637	1,267	-	1,792,774
Due to primary government	801,169	-	-	-	-	-	801,169
Deferred revenue	196,243	-	-	2,880,551	-	-	3,076,794
Total current liabilities	2,774,620	146,657	3,863,975	4,799,385	4,077	2,337,542	13,926,256
Noncurrent liabilities:							
Noncurrent portion of long-term debt	22,824,013	-	-	-	-	-	22,824,013
Total noncurrent liabilities	22,824,013	-	-	-	-	-	22,824,013
Total liabilities	25,598,633	146,657	3,863,975	4,799,385	4,077	2,337,542	36,750,269
NET ASSETS							
Invested in capital assets, net of related debt	21,455,872	259,071	(604,886)	11,767,373	264,328	34,353	33,176,111
Restricted for:							
Nonexpendable	-	-	-	3,103,077	-	-	3,103,077
Unrestricted	12,693,936	35,430,262	(3,015,944)	6,690,060	93,156	(816,864)	51,074,606
Total net assets	34,149,808	35,689,333	(3,620,830)	21,560,510	357,484	(782,511)	87,353,794
Total liabilities and net assets	\$ 59,748,441	\$ 35,835,990	\$ 243,145	\$ 26,359,895	\$ 361,561	\$ 1,555,031	\$ 124,104,063

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Combining Statement of Revenues, Expenses, and Changes in Net Assets
Component Units
Year Ended September 30, 2007

	FSM Tele- Communications Corporation	FSM Development Bank	National Fisheries Corporation	College of Micronesia- FSM	FSM Coconut Development Authority	MiCare Plan, Inc.	Total
Operating revenues:							
Charges for services	\$ 12,536,582	\$ 2,870,959	\$ 98,415	\$ 16,534,507	\$ 90,430	\$ 5,676,543	\$ 37,807,436
Other	286,592	74,702	-	1,140,707	-	11,266	1,513,267
Total operating revenues	<u>12,823,174</u>	<u>2,945,661</u>	<u>98,415</u>	<u>17,675,214</u>	<u>90,430</u>	<u>5,687,809</u>	<u>39,320,703</u>
Operating expenses:							
Cost of services	428,683	934,649	15,315	15,869,452	123,538	5,130,946	22,502,583
Depreciation and amortization	3,294,765	78,141	181,239	1,137,699	17,434	11,374	4,720,652
Administrative costs	9,307,235	604,203	215,392	1,960,362	171,285	117,486	12,375,963
Total operating expenses	<u>13,030,683</u>	<u>1,616,993</u>	<u>411,946</u>	<u>18,967,513</u>	<u>312,257</u>	<u>5,259,806</u>	<u>39,599,198</u>
Operating income (loss)	<u>(207,509)</u>	<u>1,328,668</u>	<u>(313,531)</u>	<u>(1,292,299)</u>	<u>(221,827)</u>	<u>428,003</u>	<u>(278,495)</u>
Nonoperating revenues (expenses):							
Net increase in the fair value of investments	1,484,615	-	-	368,067	-	43,790	1,896,472
Interest income	62,402	-	-	-	-	-	62,402
Interest expense	(1,134,788)	-	-	-	-	-	(1,134,788)
Other expense	-	-	(843,517)	-	-	-	(843,517)
Contributions from primary government	-	-	100,000	-	185,550	300,000	585,550
Other income	-	368,055	498,010	-	11,363	-	877,428
Total nonoperating revenues (expenses), net	<u>412,229</u>	<u>368,055</u>	<u>(245,507)</u>	<u>368,067</u>	<u>196,913</u>	<u>343,790</u>	<u>1,443,547</u>
Net income (loss)	<u>204,720</u>	<u>1,696,723</u>	<u>(559,038)</u>	<u>(924,232)</u>	<u>(24,914)</u>	<u>771,793</u>	<u>1,165,052</u>
Net assets at the beginning of the year	<u>33,945,088</u>	<u>33,992,610</u>	<u>(3,061,792)</u>	<u>22,484,742</u>	<u>382,398</u>	<u>(1,554,304)</u>	<u>86,188,742</u>
Net assets at the end of the year	<u>\$ 34,149,808</u>	<u>\$ 35,689,333</u>	<u>\$ (3,620,830)</u>	<u>\$ 21,560,510</u>	<u>\$ 357,484</u>	<u>\$ (782,511)</u>	<u>\$ 87,353,794</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies

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

A. Reporting Entity

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

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

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

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

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

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

Blended Component Units

The following component units are blended within the primary government:

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

Discretely Presented Component Units

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

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

FSM Development Bank (FSMDB): FSMDB was established under FSM Public Law No. 8-47 to advance the economic development of the FSM through the provision of economic development loans. FSMDB is governed by a seven-member Board of Directors appointed by election at the annual shareholders meeting by the plurality of votes thereof. As of December 31, 2007, FSMDB has issued 2,997,883 shares to the FSM National Government (98.7%), the State of Chuuk (1%), and the State of Kosrae (0.3%).

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

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

Discretely Presented Component Units, Continued

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

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

MiCare Plan, Inc. (the Plan): The Plan was established under FSM Public Law No. 12-77 to provide, arrange for, pay for, or reimburse the costs of medical, dental and vision treatment and care, hospitalization, surgery, prescription drugs, medicine, prosthetic appliances, out-patient care, and other medical care benefits. The Plan is governed by a seven-member Board of Directors appointed by the President with the advice and consent of the Congress. The Plan superseded the Employees' Health Insurance Fund, effective October 1, 2004. The Employees' Health Insurance Fund was previously accounted for as a governmental fund type - special revenue fund of the FSM National Government.

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

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

B. Government-Wide Financial Statements

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

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

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

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

- Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets.
- Restricted net assets - 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 FSM National Government 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 \$13,096,830 of restricted net assets, of which \$1,574,942 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.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

C. Fund Financial Statements

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

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

D. Measurement Focus and Basis of Accounting

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

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

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

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

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.

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

The FSM National Government reports the following fund types:

1. Governmental Fund Types

i. General Fund

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

ii. Special Revenue Funds

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

iii. Capital Projects Funds

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

iv. Permanent Funds

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

2. Fiduciary Fund Types

i. Private Purpose Trust Funds

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

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

2. Fiduciary Fund Types, Continued

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

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments: 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 FSM National Government reports the following major funds:

U.S. Federal Grants Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for all financial transactions related to federal assistance funds received from the United States government by the FSM National Government.

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

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

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

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

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

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

E. Reporting Standards

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

F. Cash and Cash Equivalents and Time Certificates of Deposit

Cash and cash equivalents include cash held in demand accounts as well as short-term investments with a maturity date within three months of the date acquired by the FSM National Government. Deposits maintained in time certificates of deposit with original maturity dates greater than ninety days are separately classified on the statement of net assets/balance sheet.

G. Investments

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

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

H. Receivables

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

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.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

J. Interfund Receivables/Payables

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

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

K. Restricted Assets

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through loan agreements or enabling legislation. Specifically, the FSM National Government has cash and cash equivalents recorded in the General Fund of \$3,165,342 and investments recorded in the Compact Trust Fund of \$11,040,196, which are restricted in that they are not available to be used in current operations. The Asian Development Bank has \$741,636 if loan proceeds maintained in an imprest revolving fund that are not available to be used in current operations.

L. Capital Assets

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

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

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

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

M. Interfund/Intrafund Transactions

As a general rule, the effect of interfund activity has been eliminated in the government-wide financial 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. Deferred Revenue

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

O. Compensated Absences

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

P. Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. 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, 2007, is represented by the following assets:

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

P. Fund Equity, Continued

	U.S. Federal Grants	Section 111 Investment Development	Early Retirement Program	Asian Development Bank Loan	Compact Sector Grants	Compact Trust	Other Government Funds	Total
Cash and cash equivalents	\$ 75,965	\$ -	\$ -	\$ 1,146,430	\$ -	\$ -	\$ -	\$ 1,222,395
Investments	1,500,000	-	4,003,410	-	-	-	3,762,944	9,266,354
Receivables:								
General	142,635	-	-	-	-	-	-	142,635
Loans	1,500,000	7,850,258	-	29,501,285	-	-	103,011	38,954,554
Federal agencies	645,149	-	-	-	-	-	-	645,149
Other governments	91,222	-	-	-	-	-	-	91,222
Deposits and others	1,149,850	-	-	-	-	-	-	1,149,850
Restricted cash	68,726	-	-	741,336	-	-	-	810,062
Investments	-	-	-	-	-	11,040,196	-	11,040,196
	<u>\$ 5,173,547</u>	<u>\$ -</u>	<u>\$ 7,850,258</u>	<u>\$ 4,003,410</u>	<u>\$ 31,389,051</u>	<u>\$ 11,040,196</u>	<u>\$ 3,865,955</u>	<u>\$ 63,322,417</u>

Q. New Accounting Standards

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, 2006. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM National Government.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment 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, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM National Government.

In 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 FSM National Government.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

Q. New Accounting Standards, Continued

In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. 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 FSM National Government.

In May 2007, GASB issued Statement No. 50, *Pension Disclosures an amendment of GASB Statements No. 25 and 27*. GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other post-employment benefits. The provisions of this statement are effective for periods beginning after June 15, 2007. Management does not believe the implementation of this statement will have a material effect on the financial statements of the FSM National Government.

In June 2007, GASB issued statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM National Government.

R. Risk Financing

The FSM National Government is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. It is the policy of the primary government not to purchase commercial insurance for the risks of loss to which it is exposed. Instead, the FSM National Government management believes it is more economical to manage its risks internally. In the event of claim settlements and judgments, the FSM National Government reports all of its risk management activities in its General Fund. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. No losses have occurred as a result of these risks in any of the past three fiscal years.

S. Estimates

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

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

T. Total Columns

Total columns are presented primarily to facilitate financial analysis. The Management's Discussion and Analysis includes certain prior year summarized comparative information in total. Such information does not include sufficient detail to constitute a full comparative presentation. Accordingly, such information should be read in conjunction with FSM National Government's financial statements for the year ended September 30, 2006 from which summarized information was derived.

(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 FSM National Government pools cash resources of its various funds in order to facilitate the management of cash. Unless otherwise required by law, interest income received on pooled cash accrues to the General Fund. Cash and cash equivalents applicable to a particular fund are readily identifiable. The FSM National Government 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 (FDA), an entity comprised of the FSM National Government and its four component states. Investment income originating from the pool accrues to the General Fund.

The deposit and investment policies of the FSM National Government are governed by legislation enacted by the Congress. The Secretary of Finance 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. Furthermore, the Secretary of Finance is responsible for the investment of any monies of the FSM National Government 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 & Poor 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%.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

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

The equity portfolio shall be diversified among issues and industry classifications. No more than 25% of the equity portfolio may be invested in any single classification, as described by the Standard and Poor 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 FSM National Government or its agent in the FSM National Government'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 FSM National Government'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 FSM National Government's name and non-collateralized deposits.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the FSM National Government'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 FSM National Government does not have a deposit policy for custodial credit risk.

As of September 30, 2007, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit was \$6,108,640 and the corresponding bank balances were \$7,039,940. Of the bank balance amounts, \$3,359,580 is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance while \$3,209,819 represents short-term investments held and administered by FSM National Government's trustees in accordance with various trust agreements and bond indentures. Based on negotiated trust and custody contracts, all of these investments were held in FSM National Government's name by FSM National Government's custodial financial institutions at September 30, 2007 while the remaining amount of \$470,621 is maintained in financial institution not subject to FDIC insurance.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

A. Deposits, Continued

As of September 30, 2007, bank deposits in the amount of \$503,048 were FDIC insured. The FSM National Government does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

As of September 30, 2007, the carrying amount of the fiduciary funds' total cash and cash equivalents and time certificates of deposit was \$5,302,246 and the corresponding bank balances were \$5,510,441. Of the bank balance amounts, \$1,772,942 is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2007, bank deposits in the amount of \$329,272 were FDIC insured. The fiduciary funds do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

As of September 30, 2007, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit was \$9,823,978 and the corresponding bank balances were \$10,486,781, which are maintained in financial institutions subject to FDIC insurance. As of September 30, 2007, bank deposits in the amount of \$906,294 were FDIC insured. The component units do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. 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 FSM National Government or its agent in the FSM National Government'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 FSM National Government'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 FSM National Government'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.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government

As of September 30, 2007, investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ <u>7,787,923</u>
Other investments:	
Domestic equities	22,329,556
Money market funds	864,684
Cash management accounts	<u>2,242,904</u>
	<u>25,437,144</u>
	\$ <u>33,225,067</u>

Additionally, the primary government owns 50,000 shares of the common stock of a commercial enterprise located in the Commonwealth of the Northern Marianas. The investment of \$1,500,000 is accounted for at cost since the investment constitutes less than a 20% ownership share. Furthermore, the primary government owns 298,745 shares of the common stock of the Bank of the Federated States of Micronesia, which engages in commercial banking services in the FSM. The investment of \$3,762,944 is accounted for on the equity method since the investment constitutes a 32% ownership share.

A summary of audited financial information as of and for the twelve months ended December 31, 2007, for investees accounted for using the equity method of accounting for investments, is as follows:

Assets	\$ <u>77,289,998</u>
Liabilities	\$ <u>62,468,529</u>
Net earnings	\$ <u>1,230,366</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

As of September 30, 2007, the primary government'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	\$ 152,171	\$ 601,376	\$ 450,823	\$ 200,622	\$ 1,404,992
U.S. government agency obligations	Aaa	3,342,269	382,079	13,708	1,305,259	5,043,315
Corporate notes and bonds	A1	15,165	129,708	91,481	26,567	262,921
Corporate notes and bonds	A2	19,734	117,600	5,798	3,589	146,721
Corporate notes and bonds	A3	-	-	4,497	2,705	7,202
Corporate notes and bonds	Aa1	-	45,356	45,204	12,606	103,166
Corporate notes and bonds	Aa2	20,066	9,121	11,032	10,860	51,079
Corporate notes and bonds	Aa3	45,817	96,029	66,366	13,792	222,004
Corporate notes and bonds	Aaa	-	40,703	-	225,147	265,850
Corporate notes and bonds	AB	185	-	-	-	185
Corporate notes and bonds	Baa1	-	-	105,304	7,693	112,997
Corporate notes and bonds	Baa2	-	5,677	11,165	-	16,842
Corporate notes and bonds	Baa3	-	23,616	-	35,257	58,873
Corporate notes and bonds	Not rated	<u>37,123</u>	<u>20,252</u>	<u>11,025</u>	<u>23,376</u>	<u>91,776</u>
		<u>\$ 3,632,530</u>	<u>\$ 1,471,517</u>	<u>\$ 816,403</u>	<u>\$ 1,867,473</u>	<u>\$ 7,787,923</u>

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. With the exception of investments in U.S. government securities, which are explicitly or implicitly guaranteed by the United States government, all other investments must be rated in accordance with the FSM National Government'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 FSM National Government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The FSM National Government's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the FSM National Government's name by the FSM National Government's custodial financial institutions at September 30, 2007.

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, 2007, the FSM National Government did not hold an investment in any one issuer that represented more than 5% of the FSM National Government's total investments.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. The FSM National Government 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.

Fiduciary Funds

The deposit and investment policies of the FSM Social Security Administration (FSMSSA) are governed by FSMSSA enabling legislation. The FSMSSA Board is required to engage one or more fund custodians to assume responsibility for the physical possession of their investments. Legally authorized investments are as follows:

- i. Government obligations - Obligations issued or guaranteed as to principal and interest by the FSM National Government and/or State governments of the Federated States of Micronesia or by the Government of the United States, provided that the principal and interest on each obligation are payable in the currency of the United States.
- ii. Corporate obligations and mortgage-backed securities - Obligations of any public or private entity or corporation created or existing under the laws of the Federated States of Micronesia or of the United States or any state, territory or commonwealth thereof, or obligations of any other government or economic community which are payable in United States dollars, or pass through and other mortgage-backed securities provided that the obligation is issued by an agency of the United States Government, the FSM National Government, or is rated in one of the three highest categories by two nationally recognized rating agencies. No investment under this heading shall exceed ten percent of the market value of the Fund or ten percent of the outstanding value of the issue at the time of purchase.
- iii. Preferred and common stocks - Shares of preferred or common stocks of any corporation created or existing under the laws of the Federated States of Micronesia or under the laws of the United States or any state, territory or commonwealth thereof provided that the purchase of such shares shall be considered reasonable and prudent by the respective investment advisors at the time of purchase, that not more than five percent of the market value of the Fund shall be invested in the stock of any one corporation, and that not more than ten percent of the market value of the Fund shall be invested in any one industry group.
- iv. Insurance company obligations - Contracts and agreements supplemental thereto providing for participation in one or more accounts of a life insurance company authorized to do business in the Federated States of Micronesia or in any state, territory or commonwealth of the United States provided that the total market value of these investments at no time shall exceed ten percent of all investments of the Fund.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

B. Investments, Continued

Fiduciary Funds, Continued

As of December 31, 2007, investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ 13,612,005
International fixed income	<u>444,826</u>
	14,056,831
Other investments:	
Domestic equities	<u>25,561,848</u>
	<u>\$ 39,618,679</u>

As of December 31, 2007, FSMSSA's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

	<u>Investment Maturities (In Years)</u>				Fair Value
	Less <u>Than 1</u>	<u>1 to 5</u>	<u>6 to 10</u>	Greater <u>Than 10</u>	
U.S. Treasury obligations	\$ -	\$ 3,028,492	\$ 1,105,481	\$ 1,017,075	\$ 5,151,048
Mortgage and asset-backed securities	-	-	-	4,494,154	4,494,154
U.S. Government agencies	307,191	880,053	510,261	95,074	1,792,579
Corporate notes	-	1,151,837	919,374	523,761	2,594,972
Municipal bonds	-	-	-	<u>24,078</u>	<u>24,078</u>
	<u>\$ 307,191</u>	<u>\$ 5,060,382</u>	<u>\$ 2,535,116</u>	<u>\$ 6,154,142</u>	<u>\$ 14,056,831</u>

The FSMSSA's exposure to credit risk at December 31, 2007, are as follows:

<u>Standard and Poors' Rating</u>	<u>Total</u>	<u>Domestic</u>	<u>International</u>
AAA	\$ 11,607,610	\$ 11,487,870	\$ 119,740
AA	376,437	376,437	-
AA-	450,331	372,092	78,239
A+	480,380	440,774	39,606
A	580,173	459,220	120,952
A-	401,312	315,022	86,289
BBB+	<u>160,590</u>	<u>160,590</u>	-
	<u>\$ 14,056,831</u>	<u>\$ 13,612,005</u>	<u>\$ 444,826</u>

FSMSSA's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in FSMSSA's name by FSMSSA's custodial financial institutions at December 31, 2007.

As of December 31, 2007, FSMSSA did not hold an investment in any one issuer that represented more than 5% of FSMSSA's total investments.

FSMSSA 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.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units

The deposit and investment policies of the discretely presented component units' generally follow those of the primary government.

As of September 30, 2007, the combined investments of FSMTC and MiCare, at fair value are as follows:

Fixed income securities:		
Domestic fixed income	\$	1,876,787
Corporate bonds		<u>2,041,006</u>
		<u>3,917,793</u>
Other investments:		
Domestic and foreign equities		6,602,283
Money market funds		<u>555,888</u>
		<u>7,158,171</u>
	\$	<u>11,075,964</u>

As of September 30, 2007, the discretely presented component units' fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

	Moody's Credit Rating	Less Than 1	Investment Maturities (In Years)			Greater Than 10	Fair Value
			1 to 5	6 to 10			
U.S. Treasury obligations	Aaa/P-1	\$ 234,981	\$ 694,185	\$ 547,938	\$ -	\$ 1,477,104	
U.S. Government agencies	Aaa/P-1	205,075	298,644	356,414	-	860,133	
Corporate notes and bonds	A1/P-1	-	290,186	-	-	290,186	
Corporate notes and bonds	A2/P-1	-	175,092	-	-	175,092	
Corporate notes and bonds	A3/P-2	101,037	-	-	-	101,037	
Corporate notes and bonds	Aaa/P-1	-	110,025	-	-	110,025	
Corporate notes and bonds	Aa1/P-1	-	256,129	-	-	256,129	
Corporate notes and bonds	Aa2/P-1	-	84,827	-	-	84,827	
Corporate notes and bonds	Aa3/P-1	-	518,559	-	-	518,559	
Corporate notes and bonds	Baa1	-	29,693	-	-	29,693	
Corporate notes and bonds	Baa2	-	-	15,008	-	15,008	
		\$ <u>541,093</u>	\$ <u>2,457,340</u>	\$ <u>919,360</u>	\$ <u>-</u>	\$ <u>3,917,793</u>	

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

The FSM Development Bank's investments at fair value as of December 31, 2007, are as follows:

Fixed income securities:		
Domestic fixed income	\$	2,859,371
Other investments:		
Domestic equities		5,347,165
Money market funds		<u>3,143,105</u>
	\$	<u>11,349,641</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units, Continued

As of December 31, 2007, the Bank's fixed income securities had the following maturities:

	Less Than 1 Year	1 to 5 Years	6 to 10 Years	Greater than 10 Years	Fair Value
U.S. Treasury obligations	\$ 69,976	\$ 904,910	\$ 398,561	\$ -	\$ 1,373,447
U.S. Government agency obligations	<u>351,582</u>	<u>931,443</u>	<u>202,899</u>	-	<u>1,485,924</u>
	<u>\$ 421,558</u>	<u>\$ 1,836,353</u>	<u>\$ 601,460</u>	<u>\$ -</u>	<u>\$ 2,859,371</u>

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

The Bank's exposure to credit risk at December 31, 2007, was as follows:

	Total	Domestic	International
Moody's Rating – AAA	\$ <u>2,859,371</u>	\$ <u>2,859,371</u>	\$ -
Total credit risk debt securities	\$ <u>2,859,371</u>	\$ <u>2,859,371</u>	\$ -

The College of Micronesia – FSM's investments at fair value as of September 30, 2007, are as follows:

Fixed income securities:	
Domestic fixed income	\$ 775,515
International fixed income	<u>33,545</u>
	<u>809,060</u>
Other investments:	
Common equities	2,236,039
Money market funds	<u>57,978</u>
	<u>2,294,017</u>
	<u>\$ 3,103,077</u>

As of September 30, 2007, the College's fixed income securities had the following maturities:

Investment Type	Fair Value	Investment Maturities (in years)			
		Less than 1	1-5	5-10	more than 10
International bond	\$ 33,545	\$ -	\$ 9,068	\$ -	\$ 24,477
Corporate bond	217,034	-	9,260	109,335	98,439
Government bond	<u>558,481</u>	<u>-</u>	<u>463,791</u>	<u>73,981</u>	<u>20,709</u>
	<u>\$ 809,060</u>	<u>\$ -</u>	<u>\$ 482,119</u>	<u>\$ 183,316</u>	<u>\$ 143,625</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units, Continued

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

The College's exposure to credit risk at September 30, 2007, was as follows:

<u>Moody's Rating</u>	<u>Total</u>	<u>Domestic</u>	<u>International</u>
AAA/AAA	\$ 587,498	\$ 587,498	\$ -
AA2/A-	6,401	6,401	-
AA2/AA	9,290	9,290	-
AA3/A+	7,330	7,330	-
AA3/A-	9,260	9,260	-
AA3/AA-	15,647	15,647	-
A1/A+	9,137	9,137	-
A1/AA-	18,105	8,801	9,304
A2/A	17,094	17,094	-
A2/A+	9,304	9,304	-
A3/A-	8,832	8,832	-
BAA1/A-	27,035	9,181	17,854
BAA1/BBB +	23,903	17,516	6,387
BAA2/BBB	15,645	15,645	-
BAA2/BBB-	9,023	9,023	-
BAA2/BBB+	17,934	17,934	-
BAA3/BBB	8,740	8,740	-
BAA3/BBB-	<u>8,882</u>	<u>8,882</u>	<u>-</u>
Total credit risk debt securities	\$ <u>809,060</u>	\$ <u>775,515</u>	\$ <u>33,545</u>

The National Fisheries Corporation (NFC) owns 50,493 shares of the common stock of the Micronesia Longline Fishing Company, Inc., an unconsolidated entity, representing a 97% ownership share. Additionally, NFC owns 50% of the shares of the common stock of the following unconsolidated entities: Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc. These investments have been written down to a nil value except for NFC's investment in Chuuk Fresh Tuna, Inc. of \$486,855.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(3) Receivables

Receivables as of September 30, 2007, for the primary government's individual major governmental funds, and nonmajor governmental and fiduciary funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	General	U.S. Federal Grants	Section 111 Investment Development	Early Retirement Program	Asian Development Bank Loan	Compact Sector Grant	Compact Trust	Nonmajor And Other Funds	Totals
Receivables:									
General	\$ 1,400,464	\$ -	\$ 279	\$ -	\$ 85,381	\$ -	\$ -	\$ -	\$ 1,486,124
Taxes	2,825,300	-	-	-	-	-	-	-	2,825,300
Federal agencies	870,672	3,905,217	-	-	-	-	-	726,754	5,502,643
Contributions	-	-	-	-	-	-	-	3,284,107	3,284,107
Loans	6,661,987	-	7,850,258	-	31,948,049	-	-	1,899,521	48,359,815
Other governments and agencies	666,597	318,848	-	-	-	-	-	-	985,445
Accrued interest	31,937	-	2,896	-	-	-	-	161,421	196,254
Other	-	-	-	-	-	-	-	36,560	36,560
	12,456,957	4,224,065	7,853,433	-	31,948,049	-	-	6,108,353	62,676,248
Less: allowance for uncollectibles	(7,090,240)	-	-	-	(2,446,764)	-	-	(2,333,707)	(11,870,711)
Net receivables	\$ 5,366,717	\$ 4,224,065	\$ 7,853,433	\$ -	\$ 29,586,666	\$ -	\$ -	\$ 3,774,656	\$ 50,805,537

During the year ended September 30, 2007, the National Government engaged in an extensive analysis of its receivables and as a result, wrote off \$944,533 of such receivables.

Receivables as of September 30, 2007, for the component units, including applicable allowances for uncollectible accounts, are as follows:

	FSM Telecommunications Corporation	FSM Development Bank	National Fisheries Corporation	College of Micronesia-FSM	FSM Coconut Development Authority	MiCare Plan, Inc.	Total
Receivables:							
General	\$ 1,256,511	\$ 2,638	\$ 676,983	\$ 6,607,740	\$ 95,705	\$ 232,412	\$ 8,195,006
Loans	-	26,020,506	-	-	-	-	26,020,506
Interest	184,602	128,529	-	-	-	-	313,131
Other	465,586	306,008	-	1,233,398	111,778	117,632	2,234,402
	1,906,699	26,457,681	676,983	7,841,138	207,483	350,044	36,763,045
Less: allowance for uncollectibles	(380,355)	(5,085,120)	(653,477)	(3,332,311)	(305,614)	(76,563)	(9,079,963)
	\$ 1,526,344	\$ 21,372,561	\$ 23,506	\$ 4,508,827	\$ 1,869	\$ 273,481	\$ 27,683,082

Loans receivable of the primary government are as follows:

Major Governmental Funds

General Fund:

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

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

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(3) Receivables, Continued

Loan receivable from the State of Kosrae, payable in equal quarterly installments of \$37,500, non-interest bearing, on each of the first day of the month of October, January, April and July starting on October 1, 2009 and ending on July 1, 2019. 1,500,000

\$ 6,661,987

These balances are fully reserved for in the accompanying financial statements.

Section 111 Investment Development Fund:

Loans receivable from businesses and individuals at varying terms and conditions administered by the FSM Development Bank. \$ 7,850,258

Asian Development Bank Loan Fund:

Loan receivable from Micronesia Longline Fishing Company, a majority-owned subsidiary of NFC, in the amount of SDR 3,514,000, interest at 6.64% per annum, repayments commencing January 15, 1998, with a maturity date of July 15, 2007. The loan is a subsidiary loan of a loan agreement (Loan Number 1257 FSM (SF)) between the FSM National Government and the Asian Development Bank (ADB). As of September 30, 2007, a reserve for this loan has been established in the amount of approximately \$2.4 million. \$ 4,893,527

Loans receivable from the Chuuk Public Utility Corporation (CPUC), the Pohnpei Utilities Corporation (PUC), and the Yap State Public Service Corporation (YSPSC). These loans are subsidiary loans of a loan agreement (Loan Number 1459 FSM (SF)) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States of Chuuk, Pohnpei and Yap whereby a portion of the loan proceeds under this ADB loan were relent under the same terms and conditions imposed by the ADB. The States in turn on lent the loan proceeds to CPUC, PUC, and YSPSC, respectively. As of September 30, 2007, the amounts outstanding from these corporations are as follows:

Chuuk Public Utility Corporation	\$	3,378,548	
Pohnpei Utilities Corporation		2,067,784	
Yap State Public Service Corporation		<u>2,216,140</u>	
			7,662,472

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(3) Receivables, Continued

Major Governmental Funds, Continued

Asian Development Bank Loan Fund, Continued:

Loans receivable from the States to assist in the implementation of an Early Retirement Scheme (ERS) in which employees holding certain nonessential positions as identified by the States were retired early with a payout of the equivalent of two-years wages. These loans are subsidiary loans of a loan agreement (Loan Number 1520 FSM (SF)) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States whereby a portion of the loan proceeds under this ADB loan were relented under the same terms and conditions imposed by the ADB. As of September 30, 2007, the amounts outstanding from the States are as follows:

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

Loans receivable from the States to assist in the implementation of the Basic Social Services Program. These loans are subsidiary loans of a loan agreement (Loan Number 1816 FSM (SF)) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States whereby a portion of the loan proceeds under this ADB loan was relented under the same terms and conditions imposed by the ADB. As of September 30, 2007, the amounts outstanding from the States are as follows:

State of Kosrae	\$ 94,751	
State of Yap	245,563	
State of Chuuk	<u>242,770</u>	
		583,084

Loans receivable from the States to assist in the implementation of the Private Sector Development Program. These loans are subsidiary loans of loan agreements (Loan Number 1873 FSM (SF) and Loan Number 1874 FSM (SF)) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States whereby a portion of the loan proceeds under these ADB loans was relented under the same terms and conditions imposed by the ADB. As of September 30, 2007, the amounts outstanding from the States are as follows:

State of Chuuk	\$ 1,172,270	
State of Kosrae	1,135,832	
State of Pohnpei	565,062	
State of Yap	<u>935,802</u>	
		<u>3,808,966</u>
		\$ <u>31,948,049</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(3) Receivables, Continued

Nonmajor Governmental and Fiduciary Funds

Student Loan Fund:

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

Loans receivable from businesses and individuals at varying terms and conditions administered by the FSM Development Bank.	67,002
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Loan receivable from the Caroline Fisheries Corporation, an investee of Pohnpei State, non-interest bearing and no specific repayment terms.	103,011
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Yap Development Loan Fund:

Loans receivable from businesses and individuals at varying terms and conditions administered by the FSM Development Bank.	<u>122,555</u>
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\$ 1,899,521

(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, 2007, are summarized as follows:

Receivable Fund	Payable Fund	Amount
General	Early Retirement Program	\$ 4,142,955
General	Asian Development Bank Loan	227,453
General	Compact Sector Grants	37,740
General	Nonmajor governmental funds	522,333
U.S. Federal Grants	General	445,978
Compact Sector Grants	General	734,044
Nonmajor governmental funds	General	<u>3,106,569</u>
		\$ <u>9,217,072</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(5) Capital Assets

Capital asset activities of the primary government for the year ended September 30, 2007, are as follows:

	Balance October <u>1, 2006</u>	<u>Additions</u>	<u>Retirements</u>	Balance September <u>30, 2007</u>
Governmental Activities:				
Buildings and improvements	\$ 14,248,976	\$ -	\$ -	\$ 14,248,976
Boats	23,319,942	2,158	-	23,322,100
Motor vehicles	4,156,884	159,846	(35,790)	4,280,940
Computer equipment	3,296,202	357,558	-	3,653,760
Aircraft	709,207	-	-	709,207
Furniture, equipment and machinery	<u>3,362,772</u>	<u>30,344</u>	<u>-</u>	<u>3,393,116</u>
	49,093,983	549,906	(35,790)	49,608,099
Less accumulated depreciation:				
Buildings and improvements	3,515,235	(281,496)	-	(3,796,731)
Boats	10,156,823	(927,785)	-	(11,084,608)
Motor vehicles	3,580,847	(314,721)	35,790	(3,859,778)
Computer equipment	2,476,710	(298,205)	-	(2,774,915)
Aircraft	264,888	(35,460)	-	(300,348)
Furniture, equipment and machinery	<u>2,822,412</u>	<u>(207,505)</u>	<u>-</u>	<u>(3,029,917)</u>
	<u>22,816,915</u>	<u>(2,065,172)</u>	<u>35,790</u>	<u>(24,846,297)</u>
	<u>\$ 26,277,068</u>	<u>\$ (1,515,266)</u>	<u>\$ -</u>	<u>\$ 24,761,802</u>

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

President's office	\$ 55,138
External affairs and LNOs	54,597
Health, education and social affairs	365,920
Economic affairs	21,456
Transportation, communication and infrastructure	865,126
Finance and administration	44,865
Justice	423,204
Office of the Public Defender	13,087
Judiciary	28,186
Legislature	110,029
Office of the Public Auditor	19,474
National government programs	16,283
Boards, commissions and other	<u>47,807</u>
	<u>\$ 2,065,172</u>

The primary government has assumed a construction management role for various infrastructure grant related expenditures. These expenditures should be accounted for at the government wide level as construction in progress until completion of the project and resulting turnover to the applicable beneficiary. Management is currently evaluating the construction related data, including related retention payables.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(6) Long-Term Obligations

Primary Government

Asian Development Bank (ADB) Loan Number 1257 FSM (SF) - Fisheries Development Project Loan (SDR 3,792,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing January 15, 2004 in an amount of SDR 46,100 increasing to SDR 92,400 on January 15, 2014, with a maturity date of July 15, 2033. \$ 4,731,606

ADB Loan Number 1459 FSM (SF) - Water Supply and Sanitation Project Loan (SDR 7,233,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing February 1, 2007 in an amount of SDR 69,200, increasing to SDR 138,500 on February 1, 2017, with a maturity date of August 1, 2036. 8,926,428

ADB Loan Number 1520 FSM (SF) - Public Sector Reform Program Loan (SDR 12,979,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing February 1, 2008 in an amount of SDR 129,800, increasing to SDR 259,600 on February 1, 2018, with a maturity date of August 1, 2037. 17,682,020

ADB Loan Number 1816 FSM (SF) - Basic Social Services Project Loan (SDR 6,199,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing February 1, 2009 in an amount of SDR 129,145, at which time the service charge increases to 1.5% per annum, with a maturity date of August 1, 2032. 1,829,927

ADB Loan Number 1873 FSM (SF) - Private Sector Development Program Loan (SDR 3,912,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing May 15, 2010 in an amount of SDR 122,250, at which time the service charge increases to 1.5% per annum, with a maturity date of November 15, 2025. 3,553,325

ADB Loan Number 1874 FSM (SF) - Private Sector Development Project Loan (SDR 6,273,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing May 15, 2010 in an amount of SDR 130,687, at which time the service charge increases to 1.5% per annum, with a maturity date of November 15, 2033. 4,907,532

\$ 41,630,838

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(6) Long-Term Obligations, Continued

Primary Government, Continued

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest and Service Charge</u>	<u>Total</u>
2008	\$ 639,001	\$ 412,772	\$ 1,051,773
2009	1,099,547	457,836	1,557,383
2010	1,099,547	444,538	1,544,085
2011	1,099,547	431,239	1,530,786
2012	1,099,547	417,941	1,517,488
2013 – 2017	6,868,935	1,863,954	8,732,889
2018 – 2022	8,780,839	1,402,138	10,182,976
2023 – 2027	8,728,949	878,329	9,607,278
2028 – 2032	7,029,536	436,636	7,466,172
2033 – 2037	5,185,390	105,297	5,290,687
	<u>\$ 41,630,838</u>	<u>\$ 6,850,680</u>	<u>\$ 48,481,518</u>

Other long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2007, 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, 2006</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance September 30, 2007</u>	<u>Due Within One Year</u>
Loans payable:					
ADB Loan 1257 FSM (SF)	\$ 4,834,406	\$ -	\$ (102,800)	\$ 4,731,606	\$ 103,088
ADB Loan 1459 FSM (SF)	9,108,517	-	(182,089)	8,926,428	182,273
ADB Loan 1520 FSM (SF)	17,682,020	-	-	17,682,020	353,640
ADB Loan 1816 FSM (SF)	946,900	883,027	-	1,829,927	-
ADB Loan 1873 FSM (SF)	2,500,000	1,053,325	-	3,553,325	-
ADB Loan 1874 FSM (SF)	3,327,908	1,579,624	-	4,907,532	-
	<u>38,399,751</u>	<u>3,515,976</u>	<u>(284,889)</u>	<u>41,630,838</u>	<u>639,001</u>
Other:					
Compensated absences	756,866	397,867	(336,597)	818,136	119,457
	<u>\$ 39,156,617</u>	<u>\$ 3,913,843</u>	<u>\$ (621,486)</u>	<u>\$ 42,448,974</u>	<u>\$ 758,458</u>

Discretely Presented Component Units

As of September 30, 2007, the discretely presented component units had the following long-term debt outstanding:

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(6) Long-Term Obligations, Continued

Discretely Presented Component Units, Continued

FSM Telecommunications Corporation (FSMTC)

Loan with the Rural Utilities Service (RUS) (formerly the Rural Electrification Administration) from the Rural Electrification and Telephone Revolving Fund, dated August 1, 1990 of \$39.6 million, with interest at 5% per annum, unconditionally guaranteed by the FSM National Government, under which the FSM National Government will make debt service payments to RUS in the event of default by FSMTC. Mortgages over specific FSMTC ground leases and essentially all assets of FSMTC collateralize the loan. \$ 23,668,097

National Fisheries Corporation (NFC)

Notes payable to the FSM National Government, due in various annual installments of \$1,962 to \$86,639, non-interest bearing, with final maturities due on various dates ranging from July 2007 through April 2014. These notes are all delinquent as payments should have commenced in 1994 and 1995. However, no repayments have been made. Therefore, these notes are classified as current. 3,600,000

\$ 27,268,097

Annual the 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>
2008	\$ 4,444,084	\$ 1,164,236	\$ 5,608,320
2009	887,269	1,121,051	2,008,320
2010	932,664	1,075,656	2,008,320
2011	980,381	1,027,939	2,008,320
2012	1,030,539	977,781	2,008,320
2013 - 2017	5,999,621	4,041,979	10,041,600
2018 - 2022	7,699,666	2,341,934	10,041,600
2023 - 2025	<u>5,293,873</u>	<u>394,038</u>	<u>5,687,911</u>
	<u>\$ 27,268,097</u>	<u>\$ 12,144,614</u>	<u>\$ 39,412,711</u>

Changes in long-term liabilities of the discretely presented component units for the year ended September 30, 2007, are as follows:

	Balance October 1, 2006	<u>Additions</u>	<u>Reductions</u>	Balance September 30, 2007	Due Within One Year
Loans payable:					
FSMTC	\$ 24,471,604	-	\$ (803,507)	\$ 23,668,097	\$ 844,084
NFC	<u>3,600,000</u>	-	-	<u>3,600,000</u>	<u>3,600,000</u>
	<u>\$ 28,071,604</u>	<u>\$ -</u>	<u>\$ (803,507)</u>	<u>\$ 27,268,097</u>	<u>\$ 4,444,084</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(7) Operating Transfers In/Out

Operating transfers in/out for each major governmental fund and nonmajor governmental funds in the aggregate, for the year ended September 30, 2007, are as follows:

<u>Source</u>	<u>Recipient</u>	<u>Transfers Out</u>	<u>Transfers In</u>
<u>Major Governmental Funds</u>			
General	Nonmajor governmental funds	\$ 2,614,729	\$ -
Nonmajor governmental funds	General	<u>-</u>	<u>1,204,672</u>
		<u>2,614,729</u>	<u>1,204,672</u>
<u>Nonmajor Governmental Funds</u>			
General	Nonmajor governmental funds	-	2,614,729
Nonmajor governmental funds	General	<u>1,204,672</u>	<u>-</u>
		<u>1,204,672</u>	<u>2,614,729</u>
		<u>\$ 3,819,401</u>	<u>\$ 3,819,401</u>

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

(8) Contingencies and Commitments

Sick Leave

It is the policy of the FSM National Government to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave as of September 30, 2007 is \$1,718,549.

Insurance Coverage

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

Federal Grants

The FSM National Government participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of \$6,832,415 have been set forth in the FSM National Government's Single Audit Report as of September 30, 2007. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements. In addition, a material amount of questioned costs exists from the four States, which receive federal funds in a subrecipient capacity. If these questioned costs are sustained, such will be funded by State resources.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2007

(8) Contingencies and Commitments, Continued

Federal Grants, Continued

Pursuant to Title I, Section 105 of United States Public Law 99-290, the FSM National Government is no longer liable for debts to U.S. federal agencies arising prior to the date of the implementation of the Compact of Free Association. This matter has not yet been officially resolved with the U.S. Government. Accordingly, the States have made no adjustment to the above questioned costs for amounts which were incurred prior to the implementation of the Compact of Free Association.

Leases

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

Litigation

The FSM National Government is party to various legal proceedings, many of which are normal recurrences in governmental operations. The Attorney General of the FSM National Government is of the opinion that the probable outcome of suits existing at September 30, 2007, is not predictable. No provision for any liability has been made in the accompanying financial statements because management believes that no unfavorable outcome is likely to occur.

Asian Development Bank (ADB) Loans

On December 20, 2000, the FSM National Government entered into a loan agreement (Loan Number 1816 FSM (SF)) with the ADB for the Basic Social Services Project in the amount of \$8,019,000. The purpose of the loan is to design and introduce reform in the health and education sectors in the FSM, which will include on lending a portion of the loan proceeds to the States under separate Financing Agreements. As of September 30, 2007, the FSM National Government had drawn down \$1,829,927 against this loan.

On December 12, 2001, the FSM National Government entered into a loan agreement (Loan Number 1874 FSM (SF)) with the ADB for the Private Sector Development Project in the amount of \$8,017,000. The purpose of this loan is to promote economic growth by expanding the private sector in the FSM, thereby raising domestic employment and incomes and reducing dependence on external assistance, which will include on lending a portion of the loan proceeds to the States under separate Financing Agreements. As of September 30, 2007, the FSM National Government had drawn down \$4,907,532 against this loan.

On November 5, 2004, the FSM National Government entered into two loan agreements (Loan Number 2099 FSM (SF) and Loan Number 2100 FSM (SF)) with the Asian Development Bank in the combined amount of \$19,000,000 for the Omnibus Infrastructure Development Project. The proceeds are to be used to enhance public health and the environment through assistance to improve water supply infrastructure in Kosrae and Yap, and wastewater infrastructure in Pohnpei; and to support economic growth and poverty reduction in Chuuk through improvements to the electrical power sector, which will include on lending a portion of the loan proceeds to the States under separate Financing Agreements. As of September 30, 2007, the FSM National Government had made no draw downs against these loans.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

YEAR ENDED SEPTEMBER 30, 2007

**NATIONAL GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual
General Fund
Year Ended September 30, 2007

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	Variance with Final Budget -
	<u>Original</u>	<u>Final</u>		Positive (Negative)
Revenues:				
Taxes	\$ 9,965,000	\$ 10,800,000	\$ 10,367,609	\$ (432,391)
Fishing rights	13,000,000	13,900,000	15,005,147	1,105,147
Postal revenues	350,000	350,000	377,566	27,566
Investment earnings	1,000,000	1,500,000	2,921,999	1,421,999
Fees and charges	-	-	218,316	218,316
Other	360,000	1,000,000	1,110,441	110,441
Total revenues	<u>24,675,000</u>	<u>27,550,000</u>	<u>30,001,078</u>	<u>2,451,078</u>
Expenditures:				
General government:				
Executive Branch	12,320,752	12,705,061	12,277,132	427,929
Judicial Branch	1,175,316	1,200,316	1,064,292	136,024
Legislative Branch	3,751,839	3,946,337	3,679,482	266,855
Office of the Public Auditor	791,330	791,330	783,469	7,861
Other National Programs	3,923,841	4,996,260	4,319,079	677,181
Boards and Commissions	1,386,699	1,453,255	1,212,663	240,592
Payments to Component Units	245,322	820,322	817,624	2,698
Legislative Appropriations	-	5,848,776	5,443,457	405,319
Total general government	<u>23,595,099</u>	<u>31,761,657</u>	<u>29,597,198</u>	<u>2,164,459</u>
Total expenditures	<u>23,595,099</u>	<u>31,761,657</u>	<u>29,597,198</u>	<u>2,164,459</u>
Excess (deficiency) of revenues over (under) expenditures	<u>1,079,901</u>	<u>(4,211,657)</u>	<u>403,880</u>	<u>4,615,537</u>
Other financing sources (uses):				
Operating transfers in	-	-	1,204,672	1,204,672
Operating transfers out	(619,858)	(827,180)	(2,614,729)	(1,666,746)
Total other financing sources (uses), net	<u>(619,858)</u>	<u>(827,180)</u>	<u>(1,410,057)</u>	<u>(462,074)</u>
Special items:				
Write-off of receivable balances	-	-	944,533	(944,533)
Net change in unreserved fund balance	460,043	(5,038,837)	(1,950,710)	3,208,930
Unreserved fund balance at the beginning of the year	4,513,590	4,513,590	4,513,590	-
Other changes in unreserved fund balance:				
Decrease in reserve for related assets, net of others	-	-	3,586,771	3,586,771
Decrease in reserve for continuing appropriations	-	-	(25,405)	(25,405)
Unreserved fund balance at the end of the year	<u>\$ 4,973,633</u>	<u>\$ (525,247)</u>	<u>\$ 6,124,246</u>	<u>\$ 6,770,296</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Required Supplementary Information - Budgetary Reporting
September 30, 2007

(1) Budgetary Information

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

During fiscal year 2007, supplemental appropriations were also made for both operating and capital purposes, to reflect the evolving priorities of the FSM National Government.

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

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

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

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

For the year ended September 30, 2007, 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>
Department of Justice	\$ 107,236

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Required Supplementary Information - Budgetary Reporting, Continued
September 30, 2007

(2) Reconciliation - GAAP and Budgetary Bases of Accounting

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.

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

Net change in fund balance (deficit)	\$ 1,022,671
Encumbrances	<u>(2,973,381)</u>
Net change in unreserved fund deficit	\$ <u>(1,950,710)</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2007

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

GENERAL FUND

Statement of Revenues, Expenditures by Function and Department,
and Changes in Fund Balance

Year Ended September 30, 2007

(with comparatives for the year ended September 30, 2006)

	2007	2006
Revenue:		
Local taxes:		
Import	\$ 3,989,403	\$ 4,270,936
Fuel	137,348	144,760
Income tax, individuals, net of tax refunds	2,398,611	3,178,727
Gross receipts tax, businesses	3,842,247	3,399,213
	10,367,609	10,993,636
Fees, licenses, and other:		
Fishing rights fees	15,005,147	13,163,759
Postal collections	377,566	386,298
Business license and firearms fees	218,316	191,222
Penalties and interest on delinquent taxes	-	14,220
Other	1,110,441	1,272,263
	16,711,470	15,027,762
Investment earnings:		
Net increase in the fair value of investments	2,459,304	1,153,677
Dividend and interest income	462,695	147,362
	2,921,999	1,301,039
Total revenues	30,001,078	27,322,437
Expenditures:		
Executive Branch:		
President's Office	721,443	729,014
Department of External Affairs and LNO's	2,958,372	3,158,558
Department of Health, Education and Social Affairs	247,949	304,242
Department of Economic Affairs	1,038,358	942,853
Department of Transportation, Communication and Infrastructure	670,924	624,951
Department of Finance and Administration	2,575,878	3,207,759
Department of Justice	3,165,860	2,736,046
Office of the Public Defender	554,836	645,192
	11,933,620	12,348,615
Judicial Branch	978,198	944,452
Legislative Branch:		
Office of the Speaker	865,916	851,159
Congress staff	1,062,770	1,133,592
Delegation offices	549,990	479,867
Official representation and others	644,339	762,682
Legislative committees	31,453	29,333
	3,154,468	3,256,633

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

GENERAL FUND

Statement of Revenues, Expenditures by Function and Department,
and Changes in Fund Balance, Continued

Year Ended September 30, 2007

(with comparatives for the year ended September 30, 2006)

	2007	2006
Expenditures, continued:		
Office of the Public Auditor	669,013	665,143
Other National Government Programs	3,828,528	3,875,834
Boards and Commissions	1,120,491	1,050,407
Payments to Component Units:		
Micare Plan, Inc.	300,000	-
College of Micronesia-FSM	294,174	-
FSM Coconut Development Authority	139,474	196,276
National Fisheries Corporation OPIC loan	100,000	135,000
	833,648	331,276
Other Legislative appropriations	3,871,555	3,414,859
Other	234,296	208,780
Total expenditures	26,623,817	26,095,999
Excess of revenues over expenditures	3,377,261	1,226,438
Other financing sources (uses):		
Operating transfers in:		
Section 215(a)(2) Communications	233,875	-
Section 216(a)(1) Marine Surveillance	266,616	-
Section 216(a)(1) Health and Medical	210,660	-
Section 216(a)(3) Post Secondary	175,486	-
Section 221(b) Special Block Grant	35,487	-
Fisheries Observer Revolving Fund	-	319,424
Passport Revolving Fund	282,548	-
	1,204,672	319,424
Operating transfers out:		
FSM Trust Fund	(1,500,000)	-
Section 215(b)(2) Communications	(14,564)	-
Section 216(b)(1) Marine Surveillance	(993)	-
Section 214 Energy	(105,246)	-
Maritime Operations Revolving Fund	(827,180)	(578,082)
Scholarship fund	(166,746)	-
	(2,614,729)	(578,082)
Total other financing uses, net	(1,410,057)	(258,658)
Special items:		
Write-off of receivable balances	944,533	10,242,788
Net change in fund balance	1,022,671	(9,275,008)
Fund balance at the beginning of the year	16,365,240	25,640,248
Fund balance at the end of the year	\$ 17,387,911	\$ 16,365,240

See Accompanying Independent Auditors' Report.

**NATIONAL GOVERNMENT
FEDERATED STATES OF MICRONESIA**

GENERAL FUND
Statement of Revenues, Expenditures and Changes in Fund Balance -
Budget and Actual, Budgetary Basis
Year Ended September 30, 2007

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
Revenues:				
Local taxes	\$ 9,965,000	\$ 10,800,000	\$ 10,367,609	\$ (432,391)
Fishing right fees	13,000,000	13,900,000	15,005,147	1,105,147
Postal revenues	350,000	350,000	377,566	27,566
Investment earnings	1,000,000	1,500,000	2,921,999	1,421,999
Fees and charges	-	-	218,316	218,316
Other	360,000	1,000,000	1,110,441	110,441
Total revenues	<u>24,675,000</u>	<u>27,550,000</u>	<u>30,001,078</u>	<u>2,451,078</u>
Expenditures-budgetary basis by department:				
Executive Branch:				
Office of the President	477,200	633,900	625,682	8,218
Disaster Office	42,612	42,612	36,422	6,190
Chuuk Disaster Relief	3,259	3,259	-	3,259
Public Information	130,356	130,356	124,140	6,216
Total	<u>653,427</u>	<u>810,127</u>	<u>786,244</u>	<u>23,883</u>
Department of External Affairs:				
Administration	260,520	254,137	215,146	38,991
Division of APA & Multilateral Affairs	97,658	97,658	97,333	325
Division of American and European Affairs	76,141	76,141	51,709	24,432
Preparation for China Embassy	207,585	207,585	200,131	7,454
FSM Consulate - Guam	223,531	223,531	208,009	15,522
FSM Consulate - Honolulu	276,052	285,052	274,945	10,107
FSM Embassy - Tokyo	884,960	884,960	853,721	31,239
FSM Embassy - Washington D.C.	394,062	404,862	340,585	64,277
FSM Embassy - Fiji	195,400	195,403	205,191	(9,788)
FSM Permanent Mission - New York	576,296	572,676	553,525	19,151
Total	<u>3,192,205</u>	<u>3,202,005</u>	<u>3,000,295</u>	<u>201,710</u>
Department of Health, Education & Social Affairs:				
Administration	47,830	44,013	36,226	7,787
Archive & Historic Preservation Unit	131,073	134,344	119,725	14,619
Women's Interests Unit	1,919	47,152	44,586	2,566
Sports & Youth Unit	60,916	81,240	77,469	3,771
Total	<u>241,738</u>	<u>306,749</u>	<u>278,006</u>	<u>28,743</u>
Department of Economic Affairs:				
Administration	113,495	163,795	143,436	20,359
Division of Sectoral Development	169,788	164,788	152,449	12,339
Planning and Economic Management	262,066	223,566	197,144	26,422
Public Enterprise Unit	24,432	24,432	20,338	4,094
Statistics	250,844	250,844	248,175	2,669
Tourism	16,732	16,732	17,381	(649)
Agriculture	215,418	218,413	222,829	(4,416)
Trade & Investment	116,173	107,178	95,819	11,359
Environmental and Sustainable Development	51,596	51,596	30,436	21,160
Total	<u>1,220,544</u>	<u>1,221,344</u>	<u>1,128,007</u>	<u>93,337</u>

See Accompanying Independent Auditors' Report.

**NATIONAL GOVERNMENT
FEDERATED STATES OF MICRONESIA**

GENERAL FUND
Statement of Revenues, Expenditures and Changes in Fund Balance -
Budget and Actual, Budgetary Basis, Continued
Year Ended September 30, 2006

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
Expenditures-budgetary basis by department, continued:				
Department of Transportation, Communication & Infrastructure:				
Administration	191,441	185,441	178,483	6,958
Division of Marine Transportation	149,442	149,442	118,826	30,616
Division of Infrastructure	334,133	327,133	298,478	28,655
Civil Aviation	204,559	60,463	59,596	867
Communication	123,903	95,903	87,791	8,112
Total	<u>1,003,478</u>	<u>818,382</u>	<u>743,174</u>	<u>75,208</u>
Department of Finance and Administration:				
Administration	208,760	285,444	281,706	3,738
Division of National Treasury & Investment	537,118	534,618	534,618	-
Division of Customs and Tax Administration	786,399	783,399	762,554	20,845
Division of Budget	139,800	140,020	135,001	5,019
Division of Personnel	872,496	907,871	888,025	19,846
Investment & International Finance	164,977	163,793	166,721	(2,928)
Total	<u>2,709,550</u>	<u>2,815,145</u>	<u>2,768,625</u>	<u>46,520</u>
Department of Justice:				
Administration	201,436	216,334	223,360	(7,026)
Division of Law	191,253	191,253	194,115	(2,862)
Division of Litigation	165,919	158,919	150,082	8,837
Division of Immigration & Labor	666,994	695,994	820,660	(124,666)
FSM National Police	1,389,809	1,594,911	1,576,430	18,481
Total	<u>2,615,411</u>	<u>2,857,411</u>	<u>2,964,647</u>	<u>(107,236)</u>
Office of the Public Defender	<u>684,399</u>	<u>673,898</u>	<u>608,134</u>	<u>65,764</u>
Total Executive Branch	<u>12,320,752</u>	<u>12,705,061</u>	<u>12,277,132</u>	<u>427,929</u>
Judicial Branch	<u>1,175,316</u>	<u>1,200,316</u>	<u>1,064,292</u>	<u>136,024</u>
Legislative Branch:				
Office of the Speaker	1,245,402	1,247,900	1,227,374	20,526
Congress staff	1,385,151	1,382,651	1,182,840	199,811
Delegation offices	515,006	586,710	592,477	(5,767)
Official representation and others	567,000	689,796	644,338	45,458
Legislative committees	39,280	39,280	32,453	6,827
Total Legislative Branch	<u>3,751,839</u>	<u>3,946,337</u>	<u>3,679,482</u>	<u>266,855</u>
Office of the Public Auditor	<u>791,330</u>	<u>791,330</u>	<u>783,469</u>	<u>7,861</u>
Other National Government Programs:				
Aid to Nonpublic School	300,000	300,000	300,000	-
Single Audit Commission	70,964	153,384	138,570	14,814
Micronesian Red Cross	70,000	70,000	70,000	-
National Election Director	353,666	483,666	424,806	58,860
Micronesia Legal Services Corporation	150,000	150,000	150,000	-
Office of Compact Management	536,797	528,297	470,709	57,588
Other	2,442,414	3,310,913	2,764,994	545,919
Total Other National Government Programs	<u>3,923,841</u>	<u>4,996,260</u>	<u>4,319,079</u>	<u>677,181</u>

See Accompanying Independent Auditors' Report.

**NATIONAL GOVERNMENT
FEDERATED STATES OF MICRONESIA**

GENERAL FUND
Statement of Revenues, Expenditures and Changes in Fund Balance -
Budget and Actual, Budgetary Basis, Continued
Year Ended September 30, 2007

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
Expenditures-budgetary basis by department, continued:				
Board and Commissions:				
Micronesian Maritime Authority	447,443	447,443	313,153	134,290
FSM Banking Board	183,418	249,974	157,794	92,180
Board of Regents-COM	58,000	58,000	58,000	-
Postal Services	681,403	681,403	667,280	14,123
National Board of Nursing	16,435	16,435	16,435	-
Total Boards and Commissions	<u>1,386,699</u>	<u>1,453,255</u>	<u>1,212,663</u>	<u>240,592</u>
Payments to component units:				
MiCare Plan, Inc.	-	300,000	300,000	-
Copra Subsidy	50,000	50,000	50,000	-
Coconut Development Authority	95,322	95,322	95,322	-
National Fisheries Corporation	100,000	100,000	100,000	-
COM-FSM	-	275,000	272,302	2,698
Total payments to component units	<u>245,322</u>	<u>820,322</u>	<u>817,624</u>	<u>2,698</u>
Other Legislative Appropriations:				
Public projects - National Government	-	5,848,776	5,443,457	405,319
	-	5,848,776	5,443,457	405,319
Total expenditures	<u>23,595,099</u>	<u>31,761,657</u>	<u>29,597,198</u>	<u>2,164,459</u>
Excess (deficiency) of revenues over (under) expenditures	<u>1,079,901</u>	<u>(4,211,657)</u>	<u>403,880</u>	<u>4,615,537</u>
Other financing sources (uses):				
Operating Transfer in:				
Section 215(a)(2) Communications	-	-	233,875	(233,875)
Section 216(a)(1) Marine Surveillance	-	-	266,616	(266,616)
Section 216(a)(1) Health and Medical	-	-	210,660	(210,660)
Section 216(a)(3) Post Secondary	-	-	175,486	(175,486)
Section 221(b) Special Block Grant	-	-	35,487	(35,487)
Passport Revolving Fund	-	-	282,548	(282,548)
Total Operating Transfer in	<u>-</u>	<u>-</u>	<u>1,204,672</u>	<u>(1,204,672)</u>
Operating Transfer out:				
Section 215(b)(2) Communications	-	-	14,564	(14,564)
Section 216(b)(1) Marine Surveillance	-	-	993	(993)
Section 214 Energy	-	-	105,246	(105,246)
Scholarship Fund	-	-	166,746	(166,746)
FSM Trust Fund	-	-	1,500,000	(1,500,000)
Maritime Revolving Fund	619,858	827,180	827,180	-
Total Operating Transfer out	<u>619,858</u>	<u>827,180</u>	<u>2,614,729</u>	<u>(1,666,746)</u>
Total other financing sources (uses), net	<u>(619,858)</u>	<u>(827,180)</u>	<u>(1,410,057)</u>	<u>462,074</u>
Special items:				
Write-off of receivable balances	-	-	944,533	(944,533)
Net change in unreserved fund balance	460,043	(5,038,837)	(1,950,710)	4,133,078
Unreserved fund balance at beginning of year	4,513,590	4,513,590	4,513,590	-
Other changes in unreserved fund balance:				
Decrease in reserve for related assets, net of others	-	-	3,586,771	3,586,771
Increase in reserve for continuing appropriations	-	-	(25,405)	(25,405)
Unreserved fund balance at end of year	<u>\$ 4,973,633</u>	<u>\$ (525,247)</u>	<u>\$ 6,124,246</u>	<u>\$ 7,694,444</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Combined Balance Sheet
Nonmajor Governmental Funds
September 30, 2007

	Other Special Revenue	Other Permanent	Other Capital Projects	Total
<u>ASSETS</u>				
Equity in internal investment pool	\$ -	\$ 1,693,690	\$ -	\$ 1,693,690
Investments	-	-	3,762,944	3,762,944
Receivables, net:				
Loans	-	-	103,011	103,011
Other	3,103	-	-	3,103
Due from other funds	2,952,389	-	154,180	3,106,569
Total assets	\$ 2,955,492	\$ 1,693,690	\$ 4,020,135	\$ 8,669,317
<u>LIABILITIES AND FUND BALANCES</u>				
Liabilities:				
Accounts payable	\$ 54,307	\$ -	\$ 525	\$ 54,832
Due to FSM State Governments	-	-	9,455	9,455
Due to other funds	-	-	522,333	522,333
Deferred revenue	1,145,418	-	75,358	1,220,776
Total liabilities	1,199,725	-	607,671	1,807,396
Fund balances:				
Reserved for:				
Related assets	-	-	3,865,955	3,865,955
Encumbrances	339,101	-	108,915	448,016
Continuing appropriations	-	-	1,003,362	1,003,362
Unreserved (deficit):				
Special revenue funds	1,416,666	1,693,690	-	3,110,356
Capital projects funds	-	-	(1,565,768)	(1,565,768)
Total fund balances	1,755,767	1,693,690	3,412,464	6,861,921
Total liabilities and fund balances	\$ 2,955,492	\$ 1,693,690	\$ 4,020,135	\$ 8,669,317

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Combined Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances
Nonmajor Governmental Funds
Year Ended September 30, 2007

	<u>Other Special Revenue</u>	<u>Other Permanent</u>	<u>Other Capital Projects</u>	<u>Total</u>
Revenues:				
Fees and charges	\$ 1,174,326	\$ -	\$ -	\$ 1,174,326
Other grants	496,319	-	-	496,319
Net increase in the fair value of investments	8,656	193,690	-	202,346
Total revenues	<u>1,679,301</u>	<u>193,690</u>	<u>-</u>	<u>1,872,991</u>
Expenditures by function:				
Current:				
General government:				
Health, education and social affairs	605,927	-	-	605,927
Economic affairs	117,590	-	-	117,590
Transportation, communication and infrastructure	892,588	-	-	892,588
Boards, commissions	466,059	-	-	466,059
Capital projects	-	-	37,255	37,255
Total expenditures	<u>2,082,164</u>	<u>-</u>	<u>37,255</u>	<u>2,119,419</u>
Excess (deficiency) of revenues over (under) expenditure	<u>(402,863)</u>	<u>193,690</u>	<u>(37,255)</u>	<u>(246,428)</u>
Other financing sources (uses):				
Operating transfers in	1,114,729	1,500,000	-	2,614,729
Operating transfers out	(1,204,672)	-	-	(1,204,672)
Total other financing sources (uses), net	<u>(89,943)</u>	<u>1,500,000</u>	<u>-</u>	<u>1,410,057</u>
Net change in fund balances	(492,806)	1,693,690	(37,255)	1,163,629
Fund balances at the beginning of the year	2,248,573	-	3,449,719	5,698,292
Fund balances at the end of the year	<u>\$ 1,755,767</u>	<u>\$ 1,693,690</u>	<u>\$ 3,412,464</u>	<u>\$ 6,861,921</u>

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS**

Combining Balance Sheet
September 30, 2007

	Section 213(a)(2) Communications	Section 215(b)(2) Communications	Section 216(a)(1) Marine Surveillance	Section 216(b)(1) Marine Surveillance	Section 216(a)(2) Health and Medical	Section 216(a)(3) Post-secondary Education	Section 221(b) Special Block Grant	Section 214 Energy	Section 212 Special Development	Maritime Operations Revolving
ASSETS										
Receivables, net:										
Other	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3,103
Due from other funds	-	-	-	-	-	-	-	-	-	200,874
Total assets	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 203,977
LIABILITIES AND FUND BALANCES										
(DEFICITS)										
Liabilities:										
Accounts payable	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 5,440
Deferred revenue	-	-	-	-	-	-	-	-	-	-
Total liabilities	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 5,440
Fund balances (deficits):										
Reserved for:										
Encumbrances	-	-	-	-	-	-	-	-	-	97,733
Unreserved (deficit)	-	-	-	-	-	-	-	-	-	100,804
Total fund balances (deficits)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 198,537
Total liabilities and fund balances	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 203,977

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS**

**Combining Balance Sheet, Continued
September 30, 2007**

	Non-U.S. Grants	Disaster Relief	Passport Revolving	Fisheries Observer Revolving	Medical Revolving	Aquaculture Revolving	Student Loans	Nurse Board Revolving	Permit Revolving Fund	Filling Office Revolving	Scholarship Fund	Total
ASSETS												
Receivables, net:												
Other	\$ 1,171,849	\$ 334,304	\$ 100,125	\$ 115,807	\$ 5,106	\$ 23,691	\$ 606,809	\$ 13,567	\$ -	\$ 11,580	\$ 209,040	\$ 3,103
Due from other funds	\$ 1,171,849	\$ 334,304	\$ 100,125	\$ 115,807	\$ 5,106	\$ 23,691	\$ 606,809	\$ 13,567	\$ -	\$ 11,580	\$ 209,040	\$ 2,952,389
Total assets												
	\$ 1,171,849	\$ 334,304	\$ 100,125	\$ 115,807	\$ 5,106	\$ 23,691	\$ 606,809	\$ 13,567	\$ -	\$ 11,580	\$ 209,040	\$ 2,955,492
LIABILITIES AND FUND BALANCES (DEFICITS)												
Liabilities:												
Accounts payable	\$ 44,143	\$ -	\$ 125	\$ 4,599	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 54,307
Deferred revenue	\$ 1,145,418	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,145,418
Total liabilities												
	\$ 1,189,561	\$ -	\$ 125	\$ 4,599	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,199,725
Fund balances (deficits):												
Reserved for:												
Encumbrances	\$ 114,131	\$ 67,420	\$ 59,817	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 339,101
Unreserved (deficit)	\$ (131,843)	\$ 266,884	\$ 40,183	\$ 111,208	\$ 5,106	\$ 23,691	\$ 606,809	\$ 13,567	\$ -	\$ 11,580	\$ 209,040	\$ 1,416,666
Total fund balances (deficits)												
	\$ (17,712)	\$ 334,304	\$ 100,000	\$ 111,208	\$ 5,106	\$ 23,691	\$ 606,809	\$ 13,567	\$ -	\$ 11,580	\$ 209,040	\$ 1,755,767
Total liabilities and fund balances												
	\$ 1,171,849	\$ 334,304	\$ 100,125	\$ 115,807	\$ 5,106	\$ 23,691	\$ 606,809	\$ 13,567	\$ 159,637	\$ 11,580	\$ 209,040	\$ 2,955,492

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS**

**Combining Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances (Deficits)
Year Ended September 30, 2007**

	Section 215(a)(2) Communications	Section 215(b)(2) Communications	Section 216(a)(1) Marine Surveillance	Section 216(b)(1) Marine Surveillance	Section 216(a)(2) Health and Medical	Section 216(a)(3) Post-secondary Education	Section 221(b) Special Block Grant	Section 214 Energy	Section 212 Special Development	Maritime Operations Revolving
Revenues:										
Fees and charges	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 118,319
Other grants	-	-	-	-	-	-	-	-	-	-
Net increase in the fair value of investments	-	-	-	-	-	-	-	-	-	-
Total revenues	-	-	-	-	-	-	-	-	-	118,319
Expenditures by function:										
Current:										
General government:										
Health, education and social affairs	-	-	-	-	993	-	5,435	-	-	-
Economic Affairs	-	-	-	-	-	-	-	-	-	-
Transportation, communication and infrastructure	-	-	-	-	-	-	-	-	-	856,606
Boards, commissions and other	-	-	-	-	-	-	-	-	-	-
Total expenditures	-	-	-	-	993	-	5,435	-	-	856,606
Excess (deficiency) of revenues over (under) expenditures	-	-	-	-	(993)	-	(5,435)	-	-	(738,287)
Other financing sources (uses):										
Operating transfers in	-	14,564	-	993	-	-	-	105,246	-	827,180
Operating transfers out	(233,875)	-	(266,616)	-	(210,560)	(175,486)	(35,487)	-	-	-
Total other financing sources (uses), net	(233,875)	14,564	(266,616)	993	(210,560)	(175,486)	(35,487)	105,246	-	827,180
Net change in fund balances (deficit) of the year	(233,875)	14,564	(266,616)	993	(211,653)	(175,486)	(40,922)	105,246	-	88,893
Fund balances (deficits) at the beginning of the year	233,875	(14,564)	266,616	(993)	211,653	175,486	40,922	(105,246)	-	109,644
Fund balances (deficits) at the end of the year	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 198,537

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS**

**Combining Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances (Deficits), Continued
Year Ended September 30, 2007**

	Non-U.S. Grants	Disaster Relief	Passport Revolving	Fisheries Observer Revolving	Medical Revolving	Aquaculture Revolving	Student Loans	Nurse Board Revolving	Permit Revolving Fund	Filling Office Revolving	Scholarship Fund	Total
Revenues:												
Fees and charges	\$ -	\$ 200,000	\$ 439,580	\$ 113,508	\$ 275	\$ -	\$ 6,204	\$ 2,845	\$ 85,346	\$ 11,580	\$ 196,669	\$ 1,174,326
Other grants	496,319	-	-	-	-	-	-	-	-	-	-	496,319
Net increase in the fair value of investments	-	8,656	-	-	-	-	-	-	-	-	-	8,656
Total revenues	496,319	208,656	439,580	113,508	275	-	6,204	2,845	85,346	11,580	196,669	1,679,301
Expenditures by function:												
Current:												
General government:												
Health, education and social affairs	444,422	-	-	-	-	-	-	702	-	-	154,375	605,927
Economic Affairs	34,551	-	-	77,269	-	5,770	-	-	-	-	-	117,590
Transportation, communication and infrastructure	35,982	-	-	-	-	-	-	-	-	-	-	892,588
Boards, commissions and other	-	-	466,059	-	-	-	-	-	-	-	-	466,059
Total expenditures	514,955	-	466,059	77,269	-	5,770	-	702	-	-	154,375	2,082,164
Excess (deficiency) of revenues over (under) expenditures	(18,636)	208,656	(26,479)	36,239	275	(5,770)	6,204	2,143	85,346	11,580	42,294	(402,863)
Other financing sources (uses):												
Operating transfers in	-	-	-	-	-	-	-	-	-	-	166,746	1,114,729
Operating transfers out	-	-	(282,548)	-	-	-	-	-	-	-	-	(1,204,672)
Total other financing sources (uses), net	-	-	(282,548)	-	-	-	-	-	-	-	166,746	(89,943)
Net change in fund balances (deficit) Fund balances (deficits) at the beginning of the year	(18,636)	208,656	(309,027)	36,239	275	(5,770)	6,204	2,143	85,346	11,580	209,040	(492,806)
Fund balances (deficits) at the end of the year	924	125,648	409,027	74,969	4,831	29,461	600,605	11,424	74,291	-	-	2,248,573
Fund balances (deficits) at the end of the year	\$ (17,712)	\$ 334,304	\$ 100,000	\$ 111,208	\$ 5,106	\$ 23,691	\$ 606,809	\$ 13,567	\$ 159,637	\$ 11,580	\$ 209,040	\$ 1,755,767

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS
CAPITAL PROJECTS FUNDS**

Combining Balance Sheet
September 30, 2007

	Compact Capital Projects	OIA Capital Projects	Total
<u>ASSETS</u>			
Investments	\$ 3,762,944	\$ -	\$ 3,762,944
Receivables, net:			
Loans	103,011	-	103,011
Due from other funds	-	154,180	154,180
	\$ 3,865,955	\$ 154,180	\$ 4,020,135
 <u>LIABILITIES AND FUND BALANCES</u>			
Liabilities:			
Accounts payable	\$ 525	\$ -	\$ 525
Due to FSM State Governments	9,455	-	9,455
Due to other funds	522,333	-	522,333
Deferred revenue	-	75,358	75,358
Total liabilities	532,313	75,358	607,671
Fund balances:			
Reserved for:			
Related assets	3,865,955	-	3,865,955
Encumbrances	108,915	-	108,915
Continuing appropriations	1,003,362	-	1,003,362
Unreserved (deficit)	(1,644,590)	78,822	(1,565,768)
Total fund balances	3,333,642	78,822	3,412,464
Total liabilities and fund balances	\$ 3,865,955	\$ 154,180	\$ 4,020,135

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

NONMAJOR GOVERNMENTAL FUNDS
CAPITAL PROJECTS FUNDS

Combining Statement of Expenditures by Function,
and Changes in Fund Balances
Year Ended September 30, 2007

	<u>Compact Capital Projects</u>	<u>OIA Capital Projects</u>	<u>Total</u>
Expenditures by function:			
Capital projects	\$ 37,255	\$ -	\$ 37,255
Total expenditures	<u>37,255</u>	<u>-</u>	<u>37,255</u>
Net change in fund balances	(37,255)	-	(37,255)
Fund balances at the beginning of the year	<u>3,370,897</u>	<u>78,822</u>	<u>3,449,719</u>
Fund balances at the end of the year	<u>\$ 3,333,642</u>	<u>\$ 78,822</u>	<u>\$3,412,464</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

SECTION 211 COMPACT SECTOR FUNDS

Combining Balance Sheet
September 30, 2007

	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Section 211(a)(5) Environment	Section 211(a)(6) Infrastructure	Supplemental Education	Total
ASSETS								
Receivables:								
Due from other funds	\$ -	\$ 208,467	\$ 2	\$ 273,532	\$ 33,576	\$ -	\$ 218,467	\$ 734,044
	<u>\$ -</u>	<u>\$ 208,467</u>	<u>\$ 2</u>	<u>\$ 273,532</u>	<u>\$ 33,576</u>	<u>\$ -</u>	<u>\$ 218,467</u>	<u>\$ 734,044</u>
LIABILITIES AND FUND BALANCES								
Liabilities:								
Accounts payable	\$ 21,017	\$ 54,370	\$ -	\$ 22,942	\$ -	\$ 90,444	\$ 25,839	\$ 214,612
Due to other funds	16,003	-	-	-	-	21,737	-	37,740
Total liabilities	<u>37,020</u>	<u>54,370</u>	<u>-</u>	<u>22,942</u>	<u>-</u>	<u>112,181</u>	<u>25,839</u>	<u>252,352</u>
Fund balances:								
Reserved for:								
Encumbrances	132,476	86,893	-	215,511	-	6,236,668	57,149	6,728,697
Continuing appropriations	-	-	-	-	-	44,950,760	-	44,950,760
Unreserved	<u>(169,496)</u>	<u>67,204</u>	<u>2</u>	<u>35,079</u>	<u>33,576</u>	<u>(51,299,609)</u>	<u>135,479</u>	<u>(51,197,765)</u>
Total fund balances	<u>(37,020)</u>	<u>154,097</u>	<u>2</u>	<u>250,590</u>	<u>33,576</u>	<u>(112,181)</u>	<u>192,628</u>	<u>481,692</u>
Total liabilities and fund balances	<u>\$ -</u>	<u>\$ 208,467</u>	<u>\$ 2</u>	<u>\$ 273,532</u>	<u>\$ 33,576</u>	<u>\$ -</u>	<u>\$ 218,467</u>	<u>\$ 734,044</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

SECTION 211 COMPACT SECTOR FUNDS

**Combining Statement of Expenditures by Account,
and Changes in Fund Balances (Deficit)
Year Ended September 30, 2007**

	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Section 211(a)(5) Environment	Section 211(a)(6) Infrastructure	Supplemental Education	Total
Revenues:								
Compact funding	\$ 604,148	\$ 824,161	\$ -	\$1,144,645	\$ -	\$6,884,680	\$ 751,193	\$10,208,827
Expenditures by function:								
Current:								
General government:								
Health, education and social affairs	488,738	737,964	-	50,790	-	-	643,304	1,920,796
Economic affairs	-	-	-	198,169	-	-	-	198,169
Transportation, communication and infrastructure	-	-	-	-	-	7,403,160	-	7,403,160
Finance and administration	-	-	-	302,675	-	-	-	302,675
Judiciary	-	-	-	1,260	-	-	-	1,260
Office of the Public Auditor	-	-	-	116,433	-	-	-	116,433
Payments to component units	-	-	-	-	-	-	164,780	164,780
Total expenditures	<u>488,738</u>	<u>737,964</u>	<u>-</u>	<u>669,327</u>	<u>-</u>	<u>7,403,160</u>	<u>808,084</u>	<u>10,107,273</u>
Net change in fund balances	115,410	86,197	-	475,318	-	(518,480)	(56,891)	101,554
Fund balances (deficit) at the beginning of the year	<u>(152,430)</u>	<u>67,900</u>	<u>2</u>	<u>(224,728)</u>	<u>33,576</u>	<u>406,299</u>	<u>249,519</u>	<u>380,138</u>
Fund balances (deficit) at the end of the year	<u>\$ (37,020)</u>	<u>\$ 154,097</u>	<u>\$ 2</u>	<u>\$ 250,590</u>	<u>\$ 33,576</u>	<u>\$ (112,181)</u>	<u>\$ 192,628</u>	<u>\$ 481,692</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 Emmanuel Mori
President
Federated States of Micronesia:

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Federated States of Micronesia (FSM) National Government as of and for the year ended September 30, 2007, which collectively comprise the FSM National Government's basic financial statements, and have issued our report thereon dated June 23, 2008, which was qualified with respect to: 1) the lack of recording a liability for retentions payable in the governmental activities and the Compact Sector Grants Fund; 2) exclusion of certain capital assets in the governmental activities; 3) the inadequacy of accounting records concerning receivables, advances, amounts due to the FSM State Governments and deferred revenue for the governmental activities; 4) the inadequacy of accounting records concerning receivables, advances and amounts due to the FSM State Governments for the General Fund; 5) the inadequacy of accounting records concerning receivables and amounts due to the FSM State Governments for the U.S. Federal Grants Fund; 6) the inadequacy of accounting records concerning deferred revenue for the aggregate remaining fund information; 7) the lack of audited financial statements of Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc.; and 8) the lack of audited financial statements of the National Fisheries Corporation. 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.

For purposes of this report, our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts and grants, and other matters did not include the FSM Social Security Administration, the FSM Telecommunications Corporation, the FSM Development Bank, the FSM National Fisheries Corporation, the College of Micronesia-FSM, the FSM Coconut Development Authority, and the MiCare Plan, Inc., which were all audited by us. We have issued separate reports on our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters for these entities. The findings, if any, included in those reports are not included herein.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the FSM National Government's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the FSM National Government's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the FSM National Government's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs (pages 89 through 134) as items 2007-13, 2007-14, and 2007-16 through 2007-27 to be significant deficiencies in internal control over financial reporting.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiencies described above are material weaknesses.

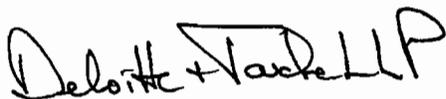
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the FSM National Government's basic 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 one instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying Schedule of Findings and Questioned Costs as item 2007-15.

We noted certain matters that we reported to management of the FSM National Government in a separate letter dated June 23, 2008.

The FSM National Government's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the FSM National Government's responses and, accordingly, we express no opinion on it.

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



June 23, 2008

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

Honorable Emmanuel Mori
President
Federated States of Micronesia:

Compliance

We have audited the compliance of the Federated States of Micronesia (FSM) National Government with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2007. The FSM National Government's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 89 through 134). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the FSM National Government's management. Our responsibility is to express an opinion on the FSM National Government's compliance based on our audit.

As discussed in Note 2b to the Schedule of Expenditures of Federal Awards, the FSM National Government's basic financial statements include the operations of certain entities whose federal awards are not included in the Schedule of Expenditures of Federal Awards for the year ended September 30, 2007. Our audit, described below, did not include the operations of the entities identified in Note 2b as these entities conducted separate audits in accordance with OMB Circular A-133, if required.

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

As described in items 2007-1, 2007-2, 2007-3, 2007-5, 2007-6, 2007-7, 2007-10, 2007-11, 2007-12, 2007-13 and 2007-25 in the accompanying Schedule of Findings and Questioned Costs, the FSM National Government did not comply with requirements regarding allowable costs/cost principles, equipment and real property management, procurement and suspension and debarment, and reporting that are applicable to its Compact of Free Association Sector Grants major program (CFDA # 15.875), cash management, equipment and real property management, period of availability of federal funds, procurement and suspension and debarment, and reporting that are applicable to its DOI Technical Assistance major program (CFDA # 15.875) and its CDC and Prevention - Investigations and Technical Assistance major program (CFDA # 93.283), and cash management, equipment and real property management, procurement and suspension and debarment, and reporting that are applicable to its Airport Improvement Program major program (CFDA # 20.106) and its IDEA Special Education - Grants to States major program (CFDA # 84.027). Compliance with such requirements is necessary, in our opinion, for the FSM National Government to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the FSM National Government complied, in all material respects, with the requirements referred to above that are applicable to its Compact of Free Association Sector Grants major program (CFDA # 15.875), its DOI Technical Assistance major program (CFDA # 15.875), its Airport Improvement Program major program (CFDA # 20.106), its IDEA Special Education - Grants to States major program (CFDA # 84.027), and its CDC and Prevention - Investigations and Technical Assistance major program (CFDA # 93.283) for the year ended September 30, 2007. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2007-4, 2007-8 and 2007-9.

Internal Control Over Compliance

The management of the FSM National Government is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the FSM National Government's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the FSM National Government's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and others that we consider to be material weaknesses.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 2007-01 through 2007-13 and 2007-25 to be significant deficiencies.

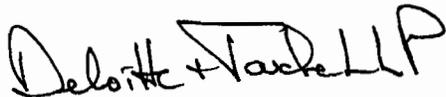
A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs, we consider items 2007-03 and 2007-13 to be material weaknesses.

The FSM National Government's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the FSM National Government's responses and, accordingly, we express no opinion on it.

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 Federated States of Micronesia (FSM) National Government as of and for the year ended September 30, 2007, which collectively comprise the FSM National Government's basic financial statements, and have issued our report thereon dated June 23, 2008, which was qualified with respect to: 1) the lack of recording a liability for retentions payable in the governmental activities and the Compact Sector Grants Fund; 2) exclusion of certain capital assets in the governmental activities; 3) the inadequacy of accounting records concerning receivables, advances, amounts due to the FSM State Governments and deferred revenue for the governmental activities; 4) the inadequacy of accounting records concerning receivables, advances and amounts due to the FSM State Governments for the General Fund; 5) the inadequacy of accounting records concerning receivables and amounts due to the FSM State Governments for the U.S. Federal Grants Fund; 6) the inadequacy of accounting records concerning deferred revenue for the aggregate remaining fund information; 7) the lack of audited financial statements of Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc.; and 8) the lack of audited financial statements of the National Fisheries Corporation. Our audit was performed for the purpose of forming our opinion on the financial statements that collectively comprise the FSM National Government's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards (pages 77 through 85) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the FSM National Government. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, except for the effects of not recording a liability for retentions payable in the Compact Sector Grants Fund, and except for the effects of such adjustments, if any, as might have been determined to be necessary had accounting records regarding amounts due to the FSM State Governments for the U.S. Federal Grants Fund, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

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



June 23, 2008

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Summary Schedule of Expenditures of Federal Awards, by Grantor
Year Ended September 30, 2007

<u>Agency/Program</u>	<u>Expenditures</u>	Amounts Passed-Through to <u>Subrecipients</u>
U.S. Department of Agriculture	\$ 36,316	\$ 165,415
U.S. Department of Commerce	1,096,129	-
U.S. Department of the Interior	13,375,281	55,603,463
U.S. Department of Labor	99,545	418,013
U.S. Department of Transportation	6,392,626	-
U.S. Department of Homeland Security	221,545	4,085,027
U.S. Department of Education	2,095,446	2,566,847
U.S. Department of Health and Human Services	3,084,020	1,461,868
Institute of Museum and Library Services	-	-
	<hr/>	<hr/>
GRAND TOTAL	\$ <u>26,400,908</u>	\$ <u>64,300,633</u>

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

Reconciliation to the financial statements:

Expenditures for U.S. Federal Grants (page 14)	\$ 15,333,263
Expenditures for Compact All Other Funds (page 66)	928,552
Expenditures for Compact Capital Fund (page 69)	37,255
Expenditures for Compact Sector Funds (page 14)	10,107,273
Others	<u>(5,435)</u>
	<hr/>
Total expenditures per financial statements	\$ <u>26,400,908</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2007

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF AGRICULTURE			
Rural Self-Help Housing Technical Assistance	10.420	\$ -	\$ -
Forestry Research	10.652	-	33,316
Cooperative Forestry Assistance	10.664	-	16,800
Urban and Community Forestry Program	10.675	36,316	60,586
Forest Stewardship Program	10.678	-	13,389
Community Facility Loans and Grants	10.766	-	-
Rural Sanitation Project	10.999	-	41,324
		<u> </u>	<u> </u>
U.S. DEPARTMENT OF AGRICULTURE TOTAL		<u>\$ 36,316</u>	<u>\$ 165,415</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2007

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF COMMERCE			
Anadromous Fish Conservation Act Program	11.405	\$ -	\$ -
Special Oceanic and Atmospheric Projects -NOAA	11.460	<u>1,096,129</u>	<u>-</u>
U.S. DEPARTMENT OF COMMERCE		<u>\$ 1,096,129</u>	<u>\$ -</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2007

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF THE INTERIOR			
Economic, Social and Political Development of the Territories	15.875		
Compact Capital Account		\$ 37,255	\$ 302,840
Compact Energy Grant		-	52,930
Compact Communications-One Time		233,875	-
Compact Marine Surveillance-Annual		-	-
Compact Health and Medical 216(a)		211,653	225,479
Compact Post Secondary Education		175,486	-
Compact Marine Surveillance-One Time		266,616	-
Compact Scholarship Grant		-	-
Compact Special Block Grant 221(b)		35,487	287,508
Compact Sector Funds:			
Infrastructure		7,403,160	865,326
Education		488,738	21,751,549
Health		737,964	15,319,825
Capacity		669,327	3,143,648
Environment		-	1,550,328
Private		-	1,827,904
Compact Supplemental Ed		808,084	9,311,429
Subtotal Compact Sector Funds		<u>10,107,273</u>	<u>53,770,009</u>
Technical Assistance:			
Single Audit		439,203	-
Other Technical Assistance:			
Technical Assistance OIA/DOI Other		1,713,151	792,860
		<u>2,152,354</u>	<u>792,860</u>
Total CFDA #15.875		13,219,999	55,431,626
Historic Preservation Fund Grants-In-Aid	15.904	<u>155,282</u>	<u>171,837</u>
U.S. DEPARTMENT OF THE INTERIOR TOTAL		<u>\$ 13,375,281</u>	<u>\$ 55,603,463</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2007

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF LABOR			
School to Work Program	17.249	\$ -	\$ -
WIA Administration	17.255	-	9,220
WIA Adult Program	17.258	-	30,755
WIA Youth Activities	17.259	99,545	16,518
WIA National Emergency/TS Chat	17.260	-	329,552
WIA Dislocated Worker	17.260	-	31,968
U.S. DEPARTMENT OF LABOR TOTAL		<u>\$ 99,545</u>	<u>\$ 418,013</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**NATIONAL GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2007

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF TRANSPORTATION			
Airport Improvement Program	20.106	\$ <u>6,392,626</u>	\$ <u>-</u>
U.S. DEPARTMENT OF TRANSPORTATION TOTAL		\$ <u><u>6,392,626</u></u>	\$ <u><u>-</u></u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2007

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF HOMELAND SECURITY			
Public Assistance Grants - Typhoon Fern HMGP/Subgrantee	83.544	\$ -	\$ 4,170
Public Assistance Grants - Public Assistance (Presidentially Declared Disasters) (B)	97.036	221,545	3,420,097
Individual and Family Grants - FEMA 1427/IFG Admin. Cost	83.543	-	-
Hazard Mitigation Grant	83.548	-	494,134
Hazard Mitigation Grant	97.039	-	166,626
Crisis Counseling	97.032	-	-
Emergency Management Performance Grants	97.042	-	-
		<u> -</u>	<u> -</u>
U.S. DEPARTMENT OF HOMELAND SECURITY TOTAL		<u>\$ 221,545</u>	<u>\$ 4,085,027</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2007

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF EDUCATION			
Adult Education-State Grant Program	84.002A	\$ -	\$ -
Special Education - Grants to States	84.027B	1,490,736	2,550,481
Public Library Services (LSCA - Title I)	84.034	-	-
Vocation Education-Basic Grants to the States	84.048B	-	13,568
Byrd Honors Scholarship	84.185A	-	-
Bilingual Education-Professional Development	84.195	-	-
Freely Associated States - Educational Grant Program	84.256A	-	-
Goals 2000-State and Local Education Systemic Improvement Grants	84.276A	739	-
School To Work Opportunities	84.278	-	-
Bilingual Education-Comprehensive School Grants	84.290	-	-
Teacher Quality Enhancement Grants	84.336A	603,971	2,798
Vocational Education-Occupational and Employment Information State Grants	84.346A	-	-
Vocational Education Improvement Project	84.994	-	-
		<u> </u>	<u> </u>
U.S. DEPARTMENT OF EDUCATION TOTAL		<u>\$ 2,095,446</u>	<u>\$ 2,566,847</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2007

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES			
Public Health and Social Services Emergency Fund	93.003	\$ -	\$ -
Maternal and Child Health Federal Consolidated Programs	93.110	64,566	19,381
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	90,990	66,418
Family Planning-Services	93.217	210,663	174,032
Community Health Centers (Community Health Centers, Migrant Health Centers, Health Care for the Homeless, Public Housing Primary Care, and School Based Health Centers)	93.224	-	236,074
Immunization Grants	93.268	680,955	199,696
Abstinence Education Program	93.235	35,169	-
Substance Abuse and Mental Health Services - Projects of Regional and National Significance	93.243	81,159	-
Centers for Disease Control and Prevention-Investigations and Technical Assistance	93.283	711,352	50,783
National Bioterrorism Hospital Preparedness Program	93.889	196,286	57,756
HIV Care Formula Grants	93.917	10,952	9,231
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938	19,745	-
HIV Prevention Activities-Health Department Based	93.940	-	76,539
Epidemiologic Research Studies of AIDS and HIV Infection in Selected Population Groups	93.943	106,596	-
HIV/AIDS Surveillance	93.944	9,322	9,173
Block Grants for Community Mental Health Services	93.958	145,198	-
Block Grants for Prevention and Treatment of Substance Abuse	93.959	278,610	282,473
Preventive Health Services - Sexually Transmitted Diseases Control Grants	93.977	28,246	6,800
Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	93.988	97,589	38,575
Preventive Health and Health Services Block Grant	93.991	28,665	14,952
Maternal and Child Health Services Block Grant to the States	93.994	280,667	193,510
Unknown	93.18C	843	-
Small Business Innovation Research	93.126	6,447	-
CCPI Cancer Program	93.999	-	-
Pacific Cancer Initiative	93.Unknown	-	26,475
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES TOTAL		<u>\$ 3,084,020</u>	<u>\$ 1,461,868</u>
INSTITUTE OF MUSEUM AND LIBRARY SERVICES			
Grants to States	45.310	\$ -	\$ -
INSTITUTE OF MUSEUM AND LIBRARY SERVICES		<u>\$ -</u>	<u>\$ -</u>
GRAND TOTAL		<u>\$ 26,400,908</u>	<u>\$ 64,300,633</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2007

1. Scope of Audit

The Federated States of Micronesia (FSM) is a governmental entity governed by its own Constitution. All significant operations of the FSM are included in the scope of the OMB Circular A-133 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as the FSM's cognizant agency for Single Audit. All programs are received in a direct capacity from the specified grantor agency.

a. Programs Subject to Single Audit

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

2. Summary of Significant Accounting Policies

A. Basis of Accounting

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

B. Reporting Entity

For purposes of complying with The Single Audit Act of 1984, as amended in 1996, the FSM National Government's reporting entity is defined in Note 1A to its September 30, 2007 basic financial statements and all of the discretely presented component units are excluded. Accordingly, the accompanying Schedule of Expenditures of Federal Awards presents the federal award programs administered by the FSM National Government, as defined above, for the year ended September 30, 2007.

C. Indirect Cost Allocation

The FSM National Government did not receive an indirect cost allocation and did not charge indirect costs against federal programs in fiscal year 2006.

D. 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.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2007

2. Summary of Significant Accounting Policies, Continued

E. Subgrantees

Certain program funds are passed through the FSM National Government to subrecipients. The Schedule of Expenditures of Federal Awards does not contain separate schedules disclosing how all subgrantees outside of the FSM National Government's control utilize these funds. However, the FSM National Government's primary subrecipients are its four component states. Per the recommendation of the U.S. Department of the Interior, Office of Inspector General (OIG), the federal expenditures of these entities that were passed through from the FSM National Government are incorporated in the accompanying Schedule of Expenditures of Federal Awards. Direct U.S. federal awards received by the four States are not included in the accompanying Schedule.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Programs
Selected for audit in accordance with
OMB Circular A-133
Year Ended September 30, 2007

<u>Grantor</u>	<u>Description</u>	<u>CFDA No.</u>	<u>Amount of 2007 Expenditures</u>
<u>U.S. Department of the Interior</u>			
	Compact of Free Association:		
	Compact Sector Grants	15.875	\$ 10,107,273
	DOI Technical Assistance	15.875	1,713,151
<u>U.S. Department of Transportation</u>			
	Airport Improvement Program	20.106	6,392,626
<u>U.S. Department of Education</u>			
	Special Education – Grants to States	84.027B	1,490,736
<u>U.S. Department of Health and Human Services</u>			
	CDC and Prevention – Investigations and Technical Assistance	93.283	<u>711,352</u>
	Total program expenditures selected		\$ <u>20,415,138</u>
	Total U.S. Federal Program expenditures		\$ <u>26,400,908</u>
	% of Total U.S. Federal expenditures covered by major programs		<u>77%</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2007

Part I - Summary of Auditors' Results

1. The Independent Auditors' Report on the basic financial statements expressed a qualified opinion due to: 1) the lack of recording a liability for retentions payable in the governmental activities and the Compact Sector Grants Fund; 2) exclusion of certain capital assets in the governmental activities; 3) the inadequacy of accounting records concerning receivables, advances, amounts due to the FSM State Governments and deferred revenue for the governmental activities; 4) the inadequacy of accounting records concerning receivables, advances and amounts due to the FSM State Governments for the General Fund; 5) the inadequacy of accounting records concerning receivables and amounts due to the FSM State Governments for the U.S. Federal Grants Fund; 6) the inadequacy of accounting records concerning deferred revenue for the aggregate remaining fund information; 7) the lack of audited financial statements of Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc.; and 8) the lack of audited financial statements of the National Fisheries Corporation.
2. Significant deficiencies in internal control over financial reporting were identified, some of which were considered to be material weaknesses.
3. Instances of noncompliance considered material to the basic financial statements were disclosed by the audit.
4. Significant deficiencies in internal control over compliance with requirements applicable to major federal award programs were identified, some of which were considered to be material weaknesses.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. The FSM National Government's major programs were:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
Economic Social and Political Development of the Territories:	
Compact Sector Grants	15.875
DOI Technical Assistance	15.875
Airport Improvement Program	20.106
Special Education – Grants to States	84.027B
CDC and Prevention – Investigations and Technical Assistance	93.283

8. A threshold of \$792,027 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
9. The FSM National Government did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Part II - Financial Statement Findings Section

<u>Reference No.</u>	<u>Findings</u>
2007-13	Reconciliation of Federal Grants Receivable
2007-14	Insufficiency of Documents on Procurement and Substantiation
2007-15	Usage of ADB Trust Account
2007-16	Reconciliation with FSM State Governments
2007-17	Construction in Progress and Infrastructure Assets
2007-18	Cash and Liability Reconciliations
2007-19	Embassy Cash Balances
2007-20	Purchase Advances
2007-21	ADB Loans
2007-22	Segregation of Duties
2007-23	Prepaid Cards
2007-24	Unreimbursed CFMS Projects
2007-25	Fixed Asset Reconciliation
2007-26	Timely Reconciliation of Accounts
2007-27	Monitoring of Deferred Revenue

Part III - Federal Award Findings and Questioned Cost Section

<u>Reference No.</u>	<u>CFDA #</u>	<u>Findings</u>	<u>Questioned Costs</u>
2007-01	84.027	Procurement and Suspension and Debarment	\$ -
2007-02	93.283	Procurement and Suspension and Debarment	\$ 33,213
2007-03	15.875	Allowable Costs/Cost Principles and Procurement	\$3,514,805
2007-04	15.875	Procurement and Suspension and Debarment	\$ 18,831
2007-05	20.106	Procurement and Suspension and Debarment	\$ 435,310
2007-06	15.875	Period of Availability of Federal Funds	\$ 65,751
2007-07	93.283	Period of Availability of Federal Funds	\$ 71,535
2007-08	93.283	Allowable Costs/Cost Principles	\$ -
2007-09	15.875	Allowable Costs/Cost Principles and Procurement	\$ -
2007-10	15.875, 84.027 93.283, 20.106	Cash Management	\$ -
2007-11	15.875, 20.106, 84.027, 93.283	Reporting	\$ -
2007-12	15.875, 20.106, 84.027, 93.283	Procurement - Contracts Provision	\$ -
2007-13	15.875, 20.106, 84.027, 93.283	Cash Management – Reconciliation of Federal Grants Receivable	\$ -
2007-25	15.875, 20.106, 84.027, 93.283	Equipment and Real Property Management	\$ -

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-01
 Agency: U.S. Department of Education
 CFDA Program: 84.027 - Special Education – Grants to States
 Grant #: H027A070005, H027B030002-04
 Requirement: Procurement and Suspension and Debarment
 Questioned Costs: \$0

Criteria: Non-payroll expenditures should be supported by purchase requisitions, purchase orders, vendor invoices, receiving reports, contracts, journal vouchers, procurement documents and other underlying supporting documentation validating the expenditure. Furthermore, such should available on file to support required audit requirements.

Conditions:

1. For 5 of 39 (18%) Special Education Program transactions tested, there was insufficient documentation to fully evidence the Program’s procurement of services under the following contracts. While we were able to ensure that we understood management’s execution of the related procurements, we believe that the methods used could be enhanced to foster better technical conduct of the procurements.

	<u>FundOrg</u>	<u>CC</u>	<u>Cost Center Name</u>	<u>Acct No.</u>	<u>APV/JV</u>	<u>Amount</u>
1	303054	NA6091	FY06 NALT. SPECIAL EDUCATION (operations)	8405	700337702	\$ 80,000
2	303054	NA6092	FY06 SPECIAL EDUCATION PROGRAM – projects	8405	700337701	12,789
3	303054	NA6092	FY06 SPECIAL EDUCATION PROGRAM – projects	8405	700363301	<u>261,960</u>
						<u>354,749</u>
6	303054	NA6091	FY06 NALT. SPECIAL EDUCATION	8405	701447301	28,904
7	303054	NA6092	FY06 SPECIAL EDUCATION PROGRAM	8405	701447502	<u>22,853</u>
						<u>51,757</u>
						<u>\$406,506</u>

Cause: Management provided email copies that were represented as being sent to potential service providers. However, there was no follow up or documentation evidencing that the emails had actually been received by the solicited parties or that alternative sources, such as web postings, had been explored.

Effect: The National Government is not fully in compliance with the criteria. No costs have been questioned as we were able to verify that the services were received and the effort made to procure the services. However, management’s understanding of the adequacy of the procurement efforts was not sufficient to maximize potential competition.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-01, Continued

Recommendation: The National Government should retain sufficient documentation on file to support compliance with the requirements. The National Government should consider procuring such services on a multi-year basis to maximize competition among interested parties. Additionally, given the specialized nature of the procured services, we recommend that the Government consider use of a Request for Interest to establish listings of eligible parties and to ensure that RFP preparation considers input received from those parties. These matters were discussed with program management and the Secretary of Education who concurred with the recommendation and who agreed to adopt the recommended measures.

Auditee Response and Corrective Action Plan:

a. APV7003377, APV7003633 Check No. 53601, \$354,749

We agree with this finding and recommendation. These were payments to San Diego State University under contract nos. CC0099 and CC103 executed in FY2006 for Data Management and General Supervision Technical Assistance and Bachelor of Arts Special Education Teacher Training projects, respectively.

An RFP was publicly announced on September 6, 2005. For the bachelor's degree, there were three (3) proposals received from San Diego State University (SDSU), College of Micronesia-FSM (COM-FSM), and University of Guam (UOG). The three proposals were reviewed by a committee consisting of the Executive Director of Special Education, Special Education Key Staff, Deputy Secretary of HESA, and Secretary of HESA. The review committee submitted their recommendation and the Secretary of HESA made the final decision based on the recommendation of the committee. The Secretary of HESA announced the selection of SDSU to deliver the BA program on November 14, 2005.

Since the selection process was not acceptable by the auditor, to correct the above finding, and to maximize potential competition among interested parties, the Secretary of Education has agreed to go to the process of soliciting another RFP on a multi year basis and ensure that alternative sources such as web postings is made.

b. APV7014473, APV7014475 Check No. 73,845, \$51,757

We agree with this finding. This was payment to University of Guam (UOG) under contract nos. CC0135 and CC0136. The RFP was sent out thru email to various institutions and agencies familiar with the Priority Area, but no document on file evidencing that the emails had actually been received by the solicited parties.

To correct the above finding, and to maximize potential competition among interested parties, the Secretary of Education has agreed to go to the process of soliciting another RFP on a multi year basis and ensure that alternative sources such as web postings is made.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-02
 Agency: U.S. Department of Health and Human Services
 CFDA Program: 93.283 – CDC and Prevention – Investigations and Technical Assistance
 Grant #: U90/CCU921821-05
 Requirement: Procurement and Suspension and Debarment
 Questioned Costs: \$33,213

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

Condition: For 5 of 50 (10%) transactions tested for CDC and Prevention – Investigations and Technical Assistance, inadequate procurement documentation exists or no solicitations were performed.

<u>Selection</u>	<u>FundOrg</u>	<u>CC</u>	<u>Acct No.</u>	<u>Amount</u>	<u>APV or JV Reference</u>	<u>Date1</u>
1	413537	NV0708	8405	\$ 7,500	700418801	2/15/07
2	413537	NV0708	8405	7,500	700700401	4/25/07
3	417658	NV6203	8110	10,089	700155001	11/30/06
4	413537	NV0706	8405	4,500	700073901	11/3/06
5	413537	NV0706	8110	<u>3,624</u>	700461801	3/1/07
				<u>\$ 33,213</u>		

Cause: There appears to be a lack of control over ensuring compliance with the criteria.

Effect: The National Government appears to be in noncompliance with the criteria and questioned costs result.

Recommendation: The National Government should comply with grant requirements and should retain sufficient documentation on file to support compliance with those requirements.

Auditee Response and Corrective Action Plan:

- APV7004188 and 7007004, Check Nos. 53536 and 55719 \$15,000.00.

We agree with this finding. These were Payments to Lisa Barrow who is under current contract as National Laboratory Coordinator. The position was not advertised.

A corrective action has been made by the Department of Health by advertising the position of National Laboratory Coordinator position last month in the kaselehli Press (May 21-June 3, 2008 edition), a leading newspaper at FSM to support the next contract for services of a laboratory coordinator.

- APV7001550, Check No. 51687 \$10,089.00.

We agree with this finding. This was payment for airfare to House of Travel for the following travel authorization:

TC2051 Dionis Saimon	\$3,363.16	Pohnpei to Washington DC	Oct. 15-19
TC2052 Stanley Mickey	\$3,363.16	Pohnpei to Washington DC	Oct. 15-19
TC2053 Carmen Jim	\$3,363.16	Pohnpei to Washington DC	Oct. 15-19

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-02, Continued

Auditee Response and Corrective Action Plan, Continued:

In June 25, 2007, acting Secretary of Finance and Administration issued a memorandum requiring all federal and amended compact travel expenditures to provide airfare price quotations that extends travel beyond Guam and Hawaii as alternative airlines service is available beyond those destinations. Travel expenditures within the FSM, Guam and Hawaii do not require price quotations.

We are currently implementing this directive and such finding did not occur after June 25, 2007.

- APV7000739, Check No. 51046 \$4,500.00

We agree with this finding. This was payment for lease rental to EMC Construction under Lease Contract No. CD0051. In summer of 2006, Secretary of the Department of Health, Education and Social Affairs decided to consolidate four of the Department's Kolonia-based program in one office. For this reason a bid for a new office space for the four (4) programs, which included the Bioterrorism (BT) Preparedness program was announced in the Kaselehli Press in August 2006. It was anticipated that a new office was going to be ready by October 2006, however, this did not happen. Instead, it renewed its contract (CD0051) with EMC Construction only to be terminated in January 2007 to move into its new office in February 2007.

The current lease agreement to the new office went through with the competitive bid procurement. Documents supporting the competitive procurement are kept on file at accounting office.

- APV7004618, Check No. 54758 \$3,624.00

We agree with this finding. This was payment for airfare to House of Travel, without the competitive procurement. The travel was made on February 19 to 25, 2007 going to Washington DC. (TD0619). In December 20, 2006, Secretary of Finance and Administration issued a memorandum suspending the required airfare price quotations effective January 1, 2007. The suspension was made due to the result of the comparative analysis and based on the documents obtained from local travel providers that the price differences for air transportation quotations was very minimal, in most cases less than \$5.00 and that price differences will not be expected to increase dramatically within the near future. The comparative price analysis focused within the FSM States and travel to Guam and Hawaii where only one airline is serving.

In June 25, 2007, acting Secretary of Finance and Administration issued another memorandum to supersede the December 2006 memorandum, requiring all federal and amended compact travel expenditures to provide airfare price quotations that extend travel beyond Guam and Hawaii as alternative airlines service are available beyond those destinations. Travel expenditures within the FSM, Guam and Hawaii do not require price quotations.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-03
 Agency: U.S. Department of the Interior
 CFDA Program: 15.875 – Compact Sector Grants
 Grant #: CSG-FSM-2007 Grants, CSG-FSM-2006 Grants, 2004 Carryover Grants
 Requirement: Procurement and Allowable Costs/Cost Principles
 Questioned Costs: \$3,514,805

Criteria:

Conditions:

- For 31 (or 38%) of 82 Compact Sector Program transactions tested, there was either insufficient documentation or none was provided to support competitive procurement requirements. Hereunder are set forth the payments made in fiscal year 2007 and the year in which the related procurement occurred.

	F/Org	CC	Cost Center Name	APV or JV Reference	CK No	Con. No	Original Contract Dates	\$ Amount
1	686802	C68C1A	WENO WASTEWATER COLL. & TREAT.	700450001	393	cd0153	FY05	51,334
2	686802	A68C4B	YAP HOSPITAL RENOVATION	700855401	561	cd0153	FY05	99,387
3	686802	C68C1A	WENO WASTEWATER COLL. & TREAT.	700499202	404	cd0153	FY05	147,019
4	686802	C68C1A	WENO WASTEWATER COLL. & TREAT.	700997801	633	cd0153	FY05	131,055
5	686802	C68C1A	WENO WASTEWATER COLL. & TREAT.	701085701	656	cd0153	FY05	393,166
6	686802	C68C1B	WENO ROAD - PHASE I	700892501	588	cd0153	FY05	183,055
7	686802	C68C1B	WENO ROAD - PHASE I	700920601	603	cd0153	FY05	61,018
8	686802	K68C2B	LELU ELEMENTARY SCHOOL	700449101	385	cd0153	FY05	101,101
9	686802	A68C4B	YAP HOSPITAL RENOVATION	700892701	588	cd0153	FY05	33,129
10	686802	C68C1A	WENO WASTEWATER COLL. & TREAT.	700499201	404	cd0153	FY05	14,793
11	686802	C68C1B	WENO ROAD - PHASE I	700499501	404	cd0153	FY05	13,947
12	686802	A68C4B	YAP HOSPITAL RENOVATION	700499401	404	cd0153	FY05	12,116
13	686802	C68C1A	WENO WASTEWATER COLL. & TREAT.	700442901	376	cd0153	FY05	88,211
14	686802	K68C2E	MALEM/UTWE POWE UPGRADE	700171201	185	cb0458	FY05	147,250
Total FY05								1,476,581
15	686802	C68C2F	DESIGN FOR CHUUK AIRPORT	700726601	498	cc0180	FY06	244,316
16	686802	C68C2F	DESIGN FOR CHUUK AIRPORT	700758001	517	cc0180	FY06	335,889
17	686802	K68C2F	DESIGN FOR KOSRAE AIRPORT	700726602	498	cc0180	FY06	533,477
18	686802	K68C2F	DESIGN FOR KOSRAE AIRPORT	700758002	517	cc0180	FY06	577,902
19	686802	K68C2F	DESIGN FOR KOSRAE AIRPORT	700894502	587	cc0180	FY06	61,591
20	686802	K68C2F	DESIGN FOR KOSRAE AIRPORT	701014402	704	cc0180	FY06	16,480
21	686802	C68C2F	DESIGN FOR CHUUK AIRPORT	701014401	704	cc0180	FY06	15,862
22	741034	NC507D	SPECIALIZED TRAINING PROGRAM	700150101	172	cc0153	FY06	18,375
23	741038	NC509C	INTERNAL CONTROLS EVALUATION	700055601	129	cc0211	FY06	32,080
24	741038	NC509C	INTERNAL CONTROLS EVALUATION	700561401	432	cc0211	FY06	32,080
25	741038	NA511C	BUDGET PREP. & EXEC. ADVISOR	700038701	119	cc0240	FY06	19,892
26	741038	NA512C	ACCOUNTING ADVISOR (FIN.&TAX)	700013501	105	md0170/cc0243	FY06	15,000
Total FY06								1,902,944
27	741401	NC501C	SECTOR PERFORMANCE REPORTING	700365201	347	cd0063	FY07	10,000
28	731071	ND320A	FY07 DOHESA/HEALTH SYSTEM SUPP	700847701	566	cd0233	FY07	14,400
29	721072	ND316B	DOE - PROFESSIONAL CONTRACTOR	701089101	661	cd0277	FY07	45,000
30	731071	ND320B	SUBSIDIES/DIVISION OF HEALTH	700771702	558	cd0199	FY07	22,080
31	731071	ND320A	FY07 DOHESA/HEALTH SYSTEM SUPP	700912101	616	cd0224	FY07	15,600
Total FY07								107,080
Grand Total								\$3,486,605

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-03, Continued

2. For 1 (or 1%) of 82 Compact Sector Program transactions tested, there were either partial or no financial and/or programmatic records (contract, receiving report, invoices, boarding passes, etc.) on file to substantiate the following:

<u>Seln</u>	<u>FundOrg</u>	<u>CC</u>	<u>Cost Center Name</u>	<u>APV or JV Reference</u>	<u>Amount</u>
19	686802	C68C1C	WENO EMERGENCY POWER	JVD0638	28,200
					<u>\$28,200</u>

Cause: There appears to be a lack of control over ensuring compliance with the criteria. It should be noted that the majority of the contracts related to the above costs were entered into in earlier fiscal years and were not initiated in fiscal year 2007. We have noted improvements in 2007 procurement activities and in attendant controls and we have seen additional measures taken in fiscal year 2008 that should assist in this regard. However, the lack of procurement controls exercised in prior years appears to be the cause of the above condition.

Effect: The National Government appears to be in noncompliance with the criteria and questioned costs result.

Recommendation: The National Government should comply with grant requirements and should retain sufficient documentation on file to support compliance with those requirements.

Auditee Response and Corrective Action Plan:

- The payments to GMP Hawaii under contract CD0153 were amendment to original contract no. CB0277 and CC0458 executed in 2005 for options set forth in the contract. In the original contract, options were enumerated for various projects without details of scope, terms and conditions. In a letter from OIA, it authorizes the use of the existing contract for ongoing work to avoid delays to the infrastructure program.

We will discuss this finding with the Secretary of Transportation and Infrastructure together with the Project Management Unit (PMU) Project Manager to come up with resolution for this finding before September 30, 2008.

- The payments to Leo Daly were an addendum no. 1 to Contract no. CC0180 executed in June 6, 2006 to provide the design of various airfield improvements for Chuuk and Kosrae International Airports.

It must be noted that in November 2004, the FSM Department of Transportation, Communications and Infrastructure solicited proposals from interested Architectural and Engineering (A&E) company for the design and construction of the eight (8) FSM Projects which includes a.) Design of the improvement of aircraft marking, lightning and signage for Kosrae and Chuuk International Airports, b.) Design for rehabilitation of terminal apron and airfield marking, signage and lighting for Yap International Airport, c.) Design for improvement & expansion of terminal apron area for Kosrae International Airport and d.) Design for Yap International Airport's damage facilities.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-03, Continued

Auditee Response and Corrective Action Plan, Continued:

Nine (9) Engineering companies responded among them Ignite/BECA, Leo Daly, SSFM, EFC, GMP,RW Armstrong, Lyon Associates, EM Chen and Mead & Hunt. FSM. Selection committee reviewed and ranked each company in accordance with FSM's bid evaluation & selection criteria. Leo A. Daly ranked first and was awarded (1) Yap international building, (2) Yap apron rehabilitation, (3) Chuuk airfield improvement, (4) Kosrae airfield improvement, and 5) Prepare airport system plan for FSM.

The information and documentation above were not provided during the audit process. We will submit the supporting documents to Deloitte & Touche before September 30, 2008.

- The payment to Kosrae State Treasury represents Compact 11 matching fund to Kosrae FEMA project for Malem/Utwe distribution system upgrade under grant no. GR670162.

The following is the narrative report of basic technical information and data in connection with the construction development and progress of the above mentioned project.

The Malem/Utwe distribution system upgrade (13.8KV Pole hardening project) was FEMA funded project under the hazard Mitigation grant program (FEMA-1427-DRFM) in the amount of \$929,001 (Federal Share =\$696,751 + Kosrae State Share=\$147,250 + KUA Share =\$85,000)

Kosrae State Government has stated in their report that invitation to bid was signed on March 28, 2005, published/advertised locally and in the website. The bid closing was June 30, 2005 and bids were opened on June 30, 2006 @ 2:20 pm.. Two international contractors participated and submitted tenders. Black Micro Corp. with bid price of \$2,288,082 & Sam Young Electric Co. with price of \$1,849,641. The committee evaluation reports showed that the bid prices were too high. The recommendation with KEPIC, with approval of FEMA, was to issue another RFP with the same scope of work to KUA. Finally, the project was awarded September 2, 2005 and contracted to KUA on October 10,2005 in the amount of \$920,2001. The contract duration was October 10, 2005 to September 30,2007.

The information and documentation above were not provided during the audit process. We will submit the supporting documents to Deloitte & Touche before September 30, 2008.

- The MI Corporation payment was under contract no. CD0277 to conduct personnel audit in Chuuk Department of Education. MI Corporation is a local based Corporation who was the sole respondents to RFP NO. NDOE07-03.
- Payments to KMH International, Alex Smith, Paul Young Fenlon, Canvass Back Mission, and Michael John Walker were not supported by competitive procurement. We will request from the departments concerned to provide the necessary justification to clear this findings before September 30, 2008.

In FY08, the certification accountants were strictly instructed to maintain complete supporting documents that pertain to competitive procurement requirement. The supporting documents for competitive procurement must be submitted and retained on file in the accounting records.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No: 2007-04
 Agency: U.S. Department of the Interior
 CFDA #: 15.875
 Grant #: MOU
 Program Name: Technical Assistance Grants: Evaluation of Overseas Medical Referral Program, FSM Financial Management Improvement
 Requirement: Procurement
 Questioned Costs: \$18,831

Criteria: Expenditures should be necessary and reasonable for program needs and should be in accordance with program requirements. Procurements shall provide full and open competition among vendors, and any allowable exceptions should be approved and documented in the procurement file.

Condition: For 2 (or 1%) of 39 Technical Assistance Program transactions tested, no competitive procurement documentation was available.

<u>FundOrg</u>	<u>CC</u>	<u>Acct No.</u>	<u>Acct Name</u>	<u>Amount</u>	<u>APV or JV Reference</u>	<u>Date</u>
373648	NH4566	8405	Contractual Services	\$12,203	700914801	6/19/2007
373654	NH2563	8408	Professional Services	<u>6,628</u>	700056201	10/30/2006
				<u>\$18,831</u>		

Cause: There appears to be a lack of control over ensuring compliance with the criteria.

Effect: The National Government appears to be in noncompliance with the criteria and questioned costs result.

Recommendation: We recommend that the National Government exercise more stringent policies in requiring supporting documents to be maintained and available.

Auditee Response and Corrective Action Plan:

- APV7009148 Check No. 57282 \$12,203

This was payment to Trinity Health International (THI) under contract no. CC0104 executed in FY06. As stated in the previous audit response under finding No. 2006-04, and as justified by the Secretary of Department of Health, Education and Social affairs on September 25, 2006, THI was selected to be the single sourced contractor. The Assistant Secretary for National Treasury will request from Secretary of Health to provide additional documents justifying the selection of THI for the resolution of prior year and current findings before September 30, 2008.

- APV7000562 Check No. 50830 \$6,628

We agree with this finding. This was payment to Lee Sinclair under contract no. CC0123 executed in 2006 to provide Project Management of Implementation of Financial Management Information System. There was no justification to support the selection of Lee Sinclair. Lee Sinclair contract ended on November 16, 2006. His position was advertised and Deborah Atwoods was selected as the new project manager for the FMIS. Competitive procurement and supporting documents for the new FMIS Manager is being kept at Personnel and accounting divisions.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-05
 Federal Agency: U.S. Department of Transportation Federal Aviation Administration
 Grant #: 3-64-0002-08, 3-64-0004-08
 CFDA #: 20.106
 Program Name: Airport Improvement Program
 Requirement: Procurement and Suspension and Debarment
 Questioned Costs: \$435,310

Criteria: Expenditures should be necessary and reasonable for program needs and should be in accordance with program requirements. Furthermore, financial and programmatic records should be maintained on file for at least three years. Procurements shall provide full and open competition among vendors, and allowable exceptions should be approved and documented in procurement file.

Conditions:

1. For 6 (or 13%) of 39 Airport Improvement Program transactions tested, no competitive procurement documentation was available to support the following payments against contracts that were procured in fiscal year 2006.:

<u>FundOrg</u>	<u>CC</u>	<u>Cost Center Name</u>	<u>APV or JV#</u>	<u>\$ Amount</u>	<u>Obligating Doc No (Contract/ PO/TA)</u>
335007	PH6004	PNI REHABIL. RUNWAY-PHASE I	700080101	89,906	cc0173
		YAP APRON REHABILITATE			
335008	AH6003	(DESIGN)	700026601	148,200	cc0180
		YAP APRON REHABILITATE			
335008	AH6003	(DESIGN)	700364101	161,528	cc0180
		YAP APRON REHABILITATE			
335008	AH6003	(DESIGN)	700724301	20,520	cc0180
335008	AH6003	Architecture and Design	700901801	2,280	
335008	AH6003	Architecture and Design	700585101	<u>12,876</u>	CC018001
				<u>\$435,310</u>	

Cause: There appears to be a lack of control over ensuring compliance with the criteria.

Effect: The National Government appears to be in noncompliance with the criteria and questioned costs result.

Recommendation: The National Government should comply with grant requirements.

Auditee Response and Corrective Action Plan:

- APV7000801 Check No. 51999 \$ 89, 906.00

This was payment to Black Micro under contract no. CC0173. In FY06, the same finding was made under CC0173 for which we disagree with the finding. We had previously provided to Deloitte & Touche' the justification, copy of the Request for Proposal (RFP) advertised in Pacific Daily News and other communication concurring to the contract from AIP officer.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-05, Continued

Auditee Response and Corrective Action Plan, Continued

We will continue to work with the auditor for the possible resolution of prior and current year findings no later than September 30, 2008.

- APV7000266,7000364,7007243,7009018,7005851 \$345,404.00

These were payments to Leo A. Daly under contract no. CC0180 executed in 2006. These payments represent 5% matching share of AIP.

As indicated in audit finding no. 2007-03. There was competitive procurement made in November 2004 under contract no. CC0180 but such was not provided to the auditor during the audit process.

We will provide the competitive procurement documents to Deloitte & Touche on or before September 30, 2008 for resolution of this finding.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-06
 Agency: U.S. Department of the Interior
 CFDA Program: 15.875 – Other Technical Assistance
 Grant #: FSM77, FSM104, FSM93, FSM111, HOFSM-2, MCI-8, FSM109, FSM103, FSM105, 134-387-823
 Requirement: Period of Availability of Federal Funds
 Questioned Costs: \$65,751

Criteria: Expenditures should be incurred and be liquidated within the grant period of availability (POA). Grantor's approvals that extend the POA should be readily available for verification.

Condition: The following items were posted after the POA. Grant extensions or grantor approval for liquidations past the POA were not available.

<u>CC</u>	<u>Grant #</u>	<u>Lapse Date</u>	<u>Ext Date</u>	<u>POA Date</u>	<u>Object Class</u>	<u>Date</u>	<u>Ref</u>	<u>Past POA Amt</u>
	FSM 77 Amd 2, FSM 104 &	2/2001 2/2004						
NH6577	FSM 93 Amd 1	2/2005		May-05	Travel & Transportation	11/23/06	700130301	\$ 895
	FSM 77 Amd 2, FSM 104 &	2/2001 2/2004						
NH6577	FSM 93 Amd 1	2/2005		May-05	Travel & Transportation	12/5/06	700177701	1,243
	FSM 77 Amd 2, FSM 104 &	2/2001 2/2004						
NH6577	FSM 93 Amd 1	2/2005		May-05	Travel & Transportation	12/13/06	700202601	1,934
	FSM 77 Amd 2, FSM 104 &	2/2001 2/2004						
NH6577	FSM 93 Amd 1	2/2005		May-05	Travel & Transportation	12/14/06	700210801	1,986
	FSM 77 Amd 2, FSM 104 &	2/2001 2/2004						
NH6577	FSM 93 Amd 1	2/2005		May-05	Travel & Transportation	12/14/06	700211001	1,536
	FSM 77 Amd 2, FSM 104 &	2/2001 2/2004						
NH6577	FSM 93 Amd 1	2/2005		May-05	Travel & Transportation	12/19/06	700222201	11,165
					Contractual Services -			
NH4566	fsm-111	Mar-06	8/01/06	Oct-06	Other	6/19/07	700914801	12,203
	FSM 77 Amd 2, FSM 104 &	2/2001 2/2004						
NH6577	FSM 93 Amd 1	2/2005		May-05	Travel & Transportation	7/25/07	700202601	(1,934)
NH4571	HOFSM - 2	Dec-05	5/30/07	Aug-07	Travel & Transportation	9/25/07	JVD0993	1,539
	FSM 77 Amd 2, FSM 104 &	2/2001 2/2004						
NH6577	FSM 93 Amd 1	2/2005		May-05	Travel & Transportation	9/30/07	701482701	1,934
					Contractual Services -			
NH6002	134-387-823	31-Oct-06		29-Jan-07	Other	9/30/07	JVD0532	33,250
								<u>\$65,751</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-06, Continued

Cause: There appears to be a lack of control over ensuring compliance with the criteria. The untimely liquidation of advances appears to have compounded the problem.

Effect: There appears to be possible noncompliance with the criteria and questioned costs result.

Recommendation: The National Government should comply with grant requirements and should retain sufficient documentation on file to support compliance with those requirements. Moreover grant period of availability should be closely monitored. Advances should be timely liquidated.

Auditee Response and Corrective Action Plan: We agree with this finding. Most of these expenditures were liquidation of Purchase advances and travel advances. When the advance was issued, it was still within the period of availability, however, the recording of liquidation passed the period of availability. During the audit process we could not provide documents as to the extension of the program grants. We will work closely with the Department concerned to provide us with the documentation extending the use of the grant.

In FY08, corrective action has been made with the untimely liquidation of travel advances and purchase advances. The procurement and supply section and travel section were strictly instructed to liquidate the advances within the period of availability and that any extension of the grant must be properly kept on file.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-07
 Agency: U.S. Department of Health and Human Services
 CFDA Program: 93.283 – CDC and Prevention – Investigations and Technical Assistance
 Grant #: U90/CCU921821-04, U90/CCU921921-04-1, U90/CCU921921-04-05,
 U90/CCU921821-02-1, U90/CCU921921-05-5
 Program Name: Public Health Preparedness and Response, Chronic Disease Prevention, CDC
 Health and Promotions Programs
 Requirement: Period of Availability of Federal Funds
 Questioned Costs: \$71,535

Criteria: Expenditures should be incurred and be liquidated within the grant period of availability (POA). Grantor approval that extends the grant POA should be readily available for verification.

Condition: The following items were posted after the POA. The entity was not able to provide a grant extension or grantor approval allowing liquidation to occur outside the POA.

CC	Project Period	Budget Period	Lapse Date	POA Date	POA	Object Class	Date	APV / JV	Oblig Doc	
					Questioned Cost					
NV0415	9/30/2002 - 9/30/2005	9/15/2003 - 8/30/2004	-	08/30/04	11/28/04	\$ 1,377	Travel & Transportation	8/14/07	701220601	TA1820
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	2,097	Travel & Transportation	12/14/06	700209601	TC1837
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	1,575	Travel & Transportation	12/14/06	700209401	TC1840
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	22,965	Contractual Services - Other	12/29/06	700305101	CC012701
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	4,270	Contractual Services - Other	3/2/07	700463901	CC012701
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	500	Freight	7/18/07	701076722	N6023526
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	495	Office Supplies And Materials	7/18/07	701076704	N6023508
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	445	Office Supplies And Materials	7/18/07	701076702	N6023506
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	341	Office Supplies And Materials	7/18/07	701076705	N6023509
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	278	Office Supplies And Materials	7/18/07	701076715	N6023519
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	245	Office Supplies And Materials	7/18/07	701076717	N6023521
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	235	Office Supplies And Materials	7/18/07	701076708	N6023512
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	213	Office Supplies And Materials	7/18/07	701076710	N6023514

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-07, Continued

Condition, Continued

CC	Project	Budget	Lapse	POA	POA	Object Class	Date	APV / JV	Oblig Doc	
	Period	Period	Date	Date	Questioned Cost					
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	202	Office Supplies And Materials	7/18/07	701076711	N6023515
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	196	Office Supplies And Materials	7/18/07	701076703	N6023507
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	175	Office Supplies And Materials	7/18/07	701076714	N6023518
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	162	Office Supplies And Materials	7/18/07	701076712	N6023516
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	160	Office Supplies And Materials	7/18/07	701076720	N6023524
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	143	Office Supplies And Materials	7/18/07	701076718	N6023522
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	139	Office Supplies And Materials	7/18/07	701076701	N6023505
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	125	Office Supplies And Materials	7/18/07	701076713	N6023517
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	102	Office Supplies And Materials	7/18/07	701076721	N6023525
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	95	Office Supplies And Materials	7/18/07	701076709	N6023513
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	81	Office Supplies And Materials	7/18/07	701076716	N6023520
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	77	Office Supplies And Materials	7/18/07	701076707	N6023511
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	57	Office Supplies And Materials	7/18/07	701076719	N6023523
NV0606	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	19	Office Supplies And Materials	7/18/07	701076706	N6023510
NV0608	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	5,069	Equipment	4/18/07	700677801	L6092901
NV0608	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	4,670	Equipment	9/30/07	JVD0602	N60231-1
NV0608	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	4,670	Equipment	9/30/07	JVD0602	N60252-1
NV0608	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	1,868	Freight	9/30/07	JVD0602	N60231-2
NV0610	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	110	Travel & Transportation	3/22/07	700569201	TC1456
NV0612	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	2,025	Medical Supplies	12/14/06	700210903	L6092603
NV0612	8/31/2005 - 8/30/2010	8/31/2005 - 8/30/2006	-	08/30/06	11/28/06	1,969	Medical Supplies	12/14/06	700210902	L6092602

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-07, Continued

Condition, Continued

<u>CC</u>	<u>Project Period</u>	<u>Budget Period</u>	<u>Lapse Date</u>	<u>POA Date</u>	<u>POA Questioned Cost</u>	<u>Object Class</u>	<u>Date</u>	<u>APV / JV</u>	<u>Oblig Doc</u>
	8/31/2005 -	8/31/2005 -							
NV0612	8/30/2010	8/30/2006	08/30/06	11/28/06	1,889	Medical Supplies	12/14/06	700210901	L6092601
	8/31/2005 -	8/31/2005 -							
NV0612	8/30/2010	8/30/2006	08/30/06	11/28/06	1,485	Medical Supplies	12/14/06	700210603	L6088303
	8/31/2005 -	8/31/2005 -							
NV0612	8/30/2010	8/30/2006	08/30/06	11/28/06	1,444	Medical Supplies	12/14/06	700210602	L6088302
	8/31/2005 -	8/31/2005 -							
NV0612	8/30/2010	8/30/2006	08/30/06	11/28/06	1,385	Medical Supplies	12/14/06	700210601	L6088301
	8/31/2005 -	8/31/2005 -				Printing	And		
NV0612	8/30/2010	8/30/2006	08/30/06	11/28/06	150	Reproduction	1/18/07	700306501	L6082802
	8/31/2005 -	8/31/2005 -							
NV0612	8/30/2010	8/30/2006	08/30/06	11/28/06	1,868	Freight	9/30/07	JVD0602	N60252-2
	6/30/2003 -	6/30/2004 -							
NV4100	6/29/2008	3/31/2005	03/31/05	06/29/05	422	Travel & Transportation	9/24/07	701388001	TA2102
	6/30/2003 -	6/30/2005 -				Office Supplies	And		
NV5100	6/29/2006	6/29/2006	06/29/06	09/27/06	1,098	Materials	11/9/06	JVD0006	N6017202
	6/30/2003 -	6/30/2005 -				Office Supplies	And		
NV5100	6/29/2006	6/29/2006	06/29/06	09/27/06	998	Materials	11/9/06	JVD0006	N6017201
	6/30/2003 -	6/30/2005 -				Office Supplies	And		
NV5100	6/29/2006	6/29/2006	06/29/06	09/27/06	600	Materials	11/9/06	JVD0006	N6017302
	6/30/2003 -	6/30/2005 -				Office Supplies	And		
NV5100	6/29/2006	6/29/2006	06/29/06	09/27/06	560	Materials	11/9/06	JVD0006	N6017303
	6/30/2003 -	6/30/2005 -				Office Supplies	And		
NV5100	6/29/2006	6/29/2006	06/29/06	09/27/06	400	Materials	11/9/06	JVD0006	N6017301
	6/30/2003 -	6/30/2005 -				Office Supplies	And		
NV5100	6/29/2006	6/29/2006	06/29/06	09/27/06	398	Materials	11/9/06	JVD0006	N6017203
	6/30/2003 -	6/30/2005 -				Office Supplies	And		
NV5100	6/29/2006	6/29/2006	06/29/06	09/27/06	177	Materials	11/9/06	JVD0006	N6017313
	6/30/2003 -	6/30/2005 -				Office Supplies	And		
NV5100	6/29/2006	6/29/2006	06/29/06	09/27/06	86	Materials	11/9/06	JVD0006	N6017305
	6/30/2003 -	6/30/2005 -				Office Supplies	And		
NV5100	6/29/2006	6/29/2006	06/29/06	09/27/06	86	Materials	11/9/06	JVD0006	N6017306
	6/30/2003 -	6/30/2005 -				Office Supplies	And		
NV5100	6/29/2006	6/29/2006	06/29/06	09/27/06	78	Materials	11/9/06	JVD0006	N6017304
	6/30/2003 -	6/30/2005 -				Office Supplies	And		
NV5100	6/29/2006	6/29/2006	06/29/06	09/27/06	76	Materials	11/9/06	JVD0006	N6017307
	6/30/2003 -	6/30/2005 -				Office Supplies	And		
NV5100	6/29/2006	6/29/2006	06/29/06	09/27/06	76	Materials	11/9/06	JVD0006	N6017309

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-07, Continued

Condition, Continued

CC	Project	Budget	Lapse	POA	POA	Object Class	Date	APV / JV	Oblig Doc
	Period	Period	Date	Date	Questioned Cost				
NV5100	6/30/2003 -	6/30/2005 -				Office Supplies And			
	6/29/2006	6/29/2006	06/29/06	09/27/06	76	Materials	11/9/06	JVD0006	N6017312
NV5100	6/30/2003 -	6/30/2005 -				Office Supplies And			
	6/29/2006	6/29/2006	06/29/06	09/27/06	48	Materials	11/9/06	JVD0006	N6017308
NV5100	6/30/2003 -	6/30/2005 -				Office Supplies And			
	6/29/2006	6/29/2006	06/29/06	09/27/06	46	Materials	11/9/06	JVD0006	N6017310
NV5100	6/30/2003 -	6/30/2005 -				Office Supplies And			
	6/29/2006	6/29/2006	06/29/06	09/27/06	40	Materials	11/9/06	JVD0006	N6017311
NV5100	6/30/2003 -	6/30/2005 -							
	6/29/2006	6/29/2006	06/29/06	09/27/06	904	Travel & Transportation	3/1/07	700457801	TC1250
					<u>\$71,535</u>				

Cause: There appears to be a lack of control over ensuring compliance with the criteria. The untimely liquidation of advances appears to have compounded the problem.

Effect: There appears to be possible noncompliance with the criteria and questioned costs result.

Recommendation: The National Government should comply with grant requirements and should retain sufficient documentation on file to support compliance with those requirements. Moreover, grant POA should be closely monitored and advances timely liquidated.

Auditee Response and Corrective Action Plan: We agree with this finding. Most of these expenditures were liquidation of Purchase advances and travel advances. When the advance was issued, it was still within the period of availability, however, the recording of liquidation passed the period of availability. During the audit process we could not provide documents as to the extension of the program grants. We will work closely with the Department of Education and Health to provide us with the documentation extending the use of the grant.

In FY08, corrective action has been made with the untimely liquidation of travel advances and purchase advances. The procurement and supply section and travel section were strictly instructed to liquidate the advances within the period of availability and that any extension of the grant must be properly kept on file.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-08
Agency: U.S. Department of Health and Human Services
CFDA Program: 93.283 – CDC and Prevention – Investigations and Technical Assistance
Grant #: U58-CCU922946-04
Requirement: Allowable Costs/Cost Principles
Questioned Costs: Not Determinable

Criteria: Expenditures should be incurred within the approved budget. Amount exceeding the budget should be documented by grantor approval, if necessary, and be readily available for verification.

Condition: Actual travel expenditures incurred by the National Government exceeded the approved travel budget for the entire Nation. The National Government was not able to provide the State travel expenditures for us to determine the exact overage. Moreover, grantor approval or an amended budget to rationalize the overage was also not available.

<u>Fund org</u>	<u>CC</u>	<u>Account Name</u>	<u>Amount</u>
413536	NV6100	Travel and Transportation expenses	\$ 35,872
		Travel Budget for the entire FSM	<u>29,570</u>
		Over expenditure	<u>\$ 6,302</u>

Cause: There appears to be a lack of control over ensuring compliance with the criteria.

Effect: There appears to be possible noncompliance with the criteria. We cannot determine the exact dollar amount of costs that should be questioned as a result of this finding since State expenditure reports were not provided.

Recommendation: The National Government should comply with grant requirements and should retain sufficient documentation on file to support compliance with those requirements.

Auditee Response and Corrective Action Plan: We disagree with this finding. The auditor is looking at the grant award with original travel budget of \$29,570. During the implementation of the grant, the budget was changed with grantor approval due to reprogramming of funds which includes the travel. The total budget of travel as of September 30, 2007 increased to \$40,851 as compared to the original budget of \$29,570.

We will provide the grantor approval for the reprogramming no later than September 30, 2008.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-09
Federal Agency: US Department of the Interior
Grant #: GR670039
CFDA #: 15.875
Program Name: Compact Sector Infrastructure Grant
Requirement: Allowable Costs/Cost Principles and Procurement
Questioned Costs: \$0

Criteria: Expenditures should be necessary and be reasonable for program needs and should be procured in accordance with program and local requirements.

Condition: Certain Infrastructure grants are appropriated by Congress with the approval of the grantor to fund a 5% AIP local match. In recalculating the required 5% AIP match, expenditures were charged to the matching cost center that exceeded the required match. It appears that certain non-matching expenditures were charged to this account. The National Government was not able to provide the rationale supporting the overmatch and additionally, was not able to document whether the subject expenditures were appropriate under the sector grant to which they were originally charged. Therefore, we cannot determine the legal basis for these expenditures and why they were charged in this manner or the competitive procurement activities to which they were subjected.

Recalculated match	\$ 336,454
Expenditures in Infra Fund	<u>348,732</u>
Over expenditure	<u>\$ (12,278)</u>

Cause: There appears to be a lack of control over ensuring compliance with the criteria.

Effect: The National Government appears to be in noncompliance with the criteria. However, no questioned costs resulted from the condition since the above noted expenditures were subsequently charged to local funds.

Recommendation: The National Government should comply with grant and appropriation requirements. Determination should be made if the above expenditures are chargeable to the department's budget.

Auditee Response and Corrective Action Plan: We agree with this finding. The over expenditure was the result of purchase of computer and furniture and fixture for the administration.

To correct this finding, we have requested approval from the grantor to move the 95% expenditure to the AIP account which was granted. A journal voucher was made in FY08 and was inputted in fiscal year 2008.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-10

Agency: U.S. Department of the Interior
U.S. Department of Transportation
U.S. Department of Education
U.S. Department of Health and Human Services

CFDA Program: 15.875 – DOI Other Technical Assistance Grants
84.027 - Special Education – Grants to States
93.283 – CDC and Prevention – Investigations and Technical Assistance

Grant #: 20.106 – Airport Improvement Projects (AIP)
H027A070005, H027B030002-04
U90/CCU921821-05

Requirement: Cash Management

Questioned Costs: \$0

Criteria: In accordance with applicable cash management requirements, the time elapsed between the receipt of Federal funds and the clearing of the applicable check should be minimized and any amounts for interest from advances in excess of the minimum allowable should be returned to the federal government.

Condition: For CFDA# 20.106, 84.027 and 93.283, the National Government received cash in excess of its immediate needs. An interest liability thus results.

In addition, for all 39 samples of CFDA #15.875, for 10 of 48 (21%) samples for CFDA#93.283 and for 1 of 39 (3%) samples for CFDA #20.106; the National Government could not provide documented details of certain drawdown per GAPS for the program. Therefore, it is not possible to ensure compliance with cash management requirements.

Cause: There appears to be a lack of internal controls over cash management and the National Government does not have ACH capacity, which exacerbates the cash management function.

Effect: The National Government appears to be in noncompliance with applicable cash management requirements. However, no questioned costs result from this condition as the assessed interest liability is less than the \$10,000 threshold.

For CFDA # 15.875, and certain items of CFDA#20.106 and CFDA# 93.283, it is not possible to determine the amount, if any, of the questioned costs due to the lack of available information.

Recommendation: The Government should follow applicable federal cash management policies. We are aware that the Government does not have the ability to utilize ACH as banks in the FSM do not provide that service. Therefore, we recommend that this matter be referred to JEMCO and an alternative to the three day rule be proposed. We will be happy to provide additional information for an alternative if such will be of assistance.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-10, Continued

Auditee Response and Corrective Action Plan: We agree with this finding. The Federated States of Micronesia operates in an isolated environment. Local banks do not provide ACH services and many payments are made to those who do not have bank accounts. Therefore, cash management compliance can become quite difficult.

FSM will contemplate to engage in an extensive study of its cash management clearance pattern or will have to obtain federal approval for an alternative clearance pattern. We will bring this matter to the attention of JEMCO for approval and to the other federal agencies.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding: 2007-11

Agency: U.S. Department of the Interior
U.S. Department of Transportation
U.S. Department of Education
U.S. Department of Human and Health Services

CFDA Program: 15.875 – DOI Other Technical Assistance Grants
20.106 – Airport Improvement Projects
84.027 – Special Education – Grants to States
93.283 – CDC and Prevention – Investigation and Technical Assistance

Grant #: Various

Requirement: Reporting

Questioned Costs: \$0

Criteria: Financial Status Reports (FSR's), SF 270 Request for Advance or Reimbursement, SF-271 Outlay Report and Request for Reimbursement for Construction Programs and/or its equivalent report as applicable to the program should be correctly completed and submitted in accordance with grant terms and conditions. Moreover, reports submitted should reconcile with underlying programmatic records.

Condition: For the following programs, FSR's, SF 270 Request for Advance or Reimbursement, SF-271 Outlay Report and Request for Reimbursement for Construction Programs and/or its equivalent report as applicable to the program were not provided and therefore, we could not ensure that the data in the reports is in agreement with the underlying financial statement records.

15.875 – DOI Technical Assistance Grants
20.106 – Airport Improvement Projects
84.027 – Special Education – Grants to States
93.283 – CDC and Prevention – Investigation and Technical Assistance

Cause: There appears to be a lack of control over the preparation and correctness of program financial reports.

Effect: Noncompliance with reporting requirements results from this condition.

Recommendation: The National Government should comply with the criteria.

Auditee Response and Corrective Action Plan: We agree with this finding and recommendation. The grant analyst has been working to update and complete the Financial Status Reports (FSR).

We will submit the complete and reconciled reports no later than September 30, 2008.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-12
 Agency: U.S. Department of the Interior, U.S. Department of Transportation, U.S. Department of Education, U.S. Department of Health and Social Services
 CFDA Program: 15.875 Compact Sector Grants
 15.875 Technical Assistance
 20.106 Airport Improvement Projects
 84.027 Special Education
 93.283 CDC and Prevention - Investigations and Technical Assistance
 Grant #: H027A070005, H027B030002-04, U90/CCU921821-05, CSG-FSM-2007 Grants, CSG-FSM-2006 Grants, 2004 Carryover Grants, FSM-111 Amendment-1, FSM-103, MCI-14 Amendment- 2, MOU, FSM77, FSM104, FSM93, FSM111, HOFSM-2, MCI-8, FSM109, FSM103, FSM105, 134-387-823
 Requirement: Procurement - Contract Provisions
 Questioned Costs: \$0

Criteria: For all contracts, 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 the 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 that specific 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.

Conditions: The following number of instances of non-compliance with the criteria occurred:

<u>Program</u>	<u>No of Contracts</u>	<u>Aggregate \$ Amt of Contracts</u>
Compact Sector	9	20,036,330
Technical Assistance	2	2,324,506
Airport Improvement Projects	7	16,695,900
Special Education	3	1,681,824
Bioterrorism/CDC	1	145,000

Cause: There appears to be a lack of control over ensuring compliance with the criteria.

Effect: The National Government appears to be in noncompliance with the criteria; however, no questioned costs result.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-12, Continued

Recommendation: The National Government should strengthen its control over ensuring that the abovementioned contract provisions and requirements are included, as applicable, in contracts.

Auditee Response and Corrective Action Plan: We agree with this finding. After the completion of FY06 audit in July 2007, contract for design and construction funded under the amended compact has the applicable provisions in the contract that was executed August 2007 onward.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-13
 Agency: All
 CFDA #: All
 Grant #: All
 Requirement: Cash Management - Reconciliation of Federal Grants Receivable
 Questioned Costs: \$0

Criteria: Receivables due from the federal government should be aggregated by CFDA number. Collections should be applied against a specific CFDA number/program. This detail can be maintained apart from the general ledger system but should be regularly reconciled with related general ledger balances. Abnormal balances should be timely identified and reconciled.

Condition: In the current year, effort has been made to reconcile and identify federal grant receivables. However such is not yet complete. Moreover, receivables with negative balances originating in prior years are still not completely reconciled and are presented as payables in the financial statements.

Acct Num	Grantor	Acct Name	\$ Amount
32 - 305	DOL	FEDERAL GRANT REC. US	(142,818)
33 - 305	DOT	FEDERAL GRANT REC. US	(32,676)
34 - 304	USDA	DRAWDOWNS REC. GRANTS	(121,149)
35 - 305	USDOJ	FEDERAL GRANT REC. US	(20,632)
41 - 305	DHHS	FEDERAL GRANT REC. US	(1,175,962)
41 - 308	DHHS	OTHER GRANT D/D REC.	(409,330)
Total			<u><u>\$(1,902,567)</u></u>

In addition, no aging or reconciliation was provided for the advances by the states account which totals \$318,848.

Cause: It appears that although effort to reconcile the federal receivable per CFDA number or by program has occurred, substantial additional effort is required to achieve full correction.

Effect: As a result of this condition, it is difficult to determine the amount that should be provided for an allowance for doubtful accounts for the recorded receivables due from the U. S. Government. Moreover a portion of the above amount could relate to payables to the States and this condition appears to compound the current difficulties of reconciling the National Government's records to those of its subrecipients.

Recommendation: We recommend that federal program receivables be identified per CFDA number and by program and that collections be specifically applied against those receivables. The above beginning balances should be reconciled, which will facilitate the reconciliation with the Governments subrecipients. A reconciliation of accounts between the States and National Government should occur after the aforementioned balances have been reconciled.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-13, Continued

Auditee Response and Corrective Action Plan: We agree with this finding. As indicated in the condition, effort has been made to reconcile and identify federal program receivable in the current year but the prior years remain un-reconciled. This was a repeat finding in FY06, and as compared with FY06 negative balances of \$4 million such amount reduced to negative \$1.9 million. We will continue to reconcile the AR federal grants and by the end of September 30, 2008, the amount should reflect the accurate current balance.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No. 2007-14 – Insufficiency of Documents on Procurement and Substantiation

Criteria: Non-payroll expenditures should be supported by purchase requisitions, purchase orders, vendor invoices, receiving reports, contracts, journal vouchers, procurement documents and other underlying supporting documentation validating the expenditure. Furthermore, such should be kept on file and be available for audit purposes.

Conditions:

1. For 1 (or 1%) of 92 General Fund transactions tested, no competitive procurement documents (quotations for travel beyond Guam/Hawaii) were made available for review.

<u>FundOrg</u>	<u>Org Name</u>	<u>CC</u>	<u>Date 1</u>	<u>APV or JV#</u>	<u>FY</u>	<u>Amount</u>
101100	FOSTER POLITICAL RELATIONSHIPS	IS1001	5/4/2007	700735801	2007	\$36,369.08

2. For 12 (or 16%) of 92 General Fund transactions tested, no supporting documentation/or insufficient documentation was provided to support these expenditures:

<u>FundOrg</u>	<u>Org Name</u>	<u>CC</u>	<u>Date 1</u>	<u>APV or JV#</u>	<u>FY</u>	<u>Amount</u>
101382	U.N. And Specialized Agencies	SS6003	11/24/2006	700136101	2007	\$ 60,000
101257	International Telecomm Union	SS6034	11/28/2006	700148901	2007	55,000
101400	Office Of Compact Management	XS1001	1/19/2007	700312901	2007	50,000
101400	Office Of Compact Management	XS1001	3/27/2007	700576901	2007	50,000
101400	Office Of Compact Management	XS1001	7/24/2007	701104001	2007	50,000
101260	Sopac Membership Fee	SS3013	11/30/2006	700161101	2007	40,000
102030	To Write-Off G/Fund Acct.	CS2105	6/30/2007	JVD0426	2007	29,000
101258	Internat Civil Aviation Organ	SS6035	11/29/2006	700154401	2007	28,050
111371	Fuel For Chuuk P.U.C.	147802	4/13/2007	720360701	2007	27,424
101047	Fsm Emassy, Washington, D.C.	BS1004	4/30/2007	JVD0323	2007	21,195
101064		GS4014	9/3/2007	720853801	2007	18,451
101353	Border Mgmt System	GS2014	3/30/2007	750151501	2007	25,000

3. For 2 (or 4%) of 132 Non-Major/Non US grant transactions tested, no competitive procurement documents were available in support of the following:

<u>Fund</u>	<u>CC</u>	<u>User</u>	<u>Date 1</u>	<u>APV or JV#</u>	<u>FY</u>	<u>Amount</u>
545401		ARK	5/16/2007	700771901	2007	\$ 99,000
545401		SIL	3/1/2007	700456501	2007	373,641

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No. 2007-14 – Insufficiency of Documents on Procurement and Substantiation, Continued

Conditions, Continued:

4. For 8 (or 6%) of 132 Non Major/Non US grants transactions tested, no supporting documentation/or insufficient documentation was provided to support the following expenditures:

<u>Fund</u>	<u>CC</u>	<u>User</u>	<u>Date 1</u>	<u>APV or JV#</u>	<u>FY</u>	<u>Amount</u>
477425	NU1501	RVY	9/30/2007	701497001	2007	\$ (1,062)
477423	NU1366	CJN	9/19/2007	JVD0406	2007	1,372
474005	NO1004	SIL	6/25/2007	700940301	2007	2,266
525201	ES1002	SIL	6/7/2007	700865201	2007	96
545401		NMP	9/30/2007	401296701	2007	(2,400)
545401		SIL	6/29/2007	700966701	2007	760
54		DAA	10/1/2006	JVD0033	2007	65,042
54		DAA	10/1/2006	JVD0033	2007	(65,042)

Cause: There appears to be weak internal controls over ensuring expenditures are supported by purchase requisitions, purchase orders, vendor invoices, receiving reports, contracts, journal vouchers, procurement documents and other underlying supporting documentation validating the expenditure. Furthermore, there appears to be insufficient internal control exercised over recordkeeping maintenance.

Effect: The condition may result in potential noncompliance with applicable compliance requirements and potential misstatements of expenditures or revenues.

Recommendation: The National Government should strengthen internal controls over ensuring expenditures are supported by purchase requisitions, purchase orders, vendor invoices, receiving reports, contracts, journal vouchers, procurement documents and other underlying supporting documentation validating the expenditure. Furthermore, the National Government should strengthen internal controls over its record keeping function.

Auditee Response and Corrective Action Plan:

1. We agree with this finding. The travel took place sometime in April 2007 to May 2007 where airfare quotations was suspended.

In December 20, 2006, Secretary of Finance and Administration issued a memorandum suspending the required airfare price quotations effective January 1, 2007. The suspension was made due to the result of the comparative analysis and based on the documents obtained from local travel providers that the price differences for air transportation quotations was very minimal, in most cases less than \$5.00 and that price differences will not be expected to increase dramatically within the near future. The comparative price analysis focused within the FSM States and travel to Guam and Hawaii where only one airline is serving.

In June 25, 2007, acting Secretary of Finance and Administration issued another memorandum to supersede the December 2006 memorandum, requiring all federal and amended compact travel expenditures to provide airfare price quotations that extend travel beyond Guam and Hawaii as alternative airlines service are available beyond those destinations. Travel expenditures within the FSM, Guam and Hawaii do not require price quotations.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No. 2007-14 – Insufficiency of Documents on Procurement and Substantiation, Continued

Auditee Response and Corrective Action Plan, Continued

2. We agree with this finding. Most of these were payments made by FSM field offices and FSM Embassies. We will request and obtain documentation from the field offices and FSM embassies to substantiate the recorded expenditures before September 30, 2008.
3. We do not agree with this finding. This was payment to Note Printing Australia LTD under CD0125 to provide passport machine readable booklet. FSM President waived the bidding requirement pursuant to the emergency declaration.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No. 2007-15 – Usage of ADB Trust Accounts

Criteria: Loan proceeds restricted for State use are to be used solely by the State in accordance with the loan agreement.

Condition: The National Government temporarily used ADB loan proceeds to extend a \$1.5 million loan to a State government. The amount allocated to the National Government for its use is less than \$1.5 million. The amount was subsequently repaid within a week.

Cause: The National Government administers the trust account and determined that this transaction was appropriate. Additionally, it appears that the intent was to draw down funds from the National Government's investment account but that process apparently can take up to one week. Therefore, to expedite the payment to the State, cash from ADB loan proceeds was utilized.

Effect: The effect of this condition is possible noncompliance with loan covenants.

Recommendation: We recommend that borrowings be used in accordance with the underlying loan agreements.

Auditee Response and Corrective Action Plan: We agree with this finding. The \$1.5 million loan cash was given to Kosrae State withdrawn from the ADB loan proceeds. However, such withdrawal has a corresponding investment securities from the National Government's investment accounts.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No. 2007-16 – Reconciliations with FSM State Governments

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

Condition: Intergovernmental payables to FSM State Governments for unreimbursed federal grant expenditures have been less than related subrecipient balances as of September 30, 2007. Improvements in reconciliations with the States have been noted in fiscal year 2007 and subsequently but the beginning balance issues attendant to other findings that relate to liability balances that must be reconciled by the National Government could impact those reconciliation efforts. Therefore, resolution of prior year conditions associated with this finding remain have not been fully resolved.

Cause: The cause of this condition is the lack of high level review of account balances by management and the absence of historic reconciliations with the FSM State Governments.

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

Prior Year Status: This condition was cited in the 2006 Single Audit.

Recommendation: We recommend that the National Government continue its efforts to ensure that intergovernmental payables are reconciled.

Auditee Response and Corrective Action Plan: We agree with this finding. Effort has been made in FY07 to reconcile the intergovernmental federal accounts. In FY07, reconciliation of un-reimbursed federal expenditures was made between Chuuk State, Pohnpei State and National Government, we will continue to do the same to other FSM States until the intergovernmental payables to State governments are resolved. The Accounting Advisor has been instructed to complete the reconciliation by September 30, 2008. Payments for the un-reimbursed Federal expenditures to the state governments are scheduled no later than September 30, 2008.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No. 2007-17 – Construction in Progress and Infrastructure Assets

Criteria: Generally accepted accounting principles requires that construction in progress and infrastructure assets be presented in the statement of net assets and necessary details be disclosed in the notes to the financial statements. Retentions payable for construction projects, if significant, are required to be presented as well. In addition, transfers of infrastructure and completed construction to another entity are required to be presented.

Condition: The National Government was not able to provide a list of ongoing construction in progress, related retention payable and completed construction.

Certain construction and infrastructure projects are transferred to FSM State Governments upon completion. Given the existing lack of monitoring of the State infrastructure project costs, the National Government may not have sufficient data to provide for necessary disclosures and may not have sufficient data to allow the States to record the assets upon their completion.

Currently there are several ongoing infrastructure projects both funded locally and by federal programs. The Compact Sector, Infrastructure and AIP alone have expenditures of \$13.7 million. As such, there could be significant amounts of retentions payable, construction in progress and infrastructure assets not presented in the statement of net assets.

Cause: Monitoring of project status does not currently appear to be incorporated in to monthly accounting procedures.

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

Recommendation: We recommend that the National Government ensure that construction, infrastructure assets and transfer if any, be monitored and be presented in the financial statements.

Auditee Response and Corrective Action Plan: We agree with this finding and recommendation. Construction in progress and infrastructure assets will be presented in FY08 Financial Statements. FSM Finance and Administration will work out with Department of Transportation and Department of Justice for the procedures and legal matter that are needed in order to transfer the completed projects to the states.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No. 2007-18 – Cash and Liability Reconciliations

Criteria: Drawdowns received should be timely identified and be disbursed to the entitled State. Furthermore, financial and programmatic records should be maintained on file for at least three years.

Condition: We could not determine that timely reconciliations of the federal holding account occur. A reconciliation identifying balances due per state was not provided. Moreover, transactions in this cash account were not completely accounted for in the National Government's accounting records. The cash and accounts payable balances were only updated by reversing the prior balance and recording the ending balance. Moreover, in the prior year as well, although a schedule was provided, underlying documentation to allow verification of the schedule has not been provided to the date of this report.

<u>Beginning</u>	<u>Deposits</u>	<u>Withdrawals</u>	<u>Ending</u>
\$961,881	\$18,100,749	\$18,647,756	\$414,874

Cause: It appears that reconciliation and identification of the specifics of the cash account have not yet occurred.

Effect: This condition appears to compound the current difficulties facing the National Government's attempts to reconcile its records to those of the States.

Recommendation: This account should be subjected to a monthly reconciliation and the payable should be segregated to identify the amount owed to each party.

Auditee Response and Corrective Action Plan: We agree with this finding. As stated in our 2007-17 response, payments to the states for the un-reimbursed expenditures will be made no later than September 30, 2008. Once the reconciliation is completed, we will drawdown the remaining cash to pay the states.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No. 2007-19 – Embassy Cash Balances

Criteria: Unexpended funds as of September 30, 2007 should revert to the General Fund.

Funds advanced to the embassy should be initially recorded as an advance and be charged to expenditures upon sufficient documentation being provided.

Condition: Per the underlying bank reconciliation, the Tokyo Embassy had cash on hand of \$32,589 as of September 30, 2007. There was no documentation provided us to support the rationale for this amount of cash to be held outside the bank. No subsequent liquidation of this account has occurred. In April 2008, the funds were returned to the General Fund after this matter was raised during the audit process.

As so September 30, 2007, the UN Mission Embassy in New York had \$83,639 in cash in bank of which a portion pertains to the membership fee for the United Nations (UN) for fiscal years 2006 and 2007 that was appropriated but unpaid. There was no rationale provided for nonpayment of the UN fees but these funds were not returned to the general fund as of September 30, 2007. UN mission fees were recorded as an expenditure by the general fund upon disbursement of the cash to the embassy.

Cause: Inadequate monitoring of cash and timely liquidation appears to be the cause of this condition.

Effect: As no subsequent liquidation occurred, it appears that the aforementioned amount could represent excess cash that should be returned to the General Fund.

Recommendation: Adherence to FSM regulations occur. Unexpended funds should be timely monitored and revert, if appropriate, to the General fund.

Auditee Response and Corrective Action Plan: We agree with this finding. We have discussed this matter with Ambassador to the UN Mission Embassy New York and agreed to either return back the unused cash or such amount is offsetted against their current year allotments.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No. 2007- 20 – Purchase Advances

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

Condition: 55% of purchase advances tested resulted in exceptions. Two of the items, totaling \$349,849, were no longer valid as of September 30, 2007. This matter was subsequently corrected in May 2008.

We could not determine the validity of three other items, aggregating \$94,428, as management could not determine whether the goods had been received.

Cause: It appears that additional effort is necessary to monitor advances. Additionally, due to the decentralized procurement process, departments who receive these goods and services are not forwarding receiving reports in a timely manner to Finance.

Effect: This condition could result in an overstatement of assets and an under statement of expenditures.

Prior Year Status: This condition was cited in the 2006 Single Audit.

Recommendation: We recommend that purchase advances be timely reconciled and that dated items be investigated. Again, we recommend whether it is appropriate for departments to directly receive goods and services if those departments do not timely provide finance with receiving report data.

Auditee Response and Corrective Action Plan: We agree with this finding. In FY08, the Assistant Secretary of Finance for National Treasury has been monitoring the outstanding purchase order advance and efforts have been made to liquidate these advances.

A directive will be issued before September 30, 2008 to all departments who directly receive goods and services to provide finance with receiving report data on a timely manner.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No. 2007-21 – ADB Loans

Criteria: All loan transactions should be appropriately and timely recorded in the financial statements. Timely reconciliation between the States and National Government should occur for all loan draw downs and for all repayments.

Condition: Timely reconciliation of loan balance activity between the States and the National Government did not occur. The State Finance Officers were not made aware of certain loan movements, particularly when the National Government paid vendors on behalf of the States.

During the year, loan payments were made in the amount of \$182,089 for ADB Loan Number 1459 FSM (SF), Water Supply and Sanitation Project Loan. In the National Government records, this loan was allocated to three states and to the National Government. Consequently, the National Government should record and contribute to a portion of the loan payments. However the entire principal paid during the fiscal year was allocated solely to the three states as indicated in the table below. The \$6,779 addition to the National Government allocation was also the difference between the National Government records when compared to ADB's records. Moreover, loan proceeds of \$85,381 are understated when compared with balances confirmed by ADB. This difference has been recorded as accounts receivable – general. No reconciliation or investigation occurred relative to this difference. Additionally, the National Government could not provide a schedule of the amount of interest and principal paid per loan.

ADB Loan 1459 Allocation	Beginning	Payments	Ending
Chuuk Public Utility Corp	\$ 3,461,734	\$(83,186)	\$3,378,548
Pohnpei Utilities Corp	2,118,769	(50,985)	2,067,784
Yap State Public Services Corp	2,270,837	(54,697)	2,216,140
FSM National Government	1,257,177	6,779	1,263,956
	<u>\$9,108,517</u>	<u>\$(182,089)</u>	<u>\$8,926,428</u>

Cause: Monitoring and reconciliation of payments and draw downs of loans against ADB records and investigation of differences has not occurred. Additionally, reporting to the affected States does not appear to occur.

We understand that the National Government's allocation resulted from unidentified prior year loan proceeds. Therefore, allocations of loan payments have not been reflected against the National Government's balance even though it appears that loan proceeds were received by the National Government.

Effect: This condition may result in an understatement of expenditures and a misstatement of receivables.

Due to non-reconciliation with ADB records, erroneous applications of loan payments could result and loan proceeds may not be correctly accounted for.

Additionally, it appears that the States could be overcharged for the respective loans since the National Government appears to have received loan proceeds and does not make loan repayments.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No. 2007-21 – ADB Loans, Continued

Recommendation: We recommend that timely monitoring and communications of ADB loan transactions be performed by the National Government. Moreover, loan related payments should be recorded as such and not be netted against related income.

Reconciliation of payments made to ADB records and investigation of differences should occur.

The National Government should investigate loan proceeds that it received and determine whether it should share in attendant loan payments.

Auditee Response and Corrective Action Plan: We agree with this finding. The ADB accountant has been instructed to ensure that monitoring and reconciliation of payments and drawdown of loans will be observed and performed and that reporting to the affected states will be made timely.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No. 2007-22 –Segregation of Duties

Criteria: A functioning system of internal control requires that appropriate segregation of duties be implemented among those who (a) execute transactions (handling of cash), (b) approve transactions (c) have access to assets or the ability to issue disbursements or handle collections and (d) post or reconcile related accounting records.

Condition: For certain investment related transactions, including fishing fees, initiation of the transfer of funds between accounts and the recording of transactions are performed by the same person. Initiation of entries in recording the transaction is approved by the same person who reviews and approves investment activity. However, all investment transactions require final approval by the Secretary of Finance.

Cause: It appears that adequate segregation of duties has not been reflected in the investment function.

Effect: The effect of this condition is that inadequate segregation of duties exists.

Recommendation: Segregation of incompatible duties is important to provide assurance that assets are safeguarded against irregularities. Fundamentally, persons who have the ability to cause investments to be recorded or written down without a higher level of approval should not also have access to assets. In addition, persons reconciling investments and related amounts and approving ledger postings should not have unrestricted access to assets.

Auditee Response and Corrective Action Plan: We agree with this finding. This matter will be discussed with the Assistant Secretary for Investment and International Finance and Assistant Secretary for National Treasury for eventual transfer of responsibility no later than September 30, 2008.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No. 2007-23 – Prepaid Cards

Criteria: Expenditures incurred should be documented to demonstrate the business purpose.

Condition: The National Government uses prepaid cards for long distance calls. In addition, prepaid cards are also approved for travel reimbursements. There is no documentation to show that the usage of prepaid cards is related to the conduct of National or federal programs.

Cause: Prepaid card usage is a practice of the National Government.

Effect: The effect of this condition is that we cannot determine whether use of the phone cards is used for appropriate purposes.

Recommendation: We recommend that the National Government consider monitoring card usage. Travelers should log calls and be able to substantiate business purpose.

Auditee Response and Corrective Action Plan: We agree with this finding. We will discuss this matter to all the department and other branches of the government.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No. 2007-24 – Unreimbursed CFSM Projects

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

Condition: Intergovernmental payables to FSM State Governments for unreimbursed CFSM projects differ from related subrecipient balances as of September 30, 2007. Improvements in reconciliations with the States have been noted in fiscal year 2007 and subsequently but the beginning balance issues attendant to other findings that relate to liability balances that must be reconciled by the National Government could impact those reconciliation efforts. Therefore, resolution of prior year conditions associated with this finding remain have not been fully resolved.

Cause: The cause of this condition is the lack of high level review of account balances by management and the absence of reconciliations with the States.

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

Prior Year Status: This condition was cited in the 2006 Single Audit.

Recommendation: We recommend that intergovernmental payables be reconciled and documented.

Auditee Response and Corrective Action Plan: To date, no FSM state balances have been provided by the auditor to compare with the payable balance recorded by National Government. However, effort has been made in FY07 to reconcile the intergovernmental CFSM accounts.

In FY07, reconciliation of un-reimbursed CFSM expenditures was made between Chuuk State, Pohnpei State and National Government, we will continue to do the same to other FSM States until the intergovernmental payables to State governments are resolved. The Accounting Advisor has been working on the reconciliation and was instructed to complete the reconciliation by September 30, 2008.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-25
 Agency: All
 CFDA #: All
 Grant #: All
 Requirement: Fixed Asset Reconciliation/Equipment and Real Property Management
 Questioned Costs: \$0

Criteria: Fixed asset records should be periodically reconciled and all disposals should be recorded. Assets that are deeded to other governments should be subject to formal agreements and adequate maintenance of fixed assets should occur.

Condition:

1. Fiscal year 2007 capital expenditures were not reconciled to the fixed asset register.

Total fixed asset related expenditures			\$5,065,106
Less: estimated non-capital items :			
Infrastructure fund expenditures	\$2,665,938		
AIP Fund Expenditures	1,414,540		
Expenditures less than \$1,000	15,412		
Purchase of land for Chuuk State	262,576	4,358,466	
Estimated fixed asset additions		706,640	
Additions per the fixed asset register		549,906	
Potential understatement of fixed assets		\$156,734	

2. Fixed asset disposals during the current year were not recorded and were not reflected in the fixed asset register. However, in May 2008, this matter was subsequently corrected.
3. There appears to be an absence of documentation formalizing the turnover of assets purchased by the National Government to the recipient states and/or component units.
4. No formal maintenance procedures for equipment are established and we could not determine the manner in which maintenance responsibilities are carried out.

Cause: For condition one and two, the person in-charge of fixed asset was on sick leave and no other party assumed related responsibilities. The absence of a formal transfer of assets to the States and component units has been a recurring audit concern as has absence of adequate maintenance procedures.

Effect: The effect of this condition is that inadequate accounting for fixed assets occurs and that complications between the National Government and the States result due to potential misunderstandings concerning ownership and accountability over fixed assets. Additionally, noncompliance has resulted with federal compliance requirements applicable to equipment maintenance.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-25, Continued

Recommendation: Quarterly reconciliations of the fixed asset register should occur. A formal document should be utilized to convey ownership of assets provided to the States or to component units. A formal maintenance program should also be developed.

Auditee Response and Corrective Action Plan: We agree with this finding. The procurement and supply will ensure that quarterly reconciliation of the fixed assets register will occur. A procedure has already been made to document the transfer of ownership of assets to the states or to component units.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No. 2007-26 – Timely Reconciliation of Accounts

Criteria: A functioning internal control requires timely reconciliation and identification of accounts, especially those with abnormal balances.

Condition:

1. The National Government provided several adjusting entries in May 2008 to correct and reconcile various accounts including accounts payable, accounts receivable with an offset against cash account. The subsequent reconciliation resulted to unidentified cash difference of \$36,690 in the general checking account.
2. Account 10-295 “A/R Receipt Clearing” has a negative balance of \$87,966. These are receipts received awaiting application and or identification to the specific accounts receivable and are netted against the accounts receivable balance in the financial statements.
3. Payroll allotment accounts have not been reconciled and contain debit balances approximating \$49,000.
4. The payroll fund, Fund 66, contains balances from pay periods other than the last payroll accrued in fiscal year 2007.

<u>Year</u>	<u>Fund 66</u> <u>\$ Amounts</u>
2000	\$ (663)
2001	(2,821)
2002	(265)
2003	17,551
2004	(219)
2005	8,265
2006	(757)
2007	201,765
	\$ 222,856

3. Untimely reconciliation of travel related payables occurs. This condition resulted in a negative balance being recorded in the general fund. The original travel expenditure is recorded in a separate fund. The general fund paid for the expenditure, which created a negative payable in the general fund. This negative payable must be reconciled and be offset against payables recorded in the other funds.

<u>Fund Name</u>	<u>Fund Num</u>	<u>Amount</u>
General Fund	10	\$(257,751)
Payroll Fund	66	(11,016)
		\$ (268,766)

Cause: It appears that reconciliation of the above accounts did not occur on a timely basis.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No. 2007-26 – Timely Reconciliation of Accounts, Continued

Effect:

Condition 1: This condition appears to indicate that there is unrecorded cash of \$36,690

Condition 2: This hinders proper aging of the accounts receivable.

Condition 3: This condition appears to indicate that employee receivables exist in this amount.

Condition 4: This condition could result in an overstatement of accounts payable or an overstatement of expenditures. As no reconciliation was provided, we cannot specifically determine the impacted accounts.

Condition 5: This condition resulted in a misstatement of accounts payable. The General Fund could be understated and other funds overstated. As there is no reconciliation provided, we cannot determine the impact on related funds.

Prior Year Status: This condition was cited in the 2006 Single Audit.

Recommendation: We recommend that timely reconciliation of the account occur.

Auditee Response and Corrective Action Plan: We agree with this finding and recommendation. Payroll allotments balances have been reconciled in FY08. The accounts 10-295 will be reconciled in FY08 by the accounts receivable accountant. The negative balances in accounts payable has been corrected in June 2008.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No. 2007-27 – Monitoring of Deferred Revenue

Criteria: Collections should be applied against specific programs. This detail can be maintained apart from the general ledger system but should be regularly reconciled with related general ledger balances. Abnormal balances should be timely identified and reconciled

Condition:

No aging or details per program was provided for Fund 47, which accounts for various non-US grants. The amounts are not reconciled, are netted and are recorded as payables. As the funds are received from various grantors, a right to offset does not appear warranted.

<u>Acct</u>	<u>Acct Name</u>	<u>Balance</u>
47 -502	OTHER GRANT	\$(1,472,518)

Cause: Current practice requires that collections be applied against related billings and that the amount per the subsidiary ledger is reconciled to the general ledger.

Effect: Given this scenario, we cannot determine if a portion of deferred revenue should be recognized as revenue. Moreover, grantor programs may not be properly implemented as the availability of funds per a specific program does not appear to be monitored.

Prior Year Status: This condition was cited in the 2006 Single Audit.

Recommendation: We recommend that receivable or deferred revenue balances be supported per grantor and be reconciled with the general ledger.

Auditee Response and Corrective Action Plan: We agree with this finding and recommendation. The deferred revenue arises from the advance collection of cash from non-US grants. Most of these grants have more than one year of budget performance. The cash was collected in current year but expenditures were reported in the next fiscal years. The accounting advisor will reconcile this account and ensure that detail balances of deferred revenue be supported per grantor and reconciled with the general ledger. Aging or details per program will be provided in FY08 and ensure that collections be applied against specific programs.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Unresolved Prior Years' Questioned Costs
Year Ended September 30, 2007

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

	Questioned Costs Set Forth in Prior Audit Report <u>2006</u>	Questioned Costs Resolved in Fiscal Year <u>2007</u>	Questioned Costs at <u>September 30, 2007</u>
Unresolved Questioned Costs FY 02	\$ 582,927	\$ 582,927	\$ -
Unresolved Questioned Costs FY 03	252,066	50,069	201,997
Unresolved Questioned Costs FY 04	266,879	137,536	129,343
Unresolved Questioned Costs FY 05	1,914,909	948,897	966,012
Unresolved Questioned Costs FY 06	<u>1,622,274</u>	<u>226,656</u>	<u>1,395,618</u>
	\$ <u>4,639,055</u>	\$ <u>1,946,085</u>	2,692,970
Questioned Costs FY 07			<u>4,139,445</u>
			\$ <u>6,832,415</u>