

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2007

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2007

INDEX

	<u>Page No.</u>
INDEPENDENT AUDITORS' REPORT, BASIC FINANCIAL STATEMENTS AND ADDITIONAL INFORMATION	1 - 64
INDEPENDENT AUDITORS' REPORTS ON INTERNAL CONTROL AND ON COMPLIANCE	65 - 91

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Table of Contents
Year Ended September 30, 2007

	<u>Page No.</u>
I. Independent Auditors' Report	1
II. Basic Financial Statements:	
Management's Discussion and Analysis	3
Government-Wide Financial Statements:	
Statement of Net Assets	10
Statement of Activities	11
Governmental Fund Financial Statements:	
Balance Sheet	12
Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficits)	13
Reconciliation of Statement of Revenues, Expenditures and Changes in Fund Balances of Governmental Funds to the Statement of Activities	14
Discretely Presented Component Unit Financial Statements:	
Combining Statement of Net Assets	15
Combining Statement of Revenues, Expenses and Changes in Net Assets	16
Notes to the Basic Financial Statements	17
III. Required Supplementary Information - Other than Management's Discussion and Analysis	40
Schedule of Revenues, Expenditures and Changes in Fund Deficit - Budget and Actual - General Fund	41
Note to Required Supplementary Information - Budgetary Reporting	42
IV. Other Supplementary Information	44
Combining Schedule of Expenditures by Account - Governmental Funds	45
General Fund:	
Statement of Revenues, Expenditures by Function, and Changes in Fund Deficit	46
Statement of Revenues, Expenditures by Function, and Changes in Fund Deficit - Budget and Actual	48
Nonmajor Governmental Funds:	
Combined Balance Sheet	50
Combined Statement of Revenues, Expenditures by Function, and Changes in Fund Balances	51
Combined Statement of Revenues, Expenditures by Account, and Changes in Fund Balances	52

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Table of Contents, Continued
Year Ended September 30, 2007

	<u>Page No.</u>
IV. Other Supplementary Information, Continued	
Nonmajor Governmental Funds - Special Revenue Funds:	
Combining Balance Sheet	53
Combining Statement of Revenues, Expenditures by Function, and Changes in Fund Balances (Deficit)	55
Combining Statement of Revenues, Expenditures by Account, and Changes in Fund Balances (Deficit)	57
Nonmajor Governmental Funds - Capital Project Funds:	
Combining Balance Sheet	59
Combining Statement of Revenues, Expenditures by Function, and Changes in Fund Balances	60
Combining Statement of Revenues, Expenditures by Account, and Changes in Fund Balances	61
Nonmajor Governmental Funds – Section 211 Compact Sector Funds:	
Combining Balance Sheet	62
Combining Statement of Expenditures by Function, and Changes in Fund Balances	63
Combining Statement of Expenditures by Account, and Changes in Fund Balances	64
V. Independent Auditors' Reports on Compliance and Internal Control	
Independent Auditors' Report on Compliance and on Internal Control Over Financial Reporting Based Upon the Audit Performed in Accordance with Government Auditing Standards	65
Independent Auditors' Report on Compliance and Internal Control Over Compliance Applicable to Each Major Federal Award Program and on the Schedule of Expenditures of Federal Awards	67
Schedule of Expenditures of Federal Awards	70
Notes to Schedule of Expenditures of Federal Awards	72
Schedule of Programs Selected for Audit in Accordance with OMB Circular A-133	73
Schedule of Findings and Questioned Costs	74
Summary Schedule of Prior Audit Findings and Questioned Costs	91

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2007

INDEPENDENT AUDITORS' REPORT

Honorable Robert Weilbacher
Governor, State of Kosrae
Federated States of Micronesia:

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

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

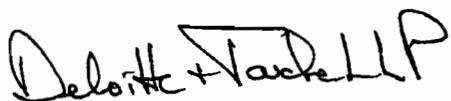
In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae 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 3 through 9, as well as the Schedule of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund and notes thereto, on pages 41 through 43, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the management of the State. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

As discussed in Note 10 to the financial statements, the beginning net assets of the governmental activities within the accompanying financial statements has been restated.

Our audit was conducted for the purpose of forming an opinion on the State's respective financial statements that collectively comprise the State's basic financial statements. The combining and individual fund financial statements, as set forth in Section IV of the foregoing table of contents, which are also the responsibility of the management of the State, are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such additional information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are 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 27, 2008 on our consideration of the State'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 + Touche LLP". The signature is written in a cursive, stylized font.

June 27, 2008

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2007

This analysis, prepared by the Department of Administration and Finance, offers readers of the Kosrae State Government's ("Kosrae State") financial statements a narrative overview of the activities of the government for the fiscal year ended September 30, 2007. We encourage readers to consider this information in conjunction with Kosrae State's financial statements, which follow. Fiscal year 2006 comparative information has been included, where appropriate. This analysis is required by the Governmental Accounting Standards Board (GASB), which provides guidelines on what must be included and excluded from this analysis.

FINANCIAL HIGHLIGHTS

- For the fiscal year ended September 30, 2007, Kosrae State's total net assets decreased by \$1.74 million (or 5%) from \$32.61 million in the prior year to \$30.87 million. This decrease is primarily attributable to depreciation expense for the year of \$2.30 million with a corresponding offset from recovery of bad debts.
- During fiscal year 2007, Kosrae State's revenues of \$10.80 million were less than total expenses (\$12.90 million) by \$2.10 million. Again, the difference arose primarily due to the decrease in the net book value of capital assets because of depreciation charges. No capital assets additions were made during fiscal year 2007.
- General Fund budgetary deficits were incurred in fiscal year 2007: budgeted revenues of \$2.07 million exceeded actual collections of \$1.61 million by \$0.46 million (or 29%) as the result of over-estimates of FSM revenue sharing and other local revenues. The expenditure budget on the other hand reflected a positive variance of \$74,639. There were no more bad debts written off during the year; instead bad debts recovery of \$0.36 million was realized.
- During fiscal year 2007, Kosrae State's general fund deficit decreased by \$3.44 million (95%); down from \$3.61 million in the prior year to \$0.17 million. The decrease primarily reflects loan proceeds received during the year, operating transfers in from other funds (Compact CIP, Early Retirement Program and U.S. Federal Grants) and the recovery of bad debts.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to Kosrae State's basic financial statements. Kosrae State's basic financial statements comprise three components: 1) governmental-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements.

This report also contains additional required supplementary information in the form of budgetary schedules, which are prepared on the budgetary basis of accounting, and other optional supplementary information, in addition to the basic financial statements themselves, which includes combining statements for governmental funds and component units.

Government-Wide Financial Statements

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2007

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

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

The government-wide financial statements of Kosrae State are divided into two categories:

- **Governmental activities** - Most of Kosrae State's basic services are included here, such as education, health, special appropriations, finance, judiciary, and general administration. Compact sector and other federal grants finance most of these activities.
- **Component Units** - Kosrae State includes the operating results of the Kosrae Utilities Authority and Micronesia Petroleum Corporation in its report. Although legally separate, these "component units" are important because Kosrae State is financially accountable for them.

Fund Financial Statements

The fund financial statements provide more detailed information about Kosrae State's significant funds. Funds are accounting devices that Kosrae State uses to keep track of specific sources of funding and spending for particular services. The State uses fund accounting to comply with financial and related legal requirements. The fund financial statements present a balance sheet and a statement of revenues, expenditures, and changes in fund balances for its major and aggregated non-major funds.

Most of Kosrae State's basic services are included in governmental funds, which focus on (1) how cash and other financial assets that can readily be converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance Kosrae State programs. Because this information does not encompass the additional long-term focus of the government-wide statements, we provide additional information at the bottom of the governmental funds statements, or on the subsequent page, that explains and reconciles the relationship (or differences) between them.

The State maintains individual governmental funds, which are categorized as major and non-major. The major funds comprise the General Fund, the Compact Sector Grants Fund, and the Compact Trust Fund.

FINANCIAL ANALYSIS OF KOSRAE STATE AS A WHOLE

Net assets may serve over time as a useful indicator of a government's financial position. At the end of fiscal year 2007, Kosrae State's assets exceeded liabilities by \$30.87 million. However, all these net assets are restricted as to the purposes they can be used for or are invested in capital assets. Kosrae State uses theses capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although Kosrae State's investment 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 sources, since the capital assets themselves cannot be used to liquidate these liabilities. The following summary of Kosrae State's net assets as of September 30, 2007, with comparable balances for the fiscal year 2006, discloses this relationship:

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2007

	<u>2007</u>	<u>2006</u> <u>Restated</u>
Current and other non-capital assets	\$ 8,367,092	\$ 8,661,612
Capital assets	<u>28,333,206</u>	<u>30,634,012</u>
Total Assets	<u>36,700,298</u>	<u>39,295,624</u>
Long-term liabilities	4,932,825	3,235,913
Other liabilities	<u>901,956</u>	<u>3,453,438</u>
Total Liabilities	<u>5,834,781</u>	<u>6,689,351</u>
Net Assets		
Invested in capital assets, net of related debt	28,333,206	30,634,012
Restricted	6,918,225	8,824,483
Unrestricted	<u>(4,385,914)</u>	<u>(6,852,222)</u>
Total Net Assets	\$ <u>30,865,517</u>	\$ <u>32,606,273</u>

At the end of fiscal year 2007, Kosrae State's unrestricted assets showed a deficit of \$4.38 million, a decrease of \$2.47 million (or 36%) from the prior year. The decrease is partly due to the recovery of bad debts. The deficit, however, is the result of having current and long-term commitments that are greater than currently available resources. Specifically, Kosrae State did not include in past annual budgets the full amounts needed to finance its current liabilities to vendors and others or its long-term liabilities arising from Asian Development Bank (ADB) loans and unused employee leave balances. Kosrae State will include these amounts in future year's budgets as funding permits.

Net assets declined by \$1.74 million (or 5%) from the prior year. Key elements for the decrease and the differences from the prior year are shown in the following schedule.

	<u>2007</u>	<u>2006</u>
Revenues:		
Capital grants and contributions	\$ 60,436	\$ 97,600
Operating grants and contributions	8,877,602	9,655,721
Charges for services	610,527	399,535
Revenue sharing	1,003,623	1,216,477
Unrestricted investment earnings	161,830	71,951
Taxes	8,686	157,598
Other	<u>76,293</u>	<u>106,950</u>
Total revenues	<u>10,798,997</u>	<u>11,705,832</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

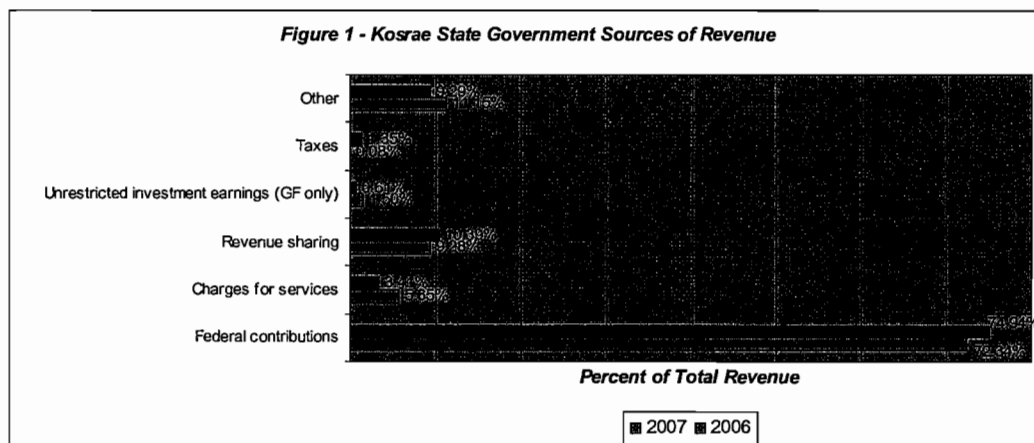
Management's Discussion and Analysis
September 30, 2007

	<u>2007</u>	<u>2006</u> <u>Restated</u>
Expenses:		
General government	2,905,093	6,717,127
Education	3,736,983	3,102,602
Health services	1,859,178	2,191,888
Capital projects	53,325	196,909
Economic development	2,773,410	2,105,967
Land and natural resources	-	28,870
Environment protection and sanitation	359,959	-
Public safety	63,160	35,852
Other miscellaneous	<u>1,151,692</u>	<u>575,747</u>
Total expenses	<u>12,902,800</u>	<u>14,954,962</u>
Special items	<u>363,047</u>	<u>(4,016,270)</u>
Change in net assets	(1,740,756)	(7,265,400)
Net assets at the beginning of the year	<u>32,606,273</u>	<u>39,871,673</u>
Net assets at the end of the year	\$ <u>30,865,517</u>	\$ <u>32,606,273</u>

Total revenues in fiscal year 2007 of \$10.80 million decreased \$0.91 million from the prior year's \$11.71 million (down 8%) primarily due to decreases in US Federal Grants, revenue sharing, and taxes. In fiscal year 2007, Compact sector grants comprised 65% of all Kosrae State funding sources whereas general revenues comprised only 15%.

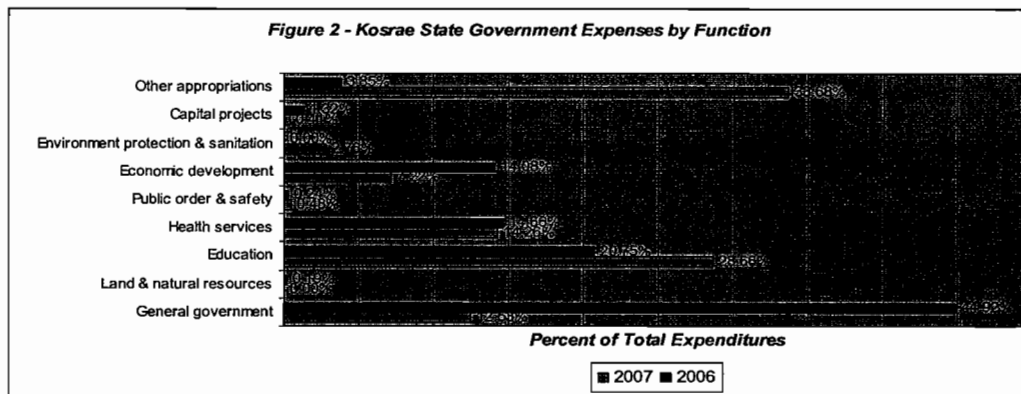
Total expenses of \$12.90 million reflected a \$2.05 million (or 14%) decrease from the prior year expenses without special items. Without write-offs, operating expenses decreased due to cost cutting measures initiated by Kosrae State that included a reduction in working hours and a reduction in workforce.

The following graphs show the major components of revenues and expenditures of governmental funds for the year ended September 30, 2007.



STATE OF KOSRAE FEDERATED STATES OF MICRONESIA

Management's Discussion and Analysis September 30, 2007



FINANCIAL ANALYSIS OF KOSRAE STATE'S FUNDS

As noted earlier, Kosrae State uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. As of the end of fiscal year 2007, Kosrae State governmental funds reported a combined fund balance of \$7.51 million which represents a \$2.30 million increase or 44% from the \$5.21 million recorded at the end of fiscal 2006. This increase is attributable to loan proceeds of \$1.5 million and the recovery of bad debts. Of this total combined fund balance, \$8.27 million is reserved to indicate that it is not available for new spending because it has already been committed: 1) to generate income for future operations or to reflect long-term loan or investment activities (\$7.00 million); 2) to liquidate contracts and purchase orders of the prior period (\$.95 million); or 3) to fund specific general fund and compact CIP-related activities (\$0.32 million). These reserved fund balances are off-set by a combined deficit of \$0.76 million, and decrease of \$2.11 million (or 74%) from fiscal year 2006. The overall increase in the unreserved fund balance is attributed to management's implementation of fiscal reforms.

GENERAL FUND BUDGETARY HIGHLIGHTS

During the course of the fiscal year, management and elected officials of Kosrae State revised the General Fund budget. The revised budget included a decrease in the authorized expenditure budget of \$1.07 million, from \$3.14 million to \$2.07 million. The primary reason for this downward revision was to reign in expenditures, when revenue collections did not match inflated revenue projections. Nevertheless, general fund expenditures excluding other financing uses exceeded revenues by \$0.44 million. This deficiency, however, was offset by the other financing sources of \$3.45 million and the recovery of bad debts of \$0.36 million resulting in a net change in unreserved fund balance of \$3.37 million. The unreserved fund deficit decreased in fiscal year 2007; from \$ 4.99 million in the prior year to \$1.37 million.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2007

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Kosrae State's investment in capital assets for the primary government as of September 30, 2007, amounted to \$90.12 million, net of accumulated depreciation of \$61.79 million, leaving a net book value of \$28.33 million. This represents a net decrease of \$2.30 million (or 7.5%) from fiscal year 2006. Net fixed assets declined in fiscal year 2007 because there are no capital assets additions that would exceed the depreciation charges for the year.

The table below summarizes Kosrae State's capital assets:

	<u>2007</u>	<u>2006</u>
Buildings	\$ 3,054,453	\$ 3,331,598
Infrastructure	24,787,796	26,698,697
Machinery, equipment, others	<u>490,957</u>	<u>603,717</u>
	\$ <u>28,333,206</u>	\$ <u>30,634,012</u>

Additional information on Kosrae State's capital assets can be found in note 5 to the financial statements.

Long-Term Debt

The following schedule shows Kosrae State's noncurrent liabilities for fiscal year 2007 which is greater than fiscal year 2006's balances due to proceeds received from FSM National Government and other ADB development loans:

	<u>2007</u>	<u>2006</u>
FSMNG Loan	\$ 1,500,000	\$ -
ADB Early Retirement Loan and Others	3,230,533	2,991,777
Malem Water Supply Loan	136,173	136,173
Other claims	<u>110,000</u>	<u>110,000</u>
Total noncurrent liabilities	\$ <u>4,976,706</u>	\$ <u>3,237,950</u>

Interest and principal payment on ADB loans commenced in fiscal year 2007.

Additional information on Kosrae State's debt obligations can be found in note 7 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

In fiscal year 2008, Kosrae State will continue to implement a process of fiscal reforms which began in fiscal year 2007. The steps are reducing the working hours and the numbers of personnel force. To ease the cash flow the accounting of US Federal grants will be transferred to the FSM National Government. Management hopes that these steps will continue to improve the financial condition of the State.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2007

Compact Sector Grants will continue to be the major funding sources for the State in fiscal year 2008.

CONTACTING KOSRAE STATE'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors, a general overview of Kosrae State's finances to demonstrate its accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Director, Administration and Finance; P.O. Box 878, Kosrae, FM, 96944.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Statement of Net Assets
September 30, 2007

	Primary Government	Component Units
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 350,033	\$ 689,735
Investments	1,100,000	698,555
Receivables, net of allowance for uncollectibles	1,227,187	455,834
Advances	101,122	31,020
Inventories	11,757	1,130,651
Other current assets	-	25,997
Total current assets	<u>2,790,099</u>	<u>3,031,792</u>
Noncurrent assets:		
Capital assets, net of accumulated depreciation	28,333,206	7,180,382
Restricted assets:		
Cash and cash equivalents	596,587	-
Time certificates of deposit	351,514	660,987
Investments	4,628,892	-
Total noncurrent assets	<u>33,910,199</u>	<u>7,841,369</u>
Total assets	<u>\$ 36,700,298</u>	<u>\$ 10,873,161</u>
<u>LIABILITIES</u>		
Current liabilities:		
Current portion of long-term obligations	\$ 43,881	\$ 870,237
Bank overdraft	49,384	-
Accounts payable	308,530	153,550
Other liabilities and accruals	286,514	42,091
Due to primary government	-	62,278
Deferred revenue	213,647	13,402
Total current liabilities	<u>901,956</u>	<u>1,141,558</u>
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	4,822,825	812,870
Other noncurrent liabilities	110,000	-
Total noncurrent liabilities	<u>4,932,825</u>	<u>812,870</u>
Total liabilities	<u>5,834,781</u>	<u>1,954,428</u>
Commitments and contingencies		
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	28,333,206	7,180,382
Restricted for:		
Nonexpendable:		
Future operations	2,982,085	-
Expendable:		
Debt service	1,646,807	-
Compact related	884,672	-
Other purposes	1,404,661	90,000
Unrestricted	<u>(4,385,914)</u>	<u>1,648,351</u>
Total net assets	<u>30,865,517</u>	<u>8,918,733</u>
Total liabilities and net assets	<u>\$ 36,700,298</u>	<u>\$ 10,873,161</u>

See accompanying notes to basic financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Statement of Activities
Year Ended September 30, 2007

Functions/Programs	Program Revenues				Net (Expenses) Revenues and Changes in Net Assets	
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government	Component Units
Primary government:						
Governmental activities:						
General government	\$ 2,905,093	\$ 354,351	\$ 2,495,999	\$ -	\$ (54,743)	\$ -
Economic development	2,773,410	-	418,577	-	(2,354,833)	-
Education	3,736,983	-	3,614,351	-	(122,632)	-
Health services	1,859,178	83,703	1,743,261	-	(32,214)	-
Public order and safety	63,160	-	-	-	(63,160)	-
Environment protection and sanitation	359,959	172,473	-	-	(187,486)	-
Boards, commissions and other	940,065	-	-	-	(940,065)	-
Future operations	-	-	444,560	-	444,560	-
Capital projects	53,325	-	-	60,436	7,111	-
Other appropriations	211,627	-	160,854	-	(50,773)	-
Total primary government	<u>\$ 12,902,800</u>	<u>\$ 610,527</u>	<u>\$ 8,877,602</u>	<u>\$ 60,436</u>	<u>(3,354,235)</u>	<u>-</u>
Component units:						
Kosrae Utilities Authority	\$ 2,285,478	\$ 1,539,653	\$ -	\$ -	-	(745,825)
Micronesia Petroleum Corporation	3,936,977	4,057,717	-	-	-	120,740
Total component units	<u>\$ 6,222,455</u>	<u>\$ 5,597,370</u>	<u>\$ -</u>	<u>\$ -</u>	<u>-</u>	<u>(625,085)</u>
General revenues:						
Taxes:						
Revenue sharing					1,003,623	-
Excise taxes					8,686	-
Unrestricted investment earnings					161,830	-
Other					76,293	123,486
Total general revenues					<u>1,250,432</u>	<u>123,486</u>
Special items:						
Bad debt recovery					363,047	-
Total special items					<u>363,047</u>	<u>-</u>
Change in net assets					(1,740,756)	(501,599)
Net assets at the beginning of the year, as restated					32,606,273	9,420,332
Net assets at the end of the year					<u>\$ 30,865,517</u>	<u>\$ 8,918,733</u>

See accompanying notes to basic financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Balance Sheet
Governmental Funds
September 30, 2007

		Special Revenue			Permanent		
	General	U.S Federal Grants	Compact Sector Grants	Early Retirement Program	Compact Trust	Other Governmental Funds	Total
ASSETS							
Cash and cash equivalents	\$ 350,033	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 350,033
Investments	200,000	-	-	-	-	900,000	1,100,000
Receivables, net:							
Loans	254,000	-	-	-	-	15,314	269,314
Federal agencies	-	-	234,848	-	-	-	234,848
FSM National Government	-	-	-	-	-	72,230	72,230
Other	355,525	-	-	-	-	295,270	650,795
Due from other funds	249,303	117,654	736,273	-	-	1,035,751	2,138,982
Advances	42,043	22,456	8,231	-	-	28,392	101,122
Inventories	11,757	-	-	-	-	-	11,757
Restricted assets:							
Cash and cash equivalents	242,204	-	-	-	-	354,383	596,587
Time certificates of deposit	313,484	-	-	-	-	38,030	351,514
Investments	-	-	-	1,646,807	2,982,085	-	4,628,892
Total assets	<u>\$ 2,018,349</u>	<u>\$ 140,111</u>	<u>\$ 979,352</u>	<u>\$ 1,646,807</u>	<u>\$ 2,982,085</u>	<u>\$ 2,739,370</u>	<u>\$ 10,506,074</u>
LIABILITIES AND FUND BALANCES							
Liabilities:							
Bank overdraft	\$ 49,384	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 49,384
Accounts payable	160,866	35,231	85,462	-	-	26,971	308,530
Other liabilities and accruals	86,062	2,637	185,799	-	-	12,017	286,514
Due to other funds	1,889,679	-	-	-	-	249,303	2,138,982
Deferred revenue	-	103,844	-	-	-	109,803	213,647
Total liabilities	<u>2,185,991</u>	<u>141,712</u>	<u>271,260</u>	<u>-</u>	<u>-</u>	<u>398,094</u>	<u>2,997,057</u>
Fund balances:							
Reserved for:							
Related assets	1,063,488	-	-	1,646,807	2,982,085	1,307,727	7,000,107
Encumbrances	11,173	35,889	824,568	-	-	76,615	948,246
Continuing appropriations	-	-	-	-	-	317,900	317,900
Unreserved:							
General fund	(1,242,303)	-	-	-	-	-	(1,242,303)
Special revenue funds	-	(37,490)	(116,476)	-	-	639,034	485,067
Total fund balances	<u>(167,642)</u>	<u>(1,601)</u>	<u>708,092</u>	<u>1,646,807</u>	<u>2,982,085</u>	<u>2,341,276</u>	<u>7,509,017</u>
Total liabilities and fund balances	<u>\$ 2,018,349</u>	<u>\$ 140,111</u>	<u>\$ 979,352</u>	<u>\$ 1,646,807</u>	<u>\$ 2,982,085</u>	<u>\$ 2,739,370</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							28,333,206
Long-term liabilities, including loans payable, are not due and payable in the current period and, therefore, are not reported in the funds. The liabilities include:							
Long-term debt payable						(4,866,706)	
Claims payable						(110,000)	
							(4,976,706)
Net assets of governmental activities							<u>\$ 30,865,517</u>

See accompanying notes to basic financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

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

		Special Revenue			Permanent	Other	
	General	U.S Federal Grants	Compact Sector Grants	Early Retirement Program	Compact Trust	Governmental Funds	Total
Revenues:							
Compact funding	\$ -	\$ -	\$ 7,061,476	\$ -	\$ -	\$ -	\$ 7,061,476
Net increase in the fair value of investments	161,830	422	-	143,181	444,560	84,481	834,474
Federal contributions	-	760,078	-	-	-	-	760,078
FSM revenue sharing	1,003,623	-	-	-	-	-	1,003,623
State taxes	8,686	-	-	-	-	-	8,686
CFSM grants	-	-	-	-	-	46,000	46,000
Fees and charges	354,351	-	-	-	-	256,176	610,527
Other grants	-	-	-	-	-	397,840	397,840
Other	76,293	-	-	-	-	-	76,293
Total revenues	1,604,783	760,500	7,061,476	143,181	444,560	784,497	10,798,997
Expenditures:							
Current:							
General government	999,227	-	1,271,601	271,290	-	296,962	2,839,081
Economic development	406,348	2,788	415,789	-	-	117,058	941,983
Education	14,655	444,268	3,170,083	-	-	4,183	3,633,189
Health services	-	156,372	1,586,797	-	-	35,563	1,778,732
Public order and safety	660	-	-	-	-	55,000	55,660
Environment protection and sanitation	50,630	7,686	102,514	-	-	199,129	359,959
Boards, commissions and other	502,881	161,985	-	-	-	275,198	940,064
Capital projects	-	-	-	-	-	53,325	53,325
Total expenditures	1,974,401	773,099	6,546,784	271,290	-	1,036,418	10,601,993
Excess (deficiency) of revenues over (under) expenditures	(369,618)	(12,599)	514,692	(128,109)	444,560	(251,921)	197,004
Other financing sources (uses):							
Loan proceeds	1,500,000	-	-	238,755	-	-	1,738,755
Operating transfers in	1,951,315	-	-	-	-	-	1,951,315
Operating transfers out	-	(1,601)	-	(344,166)	-	(1,605,549)	(1,951,315)
Total other financing sources (uses), net	3,451,315	(1,601)	-	(105,410)	-	(1,605,549)	1,738,755
Special items:							
Recovery of bad debt	363,047	-	-	-	-	-	363,047
Net change in fund balances (deficits)	3,444,744	(14,200)	514,692	(233,520)	444,560	(1,857,470)	2,298,806
Fund balances (deficits) at the beginning of the year	(3,612,386)	12,599	193,400	1,880,327	2,537,525	4,198,746	5,210,211
Fund balances (deficits) at the end of the year	\$ (167,642)	\$ (1,601)	\$ 708,092	\$ 1,646,807	\$ 2,982,085	\$ 2,341,276	\$ 7,509,017

See accompanying notes to basic financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

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

Net change in fund balances - total governmental funds from page 13	\$ 2,298,806
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded or are less than depreciation in the current period	(2,300,806)
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	(1,738,756)
Change in net assets of governmental activities as presented on page 11.	\$ (1,740,756)

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

DISCRETELY PRESENTED COMPONENT UNITS

Combining Statement of Net Assets

September 30, 2007

<u>ASSETS</u>	Kosrae Utilities Authority	Micronesia Petroleum Corporation	Total
Current assets:			
Cash and cash equivalents	\$ 559,727	\$ 130,008	\$ 689,735
Investments	666,731	31,824	698,555
Receivables, net:			
Federal agencies	7,793	-	7,793
General	153,508	294,533	448,041
Inventories	425,233	705,418	1,130,651
Prepayments	30,120	900	31,020
Other	14,358	11,639	25,997
Total current assets	<u>1,857,470</u>	<u>1,174,322</u>	<u>3,031,792</u>
Noncurrent assets:			
Time certificates of deposit-restricted	660,987	-	660,987
Capital assets, net of accumulated depreciation	5,103,684	2,076,698	7,180,382
Total noncurrent assets	<u>5,764,671</u>	<u>2,076,698</u>	<u>7,841,369</u>
Total assets	<u>\$ 7,622,141</u>	<u>\$ 3,251,020</u>	<u>\$ 10,873,161</u>
 <u>LIABILITIES AND NET ASSETS</u>			
Current liabilities:			
Current portion of long-term debt	\$ 76,694	\$ 793,543	\$ 870,237
Accounts payable	38,504	115,046	153,550
Accrued liabilities	30,945	11,146	42,091
Deferred revenue	13,402	-	13,402
Due to primary government	-	62,278	62,278
Total current liabilities	<u>159,545</u>	<u>982,013</u>	<u>1,141,558</u>
Noncurrent liabilities:			
Noncurrent portion of long-term debt	360,635	452,235	812,870
Total noncurrent liabilities	<u>360,635</u>	<u>452,235</u>	<u>812,870</u>
Total liabilities	<u>520,180</u>	<u>1,434,248</u>	<u>1,954,428</u>
Net assets:			
Invested in capital assets, net of related debt	5,103,684	2,076,698	7,180,382
Restricted	90,000	-	90,000
Unrestricted	1,908,277	(259,926)	1,648,351
Total net assets	<u>7,101,961</u>	<u>1,816,772</u>	<u>8,918,733</u>
Total liabilities and net assets	<u>\$ 7,622,141</u>	<u>\$ 3,251,020</u>	<u>\$ 10,873,161</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

DISCRETELY PRESENTED COMPONENT UNITS
Combining Statement of Revenues, Expenses, and Changes in Net Assets
Year Ended September 30, 2007

	Kosrae Utilities Authority	Micronesia Petroleum Corporation	Totals
Operating revenues:			
Charge for services	\$ 1,539,653	\$ 4,057,717	\$ 5,597,370
Operating expenses:			
Cost of goods sold	-	3,524,125	3,524,125
Fuel	1,298,004	8,547	1,306,551
Depreciation	487,376	33,009	520,385
Personnel services	331,895	135,875	467,770
Taxes	-	146,060	146,060
Administration and general	122,554	-	122,554
Repair and maintenance	45,649	11,418	57,067
Professional fees	-	20,250	20,250
Travel and entertainment	-	20,277	20,277
Bank service charges	-	2,309	2,309
Utilities	-	7,645	7,645
Rent	-	5,400	5,400
Supplies and materials	-	4,173	4,173
Insurance	-	7,329	7,329
Communications	-	5,099	5,099
Others	-	5,461	5,461
Total operating expenses	<u>2,285,478</u>	<u>3,936,977</u>	<u>6,222,455</u>
Operating (loss) income	<u>(745,825)</u>	<u>120,740</u>	<u>(625,085)</u>
Nonoperating revenues (expenses):			
Interest income	105,612	2,009	107,621
Other income (expense)	-	(51,969)	(51,969)
Federal grants	10,016	-	10,016
Interest expense	-	(64,230)	(64,230)
Total nonoperating revenues (expenses), net	<u>115,628</u>	<u>(114,190)</u>	<u>1,438</u>
Capital contributions	<u>122,048</u>	<u>-</u>	<u>122,048</u>
Change in net assets	<u>(508,149)</u>	<u>6,550</u>	<u>(501,599)</u>
Net assets at beginning of year	<u>7,610,110</u>	<u>1,810,222</u>	<u>9,420,332</u>
Net assets at end of year	<u>\$ 7,101,961</u>	<u>\$ 1,816,772</u>	<u>\$ 8,918,733</u>

See accompanying notes to financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies

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

A. Reporting Entity

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

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

Each blended and discretely presented component unit of the State has a September 30 year-end.

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

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

i. Discretely Presented Component Units

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

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

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

Kosrae Port Authority (KPA): KPA was created by KSL No. 7-91 to operate, manage, equip, and maintain all ports of entry and to expand and improve upon services offered at the ports of entry. The official transfer of assets from the State to KPA has yet to occur; therefore, KPA's financial statements, which the omission is not considered material, are not included in the accompanying financial statements. KPA is governed by a five-member Board of Directors, of which four members are appointed by the Governor subject to the advice and consent of the Legislature, and, ex-officio, the Director of the Transportation and Infrastructure.

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

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

B. Government-Wide Financial Statements

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 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 State is legally or contractually obligated to spend resources in accordance with restrictions either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.
- Unrestricted net assets consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, (for example, internally restricted), to indicate that management does not consider them to be available for general operations.

The government-wide Statement of Net Assets reports \$6,918,225 of restricted net assets, of which \$1,404,661 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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

C. Fund Financial Statements

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

Major individual governmental funds are reported as separate columns in the fund financial statements pursuant to GASB reporting standards, with nonmajor governmental funds being combined into a single column.

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

D. Measurement Focus and Basis of Accounting

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

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

Significant revenues susceptible to accrual include income and gross revenue taxes, federal grants, federal reimbursements and other reimbursements for use of materials and services. Miscellaneous revenues from other financing sources are recognized when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned, since they are both measurable and available. Expenditures generally are recorded in the period in which the related fund liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

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 discretely presented component unit's principal ongoing operations. All other revenues are reported as nonoperating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

The State reports the following fund types:

1. Governmental Funds

i. General Fund

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

ii. Special Revenue Funds

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

iii. Capital Projects Funds

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

iv. Permanent Funds

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

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - 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. The State elected to add certain other major funds that had specific public interest. Major individual governmental funds are reported as separate columns in the fund financial statements. The nonmajor funds are combined in a column in the fund financial statements and detailed in the combining statements. The State reports the following major funds:

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

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

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

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

- Early Retirement Program Fund – a Governmental Fund Type – Special Revenue Fund. This fund accounts for loan proceeds or funds from the General Fund invested with investment gains accrued within the fund to provide lower long-term costs of the State operations.

E. Reporting Standards

As allowed by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the State's 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 State. Deposits maintained in time certificates of deposit with original maturity dates greater than ninety days are separately classified on the statement of net assets/balance sheet.

G. Investments

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

H Receivables

In general, tax revenue is recognized on the government-wide financial statements when assessed or levied and on the governmental fund financial statements to the extent that it is both measurable and available. Receivables are stated net of estimated allowances for uncollectible accounts. Federal receivables include those funds which are earned, primarily from FSM National Government administered federal grants, which have yet to be reimbursed by the applicable grantor.

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

I. Prepaid Items

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

J. Interfund Receivables/Payables

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

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

K. Inventories

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

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

L. Restricted Assets

As of September 30, 2007, cash and cash equivalents and time certificates of deposit of the primary government were restricted for the following uses:

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through loan agreements or enabling legislation. Specifically, the State has collateralized investments in the amount of \$1,646,807 for the Kosrae State Early Retirement Scheme. Furthermore, investments recorded in the Compact Trust Fund of \$2,982,085 are restricted in that they are not available to be used in current operations. As of September 30, 2007, cash and cash equivalents and time certificates of deposit of the primary government were restricted for the following uses:

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

L. Restricted Assets, Continued

A demand deposit account with a local bank as remaining loan proceeds of the \$2,000,000 Early Retirement loan with the Asian Development Bank.	\$ 836
A demand deposit account with a local bank restricted for Compact Sector Grants.	80,637
Time certificate of deposit of \$38,030 and demand deposit of \$354,383 with a local bank restricted for scholarships for post-secondary students.	392,413
The State has restricted a time certificate of deposit that collateralizes a bank loan to Micronesian Petroleum Corporation.	113,484
Time certificate of deposit of \$200,000 and demand deposit account of \$160,731 for the Loan Guarantee Escrow Account established for the sole purpose of loan collateralization made through the USDA Rural Development. The escrow account may be drawn down in the event of a borrower's default on the obligation under the terms of the promissory note and the deed of trust security instrument supporting such note and for which such note is guaranteed by the State, the trustee of the Loan Guarantee Escrow Account.	<u>360,731</u>
	\$ <u>948,101</u>

M. Capital Assets

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

Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair market value at the date of donation.

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

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

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

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

N. Interfund/Intrafund Transactions

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

O. Compensated Absences

It is the government's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since the government does not have a policy to pay any amounts when employees separate from service with the government. All vacation pay is accrued when incurred in the government-wide financial statements. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements. Annual leave accumulates at the rate of one working day per bi-weekly pay period. All unused annual leave is cancelled at the end of each fiscal year. Accordingly, no liability is recorded for compensated absences in the accompanying statement of net assets.

P. Fund Equity

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

	<u>General</u>	<u>U.S. Federal Grants</u>	<u>Section 211 Sector Grant</u>	<u>Early Retirement Program</u>	<u>Section 215 Compact Trust</u>	<u>Other Governmental Funds</u>	<u>Totals</u>
Investments	\$ 200,000	\$ -	\$ -	\$ -	\$ -	\$ 900,000	\$ 1,100,000
Receivables:							
Loans	254,000	-	-	-	-	15,314	269,314
Advances	42,043	-	-	-	-	-	42,043
Inventory	11,757	-	-	-	-	-	11,757
Restricted assets:							
Cash and cash equivalents	242,204	-	-	-	-	354,383	596,587
Time certificates of deposits	313,484	-	-	-	-	38,030	351,514
Investments	-	-	-	1,646,807	2,982,085	-	4,628,892
	<u>\$ 1,063,488</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,646,807</u>	<u>\$ 2,982,085</u>	<u>\$ 1,307,727</u>	<u>\$ 7,000,107</u>

As of September 30, 2007, continuing appropriations reported as Other Governmental Funds, Foreign Assistance Fund were restricted for the following:

Solid Waste Recycling Project	\$ 210,000
KSA Centralized Landfill Project	90,900
Other	<u>17,000</u>
	<u>\$ 317,900</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

Q. Risk Financing

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

R. New Accounting Standards

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 State.

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 State.

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

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 State.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

R. New Accounting Standards, Continued

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 State.

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 State.

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.

T. Deferred Revenue

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

U. 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 the State's financial statements for the year ended September 30, 2006 from which summarized information was derived.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

V. Reclassifications

Due to the provisions of GASB Statement No. 34 *Basic Financial Statements – and Management’s Discussion and Analysis – For State and Local Governments*, major funds presented in a previous year may not be major funds presented in the current year. Concurrently, major funds presented in the current year may not be major funds presented in the previous year. Accordingly, the State has presented the Early Retirement Program Fund as a major fund in the current year whereas such was presented as a nonmajor governmental fund in the previous year. In addition, the State has presented the Compact Capital Projects Fund as a nonmajor governmental fund in the current year whereas such was presented as a major fund in the previous year.

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

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

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

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

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

The Director of the Department shall be responsible for investment of all public funds collected or appropriated for use by the Kosrae State Government. Funds under this arrangement shall include all appropriations from the Kosrae State Government, whether funds are appropriated from the State Treasury or funds from other sources. Any funds in excess of the amount necessary for the operation of the Government shall be deposited or invested to earn the safest optimum interest. The Director shall determine the amount to be invested with the consideration that such amount should not cause disruption of any government service due to low or lack of funds in the operational budget. The Director shall cause all investments to be made into financially secure institutions in Kosrae or abroad as determined by the financial institution paying the highest rate of interest on savings when the investment is made.

A. Deposits

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

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

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

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

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

As of September 30, 2007, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit was \$1,298,134 and the corresponding bank balance was \$1,581,370, which is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2007, bank deposits in the amount of \$100,000 were FDIC insured. The State does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Therefore, these deposits are exposed to custodial credit risk.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

A. Deposits, Continued

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 \$1,350,722, and the corresponding bank balance was \$1,368,855, which were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2007, bank deposits in the amount of \$300,000 were FDIC insured. The component units do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Therefore, these deposits are exposed to custodial credit risk.

B. Investments

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

- Category 1 Investments that are insured or registered, or securities held by the State or its agent in the State's name;
- Category 2 Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the State's name; or
- Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the State's name.

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

As of September 30, 2007, the State's investments at fair value are as follows:

Investments:

Money market funds	\$ 1,638,965
Cash management account	<u>2,989,927</u>
	\$ <u>4,628,892</u>

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

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the State will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The State's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the State's name by the State's custodial financial institutions at September 30, 2007.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

B. Investments, Continued

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

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

As of September 30, 2007, the Compact Capital Projects Fund holds 5.4% of the shares of the Bank of the Federated States of Micronesia in the amount of \$500,000, 5.5% of the shares of the Pacific Islands Development Bank in the amount of \$300,000. As the fair market value of these investments is not readily available, such have been recorded at cost.

In addition, as of September 30, 2007, the Compact Capital Projects Fund holds 100% of the shares of Pacific Tuna Ventures, Inc. and 50% of the shares in a joint venture with the National Fisheries Corporation of Kosrae Sea Ventures, Inc. These investments are accounted for using the equity method and, accordingly, the carrying values have been reduced to \$0.

As of September 30, 2007, the General Fund holds 3.7% of the shares of the Pacific Island Development Bank in the amount of \$200,000. As the fair market value of this investment is not readily available, such has been recorded at cost.

As of September 30, 2007, the Foreign Assistance Fund holds 1.8% of the shares of the Pacific Islands Development Bank in the amount of \$100,000. As the fair market value of this investment is not readily available, such has been recorded at cost.

Discretely Presented Component Units

As of September 30, 2007, investments at fair value comprise the following:

Money market funds	\$ 247,490
Common stock	<u>451,065</u>
	\$ <u>698,555</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(3) Receivables

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

	<u>General</u>	<u>U.S. Federal Grants</u>	<u>Section 211 Sector Grant</u>	<u>Early Retirement Program</u>	<u>Section 215 Compact Trust</u>	<u>Other Governmental Funds</u>	<u>Totals</u>
Receivables:							
Federal agencies	\$ -	\$ 1,973,493	\$ 280,069	\$ -	\$ -	\$ -	\$ 2,253,562
Taxes	163,326	-	-	-	-	-	163,326
Loans	254,000	-	-	-	-	2,117,450	2,371,450
FSM National Government	-	-	-	-	-	664,956	664,956
Other	<u>253,367</u>	<u>22,962</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>657,907</u>	<u>934,236</u>
	670,693	1,996,455	280,069	-	-	3,440,314	6,387,531
Less: Allowance for uncollectible accounts	<u>(61,168)</u>	<u>(1,996,455)</u>	<u>(45,221)</u>	<u>-</u>	<u>-</u>	<u>(3,057,500)</u>	<u>(5,160,344)</u>
Net receivables	\$ <u>609,525</u>	\$ <u>-</u>	\$ <u>234,848</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>382,814</u>	\$ <u>1,277,187</u>

Receivables of the primary government are primarily due from businesses and individuals residing in the FSM. The State establishes an allowance for doubtful accounts receivable based on the credit risk of specific customers, historical trends and other information. During the year ended September 30, 2007, the State reevaluated the allowance for doubtful debts and recovered collections within the General Fund in the amount of \$363,047. Accordingly, such has been reflected as a special item within the accompanying financial statements.

Loans receivable of the primary government as of September 30, 2007 are as follows:

Major Governmental Funds

General Fund:

Note receivable due from Micronesian Petroleum Corporation, interest at 1% per annum, payable in monthly installments of \$2,000, uncollateralized, due June 1, 2005. Commencing June 1, 2008, monthly installments shall be increased to \$4,000 per month.

\$ 254,000

Nonmajor Governmental Funds

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

272,500

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

95,000

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(3) Receivables, Continued

Loans receivable from post-secondary students issued under a student financial assistance program to qualified Kosraean students, uncollateralized with interest at up to 6% per annum. These loans have been fully provided for in the allowance for uncollectibles.	436,123
Low-income housing loans, details and terms of those loans have not been compiled and such have been provided for in the allowance for uncollectibles.	<u>1,313,827</u>
	<u>\$ 2,117,450</u>

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

	<u>Kosrae Utilities Authority</u>	<u>Micronesia Petroleum Corporation</u>
Receivables:		
Federal agencies	\$ 7,793	\$ -
General	<u>350,946</u>	<u>726,346</u>
	358,739	726,346
Less: Allowance for uncollectible accounts	<u>(205,231)</u>	<u>(431,813)</u>
Net receivables	<u>\$ 153,508</u>	<u>\$ 294,533</u>

(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:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
U.S. Federal Grants	General	\$ 117,655
Section 211 Sector Grants	General	736,273
Nonmajor governmental funds	General	1,035,751
General	Nonmajor governmental funds	<u>249,303</u>
		<u>\$ 2,138,982</u>

Balances reflected as due to primary government in the statement of net assets at September 30, 2007 of \$62,278 is due to the note payable recorded in the Primary Governments, nonmajor governmental funds totaling \$95,000 that has been fully provided for in the allowance for uncollectibles.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(5) Fixed Assets

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

Primary Government

	Balance October 1, 2006	Additions	Retirements	Balance September 30, 2007
Governmental activities:				
Buildings	\$ 13,758,492	\$ -	\$ -	\$ 13,758,492
Infrastructure	72,885,749	-	-	72,885,749
Machinery, equipment, others	<u>3,479,410</u>	<u>-</u>	<u>-</u>	<u>3,479,410</u>
	<u>90,123,651</u>	<u>-</u>	<u>-</u>	<u>90,123,651</u>
Less accumulated depreciation:				
Buildings	(10,426,894)	(277,145)	-	(10,704,039)
Infrastructure	(46,187,052)	(1,910,901)	-	(48,097,953)
Machinery, equipment, others	<u>(2,875,693)</u>	<u>(112,760)</u>	<u>-</u>	<u>(2,988,453)</u>
	<u>(59,489,639)</u>	<u>(2,300,806)</u>	<u>-</u>	<u>(61,790,445)</u>
	<u>\$ 30,634,012</u>	<u>\$ (2,300,806)</u>	<u>\$ -</u>	<u>\$ 28,333,206</u>

During the year ended September 30, 2007, depreciation expense was charged as follows:

General government	\$ 66,012
Education	103,794
Health services	80,446
Public safety	7,500
Economic development	1,831,427
Other appropriations	<u>211,627</u>
	<u>\$ 2,300,806</u>

(6) Short-Term Obligations

In 2007, the State entered into a short-term bank borrowing to finance State current liabilities

Balance October 1, 2006	Additions	Reductions	Balance September 30, 2007
<u>\$ -</u>	<u>\$500,000</u>	<u>\$500,000</u>	<u>\$ -</u>

In 2006, KUA had a \$500,000 bank line of credit preceding the acquisition of the bank term loan. The line was collateralized by the same TCD described below. Movement of this short-term funding in 2007 was as follows:

Balance October 1, 2006	Additions	Reductions	Balance September 30, 2007
<u>\$ -</u>	<u>\$477,350</u>	<u>\$477,350</u>	<u>\$ -</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(7) Long-Term Obligations

Primary Government

Malem Wastewater System Project (MWSP) Loan:

The State borrowed \$145,000 from the U.S. Department of Agriculture Rural Utilities Services for the Malem Wastewater System Project, payable in annual installments of \$7,880 commencing September 28, 2001, interest at 4.5% per annum, due September 28, 2040. As of September 30, 2007, the balance payable on this mortgage loan amounted to \$136,173.

Asian Development Bank (ADB) Early Retirement Program Loan and Other ADB Debt:

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

The ADB loan has a grace period of ten years with the first payment due in February 2008 and the last payment in August 2037. However, pursuant to the terms of the Financing Agreement between the State and the FSM National Government, the State is required to deposit into the ERS Trust account held in the name of the State within the FSM National Government investment portfolio, 100% of the outstanding principal balance by September 30, 2002.

Funds for the repayment of the ADB loan are expected to be derived from the annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The Financing Agreement requires the State to continue to appropriate salaries for the abolished positions and deposit the appropriate funds into the ERS Trust Account. These funds had not been deposited to the Trust Account as of September 30, 2002. Of the required \$2,000,000 identified for future debt service payments, \$1,646,807 is deposited in an investment account held jointly with the FSM National Government. That investment account is restricted for the repayment of this debt.

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Program Loans with ADB (Loan Number 1873 (SF) and Loan Number 1874 FSM (SF)), for the purpose of promoting private sector development in Kosrae, with interest at 1 to 1.5%. The principal payments shall be made in 32 equal semi-annual payments with the first payment due on May 15, 2010 and the last payment on November 15, 2025. As of September 30, 2007, the State drew down an additional \$144,005 of the \$1,135,781 total borrowing.

As of September 30, 2007, the State entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government program loans with ADB (Loan Number 1816 FSM (SF)), for the purpose of funding the Basic Social Services Project, with interest at 1 to 1.5% per annum. The principal payments shall be made semiannually commencing February 1, 2009, with a maturity date of August 1, 2032. As of September 30, 2007, the State drew down \$94,751.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(7) Long-Term Obligations, Continued

Primary Government, Continued

During the year ended September 30, 2007, the State entered into an agreement with the FSM National Government to borrow \$1,500,000 for the purpose of repayment of Compact Sector Grant advances and to partially pay a \$500,000 bank borrowing. The principal payment shall be made 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.

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	\$ 43,881	\$ 40,503	\$ 84,384
2009	134,355	44,011	178,366
2010	246,941	42,701	289,642
2011	247,032	41,386	288,418
2012	247,127	40,067	287,194
2013 – 2017	1,320,190	178,775	1,498,965
2018 – 2022	984,530	136,654	1,121,184
2023 – 2027	707,886	88,116	796,002
2028 – 2032	482,790	48,543	531,333
2033 - 2037	430,222	21,086	451,308
2038 - 2040	<u>21,752</u>	<u>1,888</u>	<u>23,640</u>
	<u>\$ 4,866,706</u>	<u>\$ 683,730</u>	<u>\$ 5,550,436</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 loans	\$ 2,991,777	\$ 238,756	\$ -	\$ 3,230,533	\$ 40,000
MWSP loan	136,173	-	-	136,173	3,881
FSMNG loan	<u>-</u>	<u>1,500,000</u>	<u>-</u>	<u>1,500,000</u>	<u>-</u>
	<u>3,127,950</u>	<u>1,738,756</u>	<u>-</u>	<u>4,866,706</u>	<u>43,881</u>
Other:					
Claims	<u>110,000</u>	<u>-</u>	<u>-</u>	<u>110,000</u>	<u>-</u>
	<u>\$ 3,237,950</u>	<u>\$ 1,738,756</u>	<u>\$ -</u>	<u>\$ 4,976,706</u>	<u>\$ 43,881</u>

Discretely Presented Component Units

Kosrae Utilities Authority (KUA):

Term loan payable to bank, original amount of \$450,000, interest at 2.50% greater than TCD rate pledged as collateral, monthly repayment of \$8,523, collateralized by a first security interest in a time certificate of deposit of \$660,987 held by KUA. Interest rate effective as of September 30, 2007 ranges from 5.10% to 5.85%.

\$ 437,329

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(7) Long-Term Obligations, Continued

Discretely Presented Component Units, Continued

Micronesia Petroleum Corporation (MPC):

Loan payable to Kosrae State Government, in the original amount of \$300,000, due in monthly installments of \$2,628, interest at 1%, maturing on February 1, 2009.	\$ 272,500
Loan payable to Kosrae State Government in the original amount of \$300,000 due in monthly installments of \$2,000. Commencing June 1, 2008, installments shall be increased to \$4,000 per month, interest at 1%.	260,172
Loan payable to FSM Development Bank in the original amount of \$500,000 due in monthly installments of \$5,100, with a balloon payment of approximately \$264,000 due at maturity. Interest is at 9%, maturity in September 2008, collateralized by the property and inventory of the Company.	269,686
Term loan payable to Bank of the FSM, interest at 2.75% greater than TCD rate pledged as collateral by Kosrae State Government (6.25% at September 30, 2007), collateralized by a first security interest in essentially all MPC assets and a time certificate of deposit held by Kosrae State Government in the amount of \$113,484.	83,986
Loan payable to FSM Development Bank, ten year term, maturing on July 18, 2010, interest at 5%, monthly repayment of \$7,958, collateralized by MPC's accounts receivable and inventory.	272,117
Loan payable to FSM Development Bank, two year term, maturing on July 31, 2008, interest at 9%, monthly repayment of \$9,136, collateralized by interest in essentially all MPC assets.	<u>87,317</u>
	\$ <u>1,245,778</u>

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	\$ 870,237	\$ 79,171	\$ 949,408
2009	212,778	32,996	245,774
2010	222,282	23,492	245,774
2011	151,444	13,491	164,935
2012	149,562	7,005	156,567
2013	<u>76,804</u>	<u>597</u>	<u>77,401</u>
	\$ <u>1,683,107</u>	\$ <u>156,752</u>	\$ <u>1,839,859</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(7) Long-Term Obligations, Continued

Discretely Presented Component Units, Continued

Micronesia Petroleum Corporation (MPC), Continued:

During the year ended September 30, 2007, the following changes occurred in liabilities reported as part of the component unit's long-term liabilities in the statement of net assets:

	Balance October 1, 2006	Additions	Reductions	Balance September 30, 2007	Due Within One Year
KUA loans payable	\$ -	\$ 450,000	\$ (12,671)	\$ 437,329	\$ 76,694
MPC loans payable	<u>1,528,502</u>	<u>-</u>	<u>(282,724)</u>	<u>1,245,778</u>	<u>793,543</u>
	<u>\$ 1,528,502</u>	<u>\$ 450,000</u>	<u>\$ (295,395)</u>	<u>\$ 1,683,107</u>	<u>\$ 870,237</u>

(8) Commitments and Contingencies

Sick Leave

It is the policy of the State to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave as of September 30, 2007 is \$227,969.

Insurance Coverage

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

Federal Grants

The State participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of \$162,753 relating to fiscal years 2002 through 2007 have been set forth in the State's Single Audit Report for the year ended 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.

Pursuant to Title I, Section 105 of United States Public Law 99-239, the Government of the Federated States of Micronesia (FSM) (which includes the State) is no longer liable for debts to U.S. federal agencies arising prior to the date of the implementation of the Compact of Free Association. This matter has not yet been officially resolved with the U.S. Government.

The State is continuing its process of evaluating the collectability of its recorded receivables from the FSM National Government. Any matters that result from this evaluation will be accounted for prospectively as it is not presently possible to determine the ultimate outcome of this matter.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(8) Commitments and Contingencies, Continued

Loan Guarantee Escrow

As set forth in note 12, the State has pledged an escrow account in support of certain housing loans. In the event of default, the State could be exposed to a currently indeterminable liability.

Litigation

The State is party to numerous legal proceedings, many of which are normal recurrences in governmental operations. The State's Attorney General is of the opinion that the probable outcome of suits existing at September 30, 2007, is not predictable but could have a material impact on the accompanying financial statements. Such impact has currently been estimated to approximate \$110,000, which has been recorded as a liability in the accompanying statement of net assets.

(9) Individual Deficit Fund Balances

Specific individual funds which had significant deficit fund balances as at September 30, 2007, are as follows:

Airport Revolving Fund	\$ <u>39,966</u>
------------------------	------------------

(10) Restatement

Subsequent to the issuance of the State's 2006 financial statements, management of the State determined that capital assets at September 30, 2006 were understated by \$248,766. As a result, capital asset balances have been restated from the amounts previously reported as follows:

	<u>Government-Wide</u>
Net assets previously reported at September 30, 2006	\$ 32,357,507
Understatement of capital assets	<u>248,766</u>
Net assets as restated at September 30, 2006	\$ <u>32,606,273</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2007

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

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

	Budgeted Amounts		Actual - Bugetary Basis (see Note 1)	Variance with Final Budget -
	Original	Final		
Revenues:				
FSM revenue sharing	\$ 1,666,312	\$ 1,156,967	\$ 1,003,623	\$ (153,344)
State taxes	145,407	145,407	363,037	217,630
Net increase in the fair value of investments	-	-	161,830	161,830
Other	1,337,074	772,871	76,293	(696,578)
Total revenues	3,148,793	2,075,245	1,604,783	(470,462)
Expenditures:				
Current:				
General government	1,372,628	1,004,844	975,111	29,733
Economic development	87,657	417,054	402,681	14,373
Education	581,793	16,063	13,297	2,766
Health services	328,383	-	-	-
Public order and safety	-	1,500	660	840
Environment protection and sanitation	-	55,452	45,748	9,704
Boards, commissions and other	778,332	641,267	487,143	154,124
Total expenditures	3,148,793	2,136,180	1,924,639	211,541
Deficiency of revenues under expenditures	-	(60,935)	(319,856)	(258,921)
Other financing sources:				
Loan proceeds	-	-	1,500,000	1,500,000
Operating transfers in	-	-	1,951,315	1,951,315
Total other financing sources	-	-	3,451,315	3,451,315
Special items:				
Recovery of bad debts	-	-	363,047	(363,047)
Net change in unreserved deficit	-	(60,935)	3,494,506	2,829,347
Other changes in unreserved deficit:				
Increase in reserve for related assets	-	-	(251,331)	(251,331)
Decrease in reserve for continuing appropriations	-	-	501,303	501,303
Unreserved deficit at the beginning of the year	(4,986,781)	(4,986,781)	(4,986,781)	-
Unreserved deficit at the end of the year	\$ (4,986,781)	\$ (5,047,716)	\$ (1,242,303)	\$ 3,079,319

See accompanying notes to required supplementary information - budgetary reporting.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

(1) Budgetary Information

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

Formal budget integration is employed as a management control device during the year for all funds. The Kosrae State Legislature has the authority to reprogram budgeted estimates in accordance with the Constitution. All annual appropriations lapse at fiscal year end unless otherwise specified by law. Supplemental appropriations may occur throughout the year. Unexpended encumbrances at each fiscal year end are carried forward until they are expended or canceled without further legislative action. The State does not establish budgets for the operations of its other governmental funds.

Accounting principles used in developing data on a budgetary basis differ from those used in preparing the basic financial statements in conformity with GAAP. Amounts included on the Statement of Revenues, Expenditures, and Changes in Fund 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>
General Government	\$ 42,460
Election	15,995
Commerce and Industry	4,398
Sports Development	2,996
Retirement Program	13,538
RM Small Business Development Center	10,685
Other	41,669

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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)	\$ 3,444,744
Decrease in encumbrances	<u>49,762</u>
Net change in unreserved fund deficit	\$ <u>3,494,506</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2007

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Combining Schedule of Expenditures by Account
Governmental Funds
Year Ended September 30, 2007

	General	Special Revenue			Permanent	Other Governmental Funds	Total
		U.S Federal Grants	Section 211 Sector Grant	Early Retirement Program	Compact Trust		
Expenditures:							
Salaries and wages	\$ 1,296,588	\$ 354,762	\$ 3,383,819	\$ -	\$ -	\$ 466,295	\$ 5,501,464
Benefits	152,582	38,719	333,161	-	-	23,162	547,624
Travel	89,755	85,561	174,849	-	-	10,997	361,162
Capital outlay	(1,399)	124,671	169,330	-	-	74,507	367,110
Food stuffs	22,921	-	22,940	-	-	4,368	50,228
Supplies and materials	34,501	51,034	455,298	-	-	165,636	706,469
Rentals	2,176	1,816	8,093	-	-	1,253	13,338
Repairs and maintenance	396	367	1,349	-	-	40	2,152
Communications	33,768	11,487	72,759	-	-	30,106	148,120
Utilities	72,862	5,397	173,414	-	-	45,767	297,439
Advertising, printing and reproduction	4,964	2,105	12,184	-	-	1,144	20,398
Import charges	47	119	1,509	-	-	592	2,267
POL	18,979	5,951	44,070	-	-	22,019	91,019
Contributions	-	-	-	-	-	2,500	2,500
Grants and subsidies	2,000	-	-	-	-	-	2,000
Contractual services	30,746	84,603	884,653	-	-	89,574	1,089,576
Professional services	-	-	10,239	-	-	-	10,239
Leased housing, building and land	29,637	1,167	68,170	-	-	32,265	131,239
Meeting and official allowance	1,838	-	1,980	-	-	-	3,818
Training	-	-	71,531	-	-	-	71,531
Bank charges	-	-	194	32,535	-	12	32,741
Medical supplies	-	4,514	310,240	-	-	3,831	318,585
Medical referral stipend	-	-	35,681	-	-	-	35,681
Scholarships	-	-	306,341	-	-	-	306,341
Other	182,040	827	4,979	238,755	-	62,350	488,951
	<u>\$ 1,974,401</u>	<u>\$ 773,099</u>	<u>\$ 6,546,784</u>	<u>\$ 271,290</u>	<u>\$ -</u>	<u>\$ 1,036,418</u>	<u>\$ 10,601,993</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function, and Changes in Deficit
General Fund
Year Ended September 30, 2007
(with comparative totals for the year ended September 30, 2006)

	2007	2006
Revenues:		
FSM revenue sharing	1,003,623	1,216,477
State taxes:		
Sales tax	8,686	55,026
Alcohol and tobacco tax	-	50,388
Licenses and Fees	354,351	52,184
	363,037	157,598
Net increase in the fair value of investments	161,830	71,951
Other	76,293	198,364
Total revenues	1,604,783	1,644,390
Expenditures:		
Current:		
General government:		
Governor and staff	181,969	490,254
Department of Treasury and Administration	42,460	34,806
Judiciary Branch	252,471	355,471
Legislative Branch	502,378	760,904
Election	19,949	-
	999,227	1,641,435
Economic Development:		
Office of the Director of Agriculture, Land and Fisheries	57,979	360
Commerce and Industry	31,960	67,405
Land Management and Preservation	43,657	-
Housing	47,075	-
Crop Production and Research	31,865	-
Livestock Production and Research	7,816	-
Survey and Mapping	72,309	-
Marine Surveillance	32,814	-
Fisheries Development	49,296	-
Foreign Investment	8,107	-
Consumer Services	5,219	-
Market and Research	17,912	-
USDA Rural Development	340	78,667
	406,348	146,432
Education:		
Office of the Director	270	953
Scholarship Loan Collection	14,385	16,256
	14,655	17,209
Public Order and Safety:		
Parole board	660	760
	660	760
Environment Protection and Sanitation:		
Division of Water and Wastewater	50,630	-
	50,630	-

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function, and Changes in Deficit, Continued
General Fund
Year Ended September 30, 2007
(with comparative totals for the year ended September 30, 2006)

	2007	2006
Expenditures, continued:		
Current, continued:		
Boards, Commissions and Other:		
Transportation and Infrastructure	235,675	356,682
Community Affairs	47,739	122,294
Broadcast Authority	45,007	65,189
Sports Development	33,533	683
Retirement Program	78,538	-
RM Small Business Development Center	10,685	-
Other	51,704	-
	<u>502,881</u>	<u>544,848</u>
Payments to Non-governmental Agencies:		
Micronesian Legal Services Corporation	-	30,000
	<u>-</u>	<u>30,000</u>
Total expenditures	<u>1,974,401</u>	<u>2,380,684</u>
Deficiency of revenues under expenditures	<u>(369,618)</u>	<u>(736,294)</u>
Other financing sources (uses):		
Loan proceeds	1,500,000	-
Operating transfers in	1,951,315	-
Operating transfers out	-	(198,877)
Total other financing sources (uses), net	<u>3,451,315</u>	<u>(198,877)</u>
Special items:		
Recovery of bad debts	363,047	-
Bad debts	-	(2,284,270)
	<u>363,047</u>	<u>(2,284,270)</u>
Net change in deficit	3,444,744	(3,219,441)
Deficit at the beginning of the year	(3,612,386)	(392,945)
Deficit at the end of the year	<u>\$ (167,642)</u>	<u>\$ (3,612,386)</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function and Changes in Deficit
Budget and Actual - General Fund
Year Ended September 30, 2007

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final	Budgetary Basis	
Revenues:				
FSM revenue sharing:	\$ 1,666,312	\$ 1,156,967	\$ 1,003,623	\$ (153,344)
State taxes:				
Sales tax	-	-	8,686	8,686
Licences and fees	145,407	145,407	354,351	208,944
	145,407	145,407	363,037	217,630
Investment income	-	-	161,830	161,830
Other revenues	1,337,074	772,871	76,293	(696,578)
Total revenues	3,148,793	2,075,245	1,604,783	(470,462)
Expenditures:				
Current:				
General government:				
Governor and staff	259,239	200,221	174,932	25,289
Finance and Budget	-	-	42,460	(42,460)
Judiciary Branch	400,196	263,220	250,083	13,137
Legislative Branch	690,943	537,449	487,687	49,762
Office of the Attorney-General	22,250	-	-	-
Election	-	3,954	19,949	(15,995)
	1,372,628	1,004,844	975,111	29,733
Economic development:				
Director of Agriculture, Land and Fisheries	26,600	58,813	57,776	1,037
Commerce and Industry	61,057	27,390	31,788	(4,398)
Land Management and Preservation	-	46,440	43,657	2,783
Housing	-	47,498	47,269	230
Crop Production and Research	-	31,630	31,865	(235)
Livestock Production and Research	-	7,752	7,816	(64)
Survey and Mapping	-	75,216	72,423	2,793
Marine Surveillance	-	33,613	32,058	1,555
Fisheries Development	-	50,567	49,230	1,337
Consumer Services	-	10,392	5,219	5,173
Market and Research	-	18,162	17,288	874
Foreign Investment	-	8,863	6,330	2,533
USDA Rural Development	-	718	(38)	756
	87,657	417,054	402,681	14,373
Education:				
Office of the Director	-	1,232	(962)	2,193
Special Education Program	564,203	-	-	-
Scholarship Loan Collection	17,590	14,832	14,259	573
	581,793	16,063	13,297	2,766
Health services:				
Division of Administration	328,383	-	-	-
	328,383	-	-	-
Public order and safety:				
Parole board	-	1,500	660	840
	-	1,500	660	840
Environment protection and sanitation:				
Division of Water and Wastewater	-	55,452	45,748	9,704
	-	55,452	45,748	9,704

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function and Changes in Deficit, Continued
Budget and Actual - General Fund
Year Ended September 30, 2007

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final	Budgetary Basis	
Boards, commissions and other:				
Transportation and Infrastructure	547,577	449,457	227,401	222,056
Community Affairs	121,427	48,369	47,317	1,052
Broadcast Authority	59,328	45,151	45,245	(94)
Sports Development	-	28,273	31,269	(2,996)
Retirement Program	50,000	65,000	78,538	(13,538)
RM Small Business Development Center	-	-	10,685	(10,685)
Other	-	5,018	46,686	(41,668)
	<u>778,332</u>	<u>641,267</u>	<u>487,142</u>	<u>154,126</u>
Total expenditures	<u>3,148,793</u>	<u>2,136,180</u>	<u>1,924,638</u>	<u>211,542</u>
Deficiency of revenues under expenditures	<u>-</u>	<u>(60,935)</u>	<u>(319,855)</u>	<u>258,920</u>
Other financing sources:				
Loan proceeds	-	-	1,500,000	(1,500,000)
Operating transfers in	-	-	1,951,315	(1,951,315)
	<u>-</u>	<u>-</u>	<u>3,451,315</u>	<u>(3,451,315)</u>
Special items:				
Recovery of bad debts	-	-	363,047	(363,047)
Net change in unreserved deficit	-	(60,935)	3,494,507	(3,555,442)
Other changes in unreserved deficit:				
Increase in reserve for related assets	-	-	(251,331)	(251,331)
Decrease in reserve for continuing appropriations	-	-	501,303	501,303
Unreserved deficit at the beginning of the year	<u>(4,986,781)</u>	<u>(4,986,781)</u>	<u>(4,986,781)</u>	<u>-</u>
Unreserved deficit at the end of the year	<u>\$ (4,986,781)</u>	<u>\$ (5,047,716)</u>	<u>\$ (1,242,302)</u>	<u>\$ (3,305,471)</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Combined Balance Sheet
Nonmajor Governmental Funds
September 30, 2007

	Other Special Revenue	Other Capital Projects	Total
<u>ASSETS</u>			
Investments	\$ 100,000	\$ 800,000	\$ 900,000
Receivables:			
FSM National Government	-	72,230	72,230
Loans	15,314	-	15,314
Other	295,270	-	295,270
Advances	28,392	-	28,392
Due from other funds	1,035,751	-	1,035,751
Restricted assets:			
Cash and cash equivalents	354,383	-	354,383
Time certificates of deposit	38,030	-	38,030
Total assets	<u>\$ 1,867,140</u>	<u>\$ 872,230</u>	<u>\$ 2,739,370</u>
<u>LIABILITIES AND FUND BALANCES</u>			
Liabilities:			
Accounts payable	\$ 26,671	\$ 300	\$ 26,971
Other liabilities and accruals	12,116	(99)	12,017
Due to other funds	177,307	71,996	249,303
Deferred revenue	109,770	33	109,803
Total liabilities	<u>325,864</u>	<u>72,230</u>	<u>398,094</u>
Fund balances:			
Reserved for:			
Related assets	507,727	800,000	1,307,727
Encumbrances	76,615	-	76,615
Continuing appropriations	317,900	-	317,900
Unreserved:			
Special revenue funds	639,034	-	639,034
Total fund balances	<u>1,541,276</u>	<u>800,000</u>	<u>2,341,276</u>
Total liabilities and fund balances	<u>\$ 1,867,140</u>	<u>\$ 872,230</u>	<u>\$ 2,739,370</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

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

	Other Special Revenue	Other Capital Projects	Total
Revenues:			
Net increase in the fair value of investments	\$ 70,045	\$ 14,436	\$ 84,481
Fees and charges	256,176	-	256,176
CFSM grants	-	46,000	46,000
Other grants	397,840	-	397,840
Total revenues	<u>724,061</u>	<u>60,436</u>	<u>784,497</u>
Expenditures by function:			
Current:			
General government	296,962	-	296,962
Economic development	96,058	21,000	117,058
Education	4,183	-	4,183
Health services	35,563	-	35,563
Public order and safety	30,000	25,000	55,000
Environment protection and sanitation	199,129	-	199,129
Boards, commissions and other	275,198	-	275,198
Capital projects	<u>-</u>	<u>53,325</u>	<u>53,325</u>
Total expenditures	<u>937,093</u>	<u>99,325</u>	<u>1,036,418</u>
Deficiency of revenues under expenditures	<u>(213,032)</u>	<u>(38,889)</u>	<u>(251,921)</u>
Other financing uses:			
Operating transfers out	<u>-</u>	<u>(1,605,549)</u>	<u>(1,605,549)</u>
Total other financing uses	<u>-</u>	<u>(1,605,549)</u>	<u>(1,605,549)</u>
Net change in fund balances	(213,032)	(1,644,438)	(1,857,470)
Fund balances at the beginning of the year	<u>1,754,308</u>	<u>2,444,438</u>	<u>4,198,746</u>
Fund balances at the end of the year	<u>\$ 1,541,276</u>	<u>\$ 800,000</u>	<u>\$ 2,341,276</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

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

	Other Special Revenue	Other Capital Projects	Total
Revenues:			
Net increase in the fair value of investments	\$ 70,045	\$ 14,436	\$ 84,481
Fees and charges	256,176	-	256,176
CFSM grants	-	46,000	46,000
Other grants	397,840	-	397,840
Total revenues	<u>724,061</u>	<u>60,436</u>	<u>784,497</u>
Expenditures by account:			
Salaries and wages	430,295	36,000	466,295
Benefits	20,162	3,000	23,162
Travel	10,997	-	10,997
Capital outlay	74,032	475	74,507
Food stuffs	3,568	800	4,368
Supplies and materials	162,986	2,650	165,636
Rentals	1,253	-	1,253
Repairs and maintenance	40	-	40
Communications	29,306	800	30,106
Utilities	42,767	3,000	45,767
Advertising, printing and reproduction	644	500	1,144
Import charges	592	-	592
POL	21,019	1,000	22,019
Contributions	2,500	-	2,500
Contractual services	54,715	34,859	89,574
Leased housing and land	21,489	10,776	32,265
Bank charges	12	-	12
Medical supplies	3,831	-	3,831
Other	56,885	5,465	62,350
Total expenditures	<u>937,093</u>	<u>99,325</u>	<u>1,036,418</u>
Deficiency of revenues under expenditures	<u>(213,032)</u>	<u>(38,889)</u>	<u>(251,921)</u>
Other financing uses:			
Operating transfers out	<u>-</u>	<u>(1,605,549)</u>	<u>(1,605,549)</u>
Total financing uses	<u>-</u>	<u>(1,605,549)</u>	<u>(1,605,549)</u>
Net change in fund balances	(213,032)	(1,644,438)	(1,857,470)
Fund balances at the beginning of the year	<u>1,754,308</u>	<u>2,444,438</u>	<u>4,198,746</u>
Fund balances at the end of the year	<u>\$ 1,541,276</u>	<u>\$ 800,000</u>	<u>\$ 2,341,276</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

Combining Balance Sheet
September 30, 2007

	Compact Special Block 211(b)	Compact Health & Medical 216(a)(2)	Compact Scholarship 216(a)(3)	Compact Energy Block Grant 214	Compact Special Development 212(b)	Foreign Assistance	Airport Revolving	Agriculture Revolving	Fisherman
ASSETS									
Investments	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 100,000	\$ -	\$ -	\$ -
Receivables:									
Loans	-	-	-	-	-	-	-	-	-
Other	-	-	-	-	-	292,254	3,016	-	-
Advances	-	-	-	-	-	25,429	2,963	-	-
Due from other funds	19,867	147,900	-	153	8,880	-	-	-	-
Restricted:									
Cash and equivalents	-	-	-	-	-	-	-	-	-
Time certificates of deposit	-	-	-	-	-	-	-	-	-
Total assets	<u>\$ 19,867</u>	<u>\$ 147,900</u>	<u>\$ -</u>	<u>\$ 153</u>	<u>\$ 8,880</u>	<u>\$ 417,683</u>	<u>\$ 5,979</u>	<u>\$ -</u>	<u>\$ -</u>
LIABILITIES AND FUND BALANCES (DEFICITS)									
Liabilities:									
Accounts payable	\$ -	\$ 66	\$ -	\$ 153	\$ -	\$ 11,192	\$ 4,012	\$ -	\$ -
Other liabilities and accruals	-	-	-	-	-	9,631	2,485	-	-
Due to other funds	-	-	-	-	-	134,881	39,448	-	-
Deferred revenue	-	-	-	-	-	109,770	-	-	-
Total liabilities	-	<u>66</u>	<u>-</u>	<u>153</u>	<u>-</u>	<u>265,474</u>	<u>45,945</u>	<u>-</u>	<u>-</u>
Fund balances (deficits):									
Reserved for:									
Related assets	-	-	-	-	-	100,000	-	-	-
Encumbrances	-	4,658	2,461	-	348	43,088	5,185	-	-
Continuing appropriations	-	-	-	-	-	317,900	-	-	-
Unreserved (deficit)	19,867	143,176	(2,461)	-	8,532	(308,780)	(45,151)	-	-
Total fund balances (deficits)	<u>19,867</u>	<u>147,834</u>	<u>-</u>	<u>-</u>	<u>8,880</u>	<u>152,209</u>	<u>(39,966)</u>	<u>-</u>	<u>-</u>
Total liabilities and fund balances (deficits)	<u>\$ 19,867</u>	<u>\$ 147,900</u>	<u>\$ -</u>	<u>\$ 153</u>	<u>\$ 8,880</u>	<u>\$ 417,683</u>	<u>\$ 5,979</u>	<u>\$ -</u>	<u>\$ -</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

Combining Balance Sheet, Continued
September 30, 2007

ASSETS										
	Production Loan	Scholarship Revolving Loan	Housing Revolving	Aluminum Recycling	Tourism Revolving	Health Care	Sports Council	Broadcast Authority	Gifford Scholarship	Total
\$	-	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 100,000
Investments	-	-	-	-	-	-	-	-	-	-
Receivables:	-	-	-	-	-	-	-	-	-	-
Loans	-	-	15,314	-	-	-	-	-	-	15,314
Other	-	-	-	-	-	-	-	-	-	295,270
Advances	-	-	-	-	-	-	-	-	-	28,392
Due from other funds	1,495	3,600	413,614	165,824	-	269,260	502	4,656	-	1,035,751
Restricted:	-	-	-	-	-	-	-	-	-	-
Cash and equivalents	-	-	-	-	-	-	-	-	354,383	354,383
Time certificates of deposit	-	-	-	-	-	-	-	-	38,030	38,030
Total assets	\$ 1,495	\$ 3,600	\$ 428,928	\$ 165,824	\$ -	\$ 269,260	\$ 502	\$ 4,656	\$ 392,413	\$ 1,867,140
LIABILITIES AND FUND BALANCES (DEFICITS)										
Liabilities:										
Accounts payable	\$ -	\$ -	\$ 11,078	\$ 170	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 26,671
Other liabilities and accruals	-	-	-	-	-	-	-	-	-	12,116
Due to other funds	-	-	-	-	-	-	-	-	2,978	177,307
Deferred revenue	-	-	-	-	-	-	-	-	-	109,770
Total liabilities	-	-	11,078	170	-	-	-	-	2,978	325,864
Fund balances (deficits):										
Reserved for:	-	-	-	-	-	-	-	-	-	-
Related assets	-	-	15,314	-	-	-	-	-	392,413	507,727
Encumbrances	-	-	20,875	-	-	-	-	-	-	76,615
Continuing appropriations	-	-	-	-	-	-	-	-	-	317,900
Unreserved (deficit)	1,495	3,600	381,661	165,654	-	269,260	502	4,656	(2,978)	639,034
Total fund balances (deficits)	1,495	3,600	417,850	165,654	-	269,260	502	4,656	389,435	1,541,276
Total liabilities and fund balances (deficits)	\$ 1,495	\$ 3,600	\$ 428,928	\$ 165,824	\$ -	\$ 269,260	\$ 502	\$ 4,656	\$ 392,413	\$ 1,867,140

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

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

	Compact Special Block 211(b)	Compact Health & Medical 216(a)(2)	Compact Scholarship 216(a)(3)	Compact Energy Block Grant 214	Compact Special Development 212(b)	Foreign Assistance	Airport Revolving	Agriculture Revolving	Fisherman
Revenues:									
Net increase in the fair value of investments	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Fees and charges	-	-	-	-	-	-	98,788	-	-
Other grants	-	-	-	-	-	397,840	-	-	-
Total revenues	-	-	-	-	-	397,840	98,788	-	-
Expenditures by function:									
Current:									
General government	93,121	-	-	-	-	193,737	-	9,232	-
Economic development	-	-	-	-	-	96,058	-	-	-
Education	-	-	-	-	-	5,349	-	-	-
Health services	-	28,894	-	-	-	885	-	-	-
Public order and safety	-	-	-	-	-	30,000	-	-	-
Environment protection and sanitation	-	-	-	-	-	87,517	-	-	-
Boards, commissions and other	-	-	-	-	-	142,324	127,988	-	-
Total expenditures	93,121	28,894	-	-	-	555,870	127,988	9,232	-
Excess (deficiency) of revenues over (under) expenditures	(93,121)	(28,894)	-	-	-	(158,030)	(29,200)	(9,232)	-
Other financing sources (uses):									
Operating transfers in (out)	-	-	-	-	-	-	-	-	-
Total other financing sources (uses), net	-	-	-	-	-	-	-	-	-
Net change in fund balances (deficits)	(93,121)	(28,894)	-	-	-	(158,030)	(29,200)	(9,232)	-
Fund balances (deficits) at the beginning of the year	112,988	176,728	-	-	8,880	310,239	(10,766)	9,232	-
Fund balances (deficits) at the end of the year	\$ 19,867	\$ 147,834	\$ -	\$ -	\$ 8,880	\$ 152,209	\$ (39,966)	\$ -	\$ -

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

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

	Production Loan	Scholarship Revolving Loan	Housing Revolving	Aluminum Recycling	Tourism Revolving	Health Care	Sports Council	Broadcast Authority	Gifford Scholarship	Total
Revenues:										
Net increase in the fair value of investments	\$ -	\$ -	\$ 58,295	\$ 56	\$ -	\$ 92	\$ -	\$ -	\$ 11,602	\$ 70,045
Fees and charges	-	-	-	70,805	-	83,703	-	2,880	-	256,176
Other grants	-	-	-	-	-	-	-	-	-	397,840
Total revenues	-	-	58,295	70,861	-	83,795	-	2,880	11,602	724,061
Expenditures by function:										
Current:										
General government	-	-	-	-	872	-	-	-	-	296,962
Economic development	-	-	-	-	-	-	-	-	-	96,058
Education	-	(1,166)	-	-	-	-	-	-	-	4,183
Health services	-	-	-	-	-	5,784	-	-	-	35,563
Public order and safety	-	-	-	-	-	-	-	-	-	30,000
Environment protection and sanitation	-	-	-	111,612	-	-	-	-	-	199,129
Boards, commissions and other	-	-	-	-	-	-	-	4,886	-	275,198
Total expenditures	-	(1,166)	-	111,612	872	5,784	-	4,886	-	937,093
Excess (deficiency) of revenues over (under) expenditures	-	1,166	58,295	(40,751)	(872)	78,011	-	(2,006)	11,602	(213,032)
Other financing sources (uses):										
Operating transfers in (out)	-	2,434	(2,434)	-	-	-	-	-	-	-
Total other financing sources (uses), net	-	2,434	(2,434)	-	-	-	-	-	-	-
Net change in fund balances (deficits)	-	3,600	55,861	(40,751)	(872)	78,011	-	(2,006)	11,602	(213,032)
Fund balances (deficits) at the beginning of the year	1,495	-	361,989	206,405	872	191,249	502	6,662	377,833	1,754,308
Fund balances (deficits) at the end of the year	\$ 1,495	\$ 3,600	\$ 417,850	\$ 165,654	\$ -	\$ 269,260	\$ 502	\$ 4,656	\$ 389,435	\$ 1,541,276

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures By Account,
and Changes in Fund Balances (Deficits)
Year Ended September 30, 2007

	Compact Special Block 211(b)	Compact Health & Medical 216(a)(2)	Compact Scholarship 216(a)(3)	Compact Energy Block Grant 214	Compact Special Development 212(b)	Foreign Assistance	Airport Revolving	Agriculture Revolving	Fisherman
Revenues:									
Net increase in the fair value of investments	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Fees and charges	-	-	-	-	-	-	98,788	-	-
Other grants	-	-	-	-	-	397,840	-	-	-
Total revenues	-	-	-	-	-	397,840	98,788	-	-
Expenditures by account:									
Salaries and wages	-	-	-	-	-	348,864	81,431	-	-
Benefits	-	-	-	-	-	11,544	8,618	-	-
Travel	-	1,014	-	-	-	8,910	1,073	-	-
Capital outlay	70,000	-	-	-	-	4,032	-	-	-
Food stuffs	-	-	-	-	-	3,568	-	-	-
Supplies and materials	-	-	-	-	-	39,272	8,981	-	-
Rentals	-	-	-	-	-	1,253	-	-	-
Repairs and maintenance	-	-	-	-	-	15,712	-	-	-
Communications	10,371	-	-	-	-	5,179	2,331	-	-
Utilities	12,750	-	-	-	-	121	22,150	-	-
Advertising, printing and reproduction	-	-	-	-	-	-	437	-	-
Import charges	-	-	-	-	-	-	592	-	-
POL	-	-	-	-	-	17,157	3,862	-	-
Contributions	-	-	-	-	-	2,500	-	-	-
Contractual services	-	14,827	-	-	-	39,808	80	-	-
Leased housing and land	-	13,053	-	-	-	8,436	-	-	-
Bank charges	-	-	-	-	-	-	-	-	-
Medical supplies	-	-	-	-	-	-	-	-	-
Other	-	-	-	-	-	49,514	(1,567)	9,232	-
Total expenditures	93,121	28,894	-	-	-	555,870	127,988	9,232	-
Excess (deficiency) of revenues over (under) expenditures	(93,121)	(28,894)	-	-	-	(158,030)	(29,200)	(9,232)	-
Other financing sources (uses):									
Operating transfers in (out)	-	-	-	-	-	-	-	-	-
Total other financing sources (uses), net	-	-	-	-	-	-	-	-	-
Net change in fund balances	(93,121)	(28,894)	-	-	-	(158,030)	(29,200)	(9,232)	-
Fund balances (deficits) at the beginning of the year	112,988	176,728	-	-	8,880	310,239	(10,766)	9,232	-
Fund balances (deficits) at the end of the year	\$ 19,867	\$ 147,834	\$ -	\$ -	\$ 8,880	\$ 152,209	\$ (39,966)	\$ -	\$ -

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

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

	Production Loan	Scholarship Revolving Loan	Housing Revolving	Aluminum Recycling	Tourism Revolving	Health Care	Sports Council	Broadcast Authority	Gifford Scholarship	Total
Revenues:										
Net increase in the fair value of investments	\$ -	\$ -	\$ 58,295	\$ 56	\$ -	\$ 92	\$ -	\$ -	\$ 11,602	\$ 70,045
Fees and charges	-	-	-	70,805	-	83,703	-	2,880	-	256,176
Other grants	-	-	-	-	-	-	-	-	-	397,840
Total revenues	-	-	58,295	70,861	-	83,795	-	2,880	11,602	724,061
Expenditures by account:										
Salaries and wages	-	-	-	-	-	-	-	-	-	430,295
Benefits	-	-	-	-	-	-	-	-	-	20,162
Travel	-	-	-	-	-	-	-	-	-	10,997
Capital outlay	-	-	-	-	-	-	-	-	-	74,032
Food stuffs	-	-	-	-	-	-	-	-	-	3,568
Supplies and materials	-	-	-	111,606	-	1,947	-	1,180	-	162,986
Rentals	-	-	-	-	-	-	-	-	-	1,253
Repairs and maintenance	-	-	-	-	-	-	-	40	-	40
Communications	-	-	-	-	-	-	-	892	-	29,306
Utilities	-	-	-	-	-	-	-	2,688	-	42,767
Advertising, printing and reproduction	-	-	-	-	-	-	-	86	-	644
Import charges	-	-	-	-	-	-	-	-	-	592
POL	-	-	-	-	-	-	-	-	-	21,019
Contributions	-	-	-	-	-	-	-	-	-	2,500
Contractual services	-	-	-	-	-	-	-	-	-	54,715
Leased housing and land	-	-	-	-	-	-	-	-	-	21,489
Bank charges	-	-	-	6	-	-	-	-	-	12
Medical supplies	-	-	-	-	-	3,831	-	-	-	3,831
Other	-	(1,166)	-	-	872	-	-	-	-	56,885
Total expenditures	-	(1,166)	-	111,612	872	5,784	-	4,886	-	937,093
Excess (deficiency) of revenues over (under) expenditures	-	1,166	58,295	(40,751)	(872)	78,011	-	(2,006)	11,602	(213,032)
Other financing sources (uses):										
Operating transfers in (out)	-	2,434	(2,434)	-	-	-	-	-	-	-
Total other financing sources (uses), net	-	2,434	(2,434)	-	-	-	-	-	-	-
Net change in fund balances	-	-	-	-	-	-	-	-	-	-
Fund balances (deficits) at the beginning of the year	-	3,600	55,861	(40,751)	(872)	78,011	-	(2,006)	11,602	(213,032)
Fund balances (deficits) at the end of the year	1,495	-	361,989	206,405	872	191,249	502	6,662	377,833	1,754,308
	\$ 1,495	\$ 3,600	\$ 417,850	\$ 165,654	\$ -	\$ 269,260	\$ 502	\$ 4,656	\$ 389,435	\$ 1,541,276

See Accompanying Independent Auditors' Report.

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

Combining Balance Sheet
September 30, 2007

	Compact Capital Projects	TTG Capital Projects	CFSM Projects	Total
<u>ASSETS</u>				
Investments	\$ 800,000	\$ -	\$ -	\$ 800,000
Receivables:				
FSM National Government	-	-	72,230	72,230
	<u>\$ 800,000</u>	<u>\$ -</u>	<u>\$ 72,230</u>	<u>\$ 872,230</u>
<u>LIABILITIES</u>				
Liabilities:				
Accounts payable	\$ -	\$ -	\$ 300	\$ 300
Other liabilities and accruals	-	(99)	-	(99)
Deferred revenue	-	-	33	33
Due to other funds	-	99	71,897	71,996
Total liabilities	<u>-</u>	<u>-</u>	<u>72,230</u>	<u>72,230</u>
Fund balances:				
Reserved for:				
Related assets	800,000	-	-	800,000
Encumbrances	-	-	-	-
Continuing appropriations	-	-	-	-
Unreserved	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total fund balances	<u>800,000</u>	<u>-</u>	<u>-</u>	<u>800,000</u>
Total liabilities and fund balances	<u>\$ 800,000</u>	<u>\$ -</u>	<u>\$ 72,230</u>	<u>\$ 872,230</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
CAPITAL PROJECTS FUNDS

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

	Compact Capital Projects	TTG Capital Projects	CFSM Projects	Total
Revenues:				
Net increase in the fair value of investments	\$ 14,436	\$ -	\$ -	\$ 14,436
CFSM grants	-	-	46,000	46,000
	<u>14,436</u>	<u>-</u>	<u>46,000</u>	<u>60,436</u>
Expenditures by function:				
Public order and safety	-	-	25,000	25,000
Economic Development	-	-	21,000	21,000
Capital projects	<u>53,325</u>	<u>-</u>	<u>-</u>	<u>53,325</u>
Total expenditures	<u>53,325</u>	<u>-</u>	<u>46,000</u>	<u>99,325</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(38,889)</u>	<u>-</u>	<u>-</u>	<u>(38,889)</u>
Other financing uses:				
Operating transfers out	<u>(1,605,549)</u>	<u>-</u>	<u>-</u>	<u>(1,605,549)</u>
Net change in fund balances	<u>(1,644,438)</u>	<u>-</u>	<u>-</u>	<u>(1,644,438)</u>
Fund balances at the beginning of the year	<u>2,444,438</u>	<u>-</u>	<u>-</u>	<u>2,444,438</u>
Fund balances at the end of the year	<u>\$ 800,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 800,000</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
CAPITAL PROJECTS FUNDS

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

	Compact Capital Projects	TTG Capital Projects	CFSM Projects	Total
Revenues:				
Net increase in the fair value of investments	\$ 14,436	\$ -	\$ -	\$ 14,436
CFSM grants	-	-	46,000	46,000
	<u>14,436</u>	<u>-</u>	<u>46,000</u>	<u>60,436</u>
Expenditures by account:				
Salaries and wages	-	-	36,000	36,000
Benefits	-	-	3,000	3,000
Capital outlay	475	-	-	475
Food stuffs	-	-	800	800
Supplies and materials	1,750	-	900	2,650
Communications	-	-	800	800
Utilities	-	-	3,000	3,000
Advertising, printing and reproduction	-	-	500	500
POL	-	-	1,000	1,000
Contractual services	34,859	-	-	34,859
Leased housing and land	10,776	-	-	10,776
Other	5,465	-	-	5,465
Total expenditures	<u>53,325</u>	<u>-</u>	<u>46,000</u>	<u>99,325</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(38,889)</u>	<u>-</u>	<u>-</u>	<u>(38,889)</u>
Other financing uses:				
Operating transfers out	<u>(1,605,549)</u>	<u>-</u>	<u>-</u>	<u>(1,605,549)</u>
Net change in fund balances	<u>(1,644,438)</u>	<u>-</u>	<u>-</u>	<u>(1,644,438)</u>
Fund balances at the beginning of the year	<u>2,444,438</u>	<u>-</u>	<u>-</u>	<u>2,444,438</u>
Fund balances at the end of the year	<u>\$ 800,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 800,000</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

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	Section 211(a)(7) Supplemental Education	Total
<u>ASSETS</u>								
Receivables:								
Federal agencies	\$ 75,628	\$ -	\$ 159,220	\$ -	\$ -	\$ -	\$ -	\$ 234,848
Prepayments	-	-	2,500	-	-	-	5,731	8,231
Due from other funds	8,097	531,829	(118,661)	150,800	28,804	-	135,404	736,273
	<u>\$ 83,725</u>	<u>\$ 531,829</u>	<u>\$ 43,059</u>	<u>\$ 150,800</u>	<u>\$ 28,804</u>	<u>\$ -</u>	<u>\$ 141,135</u>	<u>\$ 979,352</u>
<u>LIABILITIES AND FUND BALANCES</u>								
Liabilities:								
Accounts payable	6,024	31,433	11,695	28,231	-	-	8,078	85,462
Other liabilities and accruals	77,700	47,149	6,136	44,369	4,752	-	5,693	185,799
Total liabilities	<u>83,724</u>	<u>78,583</u>	<u>17,830</u>	<u>72,600</u>	<u>4,752</u>	<u>-</u>	<u>13,772</u>	<u>271,260</u>
Fund balances:								
Reserved for:								
Encumbrances	236,147	369,825	37,216	43,547	5,646	-	132,187	824,568
Unreserved	(236,145)	83,421	(11,987)	34,653	18,406	-	(4,823)	(116,476)
Total fund balances	<u>1</u>	<u>453,246</u>	<u>25,229</u>	<u>78,200</u>	<u>24,052</u>	<u>-</u>	<u>127,363</u>	<u>708,092</u>
Total liabilities and fund balances	<u>\$ 83,725</u>	<u>\$ 531,829</u>	<u>\$ 43,059</u>	<u>\$ 150,800</u>	<u>\$ 28,804</u>	<u>\$ -</u>	<u>\$ 141,135</u>	<u>\$ 979,352</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

SECTION 211 COMPACT SECTOR FUNDS

Combining Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances
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	Section 211(a)(7) Supplemental Education	Total
Revenues:								
Compact funding	\$ 2,287,664	\$ 1,887,801	\$ 460,277	\$ 1,111,914	\$ 156,786	\$ 147,250	\$ 1,009,783	\$ 7,061,476
	<u>2,287,664</u>	<u>1,887,801</u>	<u>460,277</u>	<u>1,111,914</u>	<u>156,786</u>	<u>147,250</u>	<u>1,009,783</u>	<u>7,061,476</u>
Expenditures by function:								
Current:								
Economic development	-	-	385,569	-	30,220	-	-	415,789
Education	2,287,663	-	-	-	-	-	882,420	3,170,083
Health services	-	1,586,797	-	-	-	-	-	1,586,797
Environment protection and sanitation	-	-	-	-	102,514	-	-	102,514
Boards, commissions and other	-	-	74,709	1,049,643	-	147,250	-	1,271,601
Total expenditures	<u>2,287,663</u>	<u>1,586,797</u>	<u>460,277</u>	<u>1,049,643</u>	<u>132,734</u>	<u>147,250</u>	<u>882,420</u>	<u>6,546,784</u>
Net change in fund balances	1	301,004	-	62,271	24,052	-	127,363	514,692
Fund balances at the beginning of the year	-	152,242	25,229	15,929	-	-	-	193,400
Fund balances at the end of the year	<u>\$ 1</u>	<u>\$ 453,246</u>	<u>\$ 25,229</u>	<u>\$ 78,200</u>	<u>\$ 24,052</u>	<u>\$ -</u>	<u>\$ 127,363</u>	<u>\$ 708,092</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

SECTION 211 COMPACT SECTOR FUNDS

Combining Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances
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	Section 211(a)(7) Supplemental Education	Total
Revenues:								
Compact funding	\$ 2,287,664	\$ 1,887,801	\$ 460,277	\$ 1,111,914	\$ 156,786	\$ 147,250	\$ 1,009,783	\$ 7,061,476
	<u>2,287,664</u>	<u>1,887,801</u>	<u>460,277</u>	<u>1,111,914</u>	<u>156,786</u>	<u>147,250</u>	<u>1,009,783</u>	<u>7,061,476</u>
Expenditures by account:								
Salaries and wages	1,492,241	881,306	106,606	679,735	96,774	-	127,157	3,383,819
Benefits	158,482	77,383	13,088	62,695	9,253	-	12,261	333,161
Contractual services	20,835	61,505	235,733	38,582	5,140	147,250	375,608	884,653
Travel	7,902	42,439	14,691	24,631	1,767	-	83,419	174,849
Capital outlay	115,462	11,534	265	35,570	-	-	6,499	169,330
Food stuffs	102	22,135	-	452	-	-	250	22,940
Supplies and materials	255,446	18,952	56,833	47,932	6,194	-	69,941	455,298
Rentals	-	-	836	7,158	-	-	100	8,093
Repairs and maintenance	335	-	115	425	414	-	60	1,349
Communications	22,781	6,003	10,295	22,110	3,961	-	7,609	72,759
Utilities	40,725	102,901	5,842	19,878	3,968	-	100	173,414
Advertising, printing and reproduction	-	6,758	1,340	2,893	783	-	411	12,184
Import charges	734	62	-	681	-	-	32	1,509
POL	16,425	4,949	1,044	14,707	2,371	-	4,574	44,070
Professional services	-	-	10,239	-	-	-	-	10,239
Leased housing/land	35,893	3,485	1,950	24,913	1,300	-	630	68,170
Meeting and official allowance	-	-	1,400	-	580	-	-	1,980
Training	-	-	-	67,086	-	-	4,444	71,531
Bank charges	-	-	-	194	-	-	-	194
Medical supplies	-	308,474	-	-	-	-	1,766	310,240
Medical referral stipend	-	35,681	-	-	-	-	-	35,681
Scholarship	120,000	-	-	-	80	-	186,261	306,341
Other	300	3,230	-	-	150	-	1,300	4,979
Total expenditures	<u>2,287,663</u>	<u>1,586,797</u>	<u>460,277</u>	<u>1,049,643</u>	<u>132,734</u>	<u>147,250</u>	<u>882,420</u>	<u>6,546,784</u>
Net change in fund balances	1	301,004	-	62,271	24,052	-	127,363	514,692
Fund balances at the beginning of the year	-	152,242	25,229	15,929	-	-	-	193,400
Fund balances at the end of the year	<u>\$ 1</u>	<u>\$ 453,246</u>	<u>\$ 25,229</u>	<u>\$ 78,200</u>	<u>\$ 24,052</u>	<u>\$ -</u>	<u>\$ 127,363</u>	<u>\$ 708,092</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 Robert Weilbacher
Governor, State of Kosrae
Federated States of Micronesia:

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae as of and for the year ended September 30, 2007, which collectively comprise the State of Kosrae's basic financial statements and have issued our report thereon dated June 27, 2008. 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 discretely presented component units, 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 State of Kosrae'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 State of Kosrae's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Kosrae'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 74 through 90) as items 2007-09, 2007-11 and 2007-12 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.

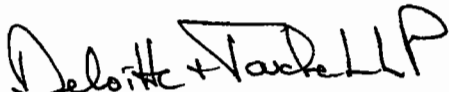
Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Kosrae's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, we did note certain matters that we reported to management of the State of Kosrae, and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2007-5 and 2007-10.

The State of Kosrae'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 State of Kosrae's responses and, accordingly, we express no opinion on it.

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


June 27, 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 Robert Weilbacher
Governor, State of Kosrae
Federated States of Micronesia:

Compliance

We have audited the compliance of the State of Kosrae with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2007. The State of Kosrae's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (pages 74 through 90). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the State of Kosrae's management. Our responsibility is to express an opinion on the State of Kosrae's compliance based on our audit.

As discussed in Note 2B to the Schedule of Expenditures of Federal Awards, Kosrae State 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 State of Kosrae's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the State of Kosrae's compliance with those requirements.

As described in items 2007-1, 2007-3, 2007-5, 2007-7 and 2007-8 in the accompanying Schedule of Findings and Questioned Costs, the State of Kosrae did not comply with requirements regarding allowable costs/cost principles, cash management, equipment and real property management, and special tests and provisions that are applicable to its IDEA Special Education-Grants to States major program (CFDA# 15.875), and equipment and real property management, and reporting that are applicable to its Compact of Free Association Sector Grants major program (CFDA # 15.875). Compliance with such requirements is necessary, in our opinion, for the State of Kosrae to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the State of Kosrae complied, in all material respects, with the requirements referred to above that are applicable to its IDEA Special Education-Grants to States major program (CFDA# 15.875) and its Compact of Free Association Sector Grants major program (CFDA # 15.875) 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 2007-2, 2007-4 and 2007-6.

Internal Control Over Compliance

The management of the State of Kosrae is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the State of Kosrae's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, 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 State of Kosrae'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 2007-1 through 2007-8 to be significant deficiencies.

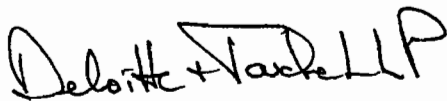
A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We did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

The State of Kosrae'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 State of Kosrae'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 State of Kosrae as of and for the year ended September 30, 2007, and have issued our report thereon dated June 27, 2008. Our audit was performed for the purpose of forming an opinion on the financial statements that collectively comprise the State of Kosrae's basic financial statements. The accompanying schedule of expenditures of federal awards (pages 70 and 71) is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the State of Kosrae. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects when considered in relation to the basic financial statements taken as a whole.

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

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

June 27, 2008

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

<u>Agency/Program</u>	<u>Expenditures</u>
U.S. Department of Agriculture	\$ 205,452
U.S. Department of the Interior	6,740,103
U.S. Department of Labor	12,504
U.S. Department of Homeland Security	16,265
U.S. Department of Education	364,068
U.S. Department of Health and Human Services	155,791
 GRAND TOTAL	 \$ <u>7,494,183</u>

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

U.S. Department of Agriculture:	
Housing Preservation Grant	10.433
Community Facilities Loans and Grants	10.766

Reconciliation to the basic financial statements:

U.S. Federal Grants Fund (page 13)	\$ 773,099
Section 211 Compact Sector Grant (page 13)	6,546,784
Compact Capital Projects Fund (page 60)	53,325
Compact Special Block 211(b) (page 57)	93,121
Compact Health Medical 216(b)(a)(2) (page 57)	28,894
Less amounts of non-federal awards included herein	<u>(1,040)</u>
	\$ <u>7,494,183</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF AGRICULTURE		
Urban and Community Forestry Program	10.675	\$ 6,282
Forest Stewardship Program	10.678	1,415
Rural Housing Preservation Grants	10.433	117,566
Forestry Research	10.652	(11)
Community Facilities Loans and Grants	10.766	80,200
Total U.S. Department of Agriculture		<u>\$ 205,452</u>
U.S. DEPARTMENT OF THE INTERIOR		
Economic, Social and Political Development of the Territories:	15.875	
Compact Section 211(A) Capital Account		\$ 53,325
Compact Special Block 211 (B)		93,121
Compact Health and Medical 216(a)(2)		28,894
Compact II Capacity Building Sector		1,049,643
Compact II Education Sector		2,287,663
Compact II Environment Sector		132,734
Compact II Health Sector		1,586,797
Compact II Private Sector		460,277
Compact II Infrastructure Sector		147,250
Supplemental Education Grant Sector		882,420
Technical Assistance:		
Road Maintenance Equipment		2,788
Medical Referral		581
Watershed Surveys and Planning	15.904	14,610
Total U.S. Department of the Interior		<u>\$ 6,740,103</u>
U.S. DEPARTMENT OF LABOR		
WIA	17.255	\$ 5,859
WIA Adult Program	17.258	4,335
WIA Dislocated Workers	17.260	2,310
Total U.S. Department of Labor		<u>\$ 12,504</u>
U.S. DEPARTMENT OF HOMELAND SECURITY		
Hazard Mitigation Grant	97.039	\$ 16,265
Total U.S. Department of Homeland Security		<u>\$ 16,265</u>
U.S. DEPARTMENT OF EDUCATION		
Special Education - Grants to States	84.027	\$ 360,568
Vocation Education - National Programs	84.048B	3,500
Total U.S. Department of Education		<u>\$ 364,068</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES		
CDC Project Grants and Cooperative Agreements for Tuberculosis		
Control Programs	93.116	\$ 8,468
Family Planning - Services	93.217	15,592
Immunization Grants	93.268	17,049
HIV Prevention Activities-Health Department Based	93.940	7,059
Block Grants for Prevention and Treatment of Substance Abuse	93.959	38,122
Cooperative Agreements for State-Based Diabetes Control		
Programs and Evaluation of Surveillance Systems	93.988	7,059
Preventive Health and Health Services Block Grant	93.991	4,072
Maternal and Child Health Services Block Grant to the States	93.994	26,155
Centers for Disease Control and Prevention Investigations and Technical Assistance	93.283	5,740
Cancer Prevention and Control Program (See Note)	93.U55/CCU923887.02	26,475
Total U.S. Department of Health and Human Services		<u>\$ 155,791</u>
GRAND TOTAL		<u>\$ 7,494,183</u>

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

(1) Scope of Review

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

A. Programs Subject to Single Audit

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

(2) Summary of Significant Accounting Policies

A. Basis of Accounting

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

B. Single Audit Reporting Entity

For purposes of complying with The Single Audit Act of 1984, as amended in 1996, Kosrae State Government's reporting entity is defined in Note 1A to its September 30, 2007 basic financial statements; except that 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 Kosrae State Government, as defined above, for the year ended September 30, 2007.

C. 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.

(3) Component Units

The Kosrae Utilities Authority (KUA), a discretely presented component unit of the State of Kosrae separately satisfies the requirements of OMB Circular A-133.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Programs Selected for
Audit In Accordance With OMB Circular A-133
Year Ended September 30, 2007

<u>Grantor Program Title</u>	<u>CFDA No.</u>	<u>2007 Fiscal Year Expenditures</u>
<u>Major Programs</u>		
<u>U.S. Dept. of the Interior</u>		
Compact of Free Association:		
Compact Sector Grants		
Compact II Capacity Building Sector	15.875	\$ 1,049,643
Compact II Education Sector	15.875	2,287,663
Compact II Environment Sector	15.875	132,734
Compact II Health Sector	15.875	1,586,797
Compact II Private Sector	15.875	460,277
Compact II Infrastructure Sector	15.875	147,250
Supplemental Education Grant Sector	15.875	882,420
<u>U.S. Department of Education</u>		
Special Education – Grants to States	84.027	360,568
Total U.S. Federal program expenditures selected		\$ <u>6,907,352</u>
Total U.S. Federal program expenditures		\$ <u>7,494,183</u>
% of total U.S. Federal Program expenditures covered by Major Programs		<u>92 %</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Part I - Summary of Auditors' Results

1. The Independent Auditors' Report on the financial statements expressed an unqualified opinion.
2. No significant deficiencies in internal control over financial reporting were identified to be material weaknesses.
3. No instances of noncompliance considered material to the financial statements were disclosed by the audit.
4. No significant deficiencies in internal control over compliance with requirements applicable to major federal award programs were identified to be material weaknesses.
5. The independent auditors' report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. The State's major programs were:

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

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

Part II - Financial Statement Findings Section

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
2007-09	Cash	\$ -
2007-10	Procurement	\$ -
2007-11	Journal Vouchers	\$ -
2007-12	Equity Investments	\$ -

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Part III - Federal Award Findings and Questioned Cost Section

Reference <u>Number</u>	<u>CFDA#</u>	<u>Findings</u>	<u>Questioned Costs</u>
2007-01	84.027	Cash Management	Undeterminable
2007-02	15.875	Procurement, Suspension and Debarment	\$141,519
	84.027	Procurement, Suspension and Debarment	\$ -
2007-03	84.027	Special Tests and Provisions	\$ -
2007-04	15.875	Subrecipient Monitoring	\$ 9,700
2007-05	10.766	Allowable Costs/Cost Principles	\$ -
	84.027	Allowable Costs/Cost Principles	\$ -
2007-06	15.875	Period of Availability	\$11,534
2007-07	15.875	Reporting	Undeterminable
2007-08	15.875	Fixed Asset Management	\$ -
	84.027	Fixed Asset Management	\$ -

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Finding No.: 2007-01
Area: Cash Management
Grantor: U.S. Department of Education
CFDA: 84.027
Program: Special Education – Grants to States
Grant No.: H027A060005
Questioned Cost: Undeterminable

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.

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

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

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

Effective May 1, 2007, this matter has been resolved as the FSM National Government elected to seize pass-through federal grants to the States.

Prior Year Status: The above condition is reiterative of conditions identified in the prior year audit of Kosrae State Government.

Recommendation: The Kosrae State Government should establish internal controls over cash management and should match applicable drawdowns with checks issued.

Auditee Response and Corrective Action Plan: We agree with this finding. Since the FSM National Government has taken over the accounting of pass-through grants, this is no longer an issue.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Finding No.:	2007-02
Grantor:	U.S. Department of the Interior
CFDA:	15.875
Program:	Compact Sector Grants
Grant No.:	CSG-FSM-2007-EDU; CSG-FSM-2007-HLT
Area:	Procurement, Suspension and Debarment
Questioned Cost:	\$141,519
Grantor:	U.S. Department of Education
CFDA:	84.027
Program:	Special Education – Grants to States
Grant No.:	H027A060005
Area:	Procurement, Suspension and Debarment
Questioned Cost:	\$0

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

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

Condition:

1. CFDA# 15.875 Compact Sector Grants: For seven (17%) of forty-one transactions tested, we noted noncompliance with procurement requirements.

For items one and two listed below, price quotation for the portion of airfare beyond Micronesia (Guam/Honolulu) was not performed. No questioned costs result from this transaction as the State is in the process of establishing travel procurement policies for travel extending to areas served by multiple airlines. At present, due to its remote location, Kosrae is not serviced by a travel agent and the State has not been able to obtain a credit card to facilitate on-line purchasing.

For items three and four listed below, KSG purchased oxygen from a supplier without price quotations when other suppliers were also available.

For items five through seven, no competitive procurement documents were provided.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Finding No.: 2007-02, Continued

Condition, Continued:

<u>Item</u>	<u>Fund</u>	<u>Forg</u>	<u>Ccled</u>	<u>Acct</u>	<u>Tc</u>	<u>Desc.01</u>	<u>TranDate.</u>	<u>Desc.03</u>	<u>Expense</u>
1	72	721410	KD100A	8110	50	700072401	11212006	T0703301	\$ 3,295
2	73	731214	KD211A	8110	50	700417201	6072007	T0713201	3,144
3	73	731211	KD220A	8314	50	700050401	11132006	L70042	5,000
4	73	731211	KD220A	8314	50	700082401	11272006	L7013201	5,000
5	76	761102	KD631H	8405	50	700438101	6192007	R&E AFFA	50,000
6	72	721413	KC116A	8210	63	JV7M0045	4302007		50,000
7	73	731210	KD225A	8460	50	700335101	4202007	MED/REF	31,519
									<u>\$ 147,958</u>

Total	\$147,958
Less item 1-2	<u>(6,439)</u>
Total questioned costs:	<u>\$141,519</u>

2. CFDA# 84.027 Special Education: For one (6%) of eighteen transactions tested, the price quotation for the portion of airfare beyond Micronesia (Guam/Honolulu) was not performed. No questioned costs result from this transaction as the State is in the process of establishing travel procurement policies for travel extending to areas served by multiple airlines. At present, due to its remote location, Kosrae is not serviced by a travel agent and the State has not been able to obtain a credit card to facilitate on-line purchasing.

<u>Fund</u>	<u>Forg</u>	<u>Ccled</u>	<u>Acct</u>	<u>Tc</u>	<u>Vendor</u>	<u>Desc.01</u>	<u>TranDate.</u>	<u>Desc.03</u>	<u>Expense</u>
30	301410	KA7091	8110	50	CONTINENTAL	700238101	2092007	T0708801	\$2,440

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

Effect: Noncompliance and questioned costs result from this condition due to insufficient competitive procurement documentation.

Prior Year Status: The above condition is reiterative of conditions identified in the prior year audit of Kosrae State Government.

Recommendation: We recommend that Kosrae State Government comply with U.S. Federal program requirements and strengthen its internal controls to ensure that adequate competitive procurement documentation is on file. We recommend that the State establish an account with a travel agency on island or off-island, to assist in meeting competitive procurement concerns for travel extending to areas served by multiple airlines.

Auditee Response and Corrective Action Plan: Although we agree to the finding, we are still of the belief that some of the items purchased locally are sole source, which would not require competitive bidding. The corrective action plan is to ensure the process identified in the Corrective Action Plan for finding no. 2006-01, which became effective October 1, 2007 is carried out and monitored.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Finding No.: 2007-03
Grantor: U.S. Department of Education
CFDA: 84.027
Program: Special Education – Grants to States
Grant No.: H027A060005
Area: Special Tests and Provisions
Questioned Cost: \$0

Criteria: When issuing statements, press releases, requests for proposals, bid solicitations, and other documents describing this project or programs funded in whole or in part with federal money, all grantees receiving federal funds, including but not limited to state and local government, shall state clearly:

- 1) The dollar amount of federal funds for the project,
- 2) The percentage of the total cost of the project that will be financed with federal funds and
- 3) The percentage and dollar amount of the total cost of the project that will be finance by non-governmental sources.

Condition: Requests for proposals or bid solicitations and other documents did not clearly state any dollar or percentage funded by federal funds for expenditures reviewed.

Cause: There appears to be weak internal controls over ensuring compliance with special conditions of the grant.

Effect: The Kosrae State Government appears to be in noncompliance with applicable special condition requirements. Due to the lack of information available and provided by the grantee, the amount of questioned costs, if any, resulting from this is condition is undeterminable.

Recommendation: The Kosrae State Government should establish internal controls to ensure special conditions of the grant award are followed.

Auditee Response and Corrective Action Plan: We agree to this finding. The Director of Finance & Administration will issue reminder and notice to departments and agencies on this requirement by July 31, 2008. Effective August 1, 2007, prior to execution and processing of financial transactions, Mr. Switson Robert will ensure that this particular issue is complied with.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Finding No.: 2007-04
Grantor: U.S. Department of the Interior
CFDA: 15.875
Program: Private Sector Development Grant
Grant No.: CSG-FSM-2007-1
Area: Subrecipient Monitoring
Questioned Cost: \$9,700

Criteria: In accordance with applicable subrecipient monitoring requirements, a pass-through entity is responsible for (1) identifying to the subrecipient the Federal award information, (2) monitoring the subrecipient's use of Federal awards, (3) ensuring that subrecipients expending \$500,000 or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of OMB Circular A-133, and (4) evaluating the impact of subrecipient activities on the pass-through entity's ability to comply with applicable Federal regulations.

Condition: For one of forty-one (3%) non-payroll expenditures (\$9,700 of the aggregate amount of \$785,438) tested during FY 2007, KSG paid municipalities a total of \$9,700 for the State of Kosrae Island Fair. No supporting invoices were provided to justify expenditures incurred as payments were given directly to the municipalities. Hence, the municipalities have now become subrecipients of the State for the Private Sector Development Grant.

No supporting documentation was provided to justify that the State has evaluated the impact of the subrecipient activities on the municipalities' ability to comply with applicable Federal regulations.

Cause: Internal controls over ensuring compliance with subrecipient monitoring requirements do not appear to have been exercised in the above condition.

Effect: KSG is in noncompliance with applicable subrecipient monitoring activities. The above costs are questioned as the projected questioned cost exceeds the threshold.

Recommendation: The Program Administrator should expand monitoring activities to include reviews of the subrecipient's financial reports and underlying financial records to ensure compliance with applicable subrecipient monitoring activities.

Auditee Response and Corrective Action Plan: We do not agree with this finding. We believe we have provided adequate documentation supporting our action in which we did not make payments to municipal governments, as stated in the finding, but to the agricultural fair coordinator, who then distribute cash prices to the municipal governments to support their individual agriculture fairs. Detail reports on the use of the fund were provided.

Auditor's Response: Given that it appears that these payments are tantamount to cash donations to individuals, we ask that the State provide detailed documentation on its efforts to ensure that this program was approved by the grantor agency (the FSM National Government) and the value to the State and to the grantor derived from these cash distributions.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Finding No.: 2007-05

Grantor: U.S. Department of Agriculture
CFDA: 10.766
Program: Community Facilities Loans and Grants-Rural Development
Grant No.: 62-008-000224507
Area: Allowable Costs/Cost Principles
Questioned Cost: \$0

Grantor: U.S. Department of Education
CFDA: 84.027
Program: Special Education – Grants to States
Grant No.: H027A060005
Area: Allowable Costs/Cost Principles
Questioned Cost: \$0

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

Condition:

1. CFDA#10.766 Community Facilities Loans and Grants-Rural Development: P60126 in the amount of \$35,000 was recorded as an advance for the purchase of school buses as of September 30, 2007. However, the buses were received on June 5, 2007.

No questioned costs result from this finding due to an audit adjustment being proposed to recognize this expenditure in the correct fiscal year.

2. CFDA#84.027 Special Education: For one of eighteen (6%) expenditures tested, purchase order P7000001 in the amount of \$23,300 was utilized to purchase a vehicle. This transaction was initially recorded as an expenditure. However, the vehicle was not received as of September 30, 2007. Additionally, no document indicating grantor approval of this purchase was provided.

No questioned costs result from this finding due to an audit adjustment being proposed to recognize the expenditure as an advance, therefore, the prior approval matters will be resolved in fiscal year 2008.

Cause: There appears to be a control deficiency over ensuring that expenditures are recorded in the appropriate period and capital asset purchases exceeding \$5,000 are subjected to prior approval by the grantor.

Effect: Expenditures appear to be misstated and noncompliance with allowable costs/cost principles result from this condition.

Recommendation: We recommend that the State record expenditures when goods or services have been received or incurred. If disbursements have been advanced for these costs, they should be recorded as prepaid or advance payments. Furthermore, capital asset purchases exceeding \$5,000 should be approved by the grantor.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Finding No.: 2007-05, Continued

Auditee Response and Corrective Action Plan: We agree to this finding. The corrective action plan is to make sure the action plan reflected in finding no. 2006-02, which requires Mr. Switson Robert to record advances are prepaid or advance effective October 1, 2007, is in full force.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Finding No.: 2007-06
Grantor: U.S. Department of the Interior
CFDA: 15.875
Program: Public Sector Capacity Building Grant
Grant No.: CSG-FSM-2006-CAP
Area: Period of Availability
Questioned Cost: \$11,534

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

Condition: For one of eleven (9%) transactions tested, obligation P60174 in the amount of \$11,534 was liquidated after the 90 day grace period.

Cause: There appears to be a control deficiency over ensuring that expenditures incurred are within the period of availability.

Effect: Noncompliance with period of availability requirement results from this condition.

Prior Year Status: The above condition is reiterative of conditions identified in the prior year audit of Kosrae State Government.

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

Auditee Response and Corrective Action Plan: We do not agree to this finding. Our records show the goods were arrived into Kosrae in February 2007, which was within the extended grant period of March 30, 2007. Although the receiving report was finally completed on April 5, 2007, the goods were actually received prior to that. We recommend that this question costs be deleted.

Auditor's Response: At issue is the charge to the grant did not occur until April 2007, which appears to be after the period of availability. We understand that the goods may have been received earlier. However, the actual charge to the program occurred after March 31 and therefore, it appears that the period of availability was exceeded due to the delay in reconciling advance payments with the receiving reports.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Finding No.: 2007-07
 Grantor: U.S. Department of the Interior
 CFDA: 15.875
 Program: Compact Sector Grants
 Grant No.: 2006-EDU-GR670009; 2006-HLTH-GR670010; 2006 PSCB-GR67011; 2006 PSD GR67007; 2006-ENV-GR670008; CSG-FSM-2005-EDU-SEG
 Area: Reporting
 Questioned Cost: Undeterminable

Criteria: Amounts reported on the Compact Financial Status Reports should be traced to accounting records that support the audited financial statements and the schedule of expenditures of Federal awards.

Condition: We were not able to reconcile the following 2006 Sector expenditures reported. The details follow:

	FY 07 expenditures charged under FY 06 and prior grants	FY 06 Audit Report	Total incurred as of 09/30/07 for FY 06 and prior	CFSR as of May 25, 2007	CFSR over (under)
2006-EDU-GR670009	261,009	2,053,842	2,314,851	2,357,549	42,698
2006-HLTH-GR670010	151,080	1,630,012	1,781,092	1,696,501	(84,591)
2006-ENV-GR670008	7,273	288,990	296,263	307,619	11,356
2006-PSD-GR67007	125,659	759,955	885,614	562,351	(323,263)
2006-PSCB-GR67011	64,587	1,157,955	1,222,542	1,235,979	13,437

Cause: While the State may be able to reconcile the balances, a reconciliation was not readily available.

Effect: Noncompliance with reporting requirements could result from this condition.

Recommendation: We recommend that the State consider reconciling the final CFSR's with the audit reports and with details of subsequent expenditures to ensure that all applicable transactions are captured in the report.

Auditee Response and Corrective Action Plan: We do not agree with this finding. The compact financial status reports are submitted thirty days after each fiscal quarter and year end. Since the audits are not completed until nine months after fiscal year ends, how could the reports reflect what are actually in the audits? We recommend this finding be deleted.

Auditor's Response: We understand State management concern and we hope that the above reconciliation can be added to subsequent audit reports to ensure that the final CFSR's are reconciled with the applicable audited information.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Finding No.:	2007-08
CFDA:	15.875
Grant:	Compact Sector Grants
Grantor Agency:	U.S. Department of the Interior
Area:	Fixed Asset Management
Questioned Cost:	\$0
Grantor:	U.S. Department of Education
CFDA:	84.027
Program:	Special Education – Grants to States
Grant No.:	H027A060005
Area:	Fixed Asset Management
Questioned Cost:	\$0

Criteria: Management should periodically review asset maintenance activities to ensure compliance with program objectives and requirements and to ensure that capital assets are identifiable.

Condition:

1. Procedures were not in place during fiscal year 2007 to ensure that fixed assets are periodically reviewed for asset maintenance. However, the State implemented a comprehensive plan in fiscal year 2008 as part of their corrective action and therefore, it is possible that this matter has been subsequently resolved, but was still an unresolved matter in the 2007 fiscal year.
2. The State does not currently tag all capital assets, a condition which may impede effective inventory procedures.

Cause: There appears to be a weakness in internal control over ensuring that fixed assets are periodically maintained and identifiable through use of property tags or indication of serial numbers on the register.

Effect: The expected life of the fixed asset may be lessened and the inability to easily identify fixed assets may increase the time required to effectively conduct requisite bi-annual inventories.

Recommendation: We recommend that the State continue its 2008 corrective action with respect to this matter and we recommend that consideration of tagging all capital assets occurs.

Auditee Response and Corrective Action Plan: We do not agree with the finding which pertains to new school buses purchased by DOE. The Kosrae DOE, as do other major government departments, has comprehensive written maintenance plans for its capital assets, including vehicle maintenance, which have been followed. Moreover, the assets are in good working condition. Management will review the documentation of these maintenance servicing to ensure a sufficient audit trail exists to evidence such.

Auditor's Response: We concur that the State engaged in corrective action in fiscal year 2008 but we believe that the maintenance plans were not fully implemented until that fiscal year.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Financial Statements Findings Section

Finding No.: 2007-09
Area: Cash

Criteria:

1. Bank reconciliations should be performed on a monthly basis for all bank accounts.
2. Cash collections should be identified and timely recorded.

Condition:

1. Monthly bank reconciliations were not prepared timely in FY 2007. Furthermore, the monthly bank reconciliations show calculations for an adjusted bank balance; however, there are no calculations for any book balance.
2. The following cash receipts totaling \$194,528 did not indicate the reason or basis for the payment and therefore, we could not ensure that the revenue category was appropriate

	<u>Receipt no.</u>	<u>Amount</u>
1	07472901	\$ 23,300
2	07472903	33,613
3	07554401	119,005
4	07554402	8,546
5	07472902	<u>10,064</u>
	TOTAL	<u>\$ 194,528</u>

Cause: Revenues are not always supported by adequate supporting documents such as bank statements, cash receipts, management approval, deposit slips, etc.

Effect: The conditions may result in potential noncompliance with applicable compliance requirements and potential misstatement of revenues may exist.

Recommendation: The State should strengthen internal controls over ensuring revenues are supported by adequate and appropriate supporting documents for journal voucher transactions and related transactions. Furthermore, the State should strengthen internal controls over ensuring proper record keeping of underlying supporting documents and that such are made available for review.

Auditee Response and Corrective Action Plan: Although we agree to this finding, we believe the responsibility lies with the FSM National Government to provide details of deposits timely and on a periodic basis. The concern \$amount resulted from deposits made on reimbursements from the FSM National Government. We will work closely with the FSM National Government to resolve this issue. The Director of Administration & Finance will work with the FSM Secretary of Finance to try and resolve this problem by August 2008.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Finding No.: 2007-10
Area: Procurement

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

Condition: For the following transactions below, there was insufficient documentation to support competitive procurement.

<u>Item</u>	<u>Fund</u>	<u>Transaction</u>		<u>Desc 1</u>	<u>Desc 2</u>	<u>Amount</u>
		<u>Date</u>				
1	23	39269	1962	L70847		\$ 3,000
2	31	10302006	700033801	L6180301		2,100
3	10-1702	6142007	700425201	T0713901		3,464
4	10-1010	11232006	700074201	T0703401		3,091
5	51	1232007	700207801	C3016004		8,786
6	51	12182006	700134401	C3016002		14,498
7	51	10302006	700033301	C3016008		1,750
8	51	6192007	700446201	C0042201		6,518
9	51	12182006	700134403	C3016006		5,382
10	51	12182006	700134402	C3016005		2,188
11	51	12182006	700134404	C3016007		<u>802</u>
						<u>\$51,579</u>

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

Effect: Noncompliance to the Financial Management Regulations results from this condition.

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

Auditee Response and Corrective Action Plan: We agree to this finding. Effective immediately, Mr. Nimos Salik, Ms. Betty Luey, under the supervision of Mr. Switson Robert, will ensure that procurement documentations are securely filed under a systematic filing system for easy reference and access.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Finding No.: 2007-11
Area: Journal Vouchers

Criteria: Journal entries should have adequate supporting documentation and reviewed and approved independently prior to posting.

Condition

1. Journal vouchers totaling \$322,002 were not reviewed and approved independently prior to posting. Additionally, such receipts represent contributions from China which were not appropriated by the Legislature.

	<u>Fund</u>	<u>Acct</u>	<u>Date</u>	<u>Description</u>	<u>Amount</u>
1	23	7310	9/30/2007	fv7d0101 stt	\$ (3,061)
3	23	7310	9/30/2007	fv7d0109 stt	(3,805)
4	23	7310	9/30/2007	fv7d0109 stt	(3,976)
5	23	7310	9/19/2007	stt	(5,800)
6	23	7310	9/30/2007	fv7d0109 stt	(6,785)
7	23	7310	9/30/2007	fv7d0109 stt	(8,598)
8	23	7310	9/30/2007	fv7d0109 stt	(8,988)
9	23	7310	9/30/2007	fv7d0109 stt	(10,016)
10	23	7310	9/30/2007	fv7d0109 stt	(10,047)
11	23	7310	9/30/2007	fv7d0110 stt	(10,239)
12	23	7310	9/30/2007	fv7d0110 stt	(13,355)
13	23	7310	9/30/2007	fv7d0101 stt	(14,087)
14	23	7310	9/30/2007	fv7d0109 stt	(19,845)
15	23	7310	9/30/2007	fv7d0109 stt	(21,665)
16	23	7310	9/30/2007	fv7d0109 stt	(24,190)
17	23	7310	9/30/2007	fv7d0109 stt	(37,770)
18	23	7310	9/30/2007	fv7d0109 stt	(56,971)
19	23	7310	9/30/2007	fv7d0109 stt	(62,804)
					<u>\$ (322,002)</u>

2. Journal vouchers are not adequately supported.

Cause: There appears to be weak internal controls over ensuring that journal vouchers are properly supported and are independently reviewed and approved prior to posting.

Effect: Nonsystematic entries such as journal vouchers recorded to the general ledger are prone to fraudulent and unauthorized activity.

Recommendation: We recommend the State ensure that journal vouchers are properly supported and a review and approval process be enforced to ensure that they are accurately recorded and to prevent unauthorized transactions.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Finding No.: 2007-11, Continued
Area: Journal Vouchers

Auditee Response and Corrective Action Plan: We agree to this finding with respect to prior approval of JVs but disagree to the notion that such receipts were not appropriated by the Legislature. Effective immediately, the Director will issue internal directive to restrict JVs without proper authorization and approval.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Finding No.: 2007-12
Area: Equity Investments

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

Condition:

Unaudited financial statements were not submitted for KSVI and SEMO in support of Kosrae State equity investments. No financial statements for Pacific Tuna Industries were furnished in support of Kosrae State equity investments

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

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

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

Auditee Response and Corrective Action Plan: We agree to this finding. We are working closely with the appropriate governmental agencies and departments, including the Legislature to have this resolve by October 2008. As it is a complex issue, we cannot yet have a clear plan as to how to proceed until certain instruments of the government are consulted.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

The following is a summary of unresolved questioned costs of the State of Kosrae as of September 30, 2007:

	Questioned Costs Set Forth in Prior Audit Reports <u>2006</u>	Questioned Costs Resolved in Fiscal Year <u>2007</u>	Questioned Costs at <u>September 30, 2007</u>
Unresolved Questioned Costs FY 2002	\$ 72,138	\$ -	\$ 72,138
Unresolved Questioned Costs FY 2003	39,811	63,682	39,811
Unresolved Questioned Costs FY 2004	237,645	-	237,645
Unresolved Questioned Costs FY 2005	462,459	-	462,459
Unresolved Questioned Costs FY 2006	<u>694,514</u>	<u>51,725</u>	<u>642,789</u>
	\$ <u>1,506,567</u>	\$ <u>115,407</u>	1,391,160
Questioned Costs FY 2007			<u>162,753</u>
			\$ <u>1,553,913</u>

The prior year status of findings is contained in the accompanying Schedule of Findings and Questioned Costs (pages 74-90).