

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2007

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2007

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**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2007

INDEPENDENT AUDITORS' REPORT

Honorable John Ehsa
Governor, State of Pohnpei
Federated States of Micronesia:

We have audited the accompanying financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Pohnpei (the State) as of and for the year ended September 30, 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 did not audit the financial statements of the Pohnpei Transportation Authority, the Small Business Guarantee and Finance Corporation, and the Pohnpei Economic Development Authority, which represent 6%, 3%, and 13%, respectively, of the assets, net assets, and revenues of the State's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion express herein, insofar as it relates to the amounts included for the Pohnpei Transportation Authority, the Small Business Guarantee and Finance Corporation, and the Pohnpei Economic Development Authority, is based solely on the reports of the other auditors.

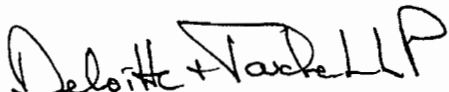
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and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

In our opinion, based on our audit and the reports of other auditors, such financial statements, as set forth in Section II of the foregoing table of contents, present fairly, in all material respects, the respective financial position of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Pohnpei as of September 30, 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 Unreserved Fund Balance - Budget and Actual - General Fund and notes thereto, on pages 42 and 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.

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, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 16, 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.



June 16, 2008

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2007

This section of Pohnpei State's financial report presents our Management's Discussion and Analysis (MD&A) for the fiscal year ended September 30, 2007. This MD&A is prepared in compliance with the GASB-34 requirement. Readers are requested to read this MD&A in conjunction with the State's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The Pohnpei State's primary government's total net assets for this year are \$50,889,913.
- The net change in governmental fund balance is a decrease of \$2,046,625. The total revenues reported are \$33,060,447 with the total expenditures of \$31,672,359 and special items of \$3,434,713.
- Actual revenues for the general fund were \$2,442,768 higher than budgeted revenues. The total expenditures, budgetary basis, showed a favorable variance of \$877,332. The general fund reported an unreserved fund balance of \$8,998,773 for the fiscal year.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of four parts-management's discussion and analysis (this section), the basic financial statements, required supplementary information and the notes to the financial statements. The basic financial statements include two kinds of statements that present different views of the State:

Government-Wide Financial Statements

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

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

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

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

Fund Financial Statements

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

- Governmental funds. Most of the State's basic services are included in governmental funds', which focus on how cash and other financial assets that can readily be converted to cash, flow in and out and the balances left at year-end that are available for spending. Unlike the government-wide financial statements, the governmental funds statements focus on the short-term financial requirements of the State. Because this information does not encompass the additional long-term focus of the government wide statements, we provide reconciliation at the bottom of the governmental funds statement, to explain the relationship between them. The State maintains individual governmental funds, which are categorized as major and non-major. The major funds includes the General Fund. The other major funds consist of the Compact II/Sector Grants, Compact Other Grants, Federal Grants and Compact CIP.

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FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2007

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

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

	<u>Governmental Activities</u>	
	<u>2007</u>	<u>2006</u>
Current and other assets	\$ 18,339,039	\$ 21,013,192
Capital assets	26,643,421	28,489,651
Other non current assets	<u>15,500,553</u>	<u>15,495,033</u>
Total assets	<u>60,483,013</u>	<u>64,998,173</u>
Current liabilities	3,080,549	3,562,854
Long-term debt	4,381,067	4,521,067
Other liabilities	<u>2,131,484</u>	<u>2,126,254</u>
Total liabilities	<u>9,593,100</u>	<u>10,210,175</u>
Net Assets:		
Invested in capital assets, net of related debt	26,643,421	28,489,651
Restricted	20,505,171	18,199,990
Unrestricted	<u>3,741,321</u>	<u>8,098,357</u>
Total net assets	\$ <u>50,889,913</u>	\$ <u>54,787,998</u>

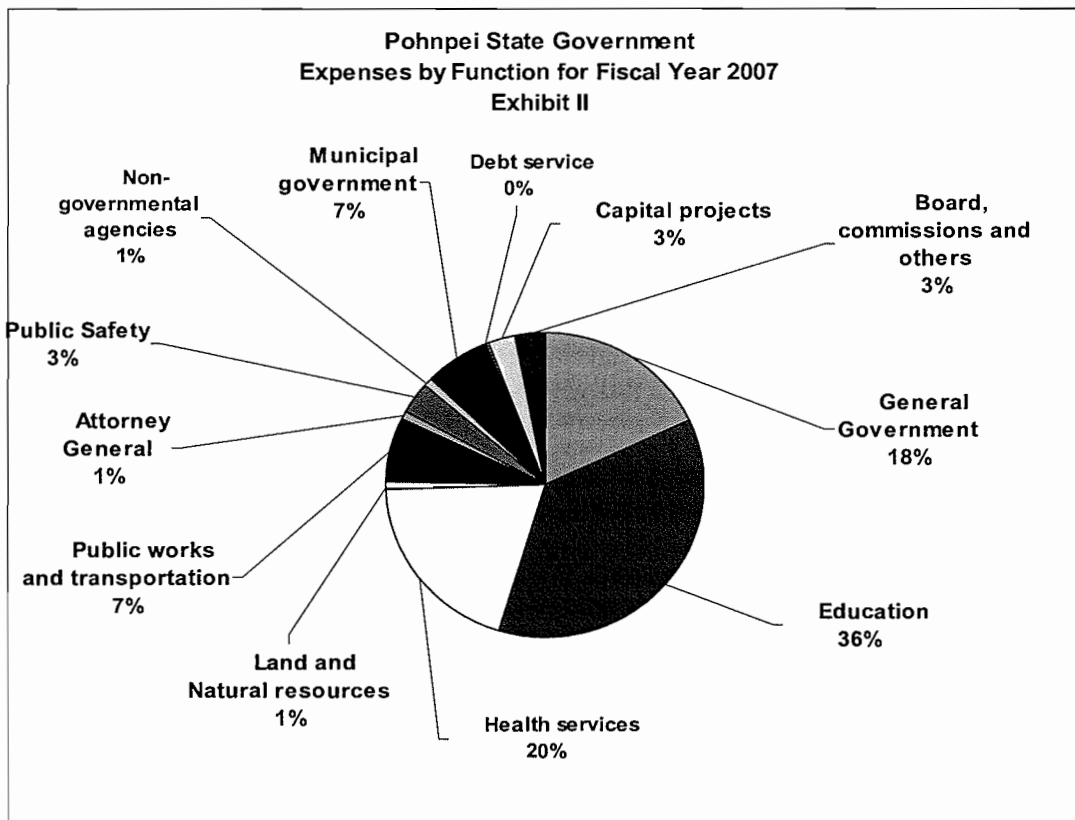
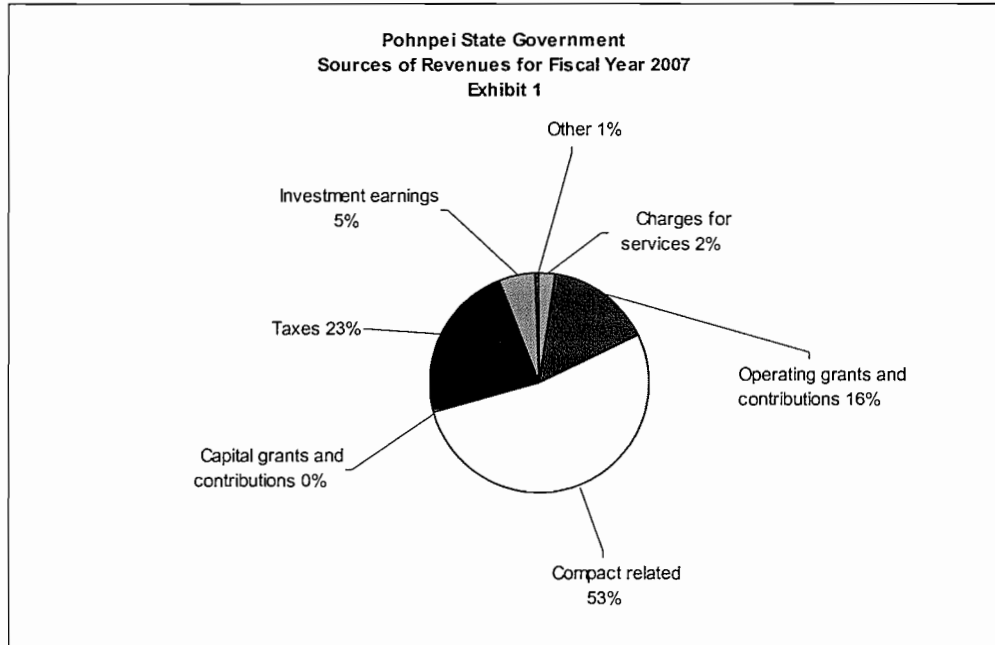
Changes in net assets. The State's statement of Changes in Net Assets for the fiscal year ended September 30 follows:

	<u>Governmental Activities</u>	
	<u>2007</u>	<u>2006</u>
Revenues:		
Program revenues:		
Charges for services	\$ 780,806	\$ 887,785
Operating grants and contributions	5,208,456	3,619,486
Compact related	17,343,833	16,601,682
Capital grants and contributions	94,790	157,667
General revenues:		
Taxes	7,717,751	8,507,190
Investment earnings	1,722,264	815,446
Other	<u>192,547</u>	<u>1,257,692</u>
Total revenues	<u>33,060,447</u>	<u>31,846,948</u>
Expenses:		
General government	6,049,172	6,755,381
Education	12,323,283	11,166,703
Health services	6,549,571	6,417,038
Land and natural resources	284,944	442,512
Public works and others	2,393,364	4,183,498
Public safety	1,141,190	1,132,077
Boards, commission and other appropriations	4,782,295	2,145,923
Other miscellaneous	<u>-</u>	<u>86,575</u>
Total expenses	<u>33,523,819</u>	<u>32,631,247</u>
Special item:		
Write-off of receivables	<u>3,434,713</u>	<u>-</u>
Increase (decrease) in net assets	\$ <u>(3,898,085)</u>	\$ <u>(990,065)</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2007

Exhibit I below, showed that 53% of the State's revenues were derived from Compact II while 23% come from taxes and licenses. The least source of revenues is capital grants and contribution. For expenses the State encompass a range of services. Exhibit II illustrated that education incurred 36% of the State's total expenses while health represented 20%.



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Management's Discussion and Analysis
September 30, 2007

GOVERNMENTAL ACTIVITIES

General Fund

The revenues decreased by \$531,517 compared to fiscal year 2006. The total expenditures without write-offs, however, increased by \$255,456 or 2.99% more than last year. The decrease in funding for the private sector grant for fiscal year 2007 was absorbed and funded by the general fund; hence this explains the increase in expenditures.

Special Revenue

As mentioned in the preceding paragraph, Compact II/Sector Grants were the major sources of Pohnpei State's operating grants for fiscal year 2007. The total revenues equals the expenditures in the amount of \$17,343,833, which is discussed below:

- The education sector grant that shall support and improve the educational system of the Federated States of Micronesia, including, without limitation, the systems for primary, secondary, and post-secondary education. The total expenditures for the grant are \$7,514,975.
- The health sector grant that shall support and improve the delivery of preventive, curative and environmental care, and develop the human and material resources necessary for the Federated States of Micronesia to perform these services. The total funding for the year is \$4,687,053.
- The sector grant for private sector development shall support the efforts of the Federated of Micronesia to attract new foreign investment and increase indigenous business activity. Priorities will be in advancing the private development of fisheries, tourism and agriculture; employing new telecommunications technologies; and analyzing and developing new systems, laws, and policies to foster private sector development, to facilitate investment by potential private investors, and develop business and entrepreneurial skills. The total of \$460,022 was expended for this activity.
- The sector for capacity building shall support the efforts of the Federated States of Micronesia to build effective, accountable and transparent national and local government and other public sector institutions and systems. The total grant expenditures are \$718,076.
- The environment sector shall support the efforts of the Federated States of Micronesia to protect the Nation's land and marine environment and to conserve and achieve sustainable use of its natural resources. The amount of \$625,825 was expended for the fiscal year.
- Public Infrastructure grant shall give priority to primary and secondary education capital projects and programs that directly affect health and safety including water and wastewater projects, solid waste disposal projects and health care facilities. The State did not receive funding for this activity for the fiscal year.
- The Supplemental Education Grant (SEG) is considered the seventh-sector grant. SEG has been offered in lieu of grants that were formerly available from various federal agencies. The federal programs that were incorporated into SEG are Territories & Freely Associated States Education Grant (T&FASEG), Adult Education & Family Literacy, Workforce Investment Act, Pacific Vocational Education Improvement Program and Early Childhood Program (formerly Head Start). For the year, the total expenses incurred were \$3,337,882.

Another major source of funding under Special Revenue funds is the US Federal Grants, which supported \$2,574,695 of expenditures of the State.

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Management's Discussion and Analysis
September 30, 2007

Capital Projects

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

Other Governmental Funds

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

FINANCIAL ANALYSIS OF THE STATE'S GOVERNMENTAL FUNDS

The State's governmental fund changes in fund balances for the year ended September 30, 2007 are shown below.

Changes in Fund Balances

	<u>General Fund</u>	<u>Other Funds</u>	<u>Total</u>
Revenues:			
Taxes	\$ 7,717,751	\$ 511,911	\$ 8,229,662
Compact	-	17,343,833	17,343,833
Other	<u>2,037,017</u>	<u>5,449,935</u>	<u>7,486,952</u>
Total revenues	<u>9,754,768</u>	<u>23,305,679</u>	<u>33,060,447</u>
Expenditures	<u>8,785,824</u>	<u>22,886,535</u>	<u>31,672,359</u>
Transfers in (out)	<u>(420,951)</u>	<u>420,951</u>	<u>-</u>
Write offs	<u>(984,713)</u>	<u>(2,450,000)</u>	<u>(3,434,713)</u>
Net change in fund balance	\$ <u>(436,720)</u>	\$ <u>(1,609,905)</u>	\$ <u>(2,046,625)</u>

General Fund Budgetary Highlights

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

The decrease in the State's general fund unreserved fund balance of \$392,699 derives mainly from receivables that were written off.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The State's capital assets at the end of fiscal years 2007 and 2006 consist basically of equipment, buildings, roads and bridges. The summary of capital assets at the end of September 30 is shown below:

	<u>Primary Government Governmental Activities</u>	
	<u>2007</u>	<u>2006</u>
Buildings	\$ 6,250,479	\$ 6,294,579
Infrastructure	52,341,781	52,241,781
Machinery	<u>6,787,737</u>	<u>6,474,918</u>
Total	\$ <u>65,379,997</u>	\$ <u>65,011,278</u>

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Management's Discussion and Analysis
September 30, 2007

Note 5 to the financial statements present more information about the State's capital assets.

Long-Term Debt

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

	<u>Primary Government Governmental Activities</u>	
	<u>2007</u>	<u>2006</u>
ADB loans	\$ <u>4,521,067</u>	\$ <u>4,521,067</u>

Note 7 to the financial statements present more information about the State's debts.

Economic Factors and Next Year's Budget

Funding for the operations of most of the government services in fiscal year 2008 will still come from the Compact II.

Fiscal year 2008 is the fifth year of the implementation of the economic assistance under the Compact II/ Sector Grant. Sector funding replaces the funding sources from the old Compact I. Under the Compact II/Sector grant, the annual budget approved by JEMCO for fiscal year 2008 is as follows:

- For education sector grant, which continues to be the funding priority, the annual budget is \$7,565,071.
- The health sector grant's budget is \$5,327,453.
- The sector grant funding for private sector development is \$142,754.
- The capacity building sector grant budget for fiscal year 2008 is \$709,883.
- The environment sector grant is \$481,576.
- The cumulative grants for the Public Infrastructure from fiscal years 2005 through 2008 is more than \$23,000,000. Priority projects are education, health related and private sector development. It is also required that 5% of the total grant be allocated to the Infrastructure Maintenance fund for the maintenance of the existing and new projects. Local matching of the same amount is required.
- In the case of the Supplemental Education Grant (SEG), the total funding from September 1, 2007 from March 31, 2009 is \$3,039,906. The programs covered in the funding are Early Childhood Education. Education Improvement Programs, Workforce Development/Skill Training, Vocational Education and Staff Development. The grant award was signed on August 30, 2007.

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For fiscal year 2008, the locally generated revenues and the revenue shares from the National Government are projected at a range of \$7,000,000 or less due to the implementation of FSM Public law No 14-90. FSM Public Law No. 14-90 allows taxpayers to deduct the wages and benefits paid to their employees from the taxable revenues; hence reducing the amount of gross revenue taxes. In fiscal year 2007; the reduction in the FSM revenue sharing was almost \$300,000. For Pohnpei State; the annual amount of expected reduction in gross revenue taxes is more than \$400,000. The Department of Treasury and Administration will, however, continue to intensify its collection effort to raise more revenues in the ensuing years. In addition, the final carry-over balances from the Compact II may be authorized to be used to fund other operations of the government.

FINANCIAL CONTACT

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

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Statement of Net Assets
September 30, 2007

	Primary Government	Component Units
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 2,076,772	\$ 3,038,249
Investments	10,119,489	1,185,000
Receivables, net of allowance for uncollectibles	5,942,891	3,039,982
Advances	100,485	-
Inventories	22,734	1,368,698
Other current assets	-	14,603
Restricted assets:		
Cash and cash equivalents	76,668	1,278,729
Total current assets	18,339,039	9,925,261
Noncurrent assets:		
Capital assets, net of accumulated depreciation	26,643,421	35,010,329
Due from component units	922,724	-
Investments	-	139,390
Other	-	759,995
Restricted assets:		
Cash and cash equivalents	552,547	-
Investments	14,025,282	-
Total noncurrent assets	42,143,974	35,909,714
Total assets	\$ 60,483,013	\$ 45,834,975
<u>LIABILITIES</u>		
Current liabilities:		
Current portion of long-term obligations	\$ 140,000	\$ 220,221
Notes payable	-	874,825
Accounts payable	459,507	947,083
Current portion of compensated absences payable	196,113	-
Due to primary government	-	922,724
Other liabilities and accruals	1,696,121	768,274
Deferred revenue	588,808	385,743
Total current liabilities	3,080,549	4,118,870
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	4,381,067	3,065,853
Compensated absences payable	681,484	-
Due to primary government	-	2,450,000
Other noncurrent liabilities	1,450,000	-
Total noncurrent liabilities	6,512,551	5,515,853
Total liabilities	9,593,100	9,634,723
Contingencies and commitments		
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	26,643,421	28,937,729
Restricted for:		
Nonexpendable:		
Future operations	9,863,333	-
Expendable:		
Compact related	2,766,097	-
Capital projects	314,299	-
Debt service	4,161,949	-
Other purposes	3,399,493	1,823,104
Unrestricted	3,741,321	5,439,419
Total net assets	50,889,913	36,200,252
Total liabilities and net assets	\$ 60,483,013	\$ 45,834,975

See accompanying notes to basic financial statements.

STATE OF POHNPEI
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	\$ 6,049,172	\$ 658,600	\$ 2,820,064	\$ 81,957	\$ (2,488,551)	\$ -
Land and natural resources	284,944	-	-	-	(284,944)	-
Education	12,323,283	-	11,991,979	-	(331,304)	-
Health services	6,549,571	-	5,464,888	-	(1,084,683)	-
Public safety	1,141,190	-	1,716	-	(1,139,474)	-
Attorney-general	264,849	-	-	-	(264,849)	-
Public works and transportation	2,393,364	-	-	-	(2,393,364)	-
Payments to non-governmental agencies	194,696	-	-	-	(194,696)	-
Boards, commissions and others	1,018,263	-	314,811	-	(703,452)	-
Municipal governments	2,233,562	-	-	-	(2,233,562)	-
Debt service	132,790	-	352,446	-	219,656	-
Future operations	-	-	1,606,385	-	1,606,385	-
Capital projects	938,135	-	-	12,833	(925,302)	-
Other appropriations	-	122,206	-	-	122,206	-
Total primary government	\$ 33,523,819	\$ 780,806	\$ 22,552,289	\$ 94,790	(10,095,934)	-
Component units:						
Pohnpei Utilities Corporation	\$ 14,585,306	\$ 11,369,043	\$ 99,140	\$ 124,753	-	(2,992,370)
Pohnpei Port Authority	1,547,051	2,781,178	-	1,269,005	-	2,503,132
Pohnpei Fisheries Corporation	278,165	32,807	-	-	-	(245,358)
Pohnpei Transportation Authority	1,606,831	1,328,638	17,819	-	-	(260,374)
Small Business Guarantee and Finance Corporation	113,123	25,040	82,530	-	-	(5,553)
Pohnpei Economic Development Authority	415,193	171,535	25,645	-	-	(218,013)
Pohnpei State Housing Authority	2,231,922	147,971	93,231	-	-	(1,990,720)
Total component units	\$ 20,777,591	\$ 15,856,212	\$ 318,365	\$ 1,393,758	-	(3,209,256)
General revenues:						
Taxes:						
Revenue sharing					5,405,136	-
Excise taxes					2,312,615	-
Unrestricted investment earnings					1,722,264	-
Other					192,547	1,652,729
Total general revenues					9,632,562	1,652,729
Special item:						
Write-off of receivables					3,434,713	-
Change in net assets					(3,898,085)	(1,556,527)
Net assets at the beginning of the year					54,787,998	37,756,779
Net assets at the end of the year					\$ 50,889,913	\$ 36,200,252

See accompanying notes to basic financial statements.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Balance Sheet
Governmental Funds
September 30, 2007

	Special Revenue Funds				Permanent	Other Governmental Funds	Total
	General	Compact Sector Grants	Compact Other Grants	U.S. Federal Grants	Compact Trust		
ASSETS							
Cash and cash equivalents	\$ 2,076,772	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 2,076,772
Investments	6,010,508	-	1,195,801	-	-	2,913,180	10,119,489
Receivables, net:							
FSM National Government	-	539,853	-	917,357	-	9,987	1,467,197
Taxes	1,701,127	-	-	-	-	-	1,701,127
Other	2,766,225	-	-	-	-	8,342	2,774,567
Due from component units	922,724	-	-	-	-	-	922,724
Due from other funds	3,135,560	1,136,858	-	-	-	3,934,867	8,207,285
Advances	97,920	1,225	-	-	-	1,340	100,485
Inventories	-	-	-	-	-	22,734	22,734
Restricted assets:							
Cash and cash equivalents	76,668	-	-	-	-	552,547	629,215
Investments	-	-	-	-	9,863,333	4,161,949	14,025,282
Total assets	<u>\$ 16,787,504</u>	<u>\$ 1,677,936</u>	<u>\$ 1,195,801</u>	<u>\$ 917,357</u>	<u>\$ 9,863,333</u>	<u>\$ 11,604,946</u>	<u>\$ 42,046,877</u>
LIABILITIES AND FUND BALANCES							
Liabilities:							
Accounts payable	\$ 84,629	\$ 274,858	\$ 1,475	\$ 80,190	\$ -	\$ 18,355	\$ 459,507
Other liabilities and accruals	1,238,625	403,751	-	48,944	-	4,801	1,696,121
Deferred revenue	-	538,004	-	23,318	-	27,486	588,808
Due to other funds	5,079,115	447,381	1,032,443	764,905	-	883,441	8,207,285
Total liabilities	<u>6,402,369</u>	<u>1,663,994</u>	<u>1,033,918</u>	<u>917,357</u>	<u>-</u>	<u>934,083</u>	<u>10,951,721</u>
Fund balances:							
Reserved for:							
Related assets	960,776	-	-	-	9,863,333	1,575,281	12,399,390
Encumbrances	137,057	355,878	10,337	69,042	-	540,279	1,112,593
Continuing appropriations	288,529	-	50,000	-	-	1,187,858	1,526,387
Debt service	-	-	-	-	-	4,161,949	4,161,949
Unreserved:							
General fund	8,998,773	-	-	-	-	-	8,998,773
Special revenue funds	-	(341,936)	101,546	(69,042)	-	2,679,213	2,369,781
Debt service fund	-	-	-	-	-	206,391	206,391
Capital projects funds	-	-	-	-	-	319,892	319,892
Total fund balances	<u>10,385,135</u>	<u>13,942</u>	<u>161,883</u>	<u>-</u>	<u>9,863,333</u>	<u>10,670,863</u>	<u>31,095,156</u>
Total liabilities and fund balances	<u>\$ 16,787,504</u>	<u>\$ 1,677,936</u>	<u>\$ 1,195,801</u>	<u>\$ 917,357</u>	<u>\$ 9,863,333</u>	<u>\$ 11,604,946</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							
26,643,421							
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:							
(4,521,067)							
(877,597)							
<u>(1,450,000)</u>							
(6,848,664)							
Net assets of governmental activities							
<u>\$ 50,889,913</u>							

See accompanying notes to basic financial statements.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	Special Revenue Funds			Permanent		Other Governmental Funds	Total
	General	Compact Sector Grants	Compact Other Grants	U.S. Federal Grants	Compact Trust		
Revenues:							
Compact funding	\$ -	\$ 17,343,833	\$ -	\$ -	\$ -	\$ -	\$ 17,343,833
Net increase in the fair value of investments	1,722,264	-	-	-	1,606,385	365,279	3,693,928
CFSM grants	-	-	-	-	-	81,957	81,957
Federal contributions	-	-	-	2,574,695	-	-	2,574,695
FSM revenue sharing	5,405,136	-	-	-	-	-	5,405,136
State taxes	2,312,615	-	-	-	-	511,911	2,824,526
Fees and charges	122,206	-	-	-	-	496,383	618,589
Other	192,547	-	-	-	-	325,236	517,783
Total revenues	<u>9,754,768</u>	<u>17,343,833</u>	<u>-</u>	<u>2,574,695</u>	<u>1,606,385</u>	<u>1,780,766</u>	<u>33,060,447</u>
Expenditures:							
Current:							
General government	3,343,295	1,803,923	52,930	341,211	-	633,329	6,174,688
Land and natural resources	288,958	-	-	-	-	-	288,958
Education	58,146	10,852,857	-	1,139,122	-	194,385	12,244,510
Health services	-	4,687,053	196,585	777,835	-	819,853	6,481,326
Public safety	1,107,667	-	-	1,716	-	-	1,109,383
Office of the Attorney-General	264,849	-	-	-	-	-	264,849
Public works	591,199	-	-	-	-	-	591,199
Payments to non-governmental agencies	194,696	-	-	-	-	-	194,696
Boards, commissions and other	703,452	-	-	314,811	-	-	1,018,263
Grants to local governments	2,233,562	-	-	-	-	-	2,233,562
Debt service	-	-	-	-	-	132,790	132,790
Capital projects	-	-	-	-	-	938,135	938,135
Total expenditures	<u>8,785,824</u>	<u>17,343,833</u>	<u>249,515</u>	<u>2,574,695</u>	<u>-</u>	<u>2,718,492</u>	<u>31,672,359</u>
Excess (deficiency) of revenues over (under) expenditures	<u>968,944</u>	<u>-</u>	<u>(249,515)</u>	<u>-</u>	<u>1,606,385</u>	<u>(937,726)</u>	<u>1,388,088</u>
Other financing sources (uses):							
Operating transfers in	-	-	-	-	-	420,951	420,951
Operating transfers out	(420,951)	-	-	-	-	-	(420,951)
Other financing sources (uses), net	<u>(420,951)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>420,951</u>	<u>-</u>
Special item:							
Write-off of receivables	(984,713)	-	-	-	-	(2,450,000)	(3,434,713)
Net change in fund balances	<u>(436,720)</u>	<u>-</u>	<u>(249,515)</u>	<u>-</u>	<u>1,606,385</u>	<u>(2,966,775)</u>	<u>(2,046,625)</u>
Fund balances at the beginning of the year	<u>10,821,855</u>	<u>13,942</u>	<u>411,398</u>	<u>-</u>	<u>8,256,948</u>	<u>13,637,638</u>	<u>33,141,781</u>
Fund balances at the end of the year	<u>\$ 10,385,135</u>	<u>\$ 13,942</u>	<u>\$ 161,883</u>	<u>\$ -</u>	<u>\$ 9,863,333</u>	<u>\$ 10,670,863</u>	<u>\$ 31,095,156</u>

See accompanying notes to basic financial statements.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

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

Net change in fund balances - total governmental funds from page 13	\$ (2,046,625)
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation exceeded capital outlays in the current period	(1,846,230)
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore, are not reported as expenditures in governmental funds. These expenses include accrued annual leave and claims and judgments payable that are reported in the statement of activities, but not in funds	<u>(5,230)</u>
Change in net assets of governmental activities as presented on page 11.	\$ <u>(3,898,085)</u>

See accompanying notes to basic financial statements.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Combining Statement of Net Assets
Component Units
September 30, 2007

	Pohnpei Utilities Corporation	Pohnpei Port Authority	Pohnpei Fisheries Corporation	Pohnpei Transportation Authority	Small Business Guarantee and Finance Corporation	Pohnpei Economic Development Authority	Pohnpei State Housing Authority	Total
ASSETS								
Current assets:								
Cash and cash equivalents	\$ 357,056	\$ 2,467,790	\$ 53,098	\$ -	\$ 28,025	\$ 20,953	\$ 111,327	\$ 3,038,249
Investments	685,000	-	-	-	-	500,000	-	1,185,000
Receivables, net:								
General	2,167,439	498,165	-	155,749	1,913	16,707	102,786	2,942,759
Other	23,698	38,618	-	-	5,893	688	28,326	97,223
Inventories	1,277,873	-	-	90,754	-	-	71	1,368,698
Other current assets	10,186	-	-	4,417	-	-	-	14,603
Restricted assets:								
Cash and cash equivalents	-	-	-	-	1,278,729	-	-	1,278,729
Total current assets	<u>4,521,252</u>	<u>3,004,573</u>	<u>53,098</u>	<u>250,920</u>	<u>1,314,560</u>	<u>538,348</u>	<u>242,510</u>	<u>9,925,261</u>
Noncurrent assets:								
Capital assets, net of accumulated depreciation	28,391,763	6,207,246	274,330	82,245	5,612	37,917	11,216	35,010,329
Investments	139,390	-	-	-	-	-	-	139,390
Other	355,011	-	-	-	404,984	-	-	759,995
Total noncurrent assets	<u>28,886,164</u>	<u>6,207,246</u>	<u>274,330</u>	<u>82,245</u>	<u>410,596</u>	<u>37,917</u>	<u>11,216</u>	<u>35,909,714</u>
Total assets	<u>\$33,407,416</u>	<u>\$ 9,211,819</u>	<u>\$ 327,428</u>	<u>\$ 333,165</u>	<u>\$ 1,725,156</u>	<u>\$ 576,265</u>	<u>\$ 253,726</u>	<u>\$45,834,975</u>
LIABILITIES								
Current liabilities:								
Current portion of long-term debt	\$ 134,922	\$ -	\$ 85,299	\$ -	\$ -	\$ -	\$ -	\$ 220,221
Notes payable	874,825	-	-	-	-	-	-	874,825
Accounts payable	503,912	85,416	57,413	63,262	-	237,080	-	947,083
Due to primary government	-	-	-	922,724	-	-	-	922,724
Other liabilities and accruals	295,127	165,212	-	17,380	6,700	269,869	13,986	768,274
Deferred revenue	312,752	4,968	66,667	1,356	-	-	-	385,743
Total current liabilities	<u>2,121,538</u>	<u>255,596</u>	<u>209,379</u>	<u>1,004,722</u>	<u>6,700</u>	<u>506,949</u>	<u>13,986</u>	<u>4,118,870</u>
Noncurrent liabilities:								
Due to primary government	-	-	2,450,000	-	-	-	-	2,450,000
Noncurrent portion of long-term debt	3,010,853	-	55,000	-	-	-	-	3,065,853
Total liabilities	<u>5,132,391</u>	<u>255,596</u>	<u>2,714,379</u>	<u>1,004,722</u>	<u>6,700</u>	<u>506,949</u>	<u>13,986</u>	<u>9,634,723</u>
NET ASSETS								
Invested in capital assets, net of related debt	24,769,163	6,207,246	(2,175,670)	82,245	5,612	37,917	11,216	28,937,729
Restricted	139,390	-	-	-	1,683,714	-	-	1,823,104
Unrestricted	<u>3,366,472</u>	<u>2,748,977</u>	<u>(211,281)</u>	<u>(753,802)</u>	<u>29,130</u>	<u>31,399</u>	<u>228,524</u>	<u>5,439,419</u>
Total net assets	<u>28,275,025</u>	<u>8,956,223</u>	<u>(2,386,951)</u>	<u>(671,557)</u>	<u>1,718,456</u>	<u>69,316</u>	<u>239,740</u>	<u>36,200,252</u>
	<u>\$33,407,416</u>	<u>\$ 9,211,819</u>	<u>\$ 327,428</u>	<u>\$ 333,165</u>	<u>\$ 1,725,156</u>	<u>\$ 576,265</u>	<u>\$ 253,726</u>	<u>\$45,834,975</u>

See accompanying notes to basic financial statements.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	Pohnpei Utilities Corporation	Pohnpei Port Authority	Pohnpei Fisheries Corporation	Pohnpei Transportation Authority	Small Business Guarantee and Finance Corporation	Pohnpei Economic Development Authority	Pohnpei State Housing Authority	Total
Operating revenues:								
Charges for services	\$ -	\$ 2,781,178	\$ 32,807	\$ 1,328,638	\$ 25,040	\$ 80,526	\$ 147,971	\$ 4,396,160
Sales	<u>11,369,043</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>91,009</u>	<u>-</u>	<u>11,460,052</u>
Total operating revenues	<u>11,369,043</u>	<u>2,781,178</u>	<u>32,807</u>	<u>1,328,638</u>	<u>25,040</u>	<u>171,535</u>	<u>147,971</u>	<u>15,856,212</u>
Operating expenses:								
Cost of services	11,144,899	1,291,470	2,660	1,556,000	-	210,025	-	14,205,054
Administration costs	1,356,059	-	1,198	-	109,174	205,168	2,227,016	3,898,615
Depreciation and amortization	<u>2,084,348</u>	<u>255,581</u>	<u>274,307</u>	<u>50,831</u>	<u>3,949</u>	<u>-</u>	<u>4,906</u>	<u>2,673,922</u>
Total operating expenses	<u>14,585,306</u>	<u>1,547,051</u>	<u>278,165</u>	<u>1,606,831</u>	<u>113,123</u>	<u>415,193</u>	<u>2,231,922</u>	<u>20,777,591</u>
Operating income (loss)	<u>(3,216,263)</u>	<u>1,234,127</u>	<u>(245,358)</u>	<u>(278,193)</u>	<u>(88,083)</u>	<u>(243,658)</u>	<u>(2,083,951)</u>	<u>(4,921,379)</u>
Nonoperating revenues (expenses):								
Contributions from the primary government	99,140	-	-	17,819	82,530	25,645	93,231	318,365
Interest income (expense)	(58,056)	18,962	(16,641)	-	46,693	30,833	-	21,791
Other	<u>16,588</u>	<u>123</u>	<u>1,010,878</u>	<u>18,352</u>	<u>12,000</u>	<u>571,464</u>	<u>1,533</u>	<u>1,630,938</u>
Total nonoperating revenues (expenses), net	<u>57,672</u>	<u>19,085</u>	<u>994,237</u>	<u>36,171</u>	<u>141,223</u>	<u>627,942</u>	<u>94,764</u>	<u>1,971,094</u>
Capital contributions	<u>124,753</u>	<u>1,269,005</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,393,758</u>
Change in net assets	(3,033,838)	2,522,217	748,879	(242,022)	53,140	384,284	(1,989,187)	(1,556,527)
Net assets at the beginning of the year	<u>31,308,863</u>	<u>6,434,006</u>	<u>(3,135,830)</u>	<u>(429,535)</u>	<u>1,665,316</u>	<u>(314,968)</u>	<u>2,228,927</u>	<u>37,756,779</u>
Net assets at the end of the year	<u>\$28,275,025</u>	<u>\$ 8,956,223</u>	<u>\$ (2,386,951)</u>	<u>\$ (671,557)</u>	<u>\$ 1,718,456</u>	<u>\$ 69,316</u>	<u>\$ 239,740</u>	<u>\$36,200,252</u>

See accompanying notes to basic financial statements.

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

A. Reporting Entity

The State is one of the four states that make up the Federated States of Micronesia (FSM), along with the states of Chuuk, Kosrae and Yap. The State is a constitutional government comprised of three branches: the Legislative Branch, consisting of 23 members elected for a term of four years by qualified voters of their respective election districts; the Executive Branch, headed by the Governor and Lt. Governor, who are primarily responsible for executing the laws and administering state government services; and the Judiciary Branch made up of the State Supreme Court, which consists of a Chief Justice and up to four Associate Justices, and other courts that may be created by law.

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

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

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

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

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 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:

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

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

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

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

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

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

i. Discretely Presented Component Units, Continued

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

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

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

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Kolonia, Pohnpei, FSM 96941

B. Government-Wide Financial Statements

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

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

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

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

- Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets.
- Restricted net assets - nonexpendable consists of permanent funds in which donors or other outside sources have stipulated that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to the principal.
- Restricted net assets - expendable consists of resources in which the State is legally or contractually obligated to spend resources in accordance with restrictions either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.
- Unrestricted net assets consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, (for example, internally restricted), to indicate that management does not consider them to be available for general operations.

The government-wide Statement of Net Assets reports \$20,505,171 of restricted net assets, of which \$3,399,493 is restricted by enabling legislation.

The Statement of Activities demonstrates the degree to which the direct expenses of given functions or segments are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function or segment. Program revenues include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not meeting the definition of program revenues are, instead, reported as general revenue.

C. Fund Financial Statements

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

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

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

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting

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

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

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

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

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 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 Governmental Fund fund types:

i. General Fund

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

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

ii. Special Revenue Funds

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

iii. Debt Service Fund

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

iv. Capital Projects Funds

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

v. Permanent Fund

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

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - 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:

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

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

Compact Other Grants Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for funds granted under the Compact of Free Association with the United States. These funds are specifically restricted for energy programs, health and medical referral, post secondary education scholarship and special development assistant programs.

**STATE OF POHNPEI
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

Compact Trust Fund, a Governmental Fund Type - Permanent Fund. This fund accounts for United States Congress appropriations under United States Public Law 99-239, as amended, Title II, Article I, Section 215 and approved by FSM Congress to provide for an additional source of revenue for the government budget that will be needed to substitute for the absence of Compact of Free Association funding. Earnings from funds invested would not be available for distribution until October 2023.

E. Reporting Standards

As allowed by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the State's 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

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

G. Investments

Investments 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.

H. Receivables

In general, tax revenue is recognized on the government-wide financial statements when assessed or levied and on the governmental fund financial statements to the extent that it is both measurable and available. Receivables in the State's governmental funds primarily consist of taxes and federal revenues. Federal receivables include those funds which are earned, primarily from FSM National Government administered federal grants, which have yet to be reimbursed by the applicable grantor.

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

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

I. Inventories and Prepaid Items

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

J. Interfund Receivables/Payables

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

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

K. Restricted Assets

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through enabling legislation and loan agreements. As of September 30, 2007, investments of \$9,863,333 recorded in the Section 215 Compact Trust Fund are restricted in that they are not available to be used in current operations. In addition, investments of \$4,161,949 recorded in the Debt Service Fund are restricted for future repayment of the Early Retirement Program loan. Furthermore, cash and cash equivalents were restricted for the following uses:

Deposit with a local bank restricted for the purchase of medical supplies for the State hospital. \$ 76,668

Loan Guarantee Escrow Account established for the sole purpose of loan collateralization made through the USDA Rural Development. The escrow account may be drawn down in the event of a borrower's default on the obligation under the terms of the promissory note and the deed of trust security instrument supporting such note and for which such note is guaranteed by the Pohnpei State Housing Authority, the trustee of the Loan Guarantee Escrow Account. 552,547

\$ 629,215

L. Capital Assets

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

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

L. Capital Assets, Continued

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

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

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

M. Interfund/Intrafund Transactions

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

N. Compensated Absences

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

O. Fund Equity

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

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

O. Fund Equity, Continued

The unreserved fund balances for the governmental funds represent the amount available for budgeting future operations. The reserve for related assets as of September 30, 2007, is represented by the following assets:

	Section 211	Compact	U.S. Federal	Compact	Other	Total
	General	Sector Grant	Other Grants	Trust	Governmental Funds	Total
Investments	\$ 38,052	\$ -	\$ -	\$ -	\$ 1,000,000	\$ 1,038,052
Due from component units	922,724	-	-	-	-	922,724
Inventories	-	-	-	-	22,734	22,734
Restricted assets:						
Cash and cash equivalents	-	-	-	-	552,547	552,547
Investments	-	-	-	9,863,333	-	9,863,333
	<u>\$ 960,776</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 9,863,333</u>	<u>\$ 1,575,281</u>	<u>\$ 12,399,390</u>

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

P. Risk Financing

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

Q. New Accounting Standards

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments. The provisions of this statement are effective for periods beginning after December 15, 2006. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other post employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this statement are effective for periods beginning after December 15, 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 POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

Q. New Accounting Standards, Continued

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.

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 that 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.

R. Estimates

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

S. 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.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

T. Total Columns

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

U. 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 Compact Other Grants 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 State pools cash resources of its various funds in order to facilitate the management of cash. Unless otherwise required by law, interest income received on pooled cash accrues to the General Fund. Cash and cash equivalents applicable to a particular fund are readily identifiable. The State has invested the majority of its excess Compact Funds in a pooled investment fund which is managed under the control of the Federated Development Authority, an entity comprised of the FSM National Government and its four component states. Investment income originating from the pool accrues to the General Fund.

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

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

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

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

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

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

A. Deposits

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

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

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

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

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.

**STATE OF POHNPEI
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 primary government's total cash and cash equivalents were \$2,705,987 and the corresponding bank balances were \$3,811,722, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2007, bank deposits in the amount of \$200,000 were FDIC insured. The State does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

B. Investments

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

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

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

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

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

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

Fixed income securities:	
Domestic fixed income	\$ <u>3,969,179</u>
Other investments:	
Domestic equities	8,590,504
Money market funds	707,838
Cash management account	<u>9,877,250</u>
	<u>19,175,592</u>
	\$ <u>23,144,771</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

B. Investments, Continued

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

	Credit Ratings	Investment Maturities (In Years)				Fair Value
		Less Than 1	1 to 5	6 to 10	Greater Than 10	
U.S. government obligations	Aaa	\$ 96,266	\$ 376,489	\$ 439,203	\$ 196,861	\$ 1,108,819
U.S. government agency obligations	Aaa	128,675	250,006	14,286	1,277,317	1,670,284
Corporate notes and bonds	Aaa	-	42,418	-	214,744	257,162
Corporate notes and bonds	Aa1	-	43,260	43,115	13,138	99,513
Corporate notes and bonds	Aa2	-	9,505	11,497	11,318	32,320
Corporate notes and bonds	Aa3	43,700	91,887	63,299	14,373	213,259
Corporate notes and bonds	A1	-	126,966	87,254	27,686	241,906
Corporate notes and bonds	A2	-	93,418	6,043	3,740	103,201
Corporate notes and bonds	A3	-	-	4,687	2,818	7,505
Corporate notes and bonds	AB	177	-	-	-	177
Corporate notes and bonds	Baa1	-	-	101,888	8,018	109,906
Corporate notes and bonds	Baa2	-	5,916	11,636	-	17,552
Corporate notes and bonds	Baa3	-	24,611	-	34,291	58,902
Corporate notes and bonds	WR	12,822	-	11,490	-	24,312
Corporate notes and bonds	Not rated	-	-	-	24,361	24,361
		<u>\$ 281,640</u>	<u>\$ 1,064,476</u>	<u>\$ 794,398</u>	<u>\$ 1,828,665</u>	<u>\$ 3,969,179</u>

As of September 30, 2007, the Compact Capital Projects Fund holds 19% of the shares of the Pacific Islands Development Bank, which is carried at a cost of \$1,000,000 as the market value of these shares is difficult to assess since they are not publicly traded. Additionally, the State acquired an interest in an airline during fiscal year 2004 and recorded an impairment of such investment in the same period. Financial statements from the investee are not currently available.

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

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

**STATE OF POHNPEI
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.

(3) Receivables

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

	<u>General</u>	Section 211 Sector <u>Grant</u>	Compact Other <u>Grants</u>	U.S. Federal <u>Grants</u>	Compact Trust	Other Governmental <u>Funds</u>	<u>Total</u>
Receivables:							
FSM National Government	\$ -	\$ 539,853	\$ 347,448	\$ 1,521,775	\$ -	\$ 21,662	\$ 2,430,738
Taxes	1,701,127	-	-	-	-	9,830	1,710,957
Other	<u>4,006,521</u>	-	-	<u>22,862</u>	-	<u>568,434</u>	<u>4,597,817</u>
	5,707,648	539,853	347,448	1,544,637	-	599,926	8,739,512
Less: allowance for uncollectibles	<u>(1,240,296)</u>	-	<u>(347,448)</u>	<u>(627,280)</u>	-	<u>(581,597)</u>	<u>(2,796,621)</u>
	<u>\$ 4,467,352</u>	<u>\$ 539,853</u>	<u>\$ -</u>	<u>\$ 917,357</u>	<u>\$ -</u>	<u>\$ 18,329</u>	<u>\$ 5,942,891</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 determined that an additional provision was required for receivables within the General Fund in the amount of \$984,713. Accordingly, such has been reflected as a special item within the accompanying financial statements.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(3) Receivables, Continued

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

	Pohnpei Utilities Corporation	Pohnpei Port Authority	Pohnpei Fisheries Corporation	Pohnpei Transportation Authority	Small Business Guarantee and Finance Corporation	Pohnpei Economic Development Authority	Pohnpei State Housing Authority	Total
Receivables:								
General	\$4,352,671	\$1,064,554	\$ -	\$ 932,375	\$ 5,320	\$ 331,213	\$6,049,588	\$12,735,721
Other	<u>159,609</u>	<u>38,618</u>	<u>-</u>	<u>-</u>	<u>5,893</u>	<u>688</u>	<u>241,379</u>	<u>446,187</u>
	4,512,280	1,103,172	-	932,375	11,213	331,901	6,290,967	13,181,908
Less: allowance for uncollectibles	<u>(2,321,143)</u>	<u>(566,389)</u>	<u>-</u>	<u>(776,626)</u>	<u>(3,407)</u>	<u>(314,506)</u>	<u>(6,159,855)</u>	<u>(10,141,926)</u>
	<u>\$2,191,137</u>	<u>\$ 536,783</u>	<u>\$ -</u>	<u>\$ 155,749</u>	<u>\$ 7,806</u>	<u>\$ 17,395</u>	<u>\$ 131,112</u>	<u>\$ 3,039,982</u>

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

(4) Interfund Receivables and Payables

Receivables and payables between funds reflected as due to/from other funds in the combined balance sheet at September 30, 2007, are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Compact Sector Grants	\$ 447,381
General	Compact Capital Projects	1,032,443
General	U.S. Federal Grants	764,905
General	Nonmajor government funds	890,831
Compact Sector Grants	General	1,136,858
Nonmajor governmental funds	General	<u>3,934,867</u>
		<u>\$ 8,207,285</u>

Receivables and payables between funds reflected as due to/from primary government in the statement of net assets at September 30, 2007, are summarized as follows:

<u>Discretely Presented Component Units</u>	<u>Due From</u>	<u>Due To</u>
Pohnpei Fisheries Corporation:		
Compact Capital Projects Fund	\$ -	\$ 2,450,000
Pohnpei Transportation Authority:		
General Fund	<u>-</u>	<u>922,724</u>
	<u>\$ -</u>	<u>\$ 3,372,724</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(4) Interfund Receivables and Payables, Continued

Receivables and payables between funds reflected as due to/from component units in the governmental funds balance sheet at September 30, 2007, are summarized as follows:

<u>Primary Government</u>	<u>Due From</u>	<u>Due To</u>
General Fund:		
Pohnpei Transportation Authority	\$ <u>922,724</u>	\$ <u> -</u>

The amount recorded as due from component units of the primary government of \$922,724 does not equal the corresponding due to primary government of the discretely presented component units of \$3,372,724 due to the recording of an allowance for uncollectible accounts of \$2,450,000 by the nonmajor governmental funds.

(5) Fixed Assets

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

	<u>Balance October 1, 2006</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance September 30, 2007</u>
Governmental activities:				
Capital assets, being depreciated:				
Buildings	\$ 6,294,579	\$ -	\$ (44,100)	\$ 6,250,479
Machinery, equipment and others	6,474,918	408,397	(95,578)	6,787,737
Infrastructure	<u>52,241,781</u>	<u>100,000</u>	<u>-</u>	<u>52,341,781</u>
Total capital assets, being depreciated	<u>65,011,278</u>	<u>508,397</u>	<u>(139,678)</u>	<u>65,379,997</u>
Less accumulated depreciation for:				
Buildings	(1,735,006)	(125,891)	44,100	(1,816,797)
Machinery, equipment and others	(5,308,385)	(496,877)	95,578	(5,709,684)
Infrastructure	<u>(29,478,236)</u>	<u>(1,731,859)</u>	<u>-</u>	<u>(31,210,095)</u>
	<u>(36,521,627)</u>	<u>(2,354,627)</u>	<u>139,678</u>	<u>(38,736,576)</u>
Governmental activities capital assets, net	\$ <u>28,489,651</u>	\$ <u>(1,846,230)</u>	\$ <u> -</u>	\$ <u>26,643,421</u>

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

General government	\$ 68,955
Department of Land and Natural Resources	9,331
Education	294,489
Health services	131,664
Public safety	48,023
Boards and commissions	<u>1,802,165</u>
	<u>\$ 2,354,627</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(6) Short-Term Debt

Discretely Presented Component Units

Notes payable by the discretely presented component units consist of the following at September 30, 2007:

Pohnpei Utilities Corporation (PUC)

Notes payable drawn on a bank line of credit of \$190,000 (line expiry March 24, 2008), interest at time certificate of deposit (TCD) rate plus 2% (5.94% at September 30, 2007), collateralized by TCD, due on January 22, 2008. \$ 190,000

Two \$104,000 notes drawn on a bank line of credit of \$850,000 (line expiry May 9, 2008), interest at bank prime rate plus 2% (9.75% at September 30, 2007), collateralized by TCD, due on November 27, 2008 and December 27, 2007, collateralized by equipment. 208,000

Note payable to an investment company, interest at 9.25% at September 30, 2007, collateralized by investments. 476,825

\$ 874,825

(7) Long-Term Obligations

Primary Government

Asian Development Bank (ADB) Early Retirement Program Loan

The State implemented an Early Retirement Scheme (ERS) in which employees holding certain nonessential positions as identified by the State were retired early with a payout of the equivalent of two-years wages. This ERS program is funded by a \$4,200,000 loan from the ADB through the FSM National Government. The activities of the ERS Program are recorded in the General Fund.

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

Funds for the repayment of the ADB loan are expected to be derived from the annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The Financing Agreement requires the State to continue to appropriate salaries for the abolished positions and deposit the appropriated funds into the ERS Trust Account. As of September 30, 2007, \$4,161,949 has been deposited to the Trust Account, which is restricted for the repayment of this debt, and the remaining amount of \$38,051 is included in the General Fund reserve for related assets.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(7) Long-Term Obligations, Continued

Asian Development Bank (ADB) Private Sector Development Program Loan

The State entered into an agreement with the Federated States of Micronesia National Government (FSM) to borrow a portion of the proceeds of the FSM Program Loan with ADB, for the purpose of promoting private sector development in Pohnpei, with interest at 1 to 1.5%.

As of September 30, 2007, an immaterial amount of drawdowns was received. The principal payments shall be made in 32 equal semi-annual payments beginning on May 15, 2011 and the last payment in November 15, 2026. As at September 30, 2007, total amount payable by the State under this program loan is \$321,067.

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	\$ 140,000	\$ 3,219	\$ 143,219
2009	140,000	3,219	143,219
2010	140,000	3,219	143,219
2011	160,153	5,542	165,695
2012	158,031	4,446	162,477
2013 – 2017	794,309	18,077	812,386
2018 – 2022	801,625	10,760	812,385
2023 – 2027	786,949	2,960	789,909
2028 – 2032	700,000	-	700,000
2033 – 2037	<u>700,000</u>	<u>-</u>	<u>700,000</u>
	<u>\$4,521,067</u>	<u>\$51,442</u>	<u>\$4,572,509</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	\$ <u>4,521,067</u>	\$ _____	\$ _____	\$ <u>4,521,067</u>	\$ <u>140,000</u>
Other:					
Compensated absences	872,367	482,755	477,525	877,597	196,113
Claims and litigation payable	<u>1,450,000</u>	<u>-</u>	<u>-</u>	<u>1,450,000</u>	<u>-</u>
	<u>2,322,367</u>	<u>482,755</u>	<u>477,525</u>	<u>2,327,597</u>	<u>196,113</u>
	\$ <u>6,843,434</u>	\$ <u>482,755</u>	\$ <u>477,525</u>	\$ <u>6,848,664</u>	\$ <u>336,113</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(7) Long-Term Obligations, Continued

Discretely Presented Component Units

A summary of long-term debt as of September 30, 2007, is as follows:

Pohnpei Utilities Corporation (PUC)

Amount drawn on a note payable to the State of Pohnpei, facilitated by an Asian Development Bank loan to the FSM, due in semi-annual installments of \$33,500 commencing February 28, 2007. The State of Pohnpei has not imposed collateralization on PUC and has waived its rights to receive 6.82% in interest. The loan agreement includes a 1% service charge to be added to the principal until installment payments commence. This service charge may be paid by PUC or by the State of Pohnpei. \$ 2,096,260

Loan payable to United States Department of Agriculture, Rural Utilities Service, due in monthly installments of \$2,654 commencing October 28, 2006. The loan is collateralized by a revenue bond. The loan bears a fixed interest rate of 4.5%. 569,552

Loan payable to FSM Development Bank, 5 year term, interest at 9%, collateralized by a \$150,000 time certificate of deposit. Pursuant to a loan agreement dated October 26, 2001, PUC is required to make monthly payments of both principal and interest in the amount \$10,379. A member of the PUC Board is also a member of management of the FSM Development Bank. 479,963

\$ 3,145,775

Pohnpei Fisheries Corporation (PFC)

Notes payable to Pohnpei Economic Development Corporation, uncollateralized and without interest, due in equal monthly installments beginning April 30, 1998 of \$20,000. \$ 40,000

Notes payable to Federated States of Micronesia Development Bank (FSMDB), collateralized by the existing assets of the Corporation, due in monthly installments of \$4,655, with 9% interest and a term of 4 years beginning June 2004, ending May 2007. 85,299

Notes payable to FSM National Government for amounts received under a conditional grant award, interest at 9% with no specified repayment term. 15,000

\$ 140,299

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(7) Long-Term Obligations, Continued

Discretely Presented Component Units, Continued

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	\$ 220,221	\$ 86,738	\$ 306,959
2009	200,938	77,460	278,398
2010	155,385	68,013	223,398
2011	165,664	57,734	223,398
2012	149,132	46,683	195,815
2013 – 2017	291,764	202,476	494,240
2018 – 2022	315,231	179,009	494,240
2023 – 2027	342,058	152,182	494,240
2028 – 2032	372,959	121,281	494,240
2033 – 2037	408,825	85,415	494,240
2038 – 2042	450,762	43,478	494,240
2043 – 2047	213,135	4,082	217,217
	<u>\$3,286,074</u>	<u>\$1,124,551</u>	<u>\$4,410,625</u>

During the year ended September 30, 2007, the following changes occurred in liabilities reported as part of the component units' 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	\$ 2,944,200	\$ 500,000	\$(158,126)	\$ 3,286,074	\$ 220,221
Other:					
Due to primary government	2,450,000	-	-	2,450,000	-
	<u>\$ 5,394,200</u>	<u>\$ 500,000</u>	<u>\$(158,126)</u>	<u>\$ 5,736,074</u>	<u>\$ 220,221</u>

(8) Contingencies and Commitments

Sick Leave

It is the policy of the State to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave as of September 30, 2007 is \$3,055,141.

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.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(8) Contingencies and Commitments, Continued

Federal Grants

The State participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed.

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

Loan Guarantees

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

Litigation

The State is party to several legal proceedings arising from governmental operations. Claims are filed with the State's Attorney General. Approved claims are usually paid under general appropriations to the affected government agency. The State Attorney General is of the opinion that the probable outcome of suits existing at September 30, 2007, is not predictable but could have a material impact on the accompanying financial statements. Such impact has currently been estimated to approximate \$1,450,000.

(9) Continuing Appropriations

Continuing appropriations as of September 30, 2007, are summarized as follows:

Major Governmental Funds

General Fund:

Each fiscal year, the Pohnpei State Legislature appropriates funds for various programs, municipal projects and other projects which are available until fully expended or project completion. \$ 288,529

Compact Other Grants Fund:

Each fiscal year, the Pohnpei State Legislature appropriates funds for capital projects and economic development projects. \$ 50,000

Nonmajor Governmental Funds

Each fiscal year, the Pohnpei State Legislature appropriates funds for various programs and other projects. \$ 1,187,858

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2007

(10) Self-Insurance Fund - Component Units

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

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

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

(11) FSM Development Bank Loan Funds

Compact Capital Account funds in an aggregate amount of \$1.7 million were transferred to the control of the FSM Development Bank (FSMDB) (a component unit of the FSM National Government) to be loaned out to borrowers from Pohnpei State mainly for economic development projects. The loan fund is administered by FSMDB in a Trust capacity. All loan decisions are made by management of the State. These loans are not controlled by the State and are not currently recorded in the accompanying financial statements. As of December 31, 2007 (FSMDB fiscal year end), the outstanding fund balance aggregated \$719,915.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2007

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	Budgeted Amounts		Actual -	Variance with Final Budget -
	Original	Final	Basis (see Note 1)	
Revenues:				
FSM revenue sharing	\$ 4,600,000	\$ 4,600,000	\$ 5,405,136	\$ 805,136
State taxes	2,712,000	2,712,000	2,312,615	(399,385)
Net increase in the fair value of investments	-	-	1,722,264	1,722,264
Other	-	-	314,753	314,753
Total revenues	<u>7,312,000</u>	<u>7,312,000</u>	<u>9,754,768</u>	<u>2,442,768</u>
Expenditures:				
Current:				
General government	3,420,280	3,657,202	3,332,424	324,778
Department of Land and Natural Resources	310,607	313,107	286,546	26,561
Department of Education	344,842	344,842	58,146	286,696
Department of Public Safety	1,105,197	1,105,197	1,108,433	(3,236)
Office of the Attorney-General	281,166	310,041	263,964	46,077
Other appropriations	1,400,957	1,524,846	1,314,152	210,694
Payments to Non-governmental Agencies	138,280	138,280	144,576	(6,296)
Grants to local governments	2,179,497	2,225,620	2,233,562	(7,942)
Total expenditures	<u>9,180,826</u>	<u>9,619,135</u>	<u>8,741,803</u>	<u>877,332</u>
Excess (deficiency) of revenues over expenditures	<u>(1,868,826)</u>	<u>(2,307,135)</u>	<u>1,012,965</u>	<u>3,320,100</u>
Other financing uses:				
Operating transfers out	-	-	(420,951)	(420,951)
Special item:				
Write-off of receivables	-	-	(984,713)	(984,713)
Net change in unreserved fund balance	<u>(1,868,826)</u>	<u>(2,307,135)</u>	<u>(392,699)</u>	<u>1,914,436</u>
Other changes in unreserved fund balance:				
Decrease in reserve for related assets	-	-	734,061	734,061
Decrease in reserve for Compact Programs	-	-	278,854	278,854
Increase in reserve for continuing appropriations	-	-	(72,822)	(72,822)
Unreserved fund balance at the beginning of the year	<u>8,451,379</u>	<u>8,451,379</u>	<u>8,451,379</u>	<u>-</u>
Unreserved fund balance at the end of the year	<u>\$ 6,582,553</u>	<u>\$ 6,144,244</u>	<u>\$ 8,998,773</u>	<u>\$ 2,854,529</u>

See accompanying notes to required supplementary information - budgetary reporting.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

(1) Budgetary Information

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

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

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

Net change in fund balance	\$ (436,720)
Decrease in reserve for encumbrances	<u>44,021</u>
Net change in unreserved fund balance	\$ <u>(392,699)</u>

For the year ended September 30, 2007, expenditures of the General Fund exceeded budget at the program area level (ei., the legal level of budgetary control) as follows:

<u>Program Area</u>	<u>Excess</u>
Department of Land- Director's Office	\$ 182
Division of Correction and Rehabilitation	\$ 9,688
Election Commissioner	\$ 830
Pohnpei State Housing Authority	\$ 9,159
USDA Rural Development	\$ 6,296

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2007

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	Special Revenue			Permanent	Other Governmental Funds	Total	
	General	Compact Sector Grants	Compact Other Grants	U.S. Federal Grants			Compact Trust
Expenditures:							
Salaries and wages	\$ 4,698,664	\$ 10,418,638	\$ -	\$ 1,267,603	\$ -	\$ 344,207	\$ 16,729,112
Grants and subsidies	2,443,536	-	-	-	-	-	2,443,536
Contractual services	77,360	1,133,094	-	183,342	-	821,497	2,215,293
Utilities	231,499	801,334	52,930	22,485	-	48,457	1,156,705
Supplies and materials	193,464	715,891	-	556,018	-	161,435	1,626,808
Books and library materials	-	976,848	-	-	-	-	976,848
Instructional materials	-	74,122	-	-	-	3,053	77,175
POL	200,812	125,392	259	67,178	-	193,197	586,838
Medical supplies	-	840,277	-	2,295	-	737,168	1,579,740
Medical referral	-	220,183	112,602	-	-	-	332,785
Scholarship and training	-	234,923	-	-	-	194,385	429,308
Capital outlay	164,571	375,888	-	130,898	-	58,053	729,410
Noncapitalized equipment and furniture	-	22,722	-	-	-	1,600	24,322
Travel	234,946	487,941	83,724	196,300	-	22,029	1,024,940
Grants and subsidies	-	123,939	-	-	-	-	123,939
Communications	99,160	134,349	-	9,049	-	4,144	246,702
Repairs and maintenance	31,731	65,373	-	9,088	-	12,194	118,386
Printing and reproduction	-	37,059	-	7,219	-	2,598	46,876
Freight	1,981	37,073	-	424	-	9,467	48,945
Rentals	6,550	12,659	-	111,841	-	762	131,812
Import tax	3,670	44,013	-	-	-	2,199	49,882
Official and housing allowance	181,159	49,940	-	8,990	-	3,660	243,749
Food stuffs	68,225	403,112	-	1,720	-	16,094	489,151
Insurance	70,874	3,696	-	-	-	-	74,570
Principal and interest payments	-	-	-	-	-	41,046	41,046
Dues, membership and contributions	-	-	-	450	-	5,067	5,517
Other	77,622	5,367	-	(205)	-	36,180	118,964
	<u>\$ 8,785,824</u>	<u>\$ 17,343,833</u>	<u>\$ 249,515</u>	<u>\$ 2,574,695</u>	<u>\$ -</u>	<u>\$ 2,718,492</u>	<u>\$ 31,672,359</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	<u>2007</u>	<u>2006</u>
Revenues:		
FSM revenue sharing	\$ 5,405,136	\$ 5,697,612
State taxes:		
Sales tax	2,005,680	2,293,026
Hotel tax	60,809	77,452
Tax penalties	246,126	145,057
	<u>2,312,615</u>	<u>2,515,535</u>
Net increase in the fair value of investments	<u>1,722,264</u>	<u>815,446</u>
Other revenues	<u>314,753</u>	<u>1,257,692</u>
Total revenues	<u>9,754,768</u>	<u>10,286,285</u>
Expenditures:		
Current:		
General government:		
Governor and staff	630,482	528,717
Department of Treasury and Administration	499,854	741,723
Judiciary Branch	569,483	350,937
Legislative Branch	1,643,476	1,602,165
	<u>3,343,295</u>	<u>3,223,542</u>
Department of Land and Natural Resources:		
Office of the Director	83,172	57,908
Division of Public Land	51,379	51,799
Division of Surveying and Mapping	154,407	157,758
	<u>288,958</u>	<u>267,465</u>
Department of Education:		
Division of Pre-School and Primary Education	2,805	-
Post-secondary education	55,341	-
	<u>58,146</u>	<u>-</u>
Department of Public Safety:		
Office of the Director	90,756	87,803
Division of Police and Security	759,276	750,926
Division of Correction and Rehabilitation	250,216	234,894
Division of Search and Rescue	7,419	5,000
	<u>1,107,667</u>	<u>1,078,623</u>
Office of the Attorney-General	<u>264,849</u>	<u>301,540</u>
Boards, Commissions and Other:		
Social Affairs	183,424	176,682
Economic Affairs	2,354	-
Transportation and Infrastructure	591,199	624,428
Environmental Protection Agency	13,750	-
Foreign Investment Board	57,655	-
Election Commissioner	67,498	54,740
Pohnpei Public Broadcasting Corporation	142,122	80,963
Public Land and Trustees	-	12,005
Pohnpei State Housing Authority	93,231	90,912
Pohnpei Ethics Commission	-	120
Health Care Plan Board	-	61,886
Pohnpei Economic Development Authority	24,535	-
Small Business Guarantee and Finance Corporation	82,530	-
Other	36,353	225,867
	<u>1,294,651</u>	<u>1,327,603</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	2007	2006
Expenditures, continued:		
Payments to Non-governmental Agencies:		
Pohnpei Public Library	52,463	52,463
Micronesia Legal Services Corporation	38,280	38,280
USDA Rural Development	103,953	94,929
	194,696	185,672
Grants to local governments	2,233,562	2,145,923
Total expenditures	8,785,824	8,530,368
Excess of revenues over expenditures	968,944	1,755,917
Other financing uses:		
Operating transfers out	(420,951)	-
Special item:		
Write-off of receivables	(984,713)	(205,766)
Net change in fund balance	(436,720)	1,550,151
Fund balance at the beginning of the year	10,821,855	9,271,704
Fund balance at the end of the year	\$ 10,385,135	\$ 10,821,855

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final		
Revenues:				
FSM revenue sharing:	\$ 4,600,000	\$ 4,600,000	\$ 5,405,136	\$ 805,136
State taxes:				
Sales tax	2,315,000	2,315,000	2,005,680	(309,320)
Hotel tax	260,000	260,000	60,809	(199,191)
Tax penalties	137,000	137,000	246,126	109,126
	<u>2,712,000</u>	<u>2,712,000</u>	<u>2,312,615</u>	<u>(399,385)</u>
Net increase in the fair value of investments	-	-	1,722,264	1,722,264
Other	-	-	314,753	314,753
Total revenues	<u>7,312,000</u>	<u>7,312,000</u>	<u>9,754,768</u>	<u>2,442,768</u>
Expenditures:				
Current:				
General government:				
Governor and staff	637,763	652,763	620,140	32,623
Department of Treasury and Administration	529,125	529,125	503,736	25,389
Judiciary Branch	465,500	676,088	564,955	111,133
Legislative Branch	1,787,892	1,799,226	1,643,593	155,633
	<u>3,420,280</u>	<u>3,657,202</u>	<u>3,332,424</u>	<u>324,778</u>
Department of Land and Natural Resources:				
Office of the Director	80,098	80,098	80,280	(182)
Division of Public Land	52,469	54,969	51,629	3,340
Division of Surveying and Mapping	178,040	178,040	154,637	23,403
	<u>310,607</u>	<u>313,107</u>	<u>286,546</u>	<u>26,561</u>
Department of Education:				
Division of Pre-School and Primary Education	100,000	100,000	2,805	97,195
Secondary Education	244,842	244,842	55,341	189,501
	<u>344,842</u>	<u>344,842</u>	<u>58,146</u>	<u>286,696</u>
Department of Public Safety:				
Office of the Director	93,719	93,719	90,647	3,072
Division of Police and Security	769,992	769,992	766,612	3,380
Division of Correction and Rehabilitation	241,486	241,486	251,174	(9,688)
	<u>1,105,197</u>	<u>1,105,197</u>	<u>1,108,433</u>	<u>(3,236)</u>
Office of the Attorney-General	<u>281,166</u>	<u>310,041</u>	<u>263,964</u>	<u>46,077</u>
Boards, Commissions and Other:				
Social Affairs	197,553	197,553	185,991	11,562
Transportation and Infrastructure	576,687	689,710	549,450	140,260
Election Commissioner	65,399	65,399	66,229	(830)
Pohnpei Public Broadcasting Corporation	159,884	170,750	144,133	26,617
Pohnpei Housing Authority	84,072	84,072	93,231	(9,159)
Other	317,362	317,362	275,118	42,244
	<u>1,400,957</u>	<u>1,524,846</u>	<u>1,314,152</u>	<u>210,694</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance</u>
	<u>Original</u>	<u>Final</u>		
Expenditures, continued:				
Payments to Non-Governmental Agencies:				
Micronesia Legal Services Corporation	38,280	38,280	38,280	-
USDA Rural Development	100,000	100,000	106,296	(6,296)
	<u>138,280</u>	<u>138,280</u>	<u>144,576</u>	<u>(6,296)</u>
Grants to local governments	2,179,497	2,225,620	2,233,562	(7,942)
Total expenditures	<u>9,180,826</u>	<u>9,619,135</u>	<u>8,741,803</u>	<u>877,332</u>
Excess (deficiency) of revenues over expenditures	(1,868,826)	(2,307,135)	1,012,965	3,320,100
Other financing uses:				
Operating transfers out	-	-	(420,951)	(420,951)
Special item:				
Write-off of receivables	-	-	(984,713)	(984,713)
Net change in unreserved fund balance	(1,868,826)	(2,307,135)	(392,699)	1,914,436
Other changes in unreserved fund balance:				
Decrease in reserve for related assets	-	-	734,061	734,061
Decrease in reserve for Compact programs	-	-	278,854	278,854
Increase in reserve for continuing appropriations	-	-	(72,822)	(72,822)
Unreserved fund balance at the beginning of the year	<u>8,451,379</u>	<u>8,451,379</u>	<u>8,451,379</u>	<u>-</u>
Unreserved fund balance at the end of the year	<u>\$ 6,582,553</u>	<u>\$ 6,144,244</u>	<u>\$ 8,998,773</u>	<u>\$ 2,854,529</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Combined Balance Sheet
Nonmajor Governmental Funds
September 30, 2007

	Other Special Revenue	Other Debt Service	Other Capital Projects	Total
<u>ASSETS</u>				
Investments	\$ 223,856	\$ -	\$ 2,689,324	\$ 2,913,180
Receivables, net:				
FSM National Government	9,987	-	-	9,987
Other	7,047	-	1,295	8,342
Due from other funds	3,410,644	206,391	317,832	3,934,867
Advances	1,340	-	-	1,340
Inventories	22,734	-	-	22,734
Restricted assets:				
Cash and cash equivalents	-	-	552,547	552,547
Investments	-	4,161,949	-	4,161,949
Total assets	\$ 3,675,608	\$ 4,368,340	\$ 3,560,998	\$ 11,604,946
<u>LIABILITIES AND FUND BALANCES</u>				
Liabilities:				
Accounts payable	\$ 16,828	\$ -	\$ 1,527	\$ 18,355
Other liabilities and accruals	1,603	-	3,198	4,801
Deferred revenue	27,486	-	-	27,486
Due to other funds	194,501	-	688,940	883,441
Total liabilities	240,418	-	693,665	934,083
Fund balances:				
Reserved for:				
Related assets	22,734	-	1,552,547	1,575,281
Encumbrances	328,434	-	211,845	540,279
Continuing appropriations	404,809	-	783,049	1,187,858
Debt service	-	4,161,949	-	4,161,949
Unreserved:				
Special revenue funds	2,679,213	-	-	2,679,213
Debt service fund	-	206,391	-	206,391
Capital projects funds	-	-	319,892	319,892
Total fund balances	3,435,190	4,368,340	2,867,333	10,670,863
Total liabilities and fund balances	\$ 3,675,608	\$ 4,368,340	\$ 3,560,998	\$ 11,604,946

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	Other Special Revenue	Other Debt Service	Other Capital Projects	Total
Revenues:				
Net increase in the fair value of investments	\$ -	\$ 352,446	\$ 12,833	\$ 365,279
CFSM grants	81,957	-	-	81,957
Fees and charges	496,383	-	-	496,383
Sales Tax	511,911	-	-	511,911
Other	325,236	-	-	325,236
	1,415,487	352,446	12,833	1,780,766
Expenditures by function:				
Current:				
General government	633,329	-	-	633,329
Education	194,385	-	-	194,385
Health services	819,853	-	-	819,853
Debt service	-	132,790	-	132,790
Capital projects	-	-	938,135	938,135
	1,647,567	132,790	938,135	2,718,492
Excess (deficiency) of revenues over (under) expenditures	(232,080)	219,656	(925,302)	(937,726)
Other financing sources:				
Operating transfers in	-	-	420,951	420,951
Special item:				
Write-off of receivables	-	-	(2,450,000)	(2,450,000)
Net change in fund balances	(232,080)	219,656	(2,954,351)	(2,966,775)
Fund balances at the beginning of the year	3,667,270	4,148,684	5,821,684	13,637,638
Fund balances at the end of the year	\$ 3,435,190	\$ 4,368,340	\$ 2,867,333	\$ 10,670,863

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	Other Special Revenue	Other Debt Service	Other Capital Projects	Total
Revenues:				
Net increase in the fair value of investments	\$ -	\$ 352,446	\$ 12,833	\$ 365,279
CFSM grants	81,957	-	-	81,957
Fees and charges	496,383	-	-	496,383
Sales tax	511,911	-	-	511,911
Other	325,236	-	-	325,236
Total revenues	1,415,487	352,446	12,833	1,780,766
Expenditures by account:				
Salaries and wages	92,528	-	251,679	344,207
Contractual services	401,566	-	419,931	821,497
Utilities	12,108	-	36,349	48,457
Supplies and materials	135,256	4,169	22,010	161,435
Instructional materials	-	-	3,053	3,053
POL	15,362	-	177,835	193,197
Medical supplies	737,168	-	-	737,168
Scholarship and training	194,385	-	-	194,385
Capital outlay	2,908	54,005	1,140	58,053
Noncapitalized equipment and furniture	-	-	1,600	1,600
Travel	22,029	-	-	22,029
Communications	(946)	-	5,090	4,144
Repairs and maintenance	2,411	-	9,783	12,194
Printing and reproduction	2,459	-	139	2,598
Freight	9,467	-	-	9,467
Rent	605	-	157	762
Import tax	1,174	1,025	-	2,199
Official and housing allowance	3,660	-	-	3,660
Food stuffs	8,316	-	7,778	16,094
Principal and interest payments	-	41,046	-	41,046
Dues, membership and contributions	3,500	-	1,567	5,067
Other	3,611	32,545	24	36,180
Total expenditures	1,647,567	132,790	938,135	2,718,492
Excess (deficiency) of revenues over (under) expenditures	(232,080)	219,656	(925,302)	(937,726)
Other financing sources:				
Operating transfers in	-	-	420,951	420,951
Special item:				
Write-off of receivables	-	-	(2,450,000)	(2,450,000)
Net change in fund balances	(232,080)	219,656	(2,954,351)	(2,966,775)
Fund balances at the beginning of the year	3,667,270	4,148,684	5,821,684	13,637,638
Fund balances at the end of the year	<u>\$ 3,435,190</u>	<u>\$ 4,368,340</u>	<u>\$ 2,867,333</u>	<u>\$ 10,670,863</u>

See Accompanying Independent Auditors' Report.

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

Combining Balance Sheet
September 30, 2007

	Section 221(b) Special Block Grant	Non-U.S. Grants	CFSM Grants	Agriculture Revolving	SVAP Revolving	Airport Operations	Recycling Revolving	Pave Road Maintenance
ASSETS								
Investments	\$ 223,856	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Receivables:								
FSM National Government	-	-	9,987	-	-	-	-	-
Other	-	-	1,145	-	-	-	-	-
Due from other funds	-	28,766	-	17,794	67	22,273	22,899	1,073,380
Advances	-	-	-	1,340	-	-	-	-
Inventories	-	-	-	22,734	-	-	-	-
Total assets	<u>\$ 223,856</u>	<u>\$ 28,766</u>	<u>\$ 11,132</u>	<u>\$ 41,868</u>	<u>\$ 67</u>	<u>\$ 22,273</u>	<u>\$ 22,899</u>	<u>\$ 1,073,380</u>
LIABILITIES AND FUND BALANCES (DEFICITS)								
Liabilities:								
Accounts payable	\$ 6,750	\$ 266	\$ -	\$ 681	\$ -	\$ -	\$ -	\$ -
Other liabilities and accruals	-	1,014	589	-	-	-	-	-
Deferred revenue	-	27,486	-	-	-	-	-	-
Due to other funds	179,868	-	10,544	-	-	-	-	-
Total liabilities	<u>186,618</u>	<u>28,766</u>	<u>11,133</u>	<u>681</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Fund balances (deficits):								
Reserved for:								
Related assets	-	-	-	22,734	-	-	-	-
Encumbrances	-	1,428	3,570	18,350	-	-	-	284,299
Continuing appropriations	-	-	-	-	-	-	-	404,809
Unreserved (deficit)	37,238	(1,428)	(3,571)	103	67	22,273	22,899	384,272
Total fund balances (deficits)	<u>37,238</u>	<u>-</u>	<u>(1)</u>	<u>41,187</u>	<u>67</u>	<u>22,273</u>	<u>22,899</u>	<u>1,073,380</u>
Total liabilities and fund balances (deficits)	<u>\$ 223,856</u>	<u>\$ 28,766</u>	<u>\$ 11,132</u>	<u>\$ 41,868</u>	<u>\$ 67</u>	<u>\$ 22,273</u>	<u>\$ 22,899</u>	<u>\$ 1,073,380</u>

See Accompanying Independent Auditors' Report.

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

Combining Balance Sheet, Continued
September 30, 2007

	Medical Supplies Revolving	Health Care Premiums	V6AH Revolving	Environmental Quality	Early Retirement	Special Police Fee	Fishing Fines	Public Lands Trust	Total
ASSETS									
Investments	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 223,856
Receivables:									
FSM National Government	-	-	-	-	-	-	-	-	9,987
Other	-	5,902	-	-	-	-	-	-	7,047
Due from other funds	-	1,220,149	-	202	-	62,112	706,559	256,443	3,410,644
Advances	-	-	-	-	-	-	-	-	1,340
Inventories	-	-	-	-	-	-	-	-	22,734
Total assets	<u>\$ -</u>	<u>\$ 1,226,051</u>	<u>\$ -</u>	<u>\$ 202</u>	<u>\$ -</u>	<u>\$ 62,112</u>	<u>\$ 706,559</u>	<u>\$ 256,443</u>	<u>\$ 3,675,608</u>
LIABILITIES AND FUND BALANCES (DEFICITS)									
Liabilities:									
Accounts payable	\$ 8,568	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 563	\$ -	\$ 16,828
Other liabilities and accruals	-	-	-	-	-	-	-	-	1,603
Deferred revenue	-	-	-	-	-	-	-	-	27,486
Due to other funds	2,549	-	1,540	-	-	-	-	-	194,501
Total liabilities	<u>11,117</u>	<u>-</u>	<u>1,540</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>563</u>	<u>-</u>	<u>240,418</u>
Fund balances (deficits):									
Reserved for:									
Related assets	-	-	-	-	-	-	-	-	22,734
Encumbrances	14,352	-	-	-	-	1,917	4,518	-	328,434
Continuing appropriations	-	-	-	-	-	-	-	-	404,809
Unreserved (deficit)	(25,469)	1,226,051	(1,540)	202	-	60,195	701,478	256,443	2,679,213
Total fund balances (deficits)	<u>(11,117)</u>	<u>1,226,051</u>	<u>(1,540)</u>	<u>202</u>	<u>-</u>	<u>62,112</u>	<u>705,996</u>	<u>256,443</u>	<u>3,435,190</u>
Total liabilities and fund balances (deficits)	<u>\$ -</u>	<u>\$ 1,226,051</u>	<u>\$ -</u>	<u>\$ 202</u>	<u>\$ -</u>	<u>\$ 62,112</u>	<u>\$ 706,559</u>	<u>\$ 256,443</u>	<u>\$ 3,675,608</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

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

	Section 221(b) Special Block Grant	Non-U.S. Grants	CFSM Grants	Agriculture Revolving	SVAP Revolving	Airport Operations	Recycling Revolving	Pave Road Maintenance
Revenues:								
CFSM grants	\$ -	\$ -	\$ 81,957	\$ -	\$ -	\$ -	\$ -	\$ -
Fees and charges	-	24,135	-	51,025	(3,551)	-	-	-
Sales tax	-	-	-	-	-	-	-	376,068
Other	-	34,792	-	-	-	-	-	-
Total revenues	<u>-</u>	<u>58,927</u>	<u>81,957</u>	<u>51,025</u>	<u>(3,551)</u>	<u>-</u>	<u>-</u>	<u>376,068</u>
Expenditures by function:								
Current:								
General government	-	14,284	81,957	45,335	1,291	-	-	410,363
Education	194,385	-	-	-	-	-	-	-
Health services	-	44,643	-	-	-	-	-	-
Total expenditures	<u>194,385</u>	<u>58,927</u>	<u>81,957</u>	<u>45,335</u>	<u>1,291</u>	<u>-</u>	<u>-</u>	<u>410,363</u>
Net change in fund balances (deficits)	(194,385)	-	-	5,690	(4,842)	-	-	(34,295)
Fund balances (deficits) at the beginning of the year	<u>231,623</u>	<u>-</u>	<u>(1)</u>	<u>35,497</u>	<u>4,909</u>	<u>22,273</u>	<u>22,899</u>	<u>1,107,675</u>
Fund balances (deficits) at the end of the year	<u>\$ 37,238</u>	<u>\$ -</u>	<u>\$ (1)</u>	<u>\$ 41,187</u>	<u>\$ 67</u>	<u>\$ 22,273</u>	<u>\$ 22,899</u>	<u>\$ 1,073,380</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

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

	Medical Supplies Revolving	Health Care Premiums	V6AH Revolving	Environmental Quality	Early Retirement	Special Police Fee	Fishing Fines	Public Lands Trust	Total
Revenues:									
CFSM grants	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 81,957
Fees and charges	350,218	-	27,279	-	-	47,277	-	-	496,383
Sales tax	-	135,843	-	-	-	-	-	-	511,911
Other	-	-	-	-	-	-	197,030	93,414	325,236
Total revenues	<u>350,218</u>	<u>135,843</u>	<u>27,279</u>	<u>-</u>	<u>-</u>	<u>47,277</u>	<u>197,030</u>	<u>93,414</u>	<u>1,415,487</u>
Expenditures by function:									
Current:									
General government	-	-	72	924	-	28,567	37,978	12,558	633,329
Education	-	-	-	-	-	-	-	-	194,385
Health services	775,210	-	-	-	-	-	-	-	819,853
Total expenditures	<u>775,210</u>	<u>-</u>	<u>72</u>	<u>924</u>	<u>-</u>	<u>28,567</u>	<u>37,978</u>	<u>12,558</u>	<u>1,647,567</u>
Net change in fund balances (deficits)	(424,992)	135,843	27,207	(924)	-	18,710	159,052	80,856	(232,080)
Fund balances (deficits) at the beginning of the year	<u>413,875</u>	<u>1,090,208</u>	<u>(28,747)</u>	<u>1,126</u>	<u>-</u>	<u>43,402</u>	<u>546,944</u>	<u>175,587</u>	<u>3,667,270</u>
Fund balances (deficits) at the end of the year	<u>\$ (11,117)</u>	<u>\$ 1,226,051</u>	<u>\$ (1,540)</u>	<u>\$ 202</u>	<u>\$ -</u>	<u>\$ 62,112</u>	<u>\$ 705,996</u>	<u>\$ 256,443</u>	<u>\$ 3,435,190</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

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

	Section 221(b) Special Block Grant	Non-U.S. Grants	CFSM Grants	Agriculture Revolving	SVAP Revolving	Airport Operations	Recycling Revolving	Pave Road Maintenance
Revenues:								
CFSM grants	\$ -	\$ -	\$ 81,957	\$ -	\$ -	\$ -	\$ -	\$ -
Fees and charges	-	24,135	-	51,025	(3,551)	-	-	-
Sales tax	-	-	-	-	-	-	-	376,068
Other	-	34,792	-	-	-	-	-	-
Total revenues	-	58,927	81,957	51,025	(3,551)	-	-	376,068
Expenditures by account:								
Salaries and wages	-	22,872	24,493	-	-	-	-	-
Contractual services	-	8,692	-	150	-	-	-	392,544
Utilities	-	300	8,898	-	-	-	-	-
Supplies and materials	-	4,590	7,723	45,267	1,291	-	-	17,214
POL	-	1,724	11,509	1,908	-	-	-	-
Medical supplies	-	-	-	-	-	-	-	-
Scholarship and training	194,385	-	-	-	-	-	-	-
Capital outlay	-	14,782	528	(12,402)	-	-	-	-
Travel	-	1,169	20,860	-	-	-	-	-
Communications	-	-	(946)	-	-	-	-	-
Repairs and maintenance	-	638	750	-	-	-	-	-
Printing and reproduction	-	-	-	187	-	-	-	-
Freight	-	161	75	8,624	-	-	-	-
Rentals	-	-	-	-	-	-	-	605
Import tax	-	-	-	1,102	-	-	-	-
Official and housing allowance	-	-	-	-	-	-	-	-
Food stuffs	-	249	8,067	-	-	-	-	-
Dues, membership and contributions	-	3,500	-	-	-	-	-	-
Other	-	250	-	499	-	-	-	-
Total expenditures	194,385	58,927	81,957	45,335	1,291	-	-	410,363
Net change in fund balances (deficits)	(194,385)	-	-	5,690	(4,842)	-	-	(34,295)
Fund balances (deficits) at the beginning of the year	231,623	-	(1)	35,497	4,909	22,273	22,899	1,107,675
Fund balances (deficits) at the end of the year	\$ 37,238	\$ -	\$ (1)	\$ 41,187	\$ 67	\$ 22,273	\$ 22,899	\$ 1,073,380

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

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

	Medical Supplies Revolving	Health Care Premiums	V6AH Revolving	Environmental Quality	Early Retirement	Special Police Fee	Fishing Fines	Public Lands Trust	Total
Revenues:									
CFSM grants	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 81,957
Fees and charges	350,218	-	27,279	-	-	47,277	-	-	496,383
Sales tax	-	135,843	-	-	-	-	-	-	511,911
Other	-	-	-	-	-	-	197,030	93,414	325,236
Total revenues	350,218	135,843	27,279	-	-	47,277	197,030	93,414	1,415,487
Expenditures by account:									
Salaries and wages	-	-	-	-	-	-	37,015	8,148	92,528
Contractual services	-	-	-	-	-	-	180	-	401,566
Utilities	-	-	-	900	-	2,000	-	10	12,108
Supplies and materials	37,435	-	-	-	-	21,008	-	728	135,256
POL	-	-	-	-	-	-	221	-	15,362
Medical supplies	737,168	-	-	-	-	-	-	-	737,168
Scholarship and training	-	-	-	-	-	-	-	-	194,385
Capital outlay	-	-	-	-	-	-	-	-	2,908
Travel	-	-	-	-	-	-	-	-	22,029
Communications	-	-	-	-	-	-	-	-	(946)
Repairs and maintenance	-	-	-	-	-	1,023	-	-	2,411
Printing and reproduction	-	-	-	24	-	2,236	-	12	2,459
Freight	607	-	-	-	-	-	-	-	9,467
Rentals	-	-	-	-	-	-	-	-	605
Import tax	-	-	72	-	-	-	-	-	1,174
Official and housing allowance	-	-	-	-	-	-	-	3,660	3,660
Food stuffs	-	-	-	-	-	-	-	-	8,316
Dues, membership and contributions	-	-	-	-	-	-	-	-	3,500
Other	-	-	-	-	-	2,300	562	-	3,611
Total expenditures	775,210	-	72	924	-	28,567	37,978	12,558	1,647,567
Net change in fund balances (deficits)	(424,992)	135,843	27,207	(924)	-	18,710	159,052	80,856	(232,080)
Fund balances (deficits) at the beginning of the year	413,875	1,090,208	(28,747)	1,126	-	43,402	546,944	175,587	3,667,270
Fund balances (deficits) at the end of the year	\$ (11,117)	\$ 1,226,051	\$ (1,540)	\$ 202	\$ -	\$ 62,112	\$ 705,996	\$ 256,443	\$ 3,435,190

See Accompanying Independent Auditors' Report.

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

Combining Balance Sheet
 September 30, 2007

	Health and Education Projects	Compact Capital Projects	Total
<u>ASSETS</u>			
Investments	\$ -	\$ 2,689,324	\$ 2,689,324
Receivables:			
Other	-	1,295	1,295
Due from other funds	317,832	-	317,832
Restricted assets:			
Cash and cash equivalents	-	552,547	552,547
	\$ 317,832	\$ 3,243,166	\$ 3,560,998
 <u>LIABILITIES AND FUND BALANCES</u>			
Liabilities:			
Accounts payable	\$ 335	\$ 1,192	\$ 1,527
Accrued liabilities	3,198	-	3,198
Due to other funds	-	688,940	688,940
Total liabilities	3,533	690,132	693,665
 <u>FUND BALANCES</u>			
Fund balances:			
Reserved for:			
Related assets	-	1,552,547	1,552,547
Encumbrances	57,161	154,684	211,845
Continuing appropriations	177,299	605,750	783,049
Unreserved	79,839	240,053	319,892
Total fund balances	314,299	2,553,034	2,867,333
Total liabilities and fund balances	\$ 317,832	\$ 3,243,166	\$ 3,560,998

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
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

	Health and Education Projects	Compact Capital Projects	Total
Revenues:			
Net increase in the fair value of investments	\$ -	\$ 12,833	\$ 12,833
Expenditures by function:			
Capital projects	575,171	362,964	938,135
Total expenditures	575,171	362,964	938,135
Deficiency of revenues under expenditures	(575,171)	(350,131)	(925,302)
Other financing sources:			
Operating transfers in	-	420,951	420,951
Special item:			
Write-off of receivables	-	(2,450,000)	(2,450,000)
Net change in fund balances	(575,171)	(2,379,180)	(2,954,351)
Fund balances at the beginning of the year	889,470	4,932,214	5,821,684
Fund balances at the end of the year	\$ 314,299	\$ 2,553,034	\$ 2,867,333

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
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

	Health and Education Projects	Compact Capital Projects	Total
Revenues:			
Net increase in the fair value of investments	\$ -	\$ 12,833	\$ 12,833
Expenditures by account:			
Salaries and wages	251,679	-	251,679
Contractual services	56,967	362,964	419,931
Utilities	36,349	-	36,349
Supplies and materials	22,010	-	22,010
Instructional materials	3,053	-	3,053
POL	177,835	-	177,835
Capital outlay	1,140	-	1,140
Noncapitalized equipment & furniture	1,600	-	1,600
Communications	5,090	-	5,090
Repairs and maintenance	9,783	-	9,783
Printing and reproduction	139	-	139
Rentals	157	-	157
Food stuffs	7,778	-	7,778
Dues membership, contribution	1,567	-	1,567
Other	24	-	24
Total expenditures	575,171	362,964	938,135
Deficiency of revenues under expenditures	(575,171)	(350,131)	(925,302)
Other financing sources:			
Operating transfers in	-	420,951	420,951
Special item:			
Write-off of receivables	-	(2,450,000)	(2,450,000)
Net change in fund balances	(575,171)	(2,379,180)	(2,954,351)
Fund balances at the beginning of the year	889,470	4,932,214	5,821,684
Fund balances at the end of the year	\$ 314,299	\$ 2,553,034	\$ 2,867,333

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
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)(1) Supplemental Education	Total
<u>ASSETS</u>							
Receivables:							
FSM National Government	\$ 50,397	\$ 9,371	\$ 305,362	\$ -	\$ 174,722	\$ -	\$ 539,852
Due from other funds	237,930	590,921	-	62,213	-	245,794	1,136,858
Advances	-	-	1,225	-	-	-	1,225
	<u>\$ 288,327</u>	<u>\$ 600,292</u>	<u>\$ 306,587</u>	<u>\$ 62,213</u>	<u>\$ 174,722</u>	<u>\$ 245,794</u>	<u>\$ 1,677,935</u>
<u>LIABILITIES AND FUND BALANCES</u>							
Liabilities:							
Accounts payable	\$ 63,995	\$ 136,664	\$ 5,561	\$ 19,386	\$ 7,495	\$ 41,756	\$ 274,857
Other liabilities and accruals	218,196	98,498	11,210	18,863	8,561	48,423	403,751
Deferred revenue	-	360,343	-	22,780	-	154,881	538,004
Due to other funds	-	-	289,279	-	158,102	-	447,381
Total liabilities	<u>282,191</u>	<u>595,505</u>	<u>306,050</u>	<u>61,029</u>	<u>174,158</u>	<u>245,060</u>	<u>1,663,993</u>
Fund balances:							
Reserved for:							
Encumbrances	60,072	73,621	34,105	26,924	14,627	146,529	355,878
Unreserved	(53,936)	(68,834)	(33,568)	(25,740)	(14,063)	(145,795)	(341,936)
Total fund balances	<u>6,136</u>	<u>4,787</u>	<u>537</u>	<u>1,184</u>	<u>564</u>	<u>734</u>	<u>13,942</u>
Total liabilities and fund balances	<u>\$ 288,327</u>	<u>\$ 600,292</u>	<u>\$ 306,587</u>	<u>\$ 62,213</u>	<u>\$ 174,722</u>	<u>\$ 245,794</u>	<u>\$ 1,677,935</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

SECTION 211 COMPACT SECTOR FUNDS

Combining Statement of Revenues, Expenditures by Function,
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)(1) Supplemental Education	Total
Revenues:							
Compact funding	\$ 7,514,975	\$ 4,687,053	\$ 460,022	\$ 718,076	\$ 625,825	\$ 3,337,882	\$ 17,343,833
	<u>7,514,975</u>	<u>4,687,053</u>	<u>460,022</u>	<u>718,076</u>	<u>625,825</u>	<u>3,337,882</u>	<u>17,343,833</u>
Expenditures by function:							
Current:							
General government	-	-	460,022	718,076	625,825	-	1,803,923
Education	7,514,975	-	-	-	-	3,337,882	10,852,857
Health services	-	4,687,053	-	-	-	-	4,687,053
Total expenditures	<u>7,514,975</u>	<u>4,687,053</u>	<u>460,022</u>	<u>718,076</u>	<u>625,825</u>	<u>3,337,882</u>	<u>17,343,833</u>
Net change in fund balances	-	-	-	-	-	-	-
Fund balances at the beginning of the year	<u>6,136</u>	<u>4,787</u>	<u>537</u>	<u>1,184</u>	<u>564</u>	<u>734</u>	<u>13,942</u>
Fund balances at the end of the year	<u>\$ 6,136</u>	<u>\$ 4,787</u>	<u>\$ 537</u>	<u>\$ 1,184</u>	<u>\$ 564</u>	<u>\$ 734</u>	<u>\$ 13,942</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

SECTION 211 COMPACT SECTOR FUNDS

Combining Statement of 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)(1) Supplemental Education	Total
Revenues:							
Compact funding	\$ 7,514,975	\$ 4,687,053	\$ 460,022	\$ 718,076	\$ 625,825	\$ 3,337,882	\$ 17,343,833
	<u>7,514,975</u>	<u>4,687,053</u>	<u>460,022</u>	<u>718,076</u>	<u>625,825</u>	<u>3,337,882</u>	<u>17,343,833</u>
Expenditures by account:							
Salaries and wages	5,648,920	2,506,062	294,166	399,365	361,662	1,208,463	10,418,638
Contractual services	105,069	146,625	5,340	71,878	146,728	657,454	1,133,094
Utilities	196,553	522,582	16,706	9,440	15,068	40,985	801,334
Supplies and materials	153,495	63,794	17,343	49,067	51,107	381,085	715,891
Books and library materials	963,574	-	-	-	-	13,274	976,848
Instructional materials	46,138	-	-	-	-	27,984	74,122
POL	31,933	13,693	12,388	2,162	8,359	56,857	125,392
Medical supplies	-	840,277	-	-	-	-	840,277
Medical referral	-	220,183	-	-	-	-	220,183
Scholarship and training	(11,593)	-	-	-	-	246,516	234,923
Capital outlay	49,500	121,542	7,975	31,130	6,600	159,141	375,888
Noncapitalized equipment and furniture	5,439	290	767	-	-	16,226	22,722
Travel	2,817	44,438	31,003	134,139	5,428	270,116	487,941
Grants and subsidies	68,249	500	50,300	890	-	4,000	123,939
Communications	32,566	17,565	16,619	10,954	15,571	41,074	134,349
Repairs and maintenance	15,631	9,945	1,641	1,368	3,001	33,787	65,373
Printing and reproduction	1,712	19,430	3,612	1,439	2,316	8,550	37,059
Freight	7,298	11,874	334	746	6,930	9,891	37,073
Rentals	-	8,217	1,908	22	-	2,512	12,659
Import tax	-	22,880	-	444	803	19,886	44,013
Official and housing allowance	400	47,720	(80)	-	2,240	(340)	49,940
Food stuffs	196,951	69,436	-	-	-	136,725	403,112
Insurance	-	-	-	-	-	3,696	3,696
Other	323	-	-	5,032	12	-	5,367
Total expenditures	<u>7,514,975</u>	<u>4,687,053</u>	<u>460,022</u>	<u>718,076</u>	<u>625,825</u>	<u>3,337,882</u>	<u>17,343,833</u>
Net change in fund balances	-	-	-	-	-	-	-
Fund balances at the beginning of the year	<u>6,136</u>	<u>4,787</u>	<u>537</u>	<u>1,184</u>	<u>564</u>	<u>734</u>	<u>13,942</u>
Fund balances at the end of the year	<u>\$ 6,136</u>	<u>\$ 4,787</u>	<u>\$ 537</u>	<u>\$ 1,184</u>	<u>\$ 564</u>	<u>\$ 734</u>	<u>\$ 13,942</u>

See Accompanying Independent Auditors' Report.

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

Honorable John Ehsa
Governor, State of Pohnpei
Federated States of Micronesia:

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Pohnpei as of and for the year ended September 30, 2007, which collectively comprise the State of Pohnpei's basic financial statements and have issued our report thereon dated June 16, 2008. Our report was modified to include a reference to other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of the Pohnpei Transportation Authority, the Small Business Guarantee and Finance Corporation, and the Pohnpei Economic Development Authority, as described in our report on the State of Pohnpei's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

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 Pohnpei Utilities Corporation, the Pohnpei Port Authority, the Pohnpei Fisheries Corporation and the Pohnpei State Housing Authority, 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 Pohnpei's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of Pohnpei's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Pohnpei'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 a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

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 accounting principles generally accepted in the United States of America 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 deficiency described in the accompanying Schedule of Findings and Questioned Costs (pages 82 through 89) as item 2007-03 to be a significant deficiency in internal control over financial reporting.

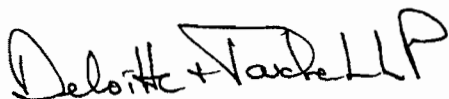
A *material weakness* is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of 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 internal control that might be significant deficiencies or material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Pohnpei's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

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



June 16, 2008

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

Honorable John Ehsa
Governor, State of Pohnpei
Federated States of Micronesia:

Compliance

We have audited the compliance of the State of Pohnpei with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2007. The State of Pohnpei's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (pages 80 and 81). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the State of Pohnpei's management. Our responsibility is to express an opinion on the State of Pohnpei's compliance based on our audit.

As discussed in Note 2b to the Schedule of Expenditures of Federal Awards, the State of Pohnpei'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; standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the State of Pohnpei's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the State of Pohnpei's compliance with those requirements.

As described in items 2007-1, 2007-3 and 2007-4 in the accompanying Schedule of Findings and Questioned Costs, the State of Pohnpei did not comply with requirements regarding procurement, and equipment and real property management that are applicable to its Compact of Free Association Sector Grants major program (CFDA # 15.875), and allowable costs/cost principles, and equipment and real property management that are applicable to its IDEA Special Education - Grants to States major program (CFDA # 84.027). Compliance with such requirements is necessary, in our opinion, for the State of Pohnpei to comply with requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the State of Pohnpei complied, in all material respects, with the requirements referred to above that are applicable to its Compact of Free Association Sector Grants major program (CFDA # 15.875) and its IDEA Special Education - Grants to States major program (CFDA # 84.027) for the year ended September 30, 2007. Also, in our opinion, the State of Pohnpei complied, in all material respects, with the requirements referred to above that are applicable to its Disaster Assistance Grant major program (CFDA # 83.516). The results of our auditing procedures also disclosed one other instance of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 as item 2007-2.

Internal Control Over Compliance

The management of the State of Pohnpei is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the State of Pohnpei's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the State of Pohnpei'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 2007-4 to be significant deficiencies.

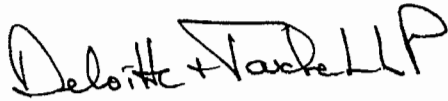
A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We did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

The State of Pohnpei'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 Pohnpei's response 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 Pohnpei as of and for the year ended September 30, 2007, and have issued our report thereon dated June 16, 2008. Our report was modified to include reference to other auditors. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the State of Pohnpei's basic financial statements. The accompanying schedule of expenditures of federal awards (pages 70 through 76) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the State of Pohnpei. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

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

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

June 16, 2008

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Agency/Program	Expenditures
U.S. Department of Agriculture	\$ 80,813
U.S. Department of the Interior	18,135,294
U.S. Department of Labor	2,154
U.S. Department of Homeland Security	473,270
U.S. Department of Education	1,139,199
U.S. Department of Health and Human Services	781,213
GRAND TOTAL	\$ 20,611,943
<u>Note:</u> All awards are received in a subgrantee capacity through the FSM National Government, except for the following, which are received directly from the grantor agency:	
Direct from the U.S. Department of Education:	
Freely Associated States Educational Grants	84.256A \$ <u>553</u>
Direct from the U.S. Department of Health and Human Services:	
Consolidated Health Centers (Community Health Centers, Migrant Health Centers, Health Care for the Homeless, Public Housing Primary Care and School Based Health Centers)	93.224 \$ <u>236,074</u>
Direct from University of Hawaii:	
CCPI Cancer Program	93.999 \$ <u>39,856</u>
Total Direct Grants	\$ 276,483
Reconciliation to the basic financial statements:	
U.S. Federal Grants Fund (page 13)	\$ 2,574,695
Section 211 Compact Sector Grant (page 13)	17,343,833
Compact Capital Projects Fund (page 60)	362,964
Compact Special Block Grants Fund (page 55)	194,385
Compact Other Grants Fund (page 13)	249,515
Total Direct Grants	(276,483)
Unallocated variance	163,034
	\$ 20,611,943

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF AGRICULTURE		
Cooperative Forestry Assistance	10.664	\$ 5,175
Urban and Community Forestry Program	10.675	31,375
Forest Stewardship Program	10.678	2,939
Rural Sanitation Project	10.999	<u>41,324</u>
U.S. DEPARTMENT OF AGRICULTURE TOTAL		<u>\$ 80,813</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF THE INTERIOR		
Economic, Social and Political Development of the Territories:	15.875	
Compact Capital Improvement Projects		\$ 249,515
Compact Energy Grants		52,930
Compact Health and Medical Grants		196,585
Compact Special Block Grants		194,387
Compact II Education Sector		7,514,975
Compact II Health Sector		4,687,053
Compact II Private Sector		460,022
Compact II Capacity Building Sector		718,076
Compact II Environment Sector		625,825
Compact II Supplemental Education		3,337,882
Technical Assistance:		
Survey and Mapping		3,025
PPA Runway Mower Unit		36,000
Historic Preservation Fund Grants-In-Aid	15.904	<u>59,019</u>
U.S. DEPARTMENT OF THE INTERIOR TOTAL		<u>\$ 18,135,294</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF LABOR		
WIA Adult Program	17.258	\$ 354
WIA Dislocated Worker	17.260	<u>1,800</u>
U.S. DEPARTMENT OF LABOR TOTAL		<u>\$ 2,154</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF HOMELAND SECURITY		
Disaster Assistance	83.516	<u>473,270</u>
U.S. DEPARTMENT OF HOMELAND SECURITY		<u>\$ 473,270</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF EDUCATION		
Special Education - Grants to States	84.027	\$ 1,128,578
Vocation Education-Basic Grants to the States	84.048B	10,068
Freely Associated States - Educational Grant Program	84.256A	<u>553</u>
U.S. DEPARTMENT OF EDUCATION TOTAL		<u>\$ 1,139,199</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES		
Maternal and Child Health Federal Consolidated Programs	93.110	\$ 14,018
Project Grants and Cooperative Agreements for Tuberculosis		
Control Programs	93.116	28,985
Family Planning - Services	93.217	90,773
Consolidated Health Centers	93.224	236,074
Immunization Grants	93.268	88,121
CDC & Prevention-Investigations & Technical Assistance	93.283	26,821
HIV Prevention Activities-Health Department Based	93.940	44,548
Block Grants for Prevention and Treatment of Substance Abuse	93.959	113,394
Preventive Health Services - Sexually Transmitted Diseases Control Grants	93.977	6,800
Cooperative Agreements for State-Based Diabetes Control		
Programs and Evaluation of Surveillance Systems	93.988	4,465
Preventive Health and Health Services Block Grant	93.991	10,360
Maternal and Child Health Services Block Grant to the States	93.994	76,998
CCPI Cancer Program	93.999	39,856
		<u>781,213</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES TOTAL		\$ 781,213
GRAND TOTAL		\$ 20,611,943

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

1. Scope

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

A. Programs Subject to Single Audit

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

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

2. Summary of Significant Accounting Policies

A. Basis of Accounting

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

B. Reporting Entity

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

C. Subgrantees

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

D. Indirect Cost Allocation

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

E. CFDA #15.875

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

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

3. Discretely Presented Component Units

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

Pohnpei Utilities Corporation

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

<u>Grantor/Program Title</u>	<u>CFDA #</u>	<u>Total Authorization</u>	<u>Receivable at Beginning of Year</u>	<u>Expenditures for the Year Ended Sept. 30, 2007</u>	<u>Cash Receipts for the Year Ended Sept. 30, 2007</u>	<u>Receivable at End of Year</u>
U.S. Department of the Interior:						
Office of Territorial and						
International Affairs:						
Operations and Maintenance						
Improvement Programs (OMIP):	15.875					
OMIP LT Training		\$ 25,000	\$ 3,312	\$ 9,200	\$ 12,512	\$ -
OMIP Strategic Plan		100,000	11,340	-	11,340	-
OMIP Tariff Study		50,000	38,650	-	38,650	-
OMIP Easy Power		50,000	-	50,000	50,000	-
OMIP Leak Detection		<u>20,000</u>	<u>-</u>	<u>20,000</u>	<u>20,000</u>	<u>-</u>
		<u>245,000</u>	<u>53,302</u>	<u>79,200</u>	<u>132,502</u>	<u>-</u>
Infrastructure Sector:						
	15.875					
Nanpil Hydro Rehabilitation Project		556,588	(39,832)	39,832	-	-
Pohnpei Water Well Drilling		<u>500,000</u>	<u>(95,499)</u>	<u>84,921</u>	<u>(10,528)</u>	<u>-</u>
		<u>1,056,588</u>	<u>(135,281)</u>	<u>124,753</u>	<u>(10,528)</u>	<u>-</u>
U.S. Department of Agriculture						
Rural Utilities Service						
Water and Waste Disposal Systems for						
Rural Communities Grant	10.760	<u>2,761,000</u>	<u>179,648</u>	<u>-</u>	<u>155,950</u>	<u>23,698</u>
		<u>\$ 4,062,588</u>	<u>\$ 97,669</u>	<u>\$ 203,953</u>	<u>\$ 277,924</u>	<u>\$ 23,698</u>

Note 1: The grant from RUS includes loan portion of \$578,000 and grant portion of \$2,183,000. Expenditures are first applied to the loan.

Note 2: The schedule of expenditures of federal awards is prepared on the accrual basis of accounting.

Note 3: The grants from U.S. DOI were received in a pass-through capacity. The grant from RUS was received in a direct recipient capacity.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Programs Selected For
Audit in Accordance with OMB Circular A-133
Year Ended September 30, 2007

<u>Grantor</u> <u>Program Title</u>	<u>CFDA No.</u>	2007 <u>Fiscal Year</u> <u>Expenditures</u>
<u>U.S. Department of the Interior</u>		
Compact of Free Association Compact II Sector Grants	15.875	
Compact II Education Sector		\$ 7,514,975
Compact II Health Sector		4,687,053
Compact II Private Sector		460,022
Compact II Capacity Building Sector		718,076
Compact II Environment Sector		625,825
Compact II Supplemental Education		<u>3,337,882</u>
Total Major Programs Under CFDA #15.875		<u>17,343,833</u>
<u>U.S. Department of Homeland Security</u>		
Disaster Assistance Grant	83.516	<u>473,270</u>
Total Major Programs Under U.S. Department of Homeland Security		<u>473,270</u>
<u>U.S. Department of Education</u>		
Special Education – Grants to States	84.027	<u>1,128,578</u>
Total Major Programs Under U.S. Department of Education		<u>1,128,578</u>
Total U.S. Federal program expenditures selected		\$ <u>18,945,681</u>
Total U.S. Federal program expenditures		\$ <u>20,611,943</u>
% of total U.S. Federal expenditures covered by major programs		<u>91%</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Part I - Summary of Auditors' Results

1. The Independent Auditor's Report on the financial statements, expressed an unqualified opinion.
2. Significant deficiencies in internal control over financial reporting were identified, none of which are considered to be material weaknesses.
3. Instances of noncompliance considered material to the financial statements were not disclosed by the audit.
4. Significant deficiencies in internal control over compliance with requirements applicable to major federal award programs were identified, none of which are considered to be material weaknesses.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. The State's major programs were:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
U.S. Department of the Interior - Compact of Free Association Compact II Sector Grants	15.875
U.S. Department of Homeland Security – Disaster Assistance Grants	83.516
U.S. Department of Education – Special Education – Grants to State	84.027

8. A threshold of \$618,358 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>
2007-3	Allowable Costs/Cost Principles

**STATE OF POHNPEI
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, Continued

<u>Reference Number</u>	<u>CFDA Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
2007-1	15.875	Procurement	\$ -
2007-2	15.875	Allowable Costs/Cost Principles	\$ -
2007-3	84.027	Allowable Costs/Cost Principles	\$ -
2007-4	15.875	Maintenance of Fixed Assets	\$ -
	84.027	Maintenance of Fixed Assets	\$ -

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Federal Award Findings and Questioned Costs Section

Finding No.: 2007-1
 CFDA No.: 15.875
 Grantor Agency: U.S. Department of the Interior
 Grant #: Compact II Sector Grants
 Program Name: Pohnpei State Government
 Requirement: Procurement
 Questioned Costs: \$0

Criteria:

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

Condition:

1. CFDA 15.875 Compact Sector Grants: For five (2%) of 100 non-payroll expenditures tested (\$357,403 of the aggregate amount of \$2,752,454), there was insufficient documentation to support competitive procurement requirements.

(i)	<u>Program</u>	<u>Expense Name</u>	<u>Date</u>	<u>Tran. No.</u>	<u>APV No.</u>	<u>Amount</u>
	1130007	Medical Supplies	11/21/2006	2479	3417	\$ 9,452
	1130007	Medical Supplies	11/21/2006	2480	3416	8,393
	1130007	Medical Supplies	11/21/2006	2481	4084	14,973
	1135007	Medical Supplies	11/21/2006	2484	3768	14,078
	1130007	Medical Supplies	11/22/2006	2632	3769	9,737
	1125007	Medical Supplies	11/29/2006	3080	4520	1,037
	1130007	Medical Supplies	11/29/2006	3064	4523	4,625
	1130007	Medical Supplies	11/29/2006	3064	4524	10,660
	1130007	Medical Supplies	11/29/2006	3069	4281	10,439
	1135007	Medical Supplies	11/29/2006	3069	4278	1,200
	1135007	Medical Supplies	11/29/2006	3069	4279	2,561
	1135007	Medical Supplies	11/29/2006	3069	4280	7,243
	1135007	Medical Supplies	11/29/2006	3082	4419	6,735
	1130007	Medical Supplies	11/30/2006	3183	3637	6,993
	1130007	Medical Supplies	11/30/2006	3183	3638	<u>16,410</u>
					Sub-total	<u>125,334</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Federal Award Findings and Questioned Costs Section

Finding No.: 2007-1, Continued

(ii)	1130007	Medical Supplies	1/23/2007	6653	12683	20,135
	1130007	Medical Supplies	1/23/2007	6653	12684	21,714
	1130007	Medical Supplies	1/23/2007	6653	12685	23,570
	1135007	Medical Supplies	1/23/2007	6653	12686	6,554
	1135007	Medical Supplies	1/23/2007	6653	12687	22,431
	1135007	Medical Supplies	1/29/2007	7011	13032	1,164
	1135007	Medical Supplies	2/1/2007	7283	5684	7,125
	1135007	Medical Supplies	2/1/2007	7290	5683	<u>2,784</u>
					Sub-total	<u>105,476</u>
(iii)	1130007	Medical Supplies	5/1/2007	12640	16611	21,528
	1130007	Medical Supplies	5/1/2007	12640	16628	10,439
	1130007	Medical Supplies	5/1/2007	12640	16629	7,926
	1130007	Medical Supplies	5/1/2007	12640	16630	7,657
	1130007	Medical Supplies	5/1/2007	12640	16631	14,510
	1150007	Medical Supplies	5/1/2007	12640	16492	7,843
	1135007	Medical Supplies	5/22/2007	13851	16847	19,319
	1135007	Medical Supplies	5/22/2007	13851	16848	21,140
	1130007	Medical Supplies	5/29/2007	14248	16627	<u>11,780</u>
					Sub-total	<u>122,142</u>
					Total	<u>\$352,952</u>
(iv)	1030007	Repairs & Maint	9/29/2007	21121	23504	<u>\$ 1,150</u>
(v)	1513005	Repairs & Maint	11/23/2006	2700	4432	<u>\$ 3,300</u>

- a. It appears that purchase of medical supplies exceeded State required open competitive bidding thresholds. There was no evidence of a formal competitive bid process (RFP) in the procurement files. Pohnpei State Government repeatedly solicited from the same three vendors as if this was subject to small purchase procurement requirements despite the grantor requirement that the same vendors not be routinely solicited from.
- b. The date that price quotations were obtained was not documented in the procurement files. Therefore, we were unable to determine whether compliance occurred with small purchase requirements.
- c. We were not able to determine how the vendor was selected as two bidders provided the same price quotations. The selection basis was not documented in the procurement file.

Cause:

There appears to be a lack of controls over ensuring compliance with applicable State and federal procurement standards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Federal Award Findings and Questioned Costs Section

Finding No.: 2007-1, Continued

Effect:

Noncompliance results from this condition due to insufficient competitive procurement documentation. However, no questioned costs result from this matter as the State subsequently charged the above costs to local funds and reimbursed the federal program.

Recommendation:

We recommend that Pohnpei State Government comply with State and federal procurement program requirements and strengthen its internal controls to ensure that adequate competitive procurement documentation is on file. If exceptions to procurement policies occur, they should be approved and be documented in file on a contemporaneous basis.

Auditee Response:

- a. We agree to the finding. As a corrective action, the procurement of medical supplies will be done through competitive bidding starting October 1, 2008. The Governor has instructed the Director of Treasury & Administration (DOTA) and the Director of Health Services to implement the RFPs that will cover six to twelve months period.
- b. The finding is well noted. The attached copy of memorandum from the Director of DOTA will ensure that this isolated case will not happen again.
- c. According to the Director of Education, the repair work was given to the chosen vendor who has the capability and the equipment to tow in the vehicle from Kitti. Although the justification was after the fact, DOE believes that their decision is reasonable and necessary on the circumstances surrounding the particular transaction. Nonetheless as corrective action; under the direction of the new Director, a policy has been in place where all financial and financial related documents have to be submitted to the DOE Fiscal officer for review prior to submission to Director for final action.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Federal Award Findings and Questioned Costs Section

Finding No.: 2007-2
CFDA No.: 15.875
Grantor Agency: U.S. Department of the Interior
Grant #: Compact II Sector Grants
Program Name: Pohnpei State Government
Requirement: Allowable Costs/Cost Principles and Procurement
Questioned Costs: \$0

Criteria:

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

Condition:

1. CFDA 15.875 Compact Sector Grants: For six of one hundred (6%) non-payroll expenditures tested (\$20,699 of the aggregate amount of \$2,752,454), the following expenditures were considered non-compliant with allowable costs/cost principles.

a.	Cmpt II Hlth Fund Hlth						
1110007	Admin FY07	82 32	Rental Services	3/28/2007	15834	\$1,500	
b.	Cmpt II Hlth Fund Medical		Professional				
1120007	Services FY07	83 20	Service	9/18/2007	23114	\$7,800	

- a. For item two, three prices were obtained. However, the purchase requisition was issued to a provider that did not submit a price quote.
- b. This expenditure relates to FY06 invoices. The expenditure ceiling for 2006 was reached and therefore, since no available federal funding source was found in 2006, the 2006 expenditures were charged to fiscal year 2007.

Cause:

There appears to be a control deficiency over ensuring that expenditures are in compliance with the criteria.

Effect:

Expenditures appear to be misstated and noncompliance with allowable costs/costs principles and procurement results from the condition. However, no questioned costs result from this finding as the State subsequently reimbursed the grantor for these disbursements.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Federal Award Findings and Questioned Costs Section

Finding No.: 2007-2, Continued

Recommendation:

We recommend that the State ensure that program expenditures are reasonable and necessary.

Auditee Response:

- a. The finding is well taken. The fund certification officer of the Department of Treasury & Administration is instructed to be cognizant of this type of situation to avoid the same incident from happening again in the future. A copy of the memorandum to this effect is attached.
- b. This finding is valid. By copy of the attached memorandum, the accounts payable manager and the fund certification officer of DOTA will not process any invoices that go beyond the period of availability. Incident as this case will be returned to the departments concerned so that the corresponding funding can be secured to settle the liability.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Federal Award Findings and Questioned Costs Section

Finding No.: 2007-3
CFDA No.: 84.027
Grantor Agency: U.S. Department of Education
Program Name: Special Education – Grants to States
Requirement: Allowable Costs/Cost Principles
Questioned Cost: \$0

Criteria:

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

Condition:

CFDA 84.027 Compact Sector Grants: For four of fifty nine (7%) non-payroll expenditures tested (\$36,803 of the aggregate amount of \$521,394), the expenditure was considered non-compliant with allowable costs and cost principle requirements.

A4 20 60-60-20010-07 8228	20 82 28	POL	1/12/2007	\$6,000	4729
A4 20 60-60-20010-07 8228	20 82 28	POL	11/24/2006	5,994	4731
A4 20 60-60-20010-07 8228	20 82 28	POL	7/31/2007	5,665	20862
A4 20 60-60-20010-07 8228	20 82 28	POL	3/14/2007	1,966	14886
A4 20 60-60-20010-07 8228	20 82 28	POL	6/11/07	9,380	18631
A4 20 60-60-20010-07 8228	20 82 28	POL	4/20/07	7,798	16704

Based on available documentation, we were not able to verify whether the above fuel purchases solely benefited the program or if such costs should have been allocated to other non-federal program funds.

Cause:

There appears to be a control deficiency over ensuring that expenditures are appropriately allocated to the benefited programs.

Effect:

No questioned costs result from this finding as in June 2008, program management provided documentation justifying the allocation of at least the above stated dollar amount of fuel for program use.

Recommendation:

We recommend that contemporaneous data be on file to document the federal share of expenditures when underlying expenditures are not solely for program use. The purpose of such documentation is to ensure that the federal program is not being charged for costs that should be borne by local or other federal programs.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Federal Award Findings and Questioned Costs Section

Finding No.: 2007-3, Continued

Auditee Response:

DOE just like other departments purchase fuel at the Pohnpei Transportation Authority (PTA). When fueling, a blanket purchase order is processed through the Department of Treasury & Administration. Once a purchase order is issued, the assigned staff of the DOE including the Special Education Program staff prepares fuel slips (bearing the plate number of the bus) that are reviewed and authorized by the Director. Once the fuel slips are signed, the bus drivers bring the slip to PTA for fueling. At PTA, no bus driver is allowed to get fuel without the authorized slips.

As an additional control, DOE also maintains log books that keep track of the bus routes as well as the estimated mileage usage. Furthermore, the Special Education Coordinator and his designated fuel issuance staff are working with the high school and elementary principals to map out the most reasonable routes for special education bus drivers based on location or residency of the special education students.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Federal Award Findings and Questioned Costs Section

Finding No.: 2007-4
CFDA No.: 15.875
Grantor Agency: U.S. Department of the Interior
Program Name: Compact Sector Grants
Requirement: Maintenance of Fixed Assets
Questioned Cost: \$0

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

Criteria:

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

Condition:

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

Cause:

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

Effect:

The expected life of fixed assets may be lessened. However, no questioned costs result from this finding as no specific instances came to our attention in fiscal year 2007 of unnecessary expenditures that occurred due to this condition.

Prior Year Status:

Noncompliance with maintenance of fixed assets was reported as a finding in the fiscal year 2006 single audit.

Recommendation:

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

Auditee Responses:

The resolution of the above finding will begin in October 2008. The attached copy of the memorandum from the Director of Treasury & Administration will address the finding. In addition, the Director of DOTA will work with the Attorney General to delineate the State's liability when accepting donated assets.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

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

	Questioned Costs Set Forth in Prior Audit Report <u>2006</u>	Questioned Costs Resolved in Fiscal Year <u>2007</u>	Questioned Costs at <u>September 30, 2007</u>
Questioned Costs FY 07	\$ <u>-</u>	\$ <u>-</u>	\$ <u>-</u>