

Financial Statements

FEDERATED STATES OF MICRONESIA
ASIAN DEVELOPMENT BANK
LOAN 1874 FSM (SF)

SEPTEMBER 30, 2007

FEDERATED STATES OF MICRONESIA
ASIAN DEVELOPMENT BANK LOAN 1874 FSM (SF)
SEPTEMBER 30, 2007

CONTENTS

	<u>Page</u>
INDEPENDENT AUDITORS' REPORT	1
FINANCIAL STATEMENT	
Statement of Project Account	3
Notes to Financial Statement	4
INTERNAL CONTROLS AND COMPLIANCE MATTERS	
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards.	6

INDEPENDENT AUDITORS' REPORT

His Excellency Manni Mori, FSM President
The Honorable Members of the FSM Congress
Palikir, Pohnpei
Federated States of Micronesia 96941

We have audited the accompanying statement of project account of the Federated States of Micronesia Asian Development Bank Loan 1874-FSM (SF) (the Project) as of and for the year ended September 30, 2007. This financial statement is the responsibility of the Project's management. Our responsibility is to express an opinion on this financial statement based on our audit. Certain prior data, as discussed in note 6, which formed part of the cumulative totals were audited by Deloitte Touche Tohmatsu and the Office of the National Public Auditor Federated States of Micronesia. The reports on 2004 and 2003 financial statements issued by Deloitte Touche Tohmatsu dated April 12, 2005 and September 15, 2004, respectively, expressed an unqualified opinion on those financials. The reports on 2006 and 2005 financial statements issued by the Office of the National Public Auditor Federated States of Micronesia dated August 2, 2007 and December 2, 2005, respectively, expressed an unqualified opinion on those financials.

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 assurance about whether the financial statement is free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 2, this financial statement was prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statement referred to above presents fairly, in all material respects, the cash receipts and disbursements of the Project for the year ended September 30, 2007 on the basis of accounting described in note 2.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 15, 2008, on our consideration of the Federated States of Micronesia Asian Development Bank Loan 1874 FSM (SF)'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.

RC Nolsinger Associates, P.C.

Wexford, Pennsylvania

February 15, 2008

FEDERATED STATES OF MICRONESIA
 ASIAN DEVELOPMENT BANK LOAN 1874 FSM (SF)
 STATEMENT OF PROJECT ACCOUNT
 YEAR ENDED SEPTEMBER 30, 2007 AND CUMULATIVE

	Fiscal Year 2007			Cumulative (Audited – Note 6)		
	ADB Share	FSM Share	Total	ADB Share	FSM Share	Total
Cash Receipts:						
Loan Proceeds - Direct	\$ 1,098,136	\$ -0-	\$ 1,098,136	\$ 3,634,216	\$ -0-	\$ 3,634,216
Loan Proceeds - Imprest Account	404,743	-0-	404,743	1,286,142	-0-	1,286,142
Contributions from FSM	<u>-0-</u>	<u>18,287</u>	<u>18,287</u>	<u>-0-</u>	<u>96,169</u>	<u>96,169</u>
Total Cash Receipts	1,502,879	18,287	1,521,166	4,920,358	96,169	5,016,527
Cash Disbursements:						
Civil Works						
Secured Transactions	-0-	-0-	-0-	45,720	-0-	45,720
Land Administration and Management	210,070	-0-	210,070	574,243	-0-	574,243
Small Business Development Center	310,874	-0-	310,874	476,397	-0-	476,397
FSMDB Strengthening	-0-	-0-	-0-	-0-	-0-	-0-
Project Implementation Unit	-0-	-0-	-0-	-0-	-0-	-0-
Equipment and Materials						
Land Administration and Management	381,144	-0-	381,144	748,524	302	748,826
Project Implementation Unit	3,500	-0-	3,500	18,980	-0-	18,980
Small Business Development Center	-0-	-0-	-0-	11,439	-0-	11,439
FSMDB Strengthening	-0-	-0-	-0-	173,543	-0-	173,543
Consulting Services						
Secured Transactions	74,758	-0-	74,758	272,364	-0-	272,364
Land Administration and Management	458,356	-0-	458,356	1,349,879	-0-	1,349,879
Small Business Development Center	-0-	-0-	-0-	57,334	-0-	57,334
FSMDB Strengthening	-0-	-0-	-0-	364,669	-0-	364,669
Project Implementation Unit	17,900	-0-	17,900	600,589	-0-	600,589
Audit	-0-	-0-	-0-	7,000	-0-	7,000
Operating Costs	<u>48</u>	<u>18,287</u>	<u>18,335</u>	<u>346</u>	<u>95,867</u>	<u>96,213</u>
Total Cash Disbursements	<u>1,456,650</u>	<u>\$ 18,287</u>	<u>1,474,937</u>	<u>4,701,027</u>	<u>\$ 96,169</u>	<u>4,797,196</u>
Net Change in Cash	46,229		46,229	219,331		219,331
Cash at Beginning of Period	<u>173,102</u>		<u>173,102</u>	<u>-0-</u>		<u>-0-</u>
Cash at End of Period	<u>\$ 219,331</u>		<u>\$ 219,331</u>	<u>\$ 219,331</u>		<u>\$ 219,331</u>

The accompanying notes are an integral part of this financial statement.

FEDERATED STATES OF MICRONESIA
ASIAN DEVELOPMENT BANK LOAN 1874 FSM (SF)
NOTES TO FINANCIAL STATEMENT
SEPTEMBER 30, 2007

NOTE 1 - ORGANIZATION

On January 24, 2002, the Federated States of Micronesia (FSM) National Government entered into a loan agreement (Loan Number 1874 FSM (SF) (the Project)) with the Asian Development Bank (ADB) in the amount equivalent to Special Drawing Rights (SDR) 6,273,000 for the purpose of developing the private sector of the Federated States of Micronesia. The accumulated drawn amount for this loan is U.S. \$4,920,358 as of September 30, 2007. The FSM National Government Department of Finance and Administration is the Project Executing Agency and is responsible for the establishment of the ADB Imprest Account to facilitate the implementation of the Project through the timely release of funds. The FSM National Government Department of Economic Affairs is the Implementing Agency and is responsible for the carrying out of the Project, including authorization of payments to be made from the Imprest Account. The Imprest Account is required to be operated and liquidated in accordance with ADB regulations. The accompanying statement of project account is prepared for the year ended September 30, 2007, and solely incorporates the activities of the Project.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES

Basis of Accounting - The Project's policy is to maintain its accounts and prepare its financial statement on the cash receipts and disbursements basis of accounting. All transactions are recognized as receipts or disbursements. Non-cash transactions are not recognized. The cash basis differs from accounting principles generally accepted in the United States of America primarily because receipts/revenues are recognized when received rather than when earned and disbursements/expenses are recognized when paid rather than when the obligation is incurred.

Cash - For the purpose of the statement of project account, the Project considers cash to be cash in deposit accounts. As of September 30, 2007, the carrying amount of the Project's total cash was \$219,331 which is maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2007, \$100,000 of the Project's deposits were FDIC insured.

NOTE 3 - ADB IMPREST FUND ACCOUNT

A reconciliation of the ADB Imprest Account to cash as of September 30, 2007 is as follows:

ADB Imprest Account Bank Balance as of September 30, 2007	\$ 224,031
Less: Outstanding checks	<u>(4,700)</u>
	<u>\$ 219,331</u>

FEDERATED STATES OF MICRONESIA
ASIAN DEVELOPMENT BANK LOAN 1874 FSM (SF)
NOTES TO FINANCIAL STATEMENT - CONTINUED
SEPTEMBER 30, 2007

NOTE 4 - FSM CONTRIBUTIONS

Under the provisions of the loan agreement, FSM is required to provide counterpart funding for expenditures incurred under certain categories of the Project. During the year FSM made available the amount of \$18,287 in counterpart funding. The accumulated amount as of September 30, 2007 for the said counterpart funding is \$96,169.

Additional in-kind assistance was provided in terms of an office for the Project Implementation Unit, and staff assistance in both the National and State governments. A monetary value for this assistance has not been computed and is therefore not included in the accompanying statement of project account.

NOTE 5 - COMPLIANCE WITH THE DEBT COVENANTS

Management is of the opinion that compliance with applicable debt covenants has occurred.

NOTE 6 - CUMULATIVE AMOUNTS

The amounts in the cumulative cash receipts columns were calculated using the Deloitte Touche Tohmatsu's audited Financial Statements for Fiscal Years 2004 and 2003 dated April 12, 2005 and September 15, 2004, respectively, with unqualified opinion on those financials and using the National Public Auditor's audited Financial Statements for Fiscal Years 2006 and 2005, dated August 2, 2007 and December 2, 2005, respectively, with unqualified opinion on those financials and using this report for Fiscal Year 2007. The amounts in the cumulative cash disbursement subcategories were calculated using audited reports from the loan project manager for Fiscal Years 2003, 2004, 2005, 2006, and this report for Fiscal Year 2007. The total cash disbursements in the cumulative columns agree with the calculation of total cash disbursements using the predecessor auditor's audited Financial Statements for Fiscal Years 2003, 2004, 2005, 2006, and this report for Fiscal Year 2007.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

His Excellency Manni Mori, FSM President
The Honorable Members of the FSM Congress
Palikir, Pohnpei
Federated States of Micronesia 96941

We have audited the financial statement of project account of the Federated States of Micronesia Asian Development Bank Loan 1874-FSM (SF) (the Project) as of and for the year ended September 30, 2007, and have issued our report thereon dated February 15, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

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 Project's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Project's financial statement that is more than inconsequential will not be prevented or detected by the Project's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statement will not be prevented or detected by the Project'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. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

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

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

RC Holsinger Associates, P.C.

Wexford, Pennsylvania
February 15, 2008