

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

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**YEAR ENDED SEPTEMBER 30, 2011**

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

YEAR ENDED SEPTEMBER 30, 2011

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

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**YEAR ENDED SEPTEMBER 30, 2011**

## **INDEPENDENT AUDITORS' REPORT**

His Excellency Emmanuel Mori  
President  
Federated States of Micronesia:

We have audited the accompanying financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Federated States of Micronesia (FSM) National Government as of and for the year ended September 30, 2011, which collectively comprise the FSM National Government's basic financial statements as set forth in Section II of the foregoing table of contents. These financial statements are the responsibility of the management of the FSM National Government. Our responsibility is to express an opinion on the respective financial statements based on our audit. We did not audit the financial statements of Caroline Islands Air, Inc., which represents 0.1%, 0.1% and 0.3%, respectively, of the assets, net assets and operating revenues of the FSM National Government's discretely presented component units. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for Caroline Islands Air, Inc., is based solely on the report 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 FSM National Government's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material aspects, the respective financial position of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the FSM National Government as of September 30, 2011, 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.

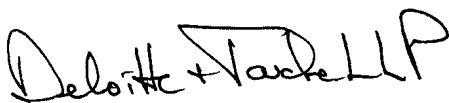
As discussed in Note 12 to the financial statements, the beginning net assets of the governmental activities has been restated to correct a misstatement.

As discussed in Note 1 to the financial statements, during the year ended September 30, 2011, the FSM National Government adopted Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 30, 2012, on our consideration of the FSM National Government's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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.

The Management's Discussion and Analysis, on pages 3 through 11, as well as the Schedule of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual - General Fund and notes thereto, as set forth in Section III of the foregoing table of contents, 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 FSM National Government. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

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

  
June 30, 2012

FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT

Management's Discussion and Analysis  
September 30, 2011

This discussion and analysis of the FSM National Government's financial performance provides an overview of the financial activities of the FSM National Government for the year ended September 30, 2011, and of the financial position of the FSM National Government at September 30, 2011. This report is to be read in conjunction with the financial statements of the FSM National Government which begin on page 12. Fiscal Year 2010 comparative information has been included, where appropriate. This MD&A is prepared in compliance with GASB-34 requirement. GASB Statement No. 54, "Fund Balance Reporting and Governmental Fund Type Definitions" was implemented, effective for the fiscal year ending September 30, 2011. This Statement establishes new categories for reporting fund balance and revises the definitions for governmental fund types. As a result of implementing this Statement, there were significant changes in the FSM National Government's fund structure. Funds that did not meet the new special revenue fund definition were moved to the General Fund.

### FINANCIAL HIGHLIGHTS

- For the fiscal year ended September 30, 2011, the FSM National Government has total net assets of \$218,340,487 (FY10 \$166,998,639 as restated). The increase is primarily due to the receipt of Compact Infrastructure Sector grants pertaining to infrastructure and construction in progress for airport improvements and infrastructure projects. Furthermore, the construction in progress is restated in the amount of \$7,523,038 to reflect prior year expenditures determined to be capitalizable in the current year.
- During the year, the FSM National Government expenses for governmental activities were \$51,997,110 (FY10 \$68,085,714) and were funded by program revenues of \$67,713,491 (FY10 \$72,921,120) and were further funded with taxes and other general revenues (excluding special items) that totaled \$34,903,562 (FY10 \$33,691,734).
- During the year, the FSM National Government wrote-off old receivables of \$3,896,617 (FY10 \$1,254,633).
- The net change in governmental funds increased by \$5,877,780 (FY10 increased by \$5,588,231). Total revenues reported are \$102,617,053 with total expenditures of \$102,957,791. Total proceeds from ADB loans are \$5,496,613.
- At September 30, 2011, the General Fund reported an unassigned surplus of \$1,851,719 (FY10 \$3,231,708). Of the total unassigned surplus, \$667,501 came from the excess of revenue against the projected budgeted amounts and the remaining \$1,184,218 came from unexpended appropriations in the budgetary expenditures, net of operating transfers in and out, write-off of old receivable balances and other changes in the unreserved fund balance. The summary and details of these amounts can be found on page 61 and pages 75-77, respectively.

### OVERVIEW OF THE FINANCIAL STATEMENTS

The Financial Statements for the year ended September 30, 2011 consist of four parts - management's discussion and analysis (this section), the basic financial statements, required supplementary information, and notes to financial statements.

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



FEDERATED STATES OF MICRONESIA  
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Management's Discussion and Analysis, Continued  
September 30, 2011

The Government-Wide Financial Statements

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

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

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

The Statement of Net Assets and the Statement of Activities are divided into two reporting units:

- **Governmental Activities** - Most of the FSM National Government's basic services are reported here. These include the services provided by the Executive Branch such as health, education, foreign affairs, transportation, resources and development, finance, the Attorney General's office, and general administration; the Judicial Branch; the Legislative Branch; other National Government programs; Boards and Commissions; and other legislative appropriations. These services are funded by Compact of Association funds, US Federal grants, FSM tax revenues, licenses, fees and investment earnings.
- **Components Units** – The FSM National Government has nine (9) component units namely, College of Micronesia - FSM, National Fisheries Corporation, FSM Telecommunications Corporation, FSM Development Bank, FSM Social Security Administration, the FSM Coconut Development Authority, FSM Petroleum Corporation, Mi Care Plan and the Caroline Islands Air, Inc. These component units are entities which are legally separate from the FSM National Government, but are financially accountable to the FSM National Government, or whose relationships with the FSM National Government is such that exclusion would cause the FSM National Government's basic financial statements to be misleading or incomplete.

Fund Financial Statements

The analysis of the FSM National Government's major funds begins on page 14. The Fund Financial Statements provide detailed information about the most significant funds - not the FSM National Government as a whole. Some funds are required to be established by FSM law. However, the FSM National Government establishes many other funds to help control and manage funds provided for particular purposes to see that expenditures meet the legal requirements for using certain taxes, grants, and other grant funds received from outsiders. The FSM National Government has two kinds of funds - government and fiduciary – each using different accounting approaches.

- **Government funds** - Most of the FSM National Government's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view of the FSM National Government general operations and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources

FEDERATED STATES OF MICRONESIA  
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Management's Discussion and Analysis, Continued  
September 30, 2011

that can be spent in the near future to finance the FSM National Government's program. We describe the relationship (or differences) between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds in reconciliation at the bottom of the page 14 and 16.

- Fiduciary funds - These funds are used to account for assets held by a Government unit in a trustee capacity for individuals, private organizations, and other governmental resources. This fund is used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent is that costs (expenses, including amortization and depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

**THE FSM NATIONAL GOVERNMENT AS A WHOLE**

Net assets may serve overtime as a useful indicator of a government's financial position. At the end of Fiscal Year 2011, the FSM National Government assets exceeded liabilities by \$218,340,487. Of the total net assets, \$189,687,538 is restricted as to purposes for which they may be used. The FSM National Government uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although the FSM National Government investments in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

Table 1 shows the schedule of the FSM National Government's net assets as of September 30, 2011 and 2010.

**Table 1 - Net Assets**

	<u>Governmental Activities</u>	
	<u>2011</u>	<u>2010</u>
Current Assets	\$ 64,848,621	\$ 68,223,997
Other Assets	58,497,486	46,063,195
Capital Assets	<u>175,384,128</u>	<u>126,277,486</u>
Total assets	<u>298,730,235</u>	<u>240,564,678</u>
Current Liabilities	26,508,179	23,230,954
Other Liabilities	<u>53,881,569</u>	<u>50,335,085</u>
Total Liabilities	<u>80,389,748</u>	<u>73,566,039</u>
Net Assets:		
Invested in capital assets	175,384,128	126,277,486
Restricted	14,303,410	22,278,421
Unrestricted	<u>28,652,949</u>	<u>18,442,732</u>
Net Assets	<u>\$218,340,487</u>	<u>\$166,998,639</u>

At the end of FY11, the FSM National Government unrestricted assets show a surplus of \$28,652,949 compared to \$18,442,732 at the end of FY10.

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Management's Discussion and Analysis, Continued  
September 30, 2011

Table 2 shows the changes in Net Assets of the FSM National Government for the years ended September 30, 2011 and 2010.

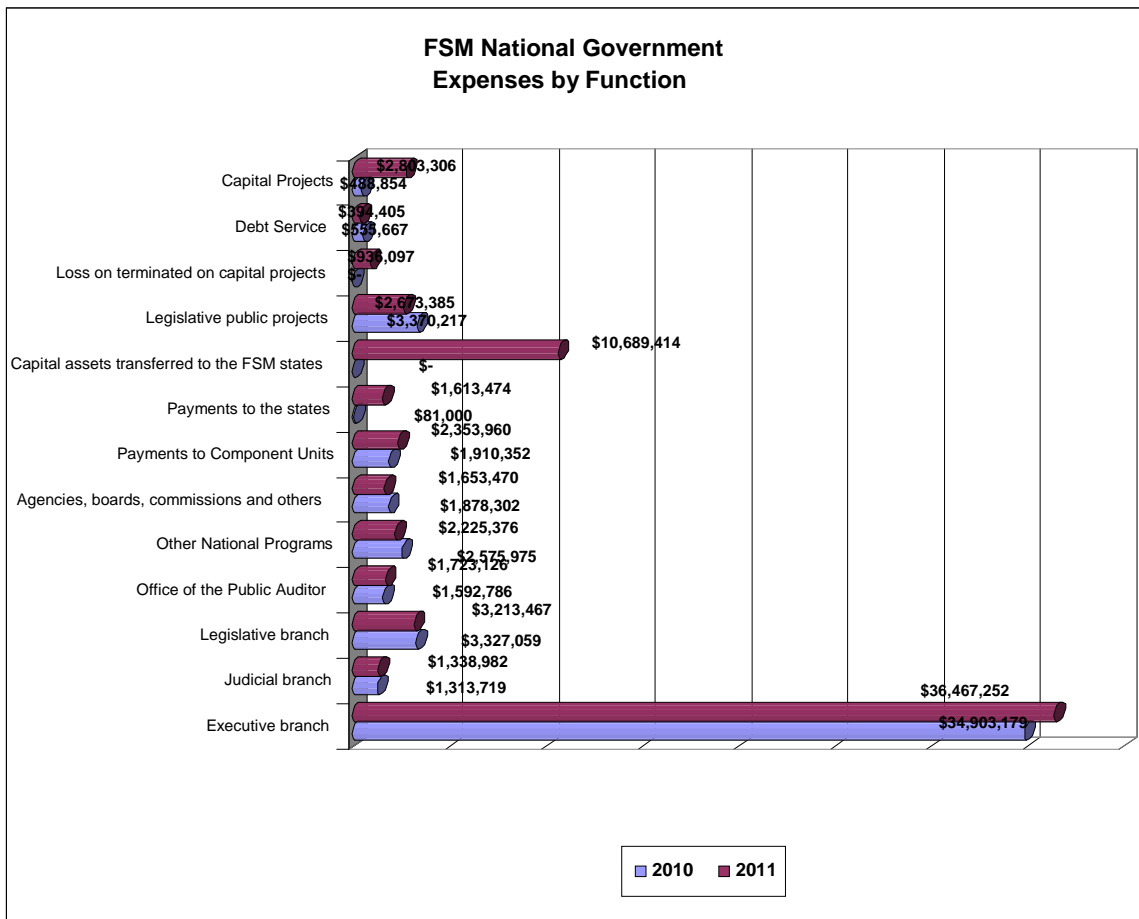
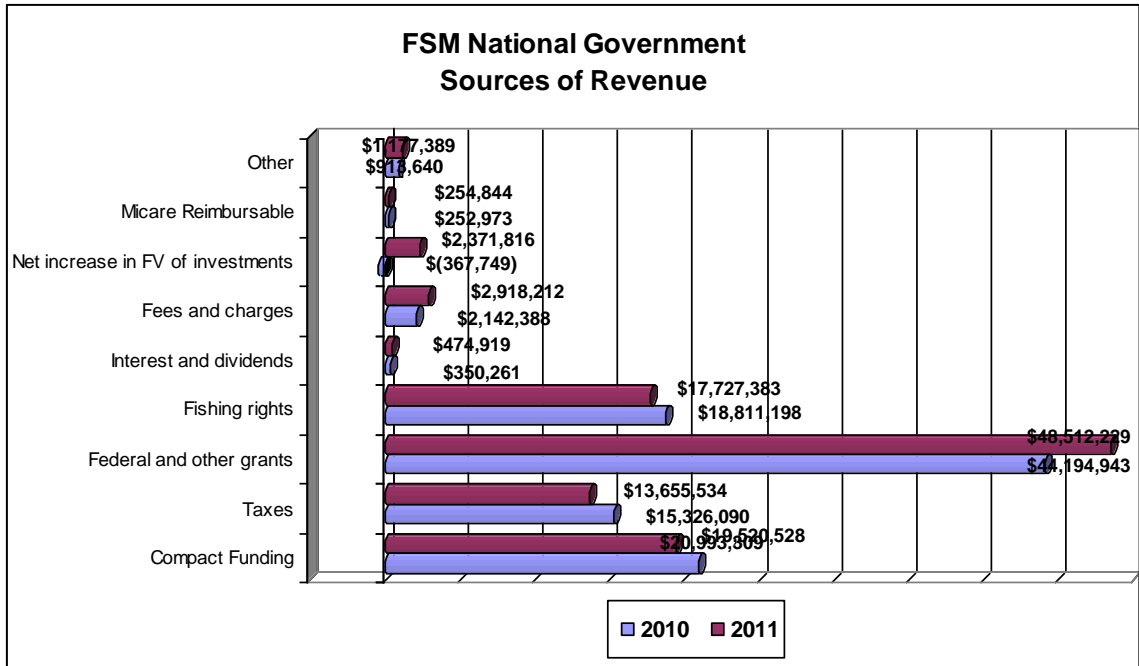
Table 2  
Changes in Net Assets

	<u>Governmental Activities</u>	
	<u>2011</u>	<u>2010</u>
Revenues:		
Program Revenues:		
Charges for services	\$ 2,667,880	\$ 3,672,829
Operating grants and contributions	13,585,074	19,903,976
Capital grants and contributions	51,460,537	49,344,315
General Revenues:		
Income tax	3,780,425	3,491,365
Fishing rights fees	18,811,198	17,727,383
Fuel	148,157	140,466
Import	4,774,857	5,091,747
Gross receipt	4,530,534	4,116,556
Corporate tax	2,092,117	815,400
Unrestricted investment earnings	111,285	1,537,051
Other	654,989	771,766
Total revenue	<u>102,617,053</u>	<u>106,612,854</u>
Expenditures:		
Executive	34,903,179	36,467,251
Judicial	1,313,719	1,338,982
Legislative	3,327,059	3,213,467
Office of Public Auditor	1,592,786	1,723,126
Other National government program	2,575,975	2,225,376
Agencies, boards and commissions	1,878,302	1,653,470
Payments to components units	1,910,352	2,353,960
Payments to the States	81,000	1,613,474
Capital assets transferred to FSM States		10,689,414
Legislative public projects	3,370,217	2,673,385
Loss on terminated capital projects		936,097
Capital projects	488,854	2,803,306
Interest-unallocated/Debt Service	555,667	394,406
Total expenditures	<u>51,997,110</u>	<u>68,085,714</u>
Excess before special items	<u>50,619,943</u>	<u>38,527,140</u>
Special items:		
Receivables written off	(3,896,617)	1,254,633
Loan allocations to the FSM States and related component units	-	1,934,018
Revaluation of ADB shares	4,618,522	-
Special items	<u>721,905</u>	<u>679,385</u>
Change in Net Assets	51,341,848	39,206,525
Net Assets, beginning of year, as restated	<u>166,998,639</u>	<u>127,792,114</u>
Net Assets, end of year	<u>\$218,340,487</u>	<u>\$166,998,639</u>

The FSM National Government revenues from governmental activities, including local revenues, gain on investments, Compact and other grants funding totaled \$102,617,053 (FY10 \$106,612,854). In FY11, the cost of governmental activities totaled \$51,997,110 (FY10 \$68,085,714). In FY11, the special items consist of receivable written-off that amounts to \$3,896,617 (FY10 \$1,254,633) and revaluation of ADB shares of \$4,618,522. The difference between the two, including special items, represents an increase in net assets of \$51,341,848 (FY10 \$39,206,525). To assist in appreciating the details of governmental activities, the above governmental activities information is shown in pictorial form in the following graph.

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Management's Discussion and Analysis, Continued  
September 30, 2011



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Management's Discussion and Analysis, Continued  
September 30, 2011

As noted earlier, the FSM National Government uses fund accounting to ensure and demonstrate compliance with finance related requirements.

### **Governmental Funds**

The focus of the FSM National Government governmental funds is to provide information on near-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing the FSM National Government's financing requirements. In particular, unassigned fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the FSM National Government governmental funds reported combined ending fund balances of \$94.55 million, which represents a slight increase of \$5.9 million (or 6%) in comparison with the prior year. This increase is primarily attributable to an increase in fund balance of the Grants Assistance Fund, the Compact Trust Fund, Other Governmental funds and the General Fund.

Of the total combined fund balance, **(1)** \$61.1 million is reserved for non-spendable. The non-spendable includes amounts that cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact such as loans receivable from States of \$37 million, equity investments of \$5.2 million, equity shares for membership of \$8 million, non-spendable for general government and permanent fund \$10.8 million **(2)** \$1.6 million is reserved for restricted as to its use of resources by laws through constitutional provisions or enabling legislation for the general government **(3)** \$27.2 million is restricted to be committed for specific purposes pursuant to constraints imposed by Congress (a) to indicate that it is not available for new spending because it has already been committed such as the IDF operations of \$6.4 million, Loan receivables of \$450 thousand, and \$7.9 million for future operations-FSM Trust Fund (b) to continuing appropriations through grant awards or enabling legislation and general governments \$12.5 million **(4)** \$2.7 million is restricted as assigned to be used for specific purposes but are neither restricted nor committed to liquidate contracts and purchase orders of the prior period. The combined Unassigned Fund Balance of the FSM National Government Governmental fund is \$1.85 million, an increase of \$113 million from the prior year. The increase in unassigned fund balance was due to the new fund balance classifications in accordance with GASB 54.

The General Fund is the chief operating fund of the FSM National Government. At the end of the current fiscal year, the unassigned fund surplus of the General Fund was \$1.8 million as compared with the prior year ending unreserved fund surplus \$3.2 million, a decrease of \$1.4 million (or 44%), while total fund balance was \$80.4 million compared with a total fund balance of \$23.5 million at the end of the prior fiscal year, an increase of \$56.9 million. The increase in the overall fund balance in the General Fund was due to the combination of funds previously classified as special revenue funds such as the Section 111 Investment Development fund, Early Retirement Fund and Asia Development Bank Loan Fund. These funds no longer fall under the new definition of a special revenue fund under the GASB 54 pronouncement. As such, they are being combined with the General Fund.

The Grants Assistance Fund has a total unreserved fund deficit of \$137 thousand as compared with prior year ending unreserved fund deficit of \$131 million, an increase of \$131 million. The increase is primarily due to the implementation of GASB 54 and reclassifications of fund balance.

The Compact Trust Fund has a total fund balance of \$10.4 million, all of which is reserved for the funding of future operations of the primary government commencing in fiscal year 2023. The net decrease in fund balance during the current year in the Compact Trust Fund was \$128,773 or 1%, due to the economic downturn during the year.

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Management's Discussion and Analysis, Continued  
September 30, 2011

The Other governmental funds have a total fund balance of \$2.6 million, all of which is reserved for future operations of the primary government.

Table 3 shows The National Governmental Fund changes in fund balances for the years ended September 30, 2011 and 2010.

Table 3  
Changes in Fund Balances

	General Fund		Other funds		Total	
	2011	2010	2011	2010	2011	2010
Revenues						
Compact funding	\$ -	\$ -	\$20,993,309	\$19,520,528	\$ 20,993,309	\$ 19,520,528
Fed and other grants	13,868	-	44,181,075	48,006,386	44,194,943	48,006,386
Taxes	15,079,493	13,374,527	246,597	281,007	15,326,090	13,655,534
Fishing rights fees	18,811,198	17,727,383			18,811,198	17,727,383
Net change in FV of inv.	(244,133)	927,645	(128,773)	1,444,171	(372,906)	2,371,816
Other	<u>2,254,754</u>	<u>3,493,283</u>	<u>1,423,533</u>	<u>1,837,924</u>	<u>3,664,419</u>	<u>5,331,207</u>
Total revenues	<u>35,901,312</u>	<u>35,522,838</u>	<u>66,715,741</u>	<u>71,090,016</u>	<u>102,617,053</u>	<u>106,612,854</u>
Expenditures	<u>35,580,589</u>	<u>30,816,549</u>	<u>67,377,202</u>	<u>71,663,469</u>	<u>102,957,791</u>	<u>102,480,018</u>
Excess of rev over expense	<u>320,723</u>	<u>4,706,289</u>	<u>(661,461)</u>	<u>(573,453)</u>	<u>(340,738)</u>	<u>4,132,836</u>
Net Transfers	<u>4,501,111</u>	<u>(2,695,541)</u>	<u>995,502</u>	<u>3,473,243</u>	<u>5,496,613</u>	<u>777,702</u>
Special Items, net	<u>721,905</u>	<u>(1,254,633)</u>	<u>-</u>	<u>1,932,326</u>	<u>721,905</u>	<u>677,693</u>
Net Change in F/B	\$ <u>5,543,739</u>	\$ <u>756,115</u>	\$ <u>334,041</u>	\$ <u>4,832,116</u>	\$ <u>5,877,780</u>	\$ <u>5,588,231</u>

Analysis of budgetary Variations- General fund:

During the year, the FSM National Government revised its budget several times to accommodate supplemental funding for departments and offices. As can be seen in the following table, actual revenue collections exceeded budgets by \$667,501 or 2% while expenditures were less than budgets by \$10,434,313 or 29%. There were no material budget overruns at any level.

	Budget	Budget	Actual	Variance
	Original	Final	Amounts	Positive(Negative)
Revenues	\$36,500,000	\$35,062,000	\$35,729,501	\$ (667,501)
Expenditures	40,129,327	45,982,544	35,485,231	(10,497,313)
Excess of Revenues	(3,629,327)	(10,920,544)	244,270	(11,164,814)
Other Financing sources (uses) and special items	(966,145)	(1,131,246)	1,299,138	(794,202)
Net Changed Unassigned	\$(4,595,472)	\$(12,051,790)	\$1,543,408	\$(13,595,199)

During the year, the FSM National Government revised its revenue projection to decrease fishing rights fees and investment earnings that resulted in a net decrease in final revenues of \$1,570,000. During the year, the FSM National government made additional supplemental appropriations under Public law Nos. 16-48,16-49,16-53,16-58,16-60,16-62,16-65, 16-69, 07-01,17-09,17-16 totaling \$5,853,217. Included in the original and final budget are encumbrances of \$3,702,466 and continuing appropriations of \$5,493,335 for a total amount of \$9,195,801. The inclusion of the prior years encumbrance and continuing appropriations in the original and final budget of resulted to a negative net change of Unassigned deficit of (\$4,595,472) and (\$12,051,790) respectively while a positive amount in the actual of \$1,543,408.

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Management's Discussion and Analysis, Continued  
September 30, 2011

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

Capital Assets

At the end of the September 30, 2011, the FSM National Government had invested \$175,384,128 (FY10 \$126,277,491) in capital assets. These assets consist basically of infrastructure, office equipment and machinery, buildings, ship, and motor vehicles and construction in progress. The summary of capital assets of the year is shown below:

	<u>Primary Government Governmental Activities</u>	
	<u>2011</u>	<u>2010</u>
Buildings	\$ 31,537,774	\$ 23,335,215
Boats and ships	22,553,101	22,223,778
Infrastructure	58,864,169	17,738,637
Motor vehicles	5,934,684	5,612,509
Computer equipment	4,702,356	4,775,133
Aircraft	709,207	709,207
Furniture, fixture, equipment	<u>8,823,902</u>	<u>8,477,075</u>
Total assets	<u>133,125,195</u>	<u>82,871,554</u>
Less: Accumulated depreciation	<u>(36,442,756)</u>	<u>(31,462,068)</u>
Construction in progress	<u>78,701,689</u>	<u>74,868,004</u>
Total Assets, net	<u>\$175,384,128</u>	<u>\$126,277,491</u>

During the year, the FSM National Government recorded additional construction in progress of \$53,161,777 while retirements and reclassifications aggregated \$49,328,092. Furthermore, construction in-progress is restated in the amount of \$7,523,038 to reflect prior year expenditures determined to be capitalizable in the current year. Major capital asset additions during the year included \$41 million in airport improvement projects, \$4 million in school buildings, and current CWIP relating to the Weno road project in Chuuk State. Further information on the FSM National Government's capital assets can be obtained from note 5 to the accompanying financial statements on pages 49 and 50.

Long Term Debt

At the end of fiscal year 2011, the FSM National Government had long term debt of \$55,817,207 (FY10 \$52,174,633) relating to Governmental Activities as shown below:

	<u>2011</u>	<u>2010</u>
ADB Loan - Early Retirement	\$18,715,129	\$19,122,003
-Fisheries and water project	14,752,915	15,152,634
-Private Sector Development	10,262,760	10,805,378
-Basic social Services	3,652,449	3,826,376
-Omnibus Infrastructure Dev.	7,219,948	1,728,721
Compensated absences (Annual Leave)	<u>1,214,006</u>	<u>1,539,521</u>
Total	<u>\$55,817,207</u>	<u>\$52,174,633</u>

FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT

Management's Discussion and Analysis, Continued  
September 30, 2011

During the year, the FSM National Government received loan proceeds of \$5,496,613 for ADB loans under 2100 FSM (SF) and 2099 FSM (SF) Omnibus Infrastructure Development Project. During the year, the FSM National Government total loan payments were \$1,528,524, included in the loan payment is a foreign exchange adjustment due to a change in SDR calculation of \$65,478. Of this amount, \$44,444 was allocated to the States, which also resulted in a decrease in loans receivable from the States of the same amount.

Further information on the FSM National Government's long term obligations can be obtained from note 6 to the accompanying financial statements on pages 50 to 52.

**ECONOMIC FACTORS AND NEXT YEAR'S BUDGET**

Fiscal year 2011 represents the eighth full year the FSM has been implementing the economic assistance provisions available under the Amended compact. The total funds appropriated for the National Government operations and programs during the fiscal year amounted to \$53 million. Funding under the amended Compact represents 29% of the National Government FY10 annual budget. The remaining 71% came from locally generated tax revenues, fishing access fees, investment earnings and related government services fees.

The FSM National Government ended fiscal year 2011 with a positive unassigned general fund surplus.

For FY2012, the total domestic revenue projection is approximately \$49,671,432, of which \$41,650,000 or 84% will come from domestic sources while \$6,844,776 or 14% will come from the amended compact sector grants and \$1,176,656 or 2% from the supplemental education grant. The revenue projection does not include potential funds from U.S. Federal grantor agencies, foreign governments, and other international and regional organizations.

In the beginning of FY2012, the first annual appropriation amounts to \$44,251,617 of which \$36,590,889 or 83% is to be funded by locally generated revenues of the FSM National Government while \$7,660,728 or 17% will come from amended sector grants. It is anticipated that the FY2012 budget will reflect an increase from the FY11 budgetary level due to an increase in collection of corporate taxes and an estimated increase in fishing access fees and other local taxes.

In addition to receiving compact grant assistance, the FSM receives substantial programs assistance from agencies of the United States Federal Government, Peoples Republic of China, Japan and other foreign governments. Grants and other technical assistance programs are also made available to the FSM from the international and regional organizations. In FY11, assistance received from these sources was estimated at \$67 million and in FY12 we estimate to receive approximately the same amount.

**FINANCIAL MANAGEMENT CONTACT –NATIONAL GOVERNMENT**

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



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Statement of Net Assets  
September 30, 2011

	Primary Government	Component Units
<b><u>ASSETS</u></b>		
Current assets:		
Cash and cash equivalents	\$ 3,042,605	\$ 19,424,580
Cash and cash equivalents - restricted	3,597,321	-
Time certificates of deposit	1,430,763	3,609,228
Investments	26,733,597	15,313,941
Receivables, net of allowance for uncollectibles	28,082,236	13,149,178
Due from primary government	-	304,640
Due from component units	500,000	-
Advances	1,462,099	-
Inventories	-	10,088,205
Other current assets	-	1,217,812
Total current assets	64,848,621	63,107,584
Noncurrent assets:		
Investments	10,377,390	3,644,100
Receivables, net of current portion	40,042,804	17,515,359
Capital assets, net of accumulated depreciation	175,384,128	75,361,640
Deposits and other assets	8,077,292	-
Total noncurrent assets	233,881,614	96,521,099
Total assets	\$ 298,730,235	\$ 159,628,683
<b><u>LIABILITIES</u></b>		
Current liabilities:		
Current portion of long-term obligations	\$ 1,537,553	\$ 5,961,457
Short-term notes payable	-	2,331,054
Accounts payable	5,383,784	3,821,042
Due to component units	304,640	-
Due to private purpose trust	900,000	-
Current portion of compensated absences payable	398,085	-
Other liabilities and accruals	1,332,755	5,967,520
Tax refunds payable	511,443	-
Retention payable	4,531,854	-
Due to federal agencies	1,444,470	-
Due to FSM State Governments	7,255,024	-
Due to primary government	-	500,000
Deferred revenue	2,908,571	2,627,200
Total current liabilities	26,508,179	21,208,273
Noncurrent liabilities:		
Long-term obligations, net of current portion	53,065,648	33,333,351
Compensated absences payable, net of current portion	815,921	-
Total noncurrent liabilities	53,881,569	33,333,351
Total liabilities	80,389,748	54,541,624
<b><u>NET ASSETS</u></b>		
Invested in capital assets, net of related debt	175,384,128	40,777,588
Restricted for:		
Nonexpendable:		
Future operations	10,377,390	-
Other purposes	-	2,981,912
Expendable:		
Compact related	1,299,321	-
Other purposes	2,626,699	-
Unrestricted	28,652,949	61,327,559
Total net assets	218,340,487	105,087,059
Total liabilities and net assets	\$ 298,730,235	\$ 159,628,683

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Statement of Activities  
Year Ended September 30, 2011

Functions/Programs	Expenses	Program Revenues			Net (Expenses) Revenues and Changes in Net Assets	
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government	Component Units
<b>Primary government:</b>						
Governmental activities:						
Office of the President	\$ 1,433,733	\$ -	\$ -	\$ -	\$ (1,433,733)	\$ -
Foreign affairs	4,052,331	-	-	-	(4,052,331)	-
Finance and administration	3,914,096	22,727	1,196,760	-	(2,694,609)	-
Resources and development	1,172,363	27,670	176,914	-	(967,779)	-
Transportation, communication and infrastructure	5,340,852	161,080	542,521	-	(4,637,251)	-
Health and social affairs	6,459,064	1,160	6,036,014	-	(421,890)	-
Education	4,321,822	730	2,857,760	-	(1,463,332)	-
Justice	4,702,417	697,828	-	-	(4,004,589)	-
Office of the Public Defender	726,716	-	-	-	(726,716)	-
SBOC Office	1,655,837	-	370,994	-	(1,284,843)	-
Environment and emergency management	791,585	-	320,160	-	(471,425)	-
National archives, cultural and historic preservation	332,363	-	179,976	-	(152,387)	-
Legislature	3,327,059	-	-	-	(3,327,059)	-
Judiciary	1,313,719	-	-	-	(1,313,719)	-
Office of the National Public Auditor	1,592,786	-	522,047	-	(1,070,739)	-
National government programs	2,575,975	-	1,406,580	-	(1,169,395)	-
Agencies, boards and commissions	1,878,302	969,810	-	-	(908,492)	-
Payments to component units	1,910,352	-	104,121	-	(1,806,231)	-
Payments to the FSM State Governments	81,000	-	-	-	(81,000)	-
Legislative public projects	3,370,217	-	-	-	(3,370,217)	-
Future operations	-	786,875	(128,773)	-	658,102	-
Capital projects	488,854	-	-	51,460,537	50,971,683	-
Unallocated interest	555,667	-	-	-	(555,667)	-
<b>Total primary government</b>	<b>\$ 51,997,110</b>	<b>\$ 2,667,880</b>	<b>\$ 13,585,074</b>	<b>\$ 51,460,537</b>	<b>15,716,381</b>	<b>-</b>
<b>Component units:</b>						
FSM Telecommunications Corporation	\$ 16,135,340	\$ 13,568,945	\$ -	\$ -	-	(2,566,395)
FSM Development Bank	1,772,707	2,877,407	250,000	-	-	1,354,700
National Fisheries Corporation	186,597	200,357	-	-	-	13,760
College of Micronesia - FSM	22,566,591	22,854,493	-	-	-	287,902
FSM Coconut Development Authority	354,335	152,317	214,848	-	-	12,830
FSM Petroleum Corporation	55,227,603	59,335,744	-	-	-	4,108,141
Caroline Islands Air, Inc.	454,713	405,065	-	-	-	(49,648)
MiCare Plan, Inc.	5,692,342	5,445,591	100,000	-	-	(146,751)
<b>Total component units</b>	<b>\$ 102,390,228</b>	<b>\$ 104,839,919</b>	<b>\$ 564,848</b>	<b>\$ -</b>	<b>-</b>	<b>3,014,539</b>
<b>General revenues:</b>						
Taxes:						
Income					3,780,425	-
Import					4,774,857	-
Gross receipts					4,530,534	-
Corporate tax					2,092,117	-
Fuel					148,157	-
Fishing rights					18,811,198	-
Unrestricted investment earnings					111,285	(178,786)
Other					654,989	32,778
Special items:						
Revaluation ADB shares					4,618,522	-
Receivables written-off					(3,896,617)	-
<b>Total general revenues and special items</b>					<b>35,625,467</b>	<b>(146,008)</b>
<b>Change in net assets</b>					<b>51,341,848</b>	<b>2,868,531</b>
Net assets at the beginning of the year, as previously reported					159,475,601	102,218,528
Prior-period adjustment (note 12)					7,523,038	-
Net assets at the beginning of the year, as restated					166,998,639	102,218,528
Net assets at the end of the year					<b>\$ 218,340,487</b>	<b>\$ 105,087,059</b>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**Balance Sheet  
Governmental Funds  
September 30, 2011**

	General	Special Revenue Grants Assistance	Permanent Compact Trust	Other Governmental Funds	Total
<b>ASSETS</b>					
Cash and cash equivalents	\$ 3,042,605	\$ -	\$ -	\$ -	\$ 3,042,605
Time certificates of deposit	1,430,763	-	-	-	1,430,763
Equity in internal investment pool	19,289,597	1,391,146	-	-	20,680,743
Investments	6,052,854	-	-	-	6,052,854
Receivables, net:					
General	500,607	-	-	-	500,607
Taxes	4,446,650	-	-	-	4,446,650
Federal agencies	140,963	17,378,072	-	-	17,519,035
Loans	41,391,579	-	-	-	41,391,579
Accrued interest	47,297	-	-	-	47,297
Due from component units	500,000	-	-	-	500,000
Due from other funds	5,901,875	2,885,133	-	2,664,375	11,451,383
Advances	-	1,462,099	-	-	1,462,099
Deposits and other assets	8,077,292	-	-	-	8,077,292
Restricted assets:					
Cash and cash equivalents	3,597,321	-	-	-	3,597,321
Investments	-	-	10,377,390	-	10,377,390
Total assets	<u>\$ 94,419,403</u>	<u>\$ 23,116,450</u>	<u>\$ 10,377,390</u>	<u>\$ 2,664,375</u>	<u>\$ 130,577,618</u>
<b>LIABILITIES AND FUND BALANCES</b>					
<b>Liabilities:</b>					
Accounts payable	\$ 1,716,166	\$ 3,629,942	\$ -	\$ 37,676	\$ 5,383,784
Retention payable	-	4,531,854	-	-	4,531,854
Other liabilities and accruals	1,332,755	-	-	-	1,332,755
Tax refunds payable	511,443	-	-	-	511,443
Due to component units	304,640	-	-	-	304,640
Due to private purpose trust fund	900,000	-	-	-	900,000
Due to federal agencies	-	1,444,470	-	-	1,444,470
Due to FSM State Governments	3,717,006	3,538,018	-	-	7,255,024
Due to other funds	5,549,508	5,901,875	-	-	11,451,383
Deferred revenue	-	2,908,571	-	-	2,908,571
Total liabilities	<u>14,031,518</u>	<u>21,954,730</u>	<u>-</u>	<u>37,676</u>	<u>36,023,924</u>
<b>Fund balances:</b>					
Non-spendable	50,739,454	-	10,377,390	-	61,116,844
Restricted	311,647	1,299,321	-	-	1,610,968
Committed	24,686,292	-	-	2,626,699	27,312,991
Assigned	2,798,773	-	-	-	2,798,773
Unassigned:					
General fund	1,851,719	-	-	-	1,851,719
Special revenue funds	-	(137,601)	-	-	(137,601)
Total fund balances	<u>80,387,885</u>	<u>1,161,720</u>	<u>10,377,390</u>	<u>2,626,699</u>	<u>94,553,694</u>
Total liabilities and fund balances	<u>\$ 94,419,403</u>	<u>\$ 23,116,450</u>	<u>\$ 10,377,390</u>	<u>\$ 2,664,375</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				175,384,128	
Loans receivable from FSM State Governments				4,219,872	
Long-term liabilities, including loans payable, are not due and payable in the current period and, therefore, are not reported in the funds.					
These liabilities include:					
Loans payable				(54,603,201)	
Compensated absences payable				(1,214,006)	
					<u>123,786,793</u>
Net assets of governmental activities					<u>\$ 218,340,487</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Statement of Revenues, Expenditures, and Changes in Fund Balances  
Governmental Funds  
Year Ended September 30, 2011

	Special Revenue		Permanent		Other Governmental Funds	Total
	General	Grants Assistance	Compact Trust			
Revenues:						
Compact funding	\$ -	\$ 20,993,309	\$ -	\$ -	\$ -	\$ 20,993,309
Taxes	15,079,493	-	-	246,597	-	15,326,090
Federal and other grants	13,868	44,181,075	-	-	-	44,194,943
Fishing rights	18,811,198	-	-	-	-	18,811,198
Interest and dividends	355,418	-	-	-	-	355,418
Fees and charges	718,855	-	-	1,423,533	-	2,142,388
Net change in the fair value of investments	(244,133)	-	(128,773)	-	-	(372,906)
MiCare reimbursible	252,973	-	-	-	-	252,973
Other	913,640	-	-	-	-	913,640
Total revenues	35,901,312	65,174,384	(128,773)	1,670,130	-	102,617,053
Expenditures:						
Current:						
General government:						
Office of the President	1,410,864	-	-	-	-	1,410,864
Foreign affairs	4,033,649	-	-	-	-	4,033,649
Finance and administration	2,773,373	1,196,805	-	-	-	3,970,178
Resources and development	975,949	176,914	-	-	-	1,152,863
Transportation, communication and infrastructure	1,978,511	542,521	-	1,262,053	-	3,783,085
Health and social affairs	316,240	6,036,014	-	1,967	-	6,354,221
Education	1,050,408	2,857,760	-	381,423	-	4,289,591
Justice	4,065,853	-	-	306,375	-	4,372,228
Office of the Public Defender	757,041	-	-	-	-	757,041
SBOC Office	1,248,191	370,994	-	-	-	1,619,185
Environment and emergency management	495,922	320,160	-	-	-	816,082
National archives, cultural and historic preservation	172,470	179,976	-	-	-	352,446
Legislature	3,281,798	-	-	-	-	3,281,798
Judiciary	1,341,678	-	-	-	-	1,341,678
Office of the National Public Auditor	1,063,891	522,047	-	-	-	1,585,938
National government programs	1,004,904	1,406,580	-	-	-	2,411,484
Agencies, boards and commissions	1,700,921	-	-	250,955	-	1,951,876
Payments to component units and fiduciary	1,809,598	104,121	-	-	-	1,913,719
Payments to the FSM State Governments	81,000	-	-	-	-	81,000
Legislative public projects	3,934,137	-	-	-	-	3,934,137
Capital projects	-	51,460,537	-	-	-	51,460,537
Debt service:						
Principal and interest payments	2,084,191	-	-	-	-	2,084,191
Total expenditures	35,580,589	65,174,429	-	2,202,773	-	102,957,791
Excess (deficiency) of revenues over (under) expenditures	320,723	(45)	(128,773)	(532,643)	-	(340,738)
Other financing sources (uses):						
Proceeds from issuance of long-term debt	5,496,613	-	-	-	-	5,496,613
Operating transfers in	285,744	-	-	1,281,246	-	1,566,990
Operating transfers out	(1,281,246)	-	-	(285,744)	-	(1,566,990)
Total other financing sources (uses), net	4,501,111	-	-	995,502	-	5,496,613
Special items:						
Revaluation of ADB shares	4,618,522	-	-	-	-	4,618,522
Write-off of receivable balances	(3,896,617)	-	-	-	-	(3,896,617)
Total special items	721,905	-	-	-	-	721,905
Net change in fund balances	5,543,739	(45)	(128,773)	462,859	-	5,877,780
Fund balances at the beginning of the year	74,844,146	1,161,765	10,506,163	2,163,840	-	88,675,914
Fund balances at the end of the year	\$ 80,387,885	\$ 1,161,720	\$ 10,377,390	\$ 2,626,699	\$ -	\$ 94,553,694

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Reconciliation of the Statement of Revenues, Expenditure, and Changes in Fund  
Balances of Governmental Funds to the Statement of Activities  
Year Ended September 30, 2011

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

Net change in fund balances - total governmental funds	\$ 5,877,780
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Capital outlays are reported as expenditures in governmental funds. However, in the statement of activities, the cost of capital assets is allocated over their estimated useful lives and reported as depreciation expense. For the current year, these amounts consist of:

Capital outlays, net of disposals	\$ 54,087,330	
Depreciation expense, net	<u>(4,980,688)</u>	49,106,642

The issuance of long-term debt (e.g. bonds, leases) provides current financial resources to governmental funds, while the repayment of principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction has any effect on net assets.

This is the amount that represents the Special Drawing Rights (SDR) adjustment to long-term loans allocated to the FSM State Governments.	2,057
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This is the additional loan proceeds received from ADB loans, excluding the SDR adjustment.	(5,496,613)
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This is the repayment of ADB loans (see Note 6).	1,526,467
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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>325,515</u>
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Change in net assets of governmental activities	\$ <u>51,341,848</u>
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**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Combining Statement of Fiduciary Net Assets  
Fiduciary Funds - Private Purpose Trusts  
September 30, 2011

	FSM Social Security Administration	Pohnpei State Development Loan Fund	Yap State Development Loan Fund	Total
<u>ASSETS</u>				
Cash and cash equivalents	\$ 1,280,202	\$ 245,044	\$ 87,585	\$ 1,612,831
Time certificates of deposit	-	575,563	145,416	720,979
Receivables, net:				
Contributions	3,051,613	-	-	3,051,613
Accrued interest	91,721	770	663	93,154
Loans	-	28,827	26,074	54,901
Other	16,448	-	27,266	43,714
Investments	35,220,871	-	-	35,220,871
Due from primary government	900,000	-	-	900,000
Capital assets, net of accumulated depreciation	109,787	-	-	109,787
	<u>\$ 40,670,642</u>	<u>\$ 850,204</u>	<u>\$ 287,004</u>	<u>\$ 41,807,850</u>
<u>LIABILITIES</u>				
Accounts payable	\$ 230,235	\$ 102,580	\$ 28,416	\$ 361,231
Other liabilities and accruals	31,038	-	-	31,038
	<u>261,273</u>	<u>102,580</u>	<u>28,416</u>	<u>392,269</u>
<u>NET ASSETS</u>				
Held in trust for:				
Social security benefits	40,409,369	-	-	40,409,369
Restricted	-	28,827	26,074	54,901
Other purposes	-	718,797	232,514	951,311
	<u>40,409,369</u>	<u>747,624</u>	<u>258,588</u>	<u>41,415,581</u>
	<u>\$ 40,670,642</u>	<u>\$ 850,204</u>	<u>\$ 287,004</u>	<u>\$ 41,807,850</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Combining Statement of Changes in Fiduciary Net Assets  
Fiduciary Funds - Private Purpose Trusts  
Year Ended September 30, 2011

	FSM Social Security Administration	Pohnpei State Development Loan Fund	Yap State Development Loan Fund	Total
Additions:				
Contributions	\$ 16,593,155	\$ -	\$ -	\$ 16,593,155
Investment earnings (loss):				
Net change in the fair value of investments	(2,181,438)	6,547	1,748	(2,173,143)
Interest and dividends	969,271	3,709	2,870	975,850
Total investment earnings (loss)	(1,212,167)	10,256	4,618	(1,197,293)
Less investment expense	208,649	-	6,134	214,783
Net investment earnings (loss)	(1,420,816)	10,256	(1,516)	(1,412,076)
Contributions from primary government	1,200,000	-	-	1,200,000
Other	351,234	12,722	12,842	376,798
Total additions	16,723,573	22,978	11,326	16,757,877
Deductions:				
Benefits	17,620,245	-	-	17,620,245
Refunds	30,630	-	-	30,630
Administrative expenses	1,067,434	-	-	1,067,434
Total deductions	18,718,309	-	-	18,718,309
Change in net assets	(1,994,736)	22,978	11,326	(1,960,432)
Net assets at the beginning of the year	42,404,105	724,646	247,262	43,376,013
Net assets at the end of the year	<u>\$ 40,409,369</u>	<u>\$ 747,624</u>	<u>\$ 258,588</u>	<u>\$ 41,415,581</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Combining Statement of Net Assets  
Component Units  
September 30, 2011

	FSM Tele- Communication Corporation	FSM Development Bank	National Fisheries Corporation	College of Micronesia- FSM	FSM Coconut Development Authority	FSM Petroleum Corporation	Caroline Islands Air, Inc.	MiCare Plan, Inc.	Total
<b>ASSETS</b>									
Current assets:									
Cash and cash equivalents	\$ 496,202	\$ 5,207,596	\$ 46,691	\$ 7,167,689	\$ 18,537	\$ 6,186,192	\$ 68,398	\$ 233,275	\$ 19,424,580
Time certificates of deposit	175,855	2,917,944	-	-	-	515,429	-	-	3,609,228
Investments	4,563,433	9,513,944	-	-	-	-	-	1,236,564	15,313,941
Receivables, net:									
General	398,723	7,632	36,489	3,485,235	15,965	1,505,502	11,947	248,793	5,710,286
Loans	-	2,951,069	-	-	-	-	-	-	2,951,069
Interest	-	268,847	-	-	-	-	-	-	268,847
Other	329,836	448,305	-	2,208,335	8,519	1,223,981	-	-	4,218,976
Due from primary government	-	-	-	304,640	-	-	-	-	304,640
Inventories	744,379	-	-	1,155,571	204,235	7,956,135	27,885	-	10,088,205
Prepaid expenses	369,749	2,500	-	287,649	743	342,015	-	215,156	1,217,812
Total current assets	<u>7,078,177</u>	<u>21,317,837</u>	<u>83,180</u>	<u>14,609,119</u>	<u>247,999</u>	<u>17,729,254</u>	<u>108,230</u>	<u>1,933,788</u>	<u>63,107,584</u>
Noncurrent assets:									
Capital assets, net of accumulated depreciation	54,906,388	1,533,822	14,347	10,125,687	141,309	8,608,118	4,620	27,349	75,361,640
Investments	-	662,188	-	2,981,912	-	-	-	-	3,644,100
Loans receivable, net	-	17,515,359	-	-	-	-	-	-	17,515,359
Total noncurrent assets	<u>54,906,388</u>	<u>19,711,369</u>	<u>14,347</u>	<u>13,107,599</u>	<u>141,309</u>	<u>8,608,118</u>	<u>4,620</u>	<u>27,349</u>	<u>96,521,099</u>
Total assets	<u>\$61,984,565</u>	<u>\$ 41,029,206</u>	<u>\$ 97,527</u>	<u>\$ 27,716,718</u>	<u>\$ 389,308</u>	<u>\$26,337,372</u>	<u>\$112,850</u>	<u>\$1,961,137</u>	<u>\$159,628,683</u>
<b>LIABILITIES</b>									
Current liabilities:									
Current portion of long-term debt	\$ 1,434,871	\$ 400,000	\$3,600,000	\$ -	\$ -	\$ 526,586	\$ -	\$ -	\$ 5,961,457
Short term notes payable	2,331,054	-	-	-	-	-	-	-	2,331,054
Accounts payable	1,427,353	333,233	236,710	349,360	25,056	307,157	4,359	1,137,814	3,821,042
Other liabilities and accruals	589,563	54,813	15,028	1,925,161	3,951	3,250,280	8,626	120,098	5,967,520
Due to primary government	-	-	-	-	-	500,000	-	-	500,000
Deferred revenue	80,114	-	-	2,547,086	-	-	-	-	2,627,200
Total current liabilities	<u>5,862,955</u>	<u>788,046</u>	<u>3,851,738</u>	<u>4,821,607</u>	<u>29,007</u>	<u>4,584,023</u>	<u>12,985</u>	<u>1,257,912</u>	<u>21,208,273</u>
Noncurrent liabilities:									
Noncurrent portion of long-term debt	30,497,987	710,755	-	-	-	2,124,609	-	-	33,333,351
Total noncurrent liabilities	<u>30,497,987</u>	<u>710,755</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,124,609</u>	<u>-</u>	<u>-</u>	<u>33,333,351</u>
Total liabilities	<u>36,360,942</u>	<u>1,498,801</u>	<u>3,851,738</u>	<u>4,821,607</u>	<u>29,007</u>	<u>6,708,632</u>	<u>12,985</u>	<u>1,257,912</u>	<u>54,541,624</u>
<b>NET ASSETS</b>									
Invested in capital assets, net of related debt	22,973,530	1,533,823	14,347	10,125,687	141,309	5,956,923	4,620	27,349	40,777,588
Restricted for:									
Nonexpendable	-	-	-	2,981,912	-	-	-	-	2,981,912
Unrestricted	<u>2,650,093</u>	<u>37,996,582</u>	<u>(3,768,558)</u>	<u>9,787,512</u>	<u>218,992</u>	<u>13,671,817</u>	<u>95,245</u>	<u>675,876</u>	<u>61,327,559</u>
Total net assets	<u>25,623,623</u>	<u>39,530,405</u>	<u>(3,754,211)</u>	<u>22,895,111</u>	<u>360,301</u>	<u>19,628,740</u>	<u>99,865</u>	<u>703,225</u>	<u>105,087,059</u>
Total liabilities and net assets	<u>\$61,984,565</u>	<u>\$ 41,029,206</u>	<u>\$ 97,527</u>	<u>\$ 27,716,718</u>	<u>\$ 389,308</u>	<u>\$26,337,372</u>	<u>\$112,850</u>	<u>\$1,961,137</u>	<u>\$159,628,683</u>

See accompanying notes to basic financial statements.



**FEDERATED STATES OF MICRONESIA**

Combining Statement of Revenues, Expenses, and Changes in Net Assets  
Component Units  
Year Ended September 30, 2011

	FSM Tele- Communications Corporation	FSM Development Bank	National Fisheries Corporation	College of Micronesia- FSM	FSM Coconut Development Authority	FSM Petroleum Corporation	Caroline Islands Air, Inc.	MiCare Plan, Inc.	Total
Operating revenues:									
Charges for services	\$ 13,568,945	\$ 2,439,560	\$ 200,357	\$ 22,854,493	\$ 152,317	\$ 59,060,690	\$ 405,065	\$ 5,443,516	\$104,124,943
Other	<u>-</u>	<u>437,847</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>275,054</u>	<u>-</u>	<u>2,075</u>	<u>714,976</u>
Total operating revenues	<u>13,568,945</u>	<u>2,877,407</u>	<u>200,357</u>	<u>22,854,493</u>	<u>152,317</u>	<u>59,335,744</u>	<u>405,065</u>	<u>5,445,591</u>	<u>104,839,919</u>
Operating expenses:									
Cost of services	479,664	955,026	-	-	113,610	47,881,765	410,182	5,180,459	55,020,706
Depreciation and amortization	4,486,879	130,700	3,422	942,211	26,102	764,721	880	15,556	6,370,471
Administrative costs	<u>9,650,709</u>	<u>623,130</u>	<u>183,175</u>	<u>21,624,380</u>	<u>214,623</u>	<u>6,383,051</u>	<u>43,651</u>	<u>481,327</u>	<u>39,204,046</u>
Total operating expenses	<u>14,617,252</u>	<u>1,708,856</u>	<u>186,597</u>	<u>22,566,591</u>	<u>354,335</u>	<u>55,029,537</u>	<u>454,713</u>	<u>5,677,342</u>	<u>100,595,223</u>
Operating income (loss)	<u>(1,048,307)</u>	<u>1,168,551</u>	<u>13,760</u>	<u>287,902</u>	<u>(202,018)</u>	<u>4,306,207</u>	<u>(49,648)</u>	<u>(231,751)</u>	<u>4,244,696</u>
Nonoperating revenues (expenses):									
Net change in the fair value of investments	120,340	(104,434)	-	(211,516)	-	-	-	16,824	(178,786)
Interest expense	(1,518,088)	(63,851)	-	-	-	(198,066)	-	-	(1,780,005)
Contributions from primary government	-	250,000	-	-	214,848	-	-	100,000	564,848
Loss on disposal of fixed assets	-	-	-	-	-	-	-	(15,000)	(15,000)
Other income (expense)	<u>-</u>	<u>3,285</u>	<u>(33)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,572</u>	<u>26,954</u>	<u>32,778</u>
Total nonoperating revenues (expenses), net	<u>(1,397,748)</u>	<u>85,000</u>	<u>(33)</u>	<u>(211,516)</u>	<u>214,848</u>	<u>(198,066)</u>	<u>2,572</u>	<u>128,778</u>	<u>(1,376,165)</u>
Net income (loss)	<u>(2,446,055)</u>	<u>1,253,551</u>	<u>13,727</u>	<u>76,386</u>	<u>12,830</u>	<u>4,108,141</u>	<u>(47,076)</u>	<u>(102,973)</u>	<u>2,868,531</u>
Net assets at the beginning of the year	<u>28,069,678</u>	<u>38,276,854</u>	<u>(3,767,938)</u>	<u>22,818,725</u>	<u>347,471</u>	<u>15,520,599</u>	<u>146,941</u>	<u>806,198</u>	<u>102,218,528</u>
Net assets at the end of the year	<u>\$ 25,623,623</u>	<u>\$39,530,405</u>	<u>\$(3,754,211)</u>	<u>\$ 22,895,111</u>	<u>\$ 360,301</u>	<u>\$ 19,628,740</u>	<u>\$ 99,865</u>	<u>\$ 703,225</u>	<u>\$105,087,059</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies

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

A. Reporting Entity

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

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

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

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

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

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

Blended Component Units

The following component unit is blended within the primary government:

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

Discretely Presented Component Units

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

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

FSM Development Bank (FSMDB): FSMDB was established under FSM Public Law No. 8-47 to advance the economic development of the FSM through the provision of economic development loans. FSMDB is governed by a seven-member Board of Directors appointed by election at the annual shareholders meeting by the plurality of votes thereof. As of December 31, 2011, FSMDB has issued 2,997,883 shares to the FSM National Government (98.7%), the State of Chuuk (1%), and the State of Kosrae (0.3%).

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

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

Discretely Presented Component Units, Continued

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

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

FSM Petroleum Corporation (FSMPC): FSMPC was established under FSM Public Law 15-08 for the purpose of providing oil and gas distribution for the entire FSM. FSMPC is governed by a seven-member Board of Directors, which includes one appointee by the President (with the advice and consent of the Congress) and four appointees by the Governor of each State (with the advice and consent of the respective State legislatures), and two appointees from the private sector by the President (with the advice and consent of the Congress).

Caroline Islands Air, Inc. (CIA): CIA was established under FSM Public Law No. 10-72 to operate, maintain, and administer an inter-island air service based in Pohnpei State. CIA is governed by a five-member Board of Directors, which includes one appointee by the President (with the advice and consent of the Congress) and four appointees by the Governor of each State (with the advice and consent of the respective State Legislatures).

MiCare Plan, Inc. (the Plan): The Plan was established under FSM Public Law No. 12-77 to provide, arrange, pay, or reimburse the costs of medical, dental and vision treatment and care, hospitalization, surgery, prescription drugs, medicine, prosthetic appliances, out-patient care, and other medical care benefits. The Plan is governed by a seven-member Board of Directors appointed by the President with the advice and consent of the Congress.

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

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

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements

The Statement of Net Assets and the Statement of Activities report financial information on all 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. The FSM National Government did not report any business-type activities during the year ended September 30, 2011. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable. Discretely presented component unit activities are presented with their business-type focus.

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

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

The government-wide Statement of Net Assets reports \$14,303,410 of restricted net assets, of which \$2,626,699 is restricted by enabling legislation.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

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 and offset or supplant the net operating deficit or surplus from governmental operations.

C. Fund Financial Statements

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

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

D. Measurement Focus and Basis of Accounting

Government-Wide Financial Statements:

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

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.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Governmental Fund Financial Statements:

Governmental fund financial statements account for the general governmental activities of the FSM National Government and are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become susceptible to accrual; generally when they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the FSM National Government considers most revenues to be available if they are collected within 90 days of the end of the current fiscal period. Federal grants and assistance awards made on the basis of entitlement periods are recorded as revenues when available and entitlement occurs, which is generally within 12 months of the end of the current fiscal period.

Significant revenues susceptible to accrual include income and gross receipts 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.

Fiduciary Fund and Component Unit Financial Statements:

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 expenses not meeting this definition are reported as nonoperating and expenses.

The FSM National Government reports the following fund types:

1. Governmental Fund Types

i. General Fund

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

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(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. Permanent Funds

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

2. Fiduciary Fund Types

i. Private Purpose Trust Funds

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

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

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments: Omnibus*, sets forth minimum criteria (percentage of the assets, liabilities, revenues or expenditures/expenses for either fund category or the governmental and enterprise combined) for the determination of major funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The nonmajor funds are combined in a column in the fund financial statements and detailed in the combining statements. The FSM National Government reports the following major funds:

Grants Assistance Fund, a Governmental Fund Type - Special Revenue Fund, which was established to account for all financial transactions that are subgranted to the FSM National Government, including federal assistance funds received from the United States government by the FSM National Government.

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



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

E. Reporting Standards

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

F. Cash and Cash Equivalents and Time Certificates of Deposit

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

G. Investments

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

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

H. Receivables

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

Receivables of the primary government and the discretely presented component units are primarily due from businesses and individuals residing in the FSM. The allowance for uncollectible amounts primarily represents estimated allowances for uncollectible amounts that are determined based upon past collection experience and aging of the accounts.

I. Prepaid Items

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

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Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

J. Interfund Receivables/Payables

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

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

K. Inventories

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

L. Restricted Assets

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through loan agreements or enabling legislation. Specifically, the FSM National Government has cash and cash equivalents recorded in the General Fund of \$3,597,321 and investments recorded in the Compact Trust Fund of \$10,377,390, which are restricted in that they are not available to be used in current operations. Included in the General Fund cash and cash equivalents is \$311,647 representing Asian Development Bank loan proceeds maintained in an imprest revolving fund that are not available to be used in current operations.

M. Capital Assets

Capital assets, which include property, plant, equipment and infrastructure (e.g. roads, bridges, ramps and other similar items), are reported in the governmental activity column of the government-wide financial statements. Singular pieces of equipment, vehicles, computer equipment and software that equal or exceed \$1,000 are capitalized. Buildings and infrastructure projects with a cost that equals or exceeds \$50,000 are capitalized. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair market value at the date of donation.

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

M. Capital Assets, Continued

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

Buildings and improvements	20 - 50 years
Infrastructure	20 years
Computer equipment	5 years
Furniture, equipment and machinery	3 - 20 years
Boats	25 years
Aircraft	20 years
Motor vehicles	3 - 10 years

N. 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.

O. 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 from grants assistance funds received in advance of eligible expenditures.

P. Compensated Absences

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

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

Q. Fund Balance

GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, was implemented, effective for the fiscal year ending September 30, 2011. It establishes fund balance classifications based on the extent to which the State is bound to honor constraints on the specific purposes for which amounts in those funds can be spent. As a result of implementing this statement, there were significant changes in the FSM National Government's fund structure. Funds that did not meet the new special revenue fund definition were moved to the General Fund. Amounts previously reported as reserved and unreserved fund balance are now reported under the following fund balance classifications:

- Non-spendable - includes fund balance amounts that cannot be spent either because it is not in spendable form or because of legal or contractual constraints.
- Restricted - includes fund balance amounts that are constrained for specific purposes which are externally imposed by providers, such as creditors or amounts constrained due to constitutional provisions or enabling legislation.
- Committed - includes fund balance amounts that are constrained for specific purposes that are internally imposed by the government through formal action of the highest level of decision making authority and does not lapse at year-end.
- Assigned - includes fund balance amounts that are intended to be used for specific purposes that are neither considered restricted or committed.
- Unassigned includes negative fund balances in other governmental funds.

The FSM National Government has a general policy to first use restricted resources for expenditures incurred for which both restricted and unrestricted (committed, assigned, and unassigned) resources are available. When expenditures are incurred for which only unrestricted resources are available, the general policy of the FSM National Government is to use committed resources first, followed by assigned, and then unassigned. The use of restricted/committed resources may be deferred based on a review of the specific transaction.

A formal minimum fund balance policy has not been adopted.

R. Risk Financing

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

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

S. New Accounting Standards

During fiscal year 2011, the FSM National Government implemented the following pronouncements:

- GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in the governmental funds. The Statement requires governments to disclose information in the notes about the processes through which constraints are imposed, as well as accounting policies that determine whether restricted, committed, assigned, and unassigned amounts are considered to be spent. This Statement also provides guidance for classifying stabilization amounts on the face of the balance sheet and requires disclosure of certain information about stabilization arrangements in the notes to the financial statements. As a result of implementation, the Statement of Revenues, Expenditures and Changes in Fund Balance for Governmental Funds have been restated due to reclassification of funds. Beginning fund balances for the Section 111 Investment Development Fund, the Asian Development Bank Loan Fund, and the FSM Trust Fund decreased by \$8,836,261, \$34,195,507 and \$8,328,558, respectively, while the General Fund correspondingly increased by \$51,360,326. Details on the FSM National Government's fund balance classifications are reflected in note 11.
- GASB Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to measurement of OPEB obligations by certain employers participating in agent multiple-employer OPEB plans. The provisions of Statement 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM National Government.

In December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM National Government.

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Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

S. New Accounting Standards, Continued

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*, which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM National Government.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM National Government.

In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM National Government.

In July 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions* (an amendment of GASB Statement No. 53), which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty’s credit support provider, is replaced. The provisions of this statement are effective for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM National Government.

T. 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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. Actual results could differ from those estimates.

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

U. Total Columns

Total columns are presented primarily to facilitate financial analysis. The Management's Discussion and Analysis includes certain prior year summarized comparative information in total. Such information does not include sufficient detail to constitute a full comparative presentation. Accordingly, such information should be read in conjunction with the FSM National Government's financial statements for the year ended September 30, 2010 from which summarized information was derived.

(2) Deposits and Investments

GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

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

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

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

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

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2011

(2) Deposits and Investments, Continued

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

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

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

A. Deposits

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

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

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

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

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



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(2) Deposits and Investments, Continued

A. Deposits, Continued

As of September 30, 2011, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit was \$8,070,689 and the corresponding bank balances were \$9,513,433. Of the bank balances, \$6,503,961 is maintained in financial institutions subject to FDIC insurance while \$1,750,194 represents short-term investments held and administered by FSM National Government's trustees in accordance with various trust agreements and bond indentures. Based on negotiated trust and custody contracts, all of these investments were held in FSM National Government's name by FSM National Government's custodial financial institutions at September 30, 2011 while the remaining amount of \$1,259,278 is maintained in financial institutions not subject to FDIC insurance. As of September 30, 2011, bank deposits in the amount of \$3,700,855 were FDIC insured. The FSM National Government does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

As of September 30, 2011, the carrying amount of the fiduciary funds' total cash and cash equivalents and time certificates of deposit was \$2,333,810 and the corresponding bank balances were \$2,593,245. Of the bank balances, \$1,885,303 is maintained in financial institutions subject to FDIC insurance. As of September 30, 2011, bank deposits in the amount of \$500,000 were FDIC insured. The fiduciary funds do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

As of September 30, 2011, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit was \$23,033,808 and the corresponding bank balances were \$23,868,499. Of this amount, \$20,236,944 is maintained in financial institutions subject to FDIC insurance and \$3,631,555 is maintained in financial institution subject to coverage by Securities Investor Protection Corporation (SIPC). As of September 30, 2011, bank deposits in the amount of \$2,878,385 were FDIC insured and \$250,000 is subject to coverage by SIPC. The component units do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

The FSM National Government maintains equity membership shares in the United Nations and Asian Development Bank amounting to \$8,077,292, which are recorded as deposits and other assets.

B. Investments

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

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

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

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2011

(2) Deposits and Investments, Continued

B. Investments, Continued

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

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

Primary Government

As of September 30, 2011, the FSM National Government's investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ <u>5,743,813</u>
Other investments:	
Equities	22,614,434
Money market funds	48,608
Cash management accounts	<u>3,479,114</u>
	<u>26,142,156</u>
	\$ <u>31,885,969</u>

Additionally, the primary government owns 50,000 shares of the outstanding common stock of a commercial enterprise located in the Commonwealth of the Northern Marianas. The investment of \$1,500,000 is accounted for at cost since the investment constitutes less than a 20% ownership share. Furthermore, the primary government owns 288,092 shares of the outstanding common stock of the Bank of the Federated States of Micronesia, which engages in commercial banking services in the FSM. The investment of \$3,725,018 is accounted for at cost since management is of the opinion that the FSM National Government does not exert significant influence over the investee.

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2011

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

As of September 30, 2011, the primary government's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

Investment Type	Rating Type	Maturity (in years)				Total
		Less than 1	1-5	6-10	Over	
U.S. Treasury Notes and Bonds	Aaa/AAA	\$ 22,873	\$ 502,439	\$ 230,839	\$ 279,913	\$ 1,036,064
U.S. Government Agencies Obligations:						
Federal Farm Credit Banks	AAA	-	5,025	-	-	5,024
Federal Home Loan Banks	AAA	-	89,683	-	-	89,683
Federal Home Loan Mortgage Corporation	AAA	-	1,660	20,321	448,063	470,044
Government National Mortgage Association	AAA	-	-	-	899,045	899,045
Federal National Mortgage Association	AAA	37,655	4,978	12,635	255,445	310,713
Private Export Funding Corporation	AAA	-	124,055	-	-	124,055
Tennessee Valley Authority	AAA	-	-	-	10,690	10,690
Tennessee Valley Authority Fed Book Notes	AAA	-	-	-	92,841	92,841
Small Business Administration	No rating	-	-	-	68,367	68,367
Housing Urban Development Financing Corporation	No rating	-	17,173	-	-	17,173
	No rating	-	-	74,936	-	74,936
Municipal Obligations	Aa1	-	-	17,407	93,371	110,778
Municipal Obligations	Aa2	-	-	-	56,055	56,055
Municipal Obligations	Aa3	-	45,764	-	-	45,764
Municipal Obligations	A1/A+	-	-	-	178,281	178,281
Municipal Obligations	No rating	-	-	76,409	-	76,409
Corporate Bonds	Aaa/AAA	-	52,865	58,508	153,332	264,705
Corporate Bonds	Aa1/AA+	-	47,544	12,487	-	60,031
Corporate Bonds	Aa2/AA	-	68,908	24,398	11,765	105,071
Corporate Bonds	Aa3/AA-	5,125	52,516	49,156	-	106,797
Corporate Bonds	A1/A+	10,243	93,360	38,206	44,033	185,842
Corporate Bonds	A2/A	10,435	300,541	54,570	-	365,546
Corporate Bonds	A3/A-	5,286	181,579	112,641	15,243	314,749
Corporate Bonds	Baa1/BBB+	-	131,458	8,948	-	140,406
Corporate Bonds	Baa2/BBB	-	207,837	-	6,293	214,130
Corporate Bonds	No rating	24,033	107,072	8,361	181,147	320,613
		\$ 115,650	\$ 2,034,457	\$ 799,822	\$ 2,793,884	\$ 5,743,813

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

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the FSM National Government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The FSM National Government's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the FSM National Government's name by the FSM National Government's custodial financial institutions at September 30, 2011.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, 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, 2011, the FSM National Government did not hold an investment in any one issuer that represented more than 5% of the FSM National Government's total investments.

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

Fiduciary Funds

FSM Social Security Administration (FSMSSA):

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

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

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(2) Deposits and Investments, Continued

B. Investments, Continued

Fiduciary Funds, Continued

FSM Social Security Administration (FSMSSA), Continued:

- iv. Insurance company obligations - Contracts and agreements supplemental thereto providing for participation in one or more accounts of a life insurance company authorized to do business in the FSM or in any state, territory or commonwealth of the United States provided that the total market value of these investments at no time shall exceed ten percent of all investments of the FSMSSA Retirement Fund.

As of December 31, 2011, the FSMSSA's investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ <u>13,384,226</u>
Other investments:	
Domestic equities	16,403,466
International equities	<u>5,433,179</u>
	<u>21,836,645</u>
	\$ <u>35,220,871</u>

As of December 31, 2011, FSMSSA's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

	<u>Investment Maturities (In Years)</u>				
	Less <u>Than 1</u>	<u>1 to 5</u>	<u>6 to 10</u>	Greater <u>Than 10</u>	Fair <u>Value</u>
U.S. Treasury obligations	\$ 599,976	\$ 626,392	\$ 121,369	\$ 643,337	\$ 1,991,074
Mortgage and asset-backed securities	-	100,912	483,225	4,882,302	5,466,439
Corporate notes and bonds	<u>204,263</u>	<u>2,163,290</u>	<u>2,110,852</u>	<u>1,448,308</u>	<u>5,926,713</u>
	<u>\$ 804,239</u>	<u>\$ 2,890,594</u>	<u>\$ 2,715,446</u>	<u>\$ 6,973,947</u>	<u>\$ 13,384,226</u>

FSMSSA's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in FSMSSA's name by FSMSSA's custodial financial institutions at December 31, 2011.

As of December 31, 2011, FSMSSA did not hold an investment in any one issuer that represented more than 5% of FSMSSA's total investments.

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

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units

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

FSM Telecommunications Corporation (FSMTC):

As of September 30, 2011, the FSMTC's investments at fair value are as follows:

Fixed income securities:		
U.S. Treasury obligations	\$	624,800
U.S. Government agencies		297,077
Corporate notes		922,941
International bonds		<u>44,447</u>
		1,889,265
Other investments:		
Domestic and international equities		2,460,770
Money market funds		<u>213,398</u>
	\$	<u>4,563,433</u>

As of September 30, 2011, FSMTC's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

	Moody's Credit Rating	Investment Maturities (In Years)				Fair Value
		Less			Greater	
		Than 1	1 to 5	6 to 10	Than 10	
U.S. Treasury obligations	Aaa/P-1	\$ 182,925	\$ 256,900	\$ 184,975	\$ -	\$ 624,800
U.S. Government agencies	Aaa/P-1	77,905	219,172	-	-	297,077
International bonds	Aa1/P-1	-	44,447	-	-	44,447
Corporate notes	A1/P-1		157,664	130,495	-	288,159
Corporate notes	A2/P-1	111,025	108,037	-	-	219,062
Corporate notes	Aa2/P-1	-	169,803	-	-	169,803
Corporate notes	Aa3/P-1	-	140,703	105,214	-	245,917
		<u>\$ 371,855</u>	<u>\$ 1,096,726</u>	<u>\$ 420,684</u>	<u>\$ -</u>	<u>\$ 1,889,265</u>

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(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units, Continued

College of Micronesia - FSM (COM-FSM):

As of September 30, 2011, the COM-FSM's investments at fair value are as follows:

Fixed income securities:		
Domestic fixed income	\$	735,548
International fixed income		<u>28,162</u>
		<u>763,710</u>
Other investments:		
Common equities		2,072,279
Money market funds		<u>145,923</u>
		<u>2,218,202</u>
	\$	<u>2,981,912</u>

As of September 30, 2011, COM-FSM's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment Maturities (in years)</u>			
		<u>Less than 1</u>	<u>1-5</u>	<u>5-10</u>	<u>more than 10</u>
Mortgage and asset backed	\$ 281	\$ -	\$ -	\$ -	\$ 281
International bond	28,162	9,208	-	18,954	-
Corporate bond	258,026	-	101,556	84,540	71,930
Government bond	<u>477,241</u>	<u>141,528</u>	<u>117,313</u>	<u>139,919</u>	<u>78,481</u>
	\$ <u>763,710</u>	\$ <u>150,736</u>	\$ <u>218,869</u>	\$ <u>243,413</u>	\$ <u>150,692</u>
<u>Moody's Rating</u>		<u>Total</u>	<u>Domestic</u>	<u>International</u>	
AAA/AAA		\$ 477,241	\$ 477,241	\$ -	
AA1/AA		11,051	11,051	-	
AA2/AA+		16,892	16,892	-	
AA2/AA		10,675	10,675	-	
AA2/AA-		9,194	9,194	-	
AA3/A+		9,272	9,272	-	
AA3/AA		18,491	18,491	-	
A1/A+		10,488	10,488	-	
A1/A		9,744	9,744	-	
A2/AA-		8,292	8,292	-	
A2/A		27,975	27,975	-	
A2/A-		10,471	10,471	-	
A3/A		8,134	8,134	-	
A3/A-		28,593	19,385	9,208	
A3/BBB+		9,136	-	9,136	
BAA1/A-		9,818	-	9,818	
BAA1/BBB+		30,380	30,380	-	
BAA2/A-		7,984	7,984	-	
BAA2/BBB		17,186	17,186	-	

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2011

(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units, Continued

College of Micronesia - FSM (COM-FSM), Continued:

<u>Moody's Rating</u>	<u>Total</u>	<u>Domestic</u>	<u>International</u>
BAA2/BBB-	3,141	3,141	-
BAA3/BBB-	19,090	19,090	-
BA2/BBB	10,182	10,182	-
Not Rated	<u>280</u>	<u>281</u>	<u>-</u>
Total credit risk debt securities	\$ <u>763,710</u>	\$ <u>735,548</u>	\$ <u>28,162</u>

FSM Development Bank (FSMDB):

As of December 31, 2011, FSMDB's investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ 3,287,268
Other investments:	
Domestic equities	4,954,480
Money market funds	<u>1,272,196</u>
	\$ <u>9,513,944</u>

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

As of December 31, 2011, FSMDB's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

	Less Than <u>1 Year</u>	1 to 5 <u>Years</u>	6 to 10 <u>Years</u>	Greater Than <u>10 Years</u>	Fair <u>Value</u>
U.S. Treasury obligations	\$ 368,603	\$ 1,336,638	\$ 348,436	\$ 348,436	\$ 2,053,677
U.S. Government agency obligations	<u>234,979</u>	<u>840,365</u>	<u>158,247</u>	<u>158,247</u>	<u>1,233,591</u>
	<u>\$ 603,582</u>	<u>\$ 2,177,003</u>	<u>\$ 506,683</u>	<u>\$ 506,683</u>	<u>\$ 3,287,268</u>

	<u>Domestic</u>
Moody's Rating – AAA	\$ <u>3,287,268</u>



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Notes to Financial Statements  
September 30, 2011

(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units, Continued

National Fisheries Corporation (NFC):

NFC owns 50,493 shares of the outstanding common stock of the Micronesia Longline Fishing Company, Inc., an unconsolidated entity, representing a 97% ownership share. Additionally, NFC owns 50% of the shares of the outstanding common stock of the following unconsolidated entities: Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc. These investments have been written down to a nil value.

MiCare Plan, Inc. (the Plan):

As of September 30, 2011, the Plan's investments at fair value are as follows:

Fixed income securities:		
Domestic fixed income		\$ 1,228,998
Other investments:		
Money market funds		<u>7,566</u>
		<u>\$ 1,236,564</u>

As of September 30, 2011, the Plan's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

	Moody's Credit Rating	Less Than 1 Year	1 to 5 Years	6 to 10 Years	Greater Than 10 Years	Fair Value
U.S. Treasury obligations	AAA	\$ 45,088	\$ 209,459	\$ -	\$ -	\$ 254,547
U.S. Government agencies obligations	AAA	305,501	393,473	-	-	698,974
Corporate bonds	AAA	5,182	8,425	-	-	13,607
Corporate bonds	AA1	-	5,386	-	-	5,386
Corporate bonds	AA2	-	33,443	-	-	33,443
Corporate bonds	AA3	5,138	31,242	-	-	36,380
Corporate bonds	A1	7,113	27,153	2,102	-	36,368
Corporate bonds	A2	7,098	70,549	-	-	77,647
Corporate bonds	A3	-	20,894	2,101	-	22,995
Corporate bonds	BAA1	-	36,270	-	-	36,270
Corporate bonds	BAA2	-	8,318	-	-	8,318
Corporate bonds	Not Rated	<u>5,063</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>5,063</u>
		<u>\$ 380,183</u>	<u>\$ 844,612</u>	<u>\$ 4,203</u>	<u>\$ -</u>	<u>\$ 1,228,998</u>

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2011

**(3) Receivables**

Receivables as of September 30, 2011, for the primary government's individual major governmental funds, and nonmajor governmental and fiduciary funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	<u>General</u>	<u>Grants Assistance</u>	<u>Compact Trust</u>	<u>Nonmajor and Fiduciary Funds</u>	<u>Totals</u>
Receivables:					
General	\$ 1,580,385	\$ -	\$ -	\$ -	\$ 1,580,385
Taxes	4,446,650	-	-	-	4,446,650
Government agencies	1,709,598	17,874,625	-	27,265	19,611,488
Contributions	-	-	-	3,051,613	3,051,613
Loans	53,614,774	-	-	1,661,854	55,276,628
Accrued interest	47,297	-	-	93,154	140,451
Other	-	-	-	11,668	11,668
	<u>61,398,704</u>	<u>17,874,625</u>	<u>-</u>	<u>4,845,554</u>	<u>84,118,883</u>
Less: allowance for uncollectable accounts	<u>(14,674,608)</u>	<u>(496,553)</u>	<u>-</u>	<u>(1,602,172)</u>	<u>(16,970,333)</u>
Net receivables	<u>\$ 46,527,096</u>	<u>\$ 17,378,072</u>	<u>\$ -</u>	<u>\$ 3,243,382</u>	<u>\$ 67,148,550</u>

Loans receivable of the primary government are as follows:

**General Fund:**

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

Loan receivable from the State of Chuuk, payable in quarterly installments of \$416,667, non-interest bearing with a service charge of 1% per annum, due on September 30, 2001. This loan has been fully provided for in the allowance for uncollectable accounts. 737,563

Loan receivable from the State of Kosrae, payable in quarterly installments of \$37,500, non-interest bearing, on each of the first day of the month of October, January, April and July starting on October 1, 2009 and ending on July 1, 2019. 1,350,000

Loans receivable from businesses and individuals at varying terms and conditions administered by the FSM Development Bank. 7,061,191

Loan receivable from Micronesia Longline Fishing Company, a majority-owned subsidiary of NFC, in the amount of SDR 3,514,000, interest at 6.64% per annum, repayments commencing January 15, 1998, with a maturity date of July 15, 2007. The loan is a subsidiary loan of a loan agreement (Loan Number 1257 FSM (SF)) between the FSM National Government and the ADB. This loan has been fully provided for in the allowance for uncollectible accounts. 4,893,527

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NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(3) Receivables, Continued

General Fund, Continued:

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

	<u>Gov Fund</u>	<u>Gov-Wide</u>	
Chuuk Public Utility Corporation	\$ 3,574,471	\$ 348,768	
Pohnpei Utilities Corporation	2,195,228	569,737	
Yap State Public Service Corporation	<u>2,347,726</u>	<u>373,708</u>	
	\$ <u>8,117,425</u>	\$ <u>1,292,213</u>	9,409,638

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

	<u>Gov Fund</u>	<u>Gov-Wide</u>	
State of Chuuk	\$ 4,844,923	\$ 779,681	
State of Yap	3,200,137	514,976	
State of Kosrae	1,828,026	294,185	
State of Pohnpei	<u>3,839,291</u>	<u>617,849</u>	
	\$ <u>13,712,377</u>	\$ <u>2,206,692</u>	15,919,069

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

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NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(3) Receivables, Continued

General Fund, Continued

	<u>Gov Fund</u>	<u>Gov-Wide</u>	
State of Chuuk	\$ 966,640	\$ 66,726	
State of Kosrae	243,374	15,993	
State of Yap	<u>366,557</u>	<u>22,357</u>	
	<u>\$ 1,576,571</u>	<u>\$ 105,076</u>	1,681,647

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

	<u>Gov Fund</u>	<u>Gov-Wide</u>	
State of Chuuk	\$ 1,771,759	\$ 174,195	
State of Yap	1,185,134	143,846	
State of Kosrae	1,450,131	195,531	
State of Pohnpei	<u>1,259,847</u>	<u>102,320</u>	
	<u>\$ 5,666,868</u>	<u>\$ 615,892</u>	6,283,449

Loans receivable from the States and the states' component units to enhance public health and the environment through assistance to improve water supply infrastructure in Kosrae and Yap, and wastewater infrastructure in Pohnpei; and to support economic growth and poverty reduction in Chuuk through improvements to the electrical power sector. These loans are subsidiary loans of loan agreements Loan Number 2099 FSM (SF) and Loan Number 2100 FSM (SF)) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States whereby a portion of the loan proceeds under these ADB loans were relent under the same terms and conditions imposed by the ADB. The amounts outstanding from the States and the States' component units are as follows:

State of Chuuk/CPUC	\$ 458,878		
State of Kosrae/KUA	209,724		
State of Pohnpei/PUC	4,519,382		
State of Yap/GTWA	<u>1,711,268</u>		<u>6,899,252</u>
			<u>\$ 57,580,091</u>

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2011

(3) Receivables, Continued

General Fund, Continued

During the year end September 30, 2011, the FSM National Government determined prior loan drawdowns of \$1,934,018, originally allocated to the FSM National Government are to be allocated to the States, which also resulted in an increase in loans receivable from the States of the same amount.

Nonmajor Governmental and Fiduciary Funds

Student Loan Fund:

Loans receivable from students under a student financial assistance loan program, interest at 4% per annum, with repayment commencing ten years and nine months after completion of study. These loans have been fully provided for in the allowance for uncollectible accounts. \$ 1,606,953

Pohnpei Development Loan Fund:

Loans receivable from businesses and individuals at varying terms and conditions administered by the FSM Development Bank. 28,827

Yap Development Loan Fund:

Loans receivable from businesses and individuals at varying terms and conditions administered by the FSM Development Bank. 26,074

\$ 1,661,854

Receivables as of September 30, 2011, for the discretely presented component units, including applicable allowances for uncollectible accounts, are as follows:

	FSM Tele- Communications Corporation	FSM Development Bank	National Fisheries Corporation	College of Micronesia- FSM	FSM Coconut Development Authority	FSM Petroleum Corporation	Caroline Islands Air, Inc.	MiCare Plan, Inc.	Total
Receivables:									
General	\$1,431,433	\$ 7,632	\$ 1,062,591	\$ 4,540,499	\$ 64,995	\$1,505,502	\$ 11,947	\$ 112,363	\$ 8,736,962
Loans	-	24,057,757	-	-	-	-	-	-	24,057,757
Interest	131,578	268,847	-	-	-	-	-	-	400,425
Other	<u>2,610</u>	<u>448,305</u>	<u>-</u>	<u>2,362,113</u>	<u>-</u>	<u>1,223,981</u>	<u>-</u>	<u>247,412</u>	<u>4,284,421</u>
	1,565,621	24,782,541	1,062,591	6,902,612	64,995	2,729,483	11,947	359,775	37,479,565
Less: allowance for uncollectible accounts	<u>(837,062)</u>	<u>(3,591,329)</u>	<u>(1,026,102)</u>	<u>(1,209,042)</u>	<u>(40,511)</u>	<u>-</u>	<u>-</u>	<u>(110,982)</u>	<u>(6,815,028)</u>
	<u>\$ 728,559</u>	<u>\$ 21,191,212</u>	<u>\$ 36,489</u>	<u>\$ 5,693,570</u>	<u>\$ 24,484</u>	<u>\$ 2,729,483</u>	<u>\$ 11,947</u>	<u>\$ 248,793</u>	<u>\$ 30,664,537</u>

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2011

**(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, 2011, are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Grants Assistance	\$ 5,901,875
Grants Assistance	General	2,885,133
Nonmajor governmental funds	General	<u>2,664,375</u>
		<u>\$ 11,451,383</u>

Receivables and payables between funds reflected as due to/due from component units in the statement of net assets at September 30, 2011, are summarized as follows:

	<u>Due From</u>	<u>Due To</u>
<b><u>Primary Government</u></b>		
General Fund:		
FSM Petroleum Corporation	\$ 500,000	\$ -
College of Micronesia-FSM	<u>-</u>	<u>304,640</u>
	<u>\$ 500,000</u>	<u>\$ 304,640</u>

**(5) Capital Assets**

Capital asset activities of the primary government for the year ended September 30, 2011, are as follows:

	Balance October 1, 2010	<u>Additions and Reclassifications</u>	<u>Retirements and Reclassifications</u>	Balance September 30, 2011
Governmental Activities:				
Buildings and improvements	\$ 23,335,215	\$ 8,202,559	\$ -	\$ \$31,537,774
Boats	22,223,777	329,324	-	22,553,101
Infrastructure	17,738,637	41,125,532	-	58,864,169
Motor vehicles	5,612,509	553,777	(231,602)	5,934,684
Computer equipment	4,775,133	(6,237)	(66,538)	4,702,358
Aircraft	709,207	-	-	709,207
Furniture, equipment and machinery	<u>8,477,072</u>	<u>392,608</u>	<u>(45,778)</u>	<u>8,823,902</u>
	<u>82,871,550</u>	<u>50,597,563</u>	<u>(343,918)</u>	<u>133,125,195</u>
Less accumulated depreciation:				
Buildings and improvements	(4,829,569)	(504,322)	-	(5,333,891)
Boats	(12,745,096)	(959,563)	-	(13,704,659)
Infrastructure	(341,207)	(1,974,159)	-	(2,315,366)
Motor vehicles	(4,424,430)	(495,426)	143,594	(4,776,262)
Computer equipment	(3,578,507)	(368,429)	62,265	(3,884,671)
Aircraft	(406,728)	(35,461)	-	(442,189)
Furniture, equipment and machinery	<u>(5,136,531)</u>	<u>(894,966)</u>	<u>45,779</u>	<u>(5,985,721)</u>
	<u>(31,462,068)</u>	<u>(5,232,326)</u>	<u>251,638</u>	<u>(36,442,756)</u>
Construction in progress	<u>74,868,004</u>	<u>53,161,777</u>	<u>(49,328,092)</u>	<u>78,701,689</u>
	<u>\$ 126,277,486</u>	<u>\$ 98,527,014</u>	<u>\$ (49,420,372)</u>	<u>\$ 175,384,128</u>

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2011

(5) Capital Assets, Continued

The primary government has assumed a construction management role for various infrastructure capital projects. These capital projects are accounted for at the government-wide level as construction in progress until completion of the project and resulting turnover to the applicable beneficiary. Until formal turnover occurs, the assets are capitalized and are depreciated by the primary government. Furthermore, the construction in progress is restated in the amount of \$7,523,038 to reflect prior years expenditures determined to be capitalizable in current year.

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

Office of the President	\$ 52,877
Foreign affairs	30,529
Health and social affairs	355,202
Education	74,496
Resources and development	50,225
Office of National Archives, Cultural and Historic	7,898
Transportation, communication and infrastructure	1,518,778
Finance and administration	72,380
Justice	395,488
Office of the Public Defender	5,279
SBOC Office	81,208
Judiciary	41,910
Legislature	123,287
Office of the National Public Auditor	20,546
Environment and emergency management	5,160
National government programs	165,340
Agencies, Boards and commissions	41,629
Capital projects	<u>2,190,094</u>
	<u>\$ 5,232,326</u>

(6) Long-Term Obligations

Primary Government

Asian Development Bank (ADB) Loan Number 1257 FSM (SF) - Fisheries Development Project Loan (SDR 3,792,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semi-annually commencing January 15, 2004 in an amount of SDR 46,100 increasing to SDR 92,400 on January 15, 2014, with a maturity date of July 15, 2033. \$ 5,343,276

ADB Loan Number 1459 FSM (SF) - Water Supply and Sanitation Project Loan (SDR 7,233,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semi-annually commencing February 1, 2007 in an amount of SDR 69,200, increasing to SDR 138,500 on February 1, 2017, with a maturity date of August 1, 2036. 9,409,639

**FEDERATED STATES OF MICRONESIA  
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(6) Long-Term Obligations, Continued

Primary Government, Continued

ADB Loan Number 1520 FSM (SF) - Public Sector Reform Program Loan (SDR 12,979,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semi-annually commencing February 1, 2008 in an amount of SDR 129,800, increasing to SDR 259,600 on February 1, 2018, with a maturity date of August 1, 2037. 18,715,129

ADB Loan Number 1816 FSM (SF) - Basic Social Services Project Loan (SDR 6,199,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semi-annually commencing February 1, 2009 in an amount of SDR 129,145, at which time the service charge increases to 1.5% per annum, with a maturity date of August 1, 2032. 3,652,449

ADB Loan Number 1873 FSM (SF) - Private Sector Development Program Loan (SDR 3,912,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semi-annually commencing May 15, 2010 in an amount of SDR 122,250, at which time the service charge increases to 1.5% per annum, with a maturity date of November 15, 2025. 3,527,341

ADB Loan Number 1874 FSM (SF) - Private Sector Development Project Loan (SDR 6,273,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semi-annually commencing May 15, 2010 in an amount of SDR 130,687, at which time the service charge increases to 1.5% per annum, with a maturity date of November 15, 2033. 6,735,419

ADB Loan Number 2100 FSM (SF) - Omnibus Infrastructure Development Project (SDR 9,686,000), interest bearing equivalent to the sum of LIBOR and .60% per annum on the amount of the loan withdrawn from the Loan account with a loan term of 25 years including a grace period of 5 years. The loan is payable semi-annually commencing January 15, 2010, at which time the grace period ends, in an amount of .83% of the outstanding loan balance and incrementing at certain years between .04% - .16% up to the maturity date of July 15, 2029. 1,457,771

ADB Loan Number 2099 FSM (SF) - Omnibus Infrastructure Development Project (SDR 9,686,000), interest bearing at the rate of 1% per annum on the amount of the loan withdrawn from the Loan Account during the grace period. The loan is payable semi-annually commencing January 15, 2013 in an amount of SDR 201,791, at which time the interest rate increases to 1.5% per annum, with a maturity date of July 15, 2036. 5,762,177

\$ 54,603,201



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(6) Long-Term Obligations, Continued

Primary Government, Continued

The abovementioned ADB loans payable are uncollateralized and are backed by the full faith and credit of the FSM National Government.

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest Service Charge</u>	<u>Total</u>
2012	\$ 1,537,553	\$ 613,901	\$ 2,151,454
2013	1,732,737	623,845	2,356,582
2014	1,863,256	601,773	2,465,029
2015	1,867,192	578,400	2,445,592
2016	1,871,274	554,992	2,426,266
2017-2021	12,108,633	2,368,957	14,477,590
2022-2026	12,582,803	1,634,558	14,217,361
2027-2031	11,433,874	924,793	12,358,667
2032-2036	8,793,252	309,918	9,103,170
2037	<u>812,627</u>	<u>8,126</u>	<u>820,753</u>
	<u>\$ 54,603,201</u>	<u>\$ 8,219,263</u>	<u>\$ 62,822,464</u>

Other long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2011, 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, 2010</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance September 30, 2011</u>	<u>Due Within One Year</u>
Loans payable:					
ADB Loan 1257 FSM (SF)	\$ 5,534,024	\$ -	\$ (190,748)	\$ 5,343,276	\$ 127,166
ADB Loan 1459 FSM (SF)	9,618,610	-	(208,971)	9,409,639	208,971
ADB Loan 1520 FSM (SF)	19,122,004	-	(406,875)	18,715,129	406,875
ADB Loan 1816 FSM (SF)	3,826,376	-	(173,927)	3,652,449	173,927
ADB Loan 1873 FSM (SF)	3,770,607	-	(243,266)	3,527,341	243,265
ADB Loan 1874 FSM (SF)	7,034,771	-	(299,352)	6,735,419	299,352
ADB Loan 2100 FSM (SF)	171,436	1,289,663	(3,328)	1,457,771	77,997
ADB Loan 2099 FSM (SF)	<u>1,557,284</u>	<u>4,206,950</u>	<u>(2,057)</u>	<u>5,762,177</u>	<u>-</u>
	50,635,112	5,496,613	(1,528,524)	54,603,201	1,537,553
Other:					
Compensated absences payable	<u>1,539,521</u>	<u>-</u>	<u>(325,515)</u>	<u>1,214,006</u>	<u>398,085</u>
	<u>\$ 52,174,633</u>	<u>\$ 5,496,613</u>	<u>\$ (1,854,039)</u>	<u>\$ 55,817,207</u>	<u>\$ 1,935,638</u>

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(6) Long-Term Obligations, Continued

Discretely Presented Component Units

As of September 30, 2011, the discretely presented component units had the following long-term debt outstanding:

FSM Telecommunications Corporation (FSMTC):

Loan with the Rural Utilities Service (RUS) (formerly the Rural Electrification Administration) from the Rural Electrification and Telephone Revolving Fund, dated August 1, 1990 of \$39.6 million, with interest at 5% per annum. Mortgages over specific FSMTC ground leases and essentially all assets of FSMTC collateralize the loan. \$ 31,932,858

National Fisheries Corporation (NFC):

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

FSM Development Bank (FSMDB):

Bank line of credit agreement with Export and Import Bank of China in the amount of \$2,000,000, due July 21, 2013, for the purpose of funding loan programs. The loan is uncollateralized, bears interest at 7.38% per annum. Repayment of principal and interest commenced January 21, 2008 in semi-annual installments of \$200,000. 1,110,755

FSM Petroleum Corporation (FSMPC):

Note payable to bank for purposes of acquiring capital assets, due in monthly installments of \$57,949, with interest at 7.75% per annum, final payment due on March 2019, unconditionally guaranteed by the FSM National Government. The loan is essentially collateralized by all assets of FSMPC. 2,651,195

\$ 39,294,808

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2011

**(6) Long-Term Obligations, Continued**

Discretely Presented Component Units, Continued

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 5,961,457	\$ 1,788,770	\$ 7,750,227
2013	2,490,348	1,647,042	4,137,390
2014	2,207,511	1,507,738	3,715,249
2015	2,332,614	1,382,635	3,715,249
2016	2,073,134	1,257,641	3,330,775
2017-2021	10,288,175	4,811,158	15,099,333
2022-2026	13,856,937	1,920,995	15,777,932
2027-2031	<u>84,632</u>	<u>10,247</u>	<u>94,879</u>
	<u>\$ 39,294,808</u>	<u>\$ 14,326,226</u>	<u>\$ 53,621,034</u>

Changes in long-term liabilities of the discretely presented component units for the year ended September 30, 2011, are as follows:

	Balance October 1, 2010	<u>Additions</u>	<u>Reductions</u>	Balance September 30, 2011	Due Within <u>One Year</u>
Loans payable:					
FSMTC	\$ 33,138,933	\$ -	\$ (1,206,075)	\$ 31,932,858	\$ 1,434,871
NFC	3,600,000	-	-	3,600,000	3,600,000
FSMDB	1,316,564	194,191	(400,000)	1,110,755	400,000
FSMPC	<u>3,622,820</u>	<u>-</u>	<u>(971,625)</u>	<u>2,651,195</u>	<u>526,586</u>
	<u>\$ 41,678,317</u>	<u>\$ 194,191</u>	<u>\$ (2,577,700)</u>	<u>\$ 39,294,808</u>	<u>\$ 5,961,457</u>

**(7) Short-Term Obligations**

Discretely Presented Component Units

FSM Telecommunications Corporation (FSMTC):

FSMTC has one line of credit facility with a bank of \$4,464,580 with interest at 5.25% per annum, collateralized by investment securities. The amount drawn against this facility and payable at September 30, 2011 is \$2,331,054.

FSM Petroleum Corporation (FSMPC):

FSMPC have one line of credit facility (LOC) with a bank of \$4,300,000. The LOC is evidenced by promissory notes drawn on various dates for various amounts. This line of credit is utilized by FSMPC to fund fuel inventory purchases. The LOC and the related long-term obligation are secured and collateralized by an executed Pledge and Security Agreement for the assignment of the Reserve Bank Account and Revenue, an executed Notice of Security Interest and Chattel Mortgage and are guaranteed by the FSM National Government. No draw downs are payable by FSMPC on this facility at September 30, 2011.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(7) Short-Term Obligations, Continued

Discretely Presented Component Units, Continued

Changes in short-term borrowings during the year were as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Reductions</u>	<u>Ending Balance</u>
Line of credit: FSMTC	\$ <u>2,252,356</u>	\$ <u>78,698</u>	<u>-</u>	\$ <u>2,331,054</u>

(8) Operating Transfers In/Out

Operating transfers in/out for each major governmental fund and nonmajor governmental funds in the aggregate, for the year ended September 30, 2011, are as follows:

<u>Source</u>	<u>Recipient</u>	<u>Transfers Out</u>	<u>Transfers In</u>
<u>General Fund</u>			
General Fund	Nonmajor governmental funds	\$ 1,281,246	\$ -
Nonmajor governmental funds	General Fund	<u>-</u>	<u>285,744</u>
		<u>1,281,246</u>	<u>285,744</u>
<u>Nonmajor Governmental Funds</u>			
General Fund	Nonmajor governmental funds	-	1,281,246
Nonmajor governmental funds	General Fund	<u>285,744</u>	<u>-</u>
		<u>285,744</u>	<u>1,281,246</u>
		\$ <u>1,566,990</u>	\$ <u>1,566,990</u>

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

(9) Contingencies and Commitments

Sick Leave

It is the policy of the FSM National Government to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury.

FSM Petroleum Corporation (FSMPC) Loan Guarantee

The FSM National Government is a full faith and credit guarantor of FSMPC's loan to a bank. The FSM National Government is jointly and severally liable for FSMPC's obligations under the loan and waives the sovereign immunity of the FSM National Government with regard to any legal action arising from the guaranty.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(9) Contingencies and Commitments, Continued

FSMPC Due to States and Primary Government

FSMPC has received a grant from Japan to fund fuel acquisition. At an undetermined time, FSMPC will distribute the grant to the States; however, the amount and time at which the amount would be distributable is currently undeterminable and therefore the FSM National Government and the States have not recorded a corresponding receivable.

Insurance Coverage

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

Federal Grants

The FSM National Government participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs exist and have been set forth in the FSM National Government's Single Audit Report as of September 30, 2011. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements. In addition, a material amount of questioned costs may exist from the four States, which receive federal funds in a subrecipient capacity. If these questioned costs are sustained, such will be funded by State resources.

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

The FSM National Government is pursuing long outstanding receivables from federal grant agencies.

Leases

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

Litigation

The FSM National Government is party to various legal proceedings, many of which are normal recurrences in governmental operations. The Attorney General of the FSM National Government is of the opinion that the probable outcome of suits existing at September 30, 2011, is not predictable. No provision for any liability has been made in the accompanying financial statements because management believes that no unfavorable outcome is likely to occur.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(9) Contingencies and Commitments, Continued

Encumbrances

The FSM National Government utilizes encumbrance accounting to identify fund obligations. Encumbrances represent commitments related to unperformed contracts for goods. At September 30, 2011, the FSM National Government has significant encumbrances summarized as follows:

	<u>General</u>	<u>Grants Assistance</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Encumbrances	<u>\$2,798,792</u>	<u>\$45,990,685</u>	<u>\$283,333</u>	<u>\$49,072,790</u>

Asian Development Bank (ADB) Loans

On November 5, 2004, the FSM National Government entered into two loan agreements (Loan Number 2099 FSM (SF) and Loan Number 2100 FSM (SF)) with the Asian Development Bank in the combined amount of \$19,000,000 for the Omnibus Infrastructure Development Project. The proceeds are to be used to enhance public health and the environment through assistance to improve water supply infrastructure in Kosrae and Yap, and wastewater infrastructure in Pohnpei; and to support economic growth and poverty reduction in Chuuk through improvements to the electrical power sector, which will include on lending a portion of the loan proceeds to the States under separate Financing Agreements. As of September 30, 2011, the FSM National Government had drawn down \$7,222,005 against these loans. A substantial portion of the ADB loans are subject to currency exchange adjustments that can ultimately impact the carrying values of the debt.

(10) Special Items

Special items consist of the write-off of certain receivables and advances in the amount of \$3,896,617 and valuation of ADB Equity shares based on revised SDR rates. The revaluation amounted to \$4,618,522 which also resulted in an increase in the FSM National Government's equity shares included in the deposits and other assets account.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

**(11) Fund Balance**

Classifications of fund balances comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. The following table enumerates the fund balance classifications:

	General <u>Fund</u>	Grants Assistance <u>Fund</u>	Compact Trust <u>Fund</u>	Nonmajor <u>Funds</u>	Total Governmental <u>Funds</u>
Non-spendable:					
Loans receivable from States	\$ 36,872,490	\$ -	\$ -	\$ -	\$36,872,490
United Micronesia Dev. Assn.	1,499,100	-	-	-	1,499,100
Bank of FSM	3,720,448	-	-	-	3,720,448
Equity shares for membership	8,077,292	-	-	-	8,077,292
General government	570,124	-	-	-	570,124
Permanent Fund	-	-	10,377,390	-	10,377,390
Restricted for:					
General government	311,647	-	-	-	311,647
Committed:					
ADB	2,546,838	-	-	-	2,546,838
IDF operations loan	4,069,089	-	-	-	4,069,089
IDF operations	2,362,254	-	-	-	2,362,254
FSM trust fund	1,000,000	-	-	-	1,000,000
Public projects	4,513,358	-	-	-	4,513,358
Department of TC&I	669,634	-	-	-	669,634
Office of SBOC	385,754	-	-	-	385,754
Loan receivable from States	450,000	-	-	-	450,000
Future operations – FSM Trust	7,961,541	-	-	-	7,961,541
Other functions and programs	1,052,051	1,161,720	-	2,346,366	4,560,137
Assigned:					
Legislative branch	489,348	-	-	-	489,348
Presidents	317,661	-	-	-	317,661
National program	293,832	-	-	-	293,832
Other functions and programs	1,373,705	-	-	280,333	1,654,038
Unassigned	<u>1,851,719</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,851,719</u>
	<u>\$80,387,885</u>	<u>\$1,161,720</u>	<u>\$10,377,390</u>	<u>\$2,626,699</u>	<u>\$94,553,694</u>

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2011

(12) Restatement

Subsequent to the issuance of the FSM National Government's 2010 financial statements, FSM National Government management determined that certain account balances of the primary government's governmental activities associated with Compact Infrastructure construction in progress were understated by \$7,523,038. As a result of this determination, this account balance has been restated from the amounts previously reported as follows:

At September 30:	As Previously <u>Reported</u>	<u>As Restated</u>
Noncurrent assets:		
Capital assets, net of accumulated depreciation	\$ <u>118,754,448</u>	\$ <u>126,277,486</u>
Net assets:		
Invested in capital assets, net of related debt	\$ <u>118,754,448</u>	\$ <u>126,277,486</u>
Total net assets	\$ <u>159,475,601</u>	\$ <u>166,998,639</u>
Year ended September 30:		
Net assets at the beginning of the year	\$ <u>120,269,076</u>	\$ <u>127,792,114</u>



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

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**YEAR ENDED SEPTEMBER 30, 2011**

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual - General Fund  
General Fund  
Year Ended September 30, 2011

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
<b>Revenues:</b>				
Taxes	\$ 14,200,000	\$ 14,747,000	\$ 15,079,493	\$ 332,493
Fishing rights	19,000,000	17,800,000	18,811,198	1,011,198
Postal revenues	500,000	500,000	427,986	(72,014)
Investment earnings	1,200,000	830,000	341,490	(488,510)
Fees and charges	100,000	185,000	290,869	105,869
Grants	-	-	13,868	13,868
Other	1,500,000	1,000,000	764,597	(235,403)
<b>Total revenues</b>	<b>36,500,000</b>	<b>35,062,000</b>	<b>35,729,501</b>	<b>667,501</b>
<b>Expenditures:</b>				
Executive Branch - Core Operational	15,518,571	15,960,665	14,733,024	1,227,641
Executive Branch - Non-Core Operational	8,012,992	8,303,480	5,514,605	2,788,875
Judicial Branch-Core Operational	1,355,306	1,355,306	1,262,014	93,292
Judicial Branch-Non-Core Operational	153,323	153,323	133,355	19,968
Legislative Branch-Core Operational	3,744,177	4,159,177	3,771,595	387,582
Office of the National Public Auditor-Core Operational	847,976	847,976	694,924	153,052
Office of the National Public Auditor-Non-Core Operational	482,482	482,482	442,349	40,133
Other National Programs	2,567,881	2,662,831	1,329,344	1,333,487
Boards and Commissions	1,848,752	2,132,355	1,770,849	361,506
Payments to Component Units	2,164,212	2,221,295	1,574,065	647,230
Legislative Appropriations	3,433,655	7,703,655	4,259,107	3,444,548
<b>Total expenditures</b>	<b>40,129,327</b>	<b>45,982,545</b>	<b>35,485,231</b>	<b>10,497,314</b>
<b>Excess (deficiency) of revenues over (under) expenditures</b>	<b>(3,629,327)</b>	<b>(10,920,545)</b>	<b>244,270</b>	<b>11,164,815</b>
<b>Other financing sources (uses):</b>				
Operating transfers in	500,000	450,000	285,744	(164,256)
Operating transfers out	(1,466,145)	(1,581,246)	(2,211,192)	(629,946)
<b>Total other financing sources (uses), net</b>	<b>(966,145)</b>	<b>(1,131,246)</b>	<b>(1,925,448)</b>	<b>(794,202)</b>
<b>Special item:</b>				
Revaluation of ADB shares	-	-	4,618,522	4,618,522
Write-off of receivable balances	-	-	(1,393,936)	(1,393,936)
<b>Total other financing sources (uses), net</b>	<b>-</b>	<b>-</b>	<b>3,224,586</b>	<b>3,224,586</b>
<b>Net change in unreserved fund balance</b>	<b>\$ (4,595,472)</b>	<b>\$ (12,051,791)</b>	<b>\$ 1,543,408</b>	<b>\$ 13,595,199</b>

See accompanying notes to required supplementary information - budgetary reporting.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Required Supplementary Information - Budgetary Reporting  
September 30, 2011

(1) Budgetary Information

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

During fiscal year 2011, supplemental appropriations were also made for both operating and capital purposes, to reflect the evolving priorities of the FSM National Government.

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

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

Accounting principles used in developing data on a budgetary basis differ from those used in preparing the basic financial statements in conformity with GAAP. Amounts included on the Schedule of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual - General Fund (which is 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 schedule.

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.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Required Supplementary Information - Budgetary Reporting, Continued  
September 30, 2011

(2) Reconciliation - GAAP and Budgetary Bases of Accounting

The Budget Act for fiscal year 2011, Public Law No. 16-43, was approved for the Executive branch and the Legislative branch. Budgets for Special Revenue Funds are generally not submitted. Accordingly, a budget to actual presentation for Special Revenue Funds is not required or presented. Project length financial plans are adopted for capital projects funds. The accompanying Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual - General Fund presents solely the financial activities of the General Fund administered by the Department of Finance and Administration, and does not include other financial activities administered by that Department and the impact of implementation of Governmental Accounting Standards Board Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions.

Accounting principles used in developing data on a budgetary basis differ from those used in preparing the financial statements in conformity with GAAP. The net change in fund balance reconciled to the net change in unreserved fund balance for the General Fund is as follows:

Net change in fund balance	\$ 3,945,017
Encumbrances	(2,401,609)
Net change in unreserved fund balance	\$ <u>1,543,408</u>

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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**OTHER SUPPLEMENTARY INFORMATION**

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**YEAR ENDED SEPTEMBER 30, 2011**

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Combined Schedule of Expenditures by Account -  
Governmental Fund Types  
Year Ended September 30, 2011

	Special Revenue		Permanent		Other Governmental Funds	Total
	General	Grants Assistance	Compact Trust	-		
Expenditures:						
Personnel	\$ 11,712,710	\$ 5,442,388	\$ -	\$ -	\$ 424,547	\$ 17,579,645
Travel and transportation	3,524,452	3,002,137	-	-	39,690	6,566,279
Books and library materials	31	2,528	-	-	-	2,559
Communications	577,294	178,689	-	-	11,415	767,398
Customs and taxes	18,899	49,286	-	-	14,063	82,248
Dues, membership and subscription	427,744	16,997	-	-	114	444,855
Food stuffs	490,083	60,504	-	-	119,330	669,917
Freight	66,734	47,770	-	-	33,341	147,845
Expendable equipment	280,116	272,525	-	-	6,305	558,946
Office supplies and materials	1,282,036	576,680	-	-	69,292	1,928,008
POL	1,129,115	286,535	-	-	539,429	1,955,079
Advertising, printing and reproduction	145,620	127,234	-	-	4,251	277,105
Rental services	326,297	278,465	-	-	2,665	607,427
Repair and maintenance	189,450	23,635	-	-	24,586	237,671
Utilities	985,297	219,060	-	-	-	1,204,357
Warehousing	638	-	-	-	-	638
Miscellaneous goods and services	160,661	30,547	-	-	-	191,208
Medical supplies	997	136,674	-	-	-	137,671
Medical claims and referrals	11,219	-	-	-	-	11,219
General contractual services	3,253,417	47,025,760	-	-	375,687	50,654,864
Professional services	242,863	1,383,556	-	-	26,507	1,652,926
Employee housing and household storage	199,347	71,500	-	-	2,307	273,154
Contributions, subsidies and grants	2,712,415	-	-	-	-	2,712,415
Training and registration fees	121,515	28,520	-	-	-	150,035
Leased housing, offices, buildings and land	2,006,529	308,972	-	-	12,843	2,328,344
Insurance and fees	76,108	1,331	-	-	96,258	173,697
Representation	1,227,850	15,965	-	-	-	1,243,815
Scholarships	555,241	118,015	-	-	381,423	1,054,679
Investment management fee	251,400	-	-	-	-	251,400
Bank charges	57,316	1,567	-	-	374	59,257
Architecture and design	-	4,577,178	-	-	-	4,577,178
Equipment	536,294	308,029	-	-	18,346	862,669
Vehicle and vessels	542,031	126,028	-	-	-	668,059
Furnitures and fixtures	11,455	19,075	-	-	-	30,530
Payment to the FSM State Governments	81,000	-	-	-	-	81,000
Construction management	-	433,323	-	-	-	433,323
Drydocking	250,000	-	-	-	-	250,000
Other	42,223	3,956	-	-	-	46,179
Principal and interest payments	2,084,192	-	-	-	-	2,084,192
Total expenditures	<u>\$ 35,580,589</u>	<u>\$ 65,174,429</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,202,773</u>	<u>\$ 102,957,791</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

GENERAL FUND

Statement of Revenues, Expenditures by Function and Department,  
and Changes in Fund Balance  
Year Ended September 30, 2011  
(with comparatives for the year ended September 30, 2010)

	2011	2010
Revenue:		
Taxes:		
Import	\$ 4,528,260	\$ 4,810,740
Fuel	148,157	140,466
Corporate tax	2,092,117	815,400
Income tax, individuals, net of tax refunds	3,780,425	3,491,365
Gross receipts tax, businesses	4,530,534	4,116,556
	15,079,493	13,374,527
Federal and other grants	13,868	505,843
Fishing rights	18,811,198	17,727,383
Fees and charges:		
Postal collections	427,986	417,558
Business license and various fees	127,149	185,434
Other	163,720	988,763
	718,855	1,591,755
Investment earnings:		
Net change in the fair value of investments	109,035	927,645
Dividend and interest income	232,455	386,224
	341,490	1,313,869
MiCare reimbursible	252,973	254,844
Other	511,624	754,617
Total revenues	35,729,501	35,522,838
Expenditures:		
Executive Branch:		
Core operational:		
President's Office	816,036	779,855
Department of External Affairs and LNO's	3,874,757	3,520,086
Department of Health and Social Affairs	152,374	193,336
Department of Education	29,825	47,446
Office of Resources and development	700,859	581,033
National archives, cultural and historic prevention	166,702	135,725
Office of SBOC	1,045,926	1,049,512
Office of Environment and emergency management	252,044	193,395
Department of Transportation, Communication and Infrastructure	1,068,638	736,063
Department of Finance and Administration	1,686,963	1,643,823
Department of Justice	3,458,888	3,441,152
Office of the Public Defender	757,041	638,572
Sub-total	14,010,053	12,959,998

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Statement of Revenues, Expenditures by Function and Department,  
and Changes in Fund Balance, Continued  
Year Ended September 30, 2011  
(with comparatives for the year ended September 30, 2010)

	<u>2011</u>	<u>2010</u>
Expenditures, continued:		
Executive Branch:		
Non-core operational:		
President's Office	594,828	1,259,318
Department of External Affairs and LNO's	172,000	142,000
Department of Health and Social Affairs	109,147	299,000
Department of Education	1,020,583	1,055,574
Office of Resources and development	238,090	153,230
National archives, cultural and historic prevention	5,768	4,264
Office of SBOC	202,265	456,073
Office of Environment and emergency management	243,878	43,158
Department of Transportation, Communication and Infrastructure	909,873	1,674,817
Department of Finance and Administration	1,086,410	416,109
Department of Justice	606,965	104,317
Sub-total	5,189,807	5,607,860
Total Executive Branch	19,199,860	18,567,858
Judicial Branch-core operational	1,211,646	1,201,750
Judicial Branch-non-core operational	130,032	143,896
Total Judicial Branch	1,341,678	1,345,646
Legislative Branch:		
Office of the Speaker and members	1,545,076	1,524,878
Congress staff	1,254,017	1,148,087
Delegation offices	482,705	538,946
Total Legislative Branch	3,281,798	3,211,911
Office of the National Public Auditor-Core operational	634,220	635,822
Office of the National Public Auditor-Non-Core operational	429,671	460,119
Total Office of the Public Auditor	1,063,891	1,095,941
Other National Government Programs	1,004,904	762,770
Agencies, Boards and Commissions	1,700,921	1,290,221
Payments to Component Units:		
College of Micronesia-FSM	25,000	57,990
FSM Social Security	1,200,000	1,195,000
FSM Coconut Development Authority	219,433	176,052
Micare Plan, Inc.	100,000	100,000
Caroline Island Air	-	48,211
Payment to Component Units-Non operational	12,000	-
	1,556,433	1,577,253
Legislative public projects	3,934,137	2,964,949
Total expenditures	33,083,622	30,816,549
Excess of revenues over expenditures	2,645,879	4,706,289

See Accompanying Independent Auditors' Report.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Statement of Revenues, Expenditures by Function and Department,  
and Changes in Fund Balance, Continued  
Year Ended September 30, 2011  
(with comparatives for the year ended September 30, 2010)

	2011	2010
Other financing sources (uses):		
Operating transfers in:		
Fisheries Observer Revolving Fund	83,197	-
Passport Revolving Fund	202,547	353,063
	285,744	353,063
Operating transfers out:		
FSM Trust Fund	-	(1,500,000)
Early Retirement Program Fund	(659,661)	(366,413)
Asian Development Bank Loan Fund	(270,285)	(104,191)
Maritime Operations Revolving Fund	(1,134,702)	(1,078,000)
ICQ Revolving Fund	(146,544)	-
	(2,211,192)	(3,048,604)
Total other financing uses, net	(1,925,448)	(2,695,541)
Special items:		
Revaluation of ADB shares	4,618,522	-
Write-off of receivable balances	(1,393,936)	(1,254,633)
	3,224,586	(1,254,633)
Net change in fund balance	3,945,017	756,115
Fund balance at the beginning of the year	23,483,820	22,727,705
Fund balance at the end of the year	\$ 27,428,837	\$ 23,483,820

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS**

Combining Balance Sheet  
September 30, 2011

	27	28	29	31	32	33	34	35	36	38	39	Total
	Permit Revolving	Filling Office Revolving	Maritime Operations Revolving	Passport Revolving	Aquaculture Revolving	Fisheries Observer Revolving	Medical Revolving	Nurse Board Revolving	ICQ Overtime Revolving	Student Loans	Scholarship	Total
<b>ASSETS</b>												
Due from other funds	\$ 1,033,834	\$ 22,745	\$ 128,233	\$ 109,229	\$ 32,369	\$ 471,228	\$ 508	\$ 13,743	\$ 130,437	\$ 613,893	\$ 108,156	\$ 2,664,375
Total assets	<u>1,033,834</u>	<u>22,745</u>	<u>128,233</u>	<u>109,229</u>	<u>32,369</u>	<u>471,228</u>	<u>508</u>	<u>13,743</u>	<u>130,437</u>	<u>613,893</u>	<u>108,156</u>	<u>2,664,375</u>
<b>LIABILITIES AND FUND BALANCES</b>												
Liabilities:												
Accounts payable	\$ 25	\$ -	\$ 14,263	\$ 9,229	\$ -	\$ 2,306	\$ -	\$ 1,603	\$ -	\$ -	\$ 10,250	\$ 37,676
Total liabilities	<u>25</u>	<u>-</u>	<u>14,263</u>	<u>9,229</u>	<u>-</u>	<u>2,306</u>	<u>-</u>	<u>1,603</u>	<u>-</u>	<u>-</u>	<u>10,250</u>	<u>37,676</u>
Fund balances:												
Committed	<u>1,033,809</u>	<u>22,745</u>	<u>113,970</u>	<u>100,000</u>	<u>32,369</u>	<u>468,922</u>	<u>508</u>	<u>12,140</u>	<u>130,437</u>	<u>613,893</u>	<u>97,906</u>	<u>2,626,699</u>
Total fund balances	<u>1,033,809</u>	<u>22,745</u>	<u>113,970</u>	<u>100,000</u>	<u>32,369</u>	<u>468,922</u>	<u>508</u>	<u>12,140</u>	<u>130,437</u>	<u>613,893</u>	<u>97,906</u>	<u>2,626,699</u>
Total liabilities and fund balances	<u>\$ 1,033,834</u>	<u>\$ 22,745</u>	<u>\$ 128,233</u>	<u>\$ 109,229</u>	<u>\$ 32,369</u>	<u>\$ 471,228</u>	<u>\$ 508</u>	<u>\$ 13,743</u>	<u>\$ 130,437</u>	<u>\$ 613,893</u>	<u>\$ 108,156</u>	<u>\$ 2,664,375</u>

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS**

**Combining Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balances  
Year Ended September 30, 2011**

	27	28	29	31	32	33	34	35	36	38	39		
	Permit Revolving	Filling Office Revolving	Maritime Operations Revolving	Passport Revolving	Aquaculture Revolving	Fisheries Observer Revolving	Medical Revolving	Nurse Board Revolving	ICQ Overtime Revolving	Student Loans	Scholarship	Total	
Revenues:													
Taxes	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 246,597	\$ 246,597	
Fees and charges	<u>255,410</u>	<u>6,315</u>	<u>154,765</u>	<u>410,666</u>	<u>-</u>	<u>511,418</u>	<u>920</u>	<u>1,160</u>	<u>82,149</u>	<u>730</u>	<u>-</u>	<u>1,423,533</u>	
Total revenues	<u>255,410</u>	<u>6,315</u>	<u>154,765</u>	<u>410,666</u>	<u>-</u>	<u>511,418</u>	<u>920</u>	<u>1,160</u>	<u>82,149</u>	<u>730</u>	<u>246,597</u>	<u>1,670,130</u>	
Expenditures by function:													
Current:													
General government:													
Transportation, communication and infrastructure	-	-	1,262,053	-	-	-	-	-	-	-	-	1,262,053	
Health and social affairs	-	-	-	-	-	-	-	1,967	-	-	-	1,967	
Education	-	-	-	-	-	-	-	-	-	-	381,423	381,423	
Justice	-	-	-	208,119	-	-	-	-	98,256	-	-	306,375	
Agencies, boards and commissions	-	-	-	-	-	250,955	-	-	-	-	-	250,955	
Total expenditures	<u>-</u>	<u>-</u>	<u>1,262,053</u>	<u>208,119</u>	<u>-</u>	<u>250,955</u>	<u>-</u>	<u>1,967</u>	<u>98,256</u>	<u>-</u>	<u>381,423</u>	<u>2,202,773</u>	
Excess (deficiency) of revenues over (under) expenditures	<u>255,410</u>	<u>6,315</u>	<u>(1,107,288)</u>	<u>202,547</u>	<u>-</u>	<u>260,463</u>	<u>920</u>	<u>(807)</u>	<u>(16,107)</u>	<u>730</u>	<u>(134,826)</u>	<u>(532,643)</u>	
Other financing sources (uses):													
Operating transfers in	-	-	1,134,702	-	-	-	-	-	146,544	-	-	1,281,246	
Operating transfers out	<u>-</u>	<u>-</u>	<u>-</u>	<u>(202,547)</u>	<u>-</u>	<u>(83,197)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(285,744)</u>	
Total other financing sources (uses), net	<u>-</u>	<u>-</u>	<u>1,134,702</u>	<u>(202,547)</u>	<u>-</u>	<u>(83,197)</u>	<u>-</u>	<u>-</u>	<u>146,544</u>	<u>-</u>	<u>-</u>	<u>995,502</u>	
Net change in fund balances	255,410	6,315	27,414	-	-	177,266	920	(807)	130,437	730	(134,826)	462,859	
Fund balances at the beginning of the year	<u>778,399</u>	<u>16,430</u>	<u>86,556</u>	<u>100,000</u>	<u>32,369</u>	<u>291,656</u>	<u>(412)</u>	<u>12,947</u>	<u>-</u>	<u>613,163</u>	<u>232,732</u>	<u>2,163,840</u>	
Fund balances at the end of the year	<u>\$ 1,033,809</u>	<u>\$ 22,745</u>	<u>\$ 113,970</u>	<u>\$ 100,000</u>	<u>\$ 32,369</u>	<u>\$ 468,922</u>	<u>\$ 508</u>	<u>\$ 12,140</u>	<u>\$ 130,437</u>	<u>\$ 613,893</u>	<u>\$ 97,906</u>	<u>\$ 2,626,699</u>	

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS**

**Combining Statement of Revenues, Expenditures by Account,  
and Changes in Fund Balances  
Year Ended September 30, 2011**

	27	28	29	31	32	33	34	35	36	38	39	Total
	Permit Revolving	Filling Office Revolving	Maritime Operations Revolving	Passport Revolving	Aquaculture Revolving	Fisheries Observer Revolving	Medical Revolving	Nurse Board Revolving	ICQ Overtime Revolving	Student Loans	Scholarship	
<b>Revenues:</b>												
Taxes	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 246,597	\$ 246,597
Fees and charges	255,410	6,315	154,765	410,666	-	511,418	920	1,160	82,149	730	-	1,423,533
<b>Total revenues</b>	<u>255,410</u>	<u>6,315</u>	<u>154,765</u>	<u>410,666</u>	<u>-</u>	<u>511,418</u>	<u>920</u>	<u>1,160</u>	<u>82,149</u>	<u>730</u>	<u>246,597</u>	<u>1,670,130</u>
<b>Expenditures by account:</b>												
Personnel	-	-	295,979	-	-	30,312	-	-	98,256	-	-	424,547
Travel and transportation	-	-	5,230	-	-	32,493	-	1,967	-	-	-	39,690
Communications	-	-	3,983	7,432	-	-	-	-	-	-	-	11,415
Customs and taxes	-	-	-	14,063	-	-	-	-	-	-	-	14,063
Dues, membership & subscription	-	-	114	-	-	-	-	-	-	-	-	114
Food stuffs	-	-	119,085	-	-	245	-	-	-	-	-	119,330
Freight	-	-	749	32,592	-	-	-	-	-	-	-	33,341
Expendable equipment	-	-	6,305	-	-	-	-	-	-	-	-	6,305
Office supplies and materials	-	-	59,596	9,188	-	508	-	-	-	-	-	69,292
POL	-	-	539,429	-	-	-	-	-	-	-	-	539,429
Advertising, printing and reproduction	-	-	1,340	2,911	-	-	-	-	-	-	-	4,251
Rental Services	-	-	300	-	-	2,365	-	-	-	-	-	2,665
Repair and maintenance	-	-	24,586	-	-	-	-	-	-	-	-	24,586
General Contractual Services	-	-	60,576	132,093	-	183,018	-	-	-	-	-	375,687
Professional Services	-	-	26,507	-	-	-	-	-	-	-	-	26,507
Employee housing and household storage	-	-	2,307	-	-	-	-	-	-	-	-	2,307
Leased housing and office	-	-	12,843	-	-	-	-	-	-	-	-	12,843
Insurance and fees	-	-	94,244	-	-	2,014	-	-	-	-	-	96,258
Scholarships	-	-	-	-	-	-	-	-	-	-	381,423	381,423
Bank charges	-	-	-	374	-	-	-	-	-	-	-	374
Equipment	-	-	8,880	9,466	-	-	-	-	-	-	-	18,346
<b>Total expenditures</b>	<u>-</u>	<u>-</u>	<u>1,262,053</u>	<u>208,119</u>	<u>-</u>	<u>250,955</u>	<u>-</u>	<u>1,967</u>	<u>98,256</u>	<u>-</u>	<u>381,423</u>	<u>2,202,773</u>
<b>Excess (deficiency) of revenues over (under) expenditures</b>	<u>255,410</u>	<u>6,315</u>	<u>(1,107,288)</u>	<u>202,547</u>	<u>-</u>	<u>260,463</u>	<u>920</u>	<u>(807)</u>	<u>(16,107)</u>	<u>730</u>	<u>(134,826)</u>	<u>(532,643)</u>
<b>Other financing sources (uses):</b>												
Operating transfers in	-	-	1,134,702	-	-	-	-	-	146,544	-	-	1,281,246
Operating transfers out	-	-	-	(202,547)	-	(83,197)	-	-	-	-	-	(285,744)
<b>Total other financing sources (uses), net</b>	<u>-</u>	<u>-</u>	<u>1,134,702</u>	<u>(202,547)</u>	<u>-</u>	<u>(83,197)</u>	<u>-</u>	<u>-</u>	<u>146,544</u>	<u>-</u>	<u>-</u>	<u>995,502</u>
<b>Net change in fund balances</b>	<u>255,410</u>	<u>6,315</u>	<u>27,414</u>	<u>-</u>	<u>-</u>	<u>177,266</u>	<u>920</u>	<u>(807)</u>	<u>130,437</u>	<u>730</u>	<u>(134,826)</u>	<u>462,859</u>
Fund balances at the beginning of the year	778,399	16,430	86,556	100,000	32,369	291,656	(412)	12,947	-	613,163	232,732	2,163,840
Fund balances (deficit) at the end of the year	<u>\$ 1,033,809</u>	<u>\$ 22,745</u>	<u>\$ 113,970</u>	<u>\$ 100,000</u>	<u>\$ 32,369</u>	<u>\$ 468,922</u>	<u>\$ 508</u>	<u>\$ 12,140</u>	<u>\$ 130,437</u>	<u>\$ 613,893</u>	<u>\$ 97,906</u>	<u>\$ 2,626,699</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT  
GRANTS ASSISTANCE FUND**

Combining Balance Sheet  
September 30, 2011

	10	11	12	13	14	15	19	18	26	20	23	Total
	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(5) Environment	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Supplemental Education	Section 211(a)(6) Infrastructure	Infrastructure Maintenance	Disaster Assistance Emergency	U.S. Federal Grants	Non-U.S. Grants	Total
<b>ASSETS</b>												
Equity in internal investment pool	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 352,148	\$ 1,038,998	\$ -	\$ -	\$ 1,391,146
Receivables:												
Federal agencies	302,680	366,363	22,083	-	1,033,748	330,599	4,143,640	-	-	11,178,959	-	17,378,072
Due from other funds	-	-	-	13,153	-	-	-	-	118,962	-	2,753,018	2,885,133
Advances	-	-	-	-	-	-	17,629	-	-	1,444,470	-	1,462,099
	<u>\$ 302,680</u>	<u>\$ 366,363</u>	<u>\$ 22,083</u>	<u>\$ 13,153</u>	<u>\$ 1,033,748</u>	<u>\$ 330,599</u>	<u>\$ 4,161,269</u>	<u>\$ 352,148</u>	<u>\$ 1,157,960</u>	<u>\$ 12,623,429</u>	<u>\$ 2,753,018</u>	<u>\$ 23,116,450</u>
<b>LIABILITIES AND FUND BALANCES</b>												
Liabilities:												
Accounts payable	\$ 17,245	\$ 11,043	\$ 208	\$ -	\$ 33,302	\$ 11,491	\$ 1,278,350	\$ -	\$ -	\$ 2,190,455	\$ 87,848	\$ 3,629,942
Retention payable	-	-	-	-	-	-	1,706,305	-	-	2,825,549	-	4,531,854
Due to FSM State Governments	-	-	-	-	-	-	-	-	-	3,538,018	-	3,538,018
Due to Federal Governments	-	-	-	-	-	-	-	-	-	1,444,470	-	1,444,470
Due to other funds	285,435	355,320	21,875	-	1,000,446	319,108	1,288,795	-	-	2,630,896	-	5,901,875
Deferred revenues	-	-	-	-	-	-	-	-	223,940	-	2,684,631	2,908,571
Total liabilities	<u>302,680</u>	<u>366,363</u>	<u>22,083</u>	<u>-</u>	<u>1,033,748</u>	<u>330,599</u>	<u>4,273,450</u>	<u>-</u>	<u>223,940</u>	<u>12,629,388</u>	<u>2,772,479</u>	<u>21,954,730</u>
Fund balances (deficits):												
Restricted	-	-	-	13,153	-	-	-	352,148	934,020	-	-	1,299,321
Unassigned	-	-	-	-	-	-	(112,181)	-	-	(5,959)	(19,461)	(137,601)
Total fund balances (deficits)	<u>-</u>	<u>-</u>	<u>-</u>	<u>13,153</u>	<u>-</u>	<u>-</u>	<u>(112,181)</u>	<u>352,148</u>	<u>934,020</u>	<u>(5,959)</u>	<u>(19,461)</u>	<u>1,161,720</u>
Total liabilities and fund balances	<u>\$ 302,680</u>	<u>\$ 366,363</u>	<u>\$ 22,083</u>	<u>\$ 13,153</u>	<u>\$ 1,033,748</u>	<u>\$ 330,599</u>	<u>\$ 4,161,269</u>	<u>\$ 352,148</u>	<u>\$ 1,157,960</u>	<u>\$ 12,623,429</u>	<u>\$ 2,753,018</u>	<u>\$ 23,116,450</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT  
GRANTS ASSISTANCE FUND**

Combining Statement of Revenues and Expenditures by Function,  
and Changes in Fund Balances  
Year Ended September 30, 2011

	10	11	12	13	14	15	19	18	26	20	23	Total
	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(5) Environment	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Supplemental Education	Section 211(a)(6) Infrastructure	Infrastructure Maintenance	Disaster Assistance Emergency	U.S. Federal Grants	Non-U.S. Grants	Total
Revenues:												
Compact funding	\$ 540,490	\$ 543,365	\$ 1,229	\$ -	\$ 1,365,949	\$ 332,634	18,209,642	\$ -	\$ -	\$ -	\$ -	\$ 20,993,309
Federal and other grants	-	-	-	-	-	-	-	-	-	42,963,421	1,217,654	44,181,075
	<u>540,490</u>	<u>543,365</u>	<u>1,229</u>	<u>-</u>	<u>1,365,949</u>	<u>332,634</u>	<u>18,209,642</u>	<u>-</u>	<u>-</u>	<u>42,963,421</u>	<u>1,217,654</u>	<u>65,174,384</u>
Expenditures by function:												
Current:												
General government:												
Finance and administration	-	-	-	-	1,196,805	-	-	-	-	-	-	1,196,805
Resources and development	-	-	-	-	-	-	-	-	-	191,041	(14,127)	176,914
Transportation, communication and infrastructure	-	-	-	-	-	-	330,456	-	-	-	212,065	542,521
Health and social affairs	-	543,365	-	-	-	-	-	-	-	5,045,176	447,473	6,036,014
Education	540,490	-	-	-	-	332,634	-	-	-	1,984,636	-	2,857,760
SBOC Office	-	-	-	-	96,089	-	-	-	-	18,003	256,902	370,994
Environment and emergency management	-	-	1,229	-	-	-	-	-	-	8,860	310,071	320,160
National archives, cultural and historic preservation	-	-	-	-	-	-	-	-	-	179,976	-	179,976
Office of the National Public Auditor	-	-	-	-	73,055	-	-	-	-	448,992	-	522,047
National government programs	-	-	-	-	-	-	-	-	-	1,401,310	5,270	1,406,580
Payments to component units	-	-	-	-	-	-	-	-	-	104,121	-	104,121
Capital Projects	-	-	-	-	-	-	17,879,186	-	-	33,581,351	-	51,460,537
Total expenditures	<u>540,490</u>	<u>543,365</u>	<u>1,229</u>	<u>-</u>	<u>1,365,949</u>	<u>332,634</u>	<u>18,209,642</u>	<u>-</u>	<u>-</u>	<u>42,963,466</u>	<u>1,217,654</u>	<u>65,174,429</u>
Net change in fund balances	-	-	-	-	-	-	-	-	-	(45)	-	(45)
Fund balances at the beginning of the year	-	-	-	13,153	-	-	(112,181)	352,148	934,020	(5,914)	(19,461)	1,161,765
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 13,153</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (112,181)</u>	<u>\$ 352,148</u>	<u>\$ 934,020</u>	<u>\$ (5,959)</u>	<u>\$ (19,461)</u>	<u>\$ 1,161,720</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**GRANTS ASSISTANCE FUND**

**Combining Statement of Revenues, Expenditures by Account,  
and Changes in Fund Balances  
Year Ended September 30, 2011**

	10	11	12	13	14	15	19	18	26	20	23	
	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(5) Environment	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Supplemental Education	Section 211(a)(6) Infrastructure	Infrastructure Maintenance	Disaster Assistance Emergency	U.S. Federal Grants	Non-U.S. Grants	Total
<b>Revenues:</b>												
Compact funding	\$ 540,490	\$ 543,365	\$ 1,229	\$ -	\$ 1,365,949	\$ 332,634	\$ 18,209,642	\$ -	\$ -	\$ -	\$ -	\$ 20,993,309
Federal and other grants	-	-	-	-	-	-	-	-	-	42,963,421	1,217,654	44,181,075
	<u>540,490</u>	<u>543,365</u>	<u>1,229</u>	<u>-</u>	<u>1,365,949</u>	<u>332,634</u>	<u>18,209,642</u>	<u>-</u>	<u>-</u>	<u>42,963,421</u>	<u>1,217,654</u>	<u>65,174,384</u>
<b>Expenditures by account:</b>												
Personnel	149,956	335,329	-	-	352,762	198,149	537,183	-	-	3,696,206	172,803	5,442,388
Travel and transportation	120,730	49,025	1,229	-	225,434	94,041	64,361	-	-	2,090,053	357,264	3,002,137
Books and library materials	-	-	-	-	-	-	-	-	-	-	2,528	2,528
Communications	13,712	12,622	-	-	-	6,433	22,219	-	-	118,097	5,606	178,689
Customs and taxes	22	1,944	-	-	39,053	226	911	-	-	7,130	-	49,286
Dues, membership and subscription	-	-	-	-	824	-	-	-	-	10,173	6,000	16,997
Food stuffs	-	-	-	-	-	-	-	-	-	17,052	43,452	60,504
Freight	572	135	-	-	372	142	1,290	-	-	38,562	6,697	47,770
Expendable equipment	2,832	1,062	-	-	11,554	2,445	142,504	-	-	98,597	13,531	272,525
Office Supplies and materials	10,584	11,261	-	-	100,013	8,039	32,158	-	-	356,811	57,814	576,680
POL	4,603	4,011	-	-	22,454	2,000	7,201	-	-	238,809	7,457	286,535
Advertising, printing and reproduction	1,654	377	-	-	5	1,856	2,815	-	-	83,787	36,740	127,234
Rental services	23,613	187	-	-	2,928	7,323	-	-	-	159,421	84,993	278,465
Repair and maintenance	1,630	455	-	-	5,991	530	852	-	-	13,483	694	23,635
Utilities	1,667	115	-	-	22,679	-	500	-	-	190,379	3,720	219,060
Miscellaneous goods and services	-	-	-	-	-	-	-	-	-	23,527	7,020	30,547
Medical Supplies	-	17,959	-	-	-	-	-	-	-	94,502	24,213	136,674
General Contractual services	23,480	42,070	-	-	167,350	7,950	12,226,231	-	-	34,207,880	350,799	47,025,760
Professional services	59,604	-	-	-	219,997	5,500	13,531	-	-	1,084,124	800	1,383,556
Employee housing and household storage	-	-	-	-	21,500	-	28,700	-	-	21,300	-	71,500
Training and registration fees	-	5,000	-	-	6,078	4,000	-	-	-	13,642	(200)	28,520
Leased housing, offices, buildings and land	11,280	15,578	-	-	58,000	-	118,635	-	-	100,479	5,000	308,972
Insurance and fees	-	-	-	-	-	-	-	-	-	1,331	-	1,331
Representation	-	-	-	-	-	-	-	-	-	15,965	-	15,965
Scholarships	112,511	-	-	-	-	(6,000)	-	-	-	-	11,504	118,015
Bank charges	75	-	-	-	486	-	50	-	-	595	361	1,567
Architecture and design	-	-	-	-	-	-	4,577,178	-	-	-	-	4,577,178
Equipment	1,965	1,235	-	-	95,969	-	-	-	-	202,580	6,280	308,029
Vehicle	-	45,000	-	-	12,500	-	-	-	-	68,528	-	126,028
Furniture and fixtures	-	-	-	-	-	-	-	-	-	6,497	12,578	19,075
Construction management	-	-	-	-	-	-	433,323	-	-	-	-	433,323
Other	-	-	-	-	-	-	-	-	-	3,956	-	3,956
Total expenditures	<u>540,490</u>	<u>543,365</u>	<u>1,229</u>	<u>-</u>	<u>1,365,949</u>	<u>332,634</u>	<u>18,209,642</u>	<u>-</u>	<u>-</u>	<u>42,963,466</u>	<u>1,217,654</u>	<u>65,174,429</u>
Net change in fund balances	-	-	-	-	-	-	-	-	-	(45)	-	(45)
Fund balances at the beginning of the year	-	-	-	13,153	-	-	(112,181)	352,148	934,020	(5,914)	(19,461)	1,161,765
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 13,153</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (112,181)</u>	<u>\$ 352,148</u>	<u>\$ 934,020</u>	<u>\$ (5,959)</u>	<u>\$ (19,461)</u>	<u>\$ 1,161,720</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**GENERAL FUND  
Statement of Revenues, Expenditures and Changes in Fund Balance -  
Budget and Actual, Budgetary Basis  
Year Ended September 30, 2011**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
Revenues:				
Local taxes	\$ 14,200,000	\$ 14,747,000	\$ 15,079,493	\$ 332,493
Fishing right fees	19,000,000	17,800,000	18,811,198	1,011,198
Postal revenues	500,000	500,000	427,986	(72,014)
Investment earnings	1,200,000	830,000	341,490	(488,510)
Fees and charges	100,000	185,000	290,869	105,869
Grants	-	-	13,868	13,868
MiCare reimbursible	-	-	252,973	252,973
Other	1,500,000	1,000,000	511,624	(488,376)
Total revenues	<u>36,500,000</u>	<u>35,062,000</u>	<u>35,729,501</u>	<u>667,501</u>
Expenditures-budgetary basis by department:				
Executive Branch-Core Operational:				
Office of the President	541,973	646,016	628,633	17,383
President's Office - Personnel	159,905	159,705	146,514	13,191
Public Information	148,884	148,884	132,581	16,303
Total Office of the President	<u>850,762</u>	<u>954,605</u>	<u>907,728</u>	<u>46,877</u>
Department of External Affairs				
Administration	577,774	577,774	303,041	274,733
Division of APA & Multilateral Affairs	103,610	103,610	105,392	(1,782)
Division of American and European Affairs	81,100	81,100	83,308	(2,208)
FSM Consulate - China	468,638	468,638	515,100	(46,462)
FSM Consulate - Guam	279,879	279,879	261,329	18,550
FSM Consulate - Honolulu	405,598	338,306	234,420	103,886
FSM Embassy - Tokyo	835,269	902,561	1,051,330	(148,769)
FSM Embassy - Washington D.C.	497,487	497,487	393,363	104,124
FSM Embassy - Fiji	232,217	232,217	227,990	4,227
FSM Permanent Mission - New York	831,884	831,884	722,945	108,939
Total Department of External Affairs	<u>4,313,456</u>	<u>4,313,456</u>	<u>3,898,218</u>	<u>415,238</u>
Department of Health and Social Affairs:				
Administration	69,742	56,000	58,891	(2,891)
Women's Interests Unit	23,826	25,786	30,006	(4,220)
Sports & Youth Unit	72,989	68,477	78,971	(10,494)
Total Health and Social Affairs	<u>166,557</u>	<u>150,263</u>	<u>167,868</u>	<u>(17,605)</u>
Department of Education:				
Administration	28,343	28,343	29,825	(1,482)
Total Department of Education	<u>28,343</u>	<u>28,343</u>	<u>29,825</u>	<u>(1,482)</u>
Department of Resources and Development-Core operational:				
Administration	168,361	168,361	157,950	10,411
Division of Sectoral Development	502,444	513,558	449,313	64,245
Division of Trade and Investment	100,354	100,354	92,717	7,637
Division of Energy	52,380	52,380	45,063	7,317
Total Department of R&D	<u>823,539</u>	<u>834,653</u>	<u>745,043</u>	<u>89,610</u>
Office of National archives, cultural and historic prevention	163,479	173,542	167,512	6,030
SBOC Office:				
Office of the Director	55,451	55,451	52,956	2,495
Division of Statistics	348,807	347,205	324,296	22,909
Division of Overseas Development	70,989	65,689	48,741	16,948
Division of Budget and Economic Management	245,157	244,907	241,618	3,289
Division of Compact Management	520,118	520,118	466,025	54,093
Total SBOC	<u>1,240,522</u>	<u>1,233,370</u>	<u>1,133,636</u>	<u>99,734</u>
Office of Environment and Emergency Management:				
Office of the Director	106,690	106,690	106,858	(168)
Division of Sustainable Development	146,472	146,472	102,633	43,839
Division of Emergency Management	90,503	85,503	54,006	31,497
Total EEM	<u>343,665</u>	<u>338,665</u>	<u>263,497</u>	<u>75,168</u>

See Accompanying Independent Auditors' Report.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Statement of Revenues, Expenditures and Changes in Fund Balance -  
Budget and Actual, Budgetary Basis, Continued  
Year Ended September 30, 2011

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
Expenditures-budgetary basis by department, continued:				
Department of Transportation, Communication & Infrastructure:				
Administration	158,342	158,342	156,154	2,188
Division of Marine Transportation	140,552	140,552	125,768	14,784
Division of Infrastructure	474,324	474,324	458,439	15,885
Civil Aviation	160,324	160,133	144,954	15,179
Communication	109,096	109,096	76,191	32,905
Other National Programs	229,651	229,651	218,242	11,409
Total Department of TC&I	<u>1,272,289</u>	<u>1,272,098</u>	<u>1,179,748</u>	<u>92,350</u>
Department of Finance and Administration:				
Administration	189,985	189,985	168,885	21,100
Division of National Treasury	590,727	590,727	567,534	23,193
Division of Customs and Tax Administration	821,735	885,735	848,469	39,266
Investment & International Finance	157,876	157,876	144,783	13,093
Total Department of Finance & Administration	<u>1,760,323</u>	<u>1,824,323</u>	<u>1,727,671</u>	<u>96,652</u>
Department of Justice:				
Administration	184,082	174,082	162,099	11,983
Registry of Corporation	46,173	46,173	45,339	834
Division of Law	205,223	205,223	183,501	21,722
Division of Litigation	191,633	191,633	182,888	8,745
Division of Immigration & Labor	793,522	916,610	892,346	24,264
FSM National Police	2,018,025	2,191,648	2,090,140	101,508
Joint Law	153,422	153,422	106,965	46,457
Total Department of Justice	<u>3,592,080</u>	<u>3,878,791</u>	<u>3,663,278</u>	<u>215,513</u>
Office of the Public Defender				
	<u>963,556</u>	<u>958,556</u>	<u>849,000</u>	<u>109,556</u>
Total Executive Branch-Core Operational	<u>15,518,571</u>	<u>15,960,665</u>	<u>14,733,024</u>	<u>1,227,641</u>
Executive Branch-Non-Core Operational:				
President's Office	1,390,963	1,606,451	828,368	778,083
Department of External Affairs and LNO's	182,000	182,000	172,000	10,000
Department of Health and Social Affairs	137,326	137,326	130,311	7,015
Department of Education	1,082,934	1,082,934	1,029,314	53,620
Office of Resources and development	406,863	406,863	266,740	140,123
National archives, cultural and historic prevention	47,014	122,014	5,798	116,216
Office of SBOC	790,899	790,899	283,641	507,258
Office of Environment and emergency management	533,603	533,603	266,688	266,915
Department of Transportation, Communication and Infrastructure	1,106,687	1,106,687	923,164	183,523
Department of Finance and Administration	1,296,492	1,296,492	1,092,644	203,848
Department of Justice	1,038,211	1,038,211	515,937	522,274
Total Executive Branch-Non-Core Operational	<u>8,012,992</u>	<u>8,303,480</u>	<u>5,514,605</u>	<u>2,788,875</u>
Total Executive Branch	<u>23,531,563</u>	<u>24,264,145</u>	<u>20,247,629</u>	<u>4,016,516</u>
Judicial Branch-core operational				
	<u>1,355,306</u>	<u>1,355,306</u>	<u>1,262,014</u>	<u>93,292</u>
Judicial Branch-noncore operational				
	<u>153,323</u>	<u>153,323</u>	<u>133,355</u>	<u>19,968</u>
Total Judicial Branch	<u>1,508,629</u>	<u>1,508,629</u>	<u>1,395,369</u>	<u>113,260</u>
Legislative Branch:				
Office of the Speaker and members	1,778,298	2,120,798	1,833,738	287,060
Congress staff	1,409,619	1,482,119	1,403,475	78,644
Delegation offices	556,260	556,260	534,382	21,878
Total Legislative Branch	<u>3,744,177</u>	<u>4,159,177</u>	<u>3,771,595</u>	<u>387,582</u>
Office of the National Public Auditor				
Public Auditor (Core)	847,976	847,976	694,924	153,052
Single Audit (Non-core)	482,482	482,482	442,349	40,133
Total Office of the Public Auditor	<u>1,330,458</u>	<u>1,330,458</u>	<u>1,137,273</u>	<u>193,185</u>
Other National Government Programs:				
FEMA Matching	-	-	40	(40)
National Election Director	799,428	894,378	711,019	183,359
Micronesia Legal Services Corporation	150,000	150,000	150,000	-
Aquaculture Center	18,420	18,420	36,432	(18,012)
Other National Programs	1,600,033	1,600,033	431,853	1,168,180
Total Other National Government Programs	<u>2,567,881</u>	<u>2,662,831</u>	<u>1,329,344</u>	<u>1,333,487</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Statement of Revenues, Expenditures and Changes in Fund Balance -  
Budget and Actual, Budgetary Basis, Continued  
Year Ended September 30, 2011

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
Expenditures-budgetary basis by department, continued:				
Board and Commissions:				
Board and Commissions - non operational	67,988	67,988	61,958	6,030
National Oceanic Resource Management Authority	511,613	761,614	494,278	267,336
FSM Insurance	212,472	240,824	209,355	31,469
FSM Banking Board	211,133	216,383	185,962	30,421
Board of Regents-COM	75,000	75,000	75,000	-
Postal Services	770,546	770,546	744,296	26,250
Total Board and Commissions	<u>1,848,752</u>	<u>2,132,355</u>	<u>1,770,849</u>	<u>361,506</u>
Payments to component units and fiduciary fund:				
FSM MiCare	100,000	100,000	100,000	-
FSM Social Security Authority	1,200,000	1,200,000	1,200,000	-
Copra Subsidy	75,000	100,000	100,000	-
Coconut Development Authority	103,302	125,385	122,781	2,604
Caroline Island Air	-	10,000	-	10,000
COM-FSM	25,000	25,000	25,000	-
Non-operational	660,910	660,910	26,284	634,626
Total payments to component units	<u>2,164,212</u>	<u>2,221,295</u>	<u>1,574,065</u>	<u>647,230</u>
Public Projects	<u>3,433,655</u>	<u>7,703,655</u>	<u>4,259,107</u>	<u>3,444,548</u>
Total expenditures	<u>40,129,327</u>	<u>45,982,545</u>	<u>35,485,231</u>	<u>10,497,314</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(3,629,327)</u>	<u>(10,920,545)</u>	<u>244,270</u>	<u>11,164,815</u>
Other financing sources (uses):				
Operating Transfers in:				
Fisheries Observer Revolving Fund	200,000	150,000	83,197	(66,803)
Passport Revolving Fund	300,000	300,000	202,547	(97,453)
Total Operating Transfers in	<u>500,000</u>	<u>450,000</u>	<u>285,744</u>	<u>(164,256)</u>
Operating Transfers out:				
Early Retirement Program	-	-	659,661	(659,661)
ADB loan fund	200,000	300,000	270,285	29,715
ICQ Revolving Fund	146,544	146,544	146,544	-
Maritime Revolving Fund	1,119,601	1,134,702	1,134,702	-
Total Operating Transfers out	<u>1,466,145</u>	<u>1,581,246</u>	<u>2,211,192</u>	<u>(629,946)</u>
Total other financing sources (uses), net	<u>(966,145)</u>	<u>(1,131,246)</u>	<u>(1,925,448)</u>	<u>(794,202)</u>
Special item:				
Revaluation of ADB shares	-	-	4,618,522	4,618,522
Write-off of receivable balances	-	-	(1,393,936)	(1,393,936)
Total other financing sources (uses), net	<u>-</u>	<u>-</u>	<u>3,224,586</u>	<u>3,224,586</u>
Net change in unreserved fund balance	<u>\$ (4,595,472)</u>	<u>\$ (12,051,791)</u>	<u>\$ 1,543,408</u>	<u>\$ 13,595,199</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 OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

His Excellency Emmanuel Mori  
President  
Federated States of Micronesia:

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Federated States of Micronesia (FSM) National Government as of and for the year ended September 30, 2011, which collectively comprise the FSM National Government's basic financial statements and have issued our report thereon dated June 30, 2012. Our report includes an explanatory paragraph concerning the correction of an error, a reference to other auditors and a reference for the adoption of a new accounting standard. 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 Caroline Islands Air, Inc., as described in our report on the FSM National Government's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting and compliance and other matters that are reported on separately by those other 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 FSM Social Security Administration, the FSM Telecommunications Corporation, the FSM Development Bank, the National Fisheries Corporation, the College of Micronesia-FSM, the FSM Coconut Development Authority, the FSM Petroleum Corporation, and the MiCare Plan, Inc., which were all audited by us. We have issued separate reports on our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters for these entities. Other auditors issued a separate report on their consideration of internal control over financial reporting and their tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters for Caroline Islands Air, Inc. The findings, if any, included in that report are not included herein.

### Internal Control Over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Questioned Costs (pages 94 through 124), we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* 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 and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 2011-02, 2011-10, 2011-13 and 2011-14 to be material weaknesses.

A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 2011-04, 2011-08 and 2011-11 to be significant deficiencies.

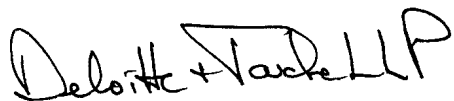
#### Compliance and Other Matters

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

We noted certain matters that we reported to management of the FSM National Government in a separate letter dated June 30, 2012.

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

This report is intended solely for the information and use of management, the Honorable Members of the FSM Congress, others within the entity, federal awarding agencies, the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties.



June 30, 2012

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT  
COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND  
ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB  
CIRCULAR A-133 AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

His Excellency Emmanuel Mori  
President  
Federated States of Micronesia:

## Compliance

We have audited the Federated States of Micronesia (FSM) National Government's compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the FSM National Government's major federal programs for the year ended September 30, 2011. The FSM National Government's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (pages 94 through 124). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the FSM National Government's management. Our responsibility is to express an opinion on the FSM National Government's compliance based on our audit.

As discussed in Note 2b to the Schedule of Expenditures of Federal Awards, the FSM National Government's basic financial statements include the operations of certain entities whose federal awards are not included in the Schedule of Expenditures of Federal Awards for the year ended September 30, 2011. Our audit, described below, did not include the operations of the entities identified in Note 2b as these entities conducted separate audits in accordance with OMB Circular A-133, if required.

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

As described in items 2011-02, 2011-05, 2011-07 and 2011-10 in the accompanying Schedule of Findings and Questioned Costs, the FSM National Government did not comply with requirements regarding cash management, and equipment and real property management that are applicable to its Compact of Free Association Compact Sector Grants (CFDA # 15.875) major program; regarding equipment and real property management, and reporting that are applicable to its Airport Improvement Program (CFDA # 20.106) major program; and regarding cash management, equipment and real property management, and period of availability of federal funds that are applicable to its Special Education-Grants to States (CFDA # 84.027) major program. Compliance with such requirements is necessary, in our opinion, for the FSM National Government to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the FSM National Government complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its Compact of Free Association Compact Sector Grants (CFDA # 15.875) major program, its Airport Improvement Program (CFDA # 20.106) major program, and its Special Education-Grants to States (CFDA # 84.027) major program for the year ended September 30, 2011. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2011-01, 2011-03, 2011-04, 2011-06, 2011-08, 2011-09, 2011-11 and 2011-12.

### Internal Control Over Compliance

Management of the FSM National Government is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the FSM National Government's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the FSM National Government's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 2011-02, 2011-05, 2011-07 and 2011-10 to be material weaknesses.

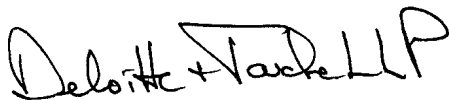
*A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 2011-01, 2011-03, 2011-04, 2011-06, 2011-08, 2011-09, 2011-11 and 2011-12 to be significant deficiencies.

#### 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 FSM National Government as of and for the year ended September 30, 2011, and have issued our report thereon dated June 30, 2012, which report includes an explanatory paragraph concerning the correction of an error, a reference to other auditors and a reference for the adoption of a new accounting standard. Our audit was performed for the purpose of forming our opinions on the financial statements that collectively comprise the FSM National Government's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards (pages 83 through 90) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the FSM National Government. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

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

This report is intended solely for the information and use of management, the Honorable Members of the FSM Congress, others within the entity, federal awarding agencies, the cognizant audit and other federal agencies, and is not intended to be and should not be used by anyone other than these specified parties.



June 30, 2012

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Summary Schedule of Expenditures of Federal Awards, by Grantor  
Year Ended September 30, 2011

<u>Agency/Program</u>	<u>Expenditures</u>	Amounts Passed-Through to <u>Subrecipients</u>
U.S. Department of Agriculture	\$ 190,041	\$ 145,791
U.S. Department of Commerce	1,401,309	-
U.S. Department of the Interior	21,586,213	69,893,502
U.S. Department of Transportation	33,581,350	-
U.S. Department of Homeland Security	8,862	1,396,164
U.S. Department of Education	1,984,636	1,707,836
U.S. Department of Health and Human Services	5,149,296	1,315,829
Institute of Museum and Library Services	55,068	-
U.S. Small Business Administration	-	18,146
GRAND TOTAL	<u>\$ 63,956,775</u>	<u>\$ 74,477,268</u>

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

Reconciliation to the basic financial statements:

Expenditures of the Grants Assistance Fund	\$ 65,174,429
Less:	
Expenditures of the Non U.S. Grants Fund (page 73)	<u>(1,217,654)</u>
Total expenditures per financial statements	<u>\$ 63,956,775</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2011

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF AGRICULTURE			
Rural Self-Help Housing Technical Assistance	10.420	\$ -	\$ -
Forestry Research	10.652	-	-
Cooperative Forestry Assistance	10.664	179,556	91,349
Urban and Community Forestry Program	10.675	10,485	-
Forest Stewardship Program	10.678	-	-
Community Facilities Loans and Grants	10.766	-	54,442
Rural Sanitation Project	10.999	-	-
U.S. DEPARTMENT OF AGRICULTURE TOTAL		<u>\$ 190,041</u>	<u>\$ 145,791</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2011

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF COMMERCE			
Anadromous Fish Conservation Act Program	11.405	\$ -	\$ -
Financial Assistance for National Centers for Coastal Ocean Science	11.426	-	-
Special Oceanic and Atmospheric Projects -NOAA	11.460	<u>1,401,309</u>	<u>-</u>
U.S. DEPARTMENT OF COMMERCE		<u>\$ 1,401,309</u>	<u>\$ -</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2011

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF THE INTERIOR			
Economic, Social and Political Development of the Territories	15.875		
Compact Sector Funds:			
Infrastructure and Infrastructure maintenance		\$ 18,209,642	\$ 2,129,750
Education		540,490	28,437,190
Health		543,365	21,379,991
Capacity Building		1,365,949	3,006,901
Environment		1,229	1,554,554
Private Sector		-	2,306,281
Compact Supplemental Education		332,634	10,736,528
Subtotal Compact Sector Funds		<u>20,993,309</u>	<u>69,551,195</u>
Technical Assistance:			
Single Audit		-	-
Technical Assistance OIA/DOI Other		476,211	193,838
		<u>476,211</u>	<u>193,838</u>
Total CFDA #15.875		21,469,520	69,745,033
Historic Preservation Fund Grants-In-Aid	15.904	<u>116,693</u>	<u>148,469</u>
U.S. DEPARTMENT OF THE INTERIOR TOTAL		<u>\$ 21,586,213</u>	<u>\$ 69,893,502</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2011

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF TRANSPORTATION			
Airport Improvement Program	20.106	\$ 33,581,350	\$ -
U.S. DEPARTMENT OF TRANSPORTATION TOTAL		<u>\$ 33,581,350</u>	<u>\$ -</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2011

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF HOMELAND SECURITY			
Public Assistance Grants - Typhoon Fern HMGP/Subgrantee	83.544	\$ -	\$ -
Disaster Grants - Public Assistance (Presidentially Declared Disasters) (B)	97.036	5,676	1,396,164
Individual and Family Grants - FEMA 1427/IFG Admin. Cost	83.543	-	-
Hazard Mitigation Grant-State Management Cost	97.038	-	-
Hazard Mitigation Grant	97.039	-	-
Crisis Counseling	97.032	-	-
Emergency Management Performance Grants	97.042	3,186	-
U.S. DEPARTMENT OF HOMELAND SECURITY TOTAL		<u>\$ 8,862</u>	<u>\$ 1,396,164</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2011

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF EDUCATION			
Special Education-Basic Grants to States	84.027A	\$ -	\$ -
Special Education - Grants to States	84.027	<u>1,984,636</u>	<u>1,707,836</u>
U.S. DEPARTMENT OF EDUCATION TOTAL		<u>\$ 1,984,636</u>	<u>\$ 1,707,836</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2011

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
<b>U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES</b>			
Public Health and Social Services Emergency Fund	93.003	\$ 115,375	\$ -
Public Health Emergency Preparedness	93.069	677,742	-
Emergency System for ARFHP, BT	93.089	14,648	-
SSDI Program	93.110	48,773	-
Maternal and Child Health Federal Consolidated Programs	93.110	-	-
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	114,279	62,333
Sexual Violence Prevention Ed	93.136	7,214	-
Health Activities Recommendation Panel Health Activities - Tobacco Use Prevention Programs	93.203	-	-
Family Planning-Services	93.217	332,239	121,051
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	-	-
Abstinence Education Program	93.235	-	-
Substance Abuse and Mental Health Services - Projects of Regional and National Significance	93.243	242,214	36,428
Universal Newborn Hearing Screening	93.251	248,586	-
Immunization Grants	93.268	995,719	174,383
Centers for Disease Control and Prevention-Investigations and Technical Assistance	93.283	858,936	207,800
ARRA Health Center Integrated Services	93.703	-	227,014
Immunization & Vaccine for Children	93.712	52,524	-
Tobacco & Diabetes Control & P	93.723	18,016	-
National Bioterrorism Hospital Preparedness Program	93.889	317,792	-
HIV Care Formula Grants	93.917	44,179	5,468
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938	-	-
HIV Prevention Activities-Health Department Based	93.940	-	106,376
Epidemiologic Research Studies of AIDS and HIV Infection in Selected Population Groups	93.943	165,126	-
HIV/AIDS Surveillance	93.944	17,977	-
Block Grants for Community Mental Health Services	93.958	143,335	-
Block Grants for Prevention and Treatment of Substance Abuse	93.959	432,855	165,501
Preventive Health Services - Sexually Transmitted Diseases Control Grants	93.977	-	2,701
Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	93.988	-	21,412
Preventive Health and Health Services Block Grant	93.991	25,079	5,000
Maternal and Child Health Services Block Grant to the States	93.994	276,688	154,846
Small Business Innovation Research (NIAAA, NIDA, NIMH)	93.126	-	-
Occupational Health and Safety Surveillance	93.957	-	-
CCPI Cancer Program	93.999	-	21,471
Others	93.Unknown	-	4,045
<b>U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES TOTAL</b>		<b>\$ 5,149,296</b>	<b>\$ 1,315,829</b>
<b>INSTITUTE OF MUSEUM AND LIBRARY SERVICES</b>			
Grants to States	45.310	\$ 55,068	\$ -
<b>INSTITUTE OF MUSEUM AND LIBRARY SERVICES</b>		<b>\$ 55,068</b>	<b>\$ -</b>
<b>U.S. SMALL ADMINISTRATION</b>			
Business Development Program	59.006	\$ -	18,146
<b>GRAND TOTAL</b>		<b>\$ 63,956,775</b>	<b>\$ 74,459,122</b>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2011

1. Scope of Audit

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

a. Programs Subject to Single Audit

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

2. Summary of Significant Accounting Policies

A. Basis of Accounting

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

B. Reporting Entity

For purposes of complying with The Single Audit Act of 1984, as amended in 1996, the FSM National Government's reporting entity is defined in Note 1A to its September 30, 2011 basic financial statements, and all of the discretely presented component units are excluded. Accordingly, the accompanying Schedule of Expenditures of Federal Awards presents the federal award programs administered by the FSM National Government, as defined above, for the year ended September 30, 2011.

C. Indirect Cost Rate Agreement

The FSM National Government did not receive an indirect cost rate agreement and did not charge indirect costs against federal programs in fiscal year 2011.

D. CFDA #15.875

CFDA #15.875 represents the Office of Insular Affairs (OIA), U. S. Department of the Interior (DOI). 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 DOI Office of Inspector General (OIG) has recommended that programs administered under CFDA #15.875 be grouped by like compliance requirements, and such groupings be separately evaluated as major programs.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2011

2. Summary of Significant Accounting Policies, Continued

E. Subgrantees

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

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Programs  
Selected for audit in accordance with  
OMB Circular A-133  
Year Ended September 30, 2011

<u>Grantor</u>	<u>Description</u>	<u>CFDA No.</u>	<u>Amount of 2011 Expenditures</u>
<u>U.S. Department of the Interior</u>			
	Economic, Social and Political Development of the Territories:		
	Compact of Free Association:		
	Compact Sector Grants	15.875	\$ 20,993,309
<u>U.S. Department of Transportation</u>			
	Airport Improvement Program	20.106	33,581,350
<u>U.S. Department of Education</u>			
	Special Education – Grants to States	84.027	<u>1,984,636</u>
	Total program expenditures selected		\$ <u>56,559,295</u>
	Total U.S. Federal Program expenditures		\$ <u>63,956,775</u>
	% of Total U.S. Federal expenditures covered by major programs		<u>88%</u>

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2011

**Part I - Summary of Auditors' Results**

*Financial Statements*

- |  |             |
|--|-------------|
| 1. Type of auditors' report issued:                      | Unqualified |
| Internal control over financial reporting:               |             |
| 2. Material weakness(es) identified?                     | Yes         |
| 3. Significant deficiency(ies) identified?               | Yes         |
| 4. Noncompliance material to financial statements noted? | No          |

*Federal Awards*

- |   |  |             |
|---|--|-------------|
| Internal control over major programs:   |  |             |
| 5. Material weakness(es) identified?  |  | Yes         |
| 6. Significant deficiency(ies) identified?  |  | Yes         |
| 7. Type of auditors' report issued on compliance for major programs:  |  | Qualified   |
| 8. Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? |  | Yes         |
| 9. Identification of major programs:  |  |             |
| <u>CFDA Number</u>  | <u>Federal Program</u>                             |             |
| 15.875  | Compact of Free Association, Compact Sector Grants |             |
| 20.106  | Airport Improvement Program                        |             |
| 84.027  | Special Education – Grants to States               |             |
| 10. Dollar threshold used to distinguish between Type A and Type B Programs:  |  | \$1,918,703 |
| 11. Auditee qualified as a low-risk auditee?  |  | No          |

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

**Part II - Financial Statement Findings Section**

<u>Finding #</u>	<u>Findings</u>
2011-02	Fixed Asset Reconciliation
2011-04	Allowable Costs/Cost Principles
2011-08	Reconciliations
2011-10	Reconciliations
2011-11	Allowable Costs/Cost Principles
2011-13	Timely and Accurate Reconciliation, Record Maintenance
2011-14	Travel Advances

**Part III - Federal Award Findings and Questioned Cost Section**

<u>Finding #</u>	<u>CFDA #</u>	<u>Findings</u>	<u>Questioned Costs</u>
2011-01	15.875	Cash Management	\$ -
2011-02	15.875	Equipment and Real Property Management	\$ -
2011-03	15.875	Matching, Level of Effort, Earmarking	\$ -
2011-08	15.875	Reporting	\$ -
2011-09	15.875	Period of Availability of Federal Funds	\$ 74,347
2011-10	15.875	Cash Management	\$ -
2011-11	15.875	Allowable Costs/Cost Principles	\$ 47,213
2011-11	15.875	Procurement and Suspension and Debarment	\$ 108,831
2011-01	20.106	Cash Management	\$ 20,237
2011-02	20.106	Equipment and Real Property Management	\$ -
2011-04	20.106	Allowable Costs/Cost Principles	\$ 13,343
2011-04	20.106	Cash Management	\$ -
2011-05	20.106	Reporting	\$ -
2011-12	20.106	Reporting	\$ -
2011-02	84.027	Equipment and Real Property Management	\$ -
2011-06	84.027	Period of Availability of Federal Funds	\$ 37,043
2011-07	84.027	Period of Availability of Federal Funds	\$ -
Total Questioned Costs			\$ <u><u>301,014</u></u>

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-01  
Federal Agency: U.S. Department of the Interior  
CFDA Program: 15.875 Compact of Free Association, Compact Sector Grants  
Grant Number: Various Infrastructure Projects

Federal Agency: U.S. Department of Transportation  
CFDA Program: 20.106 Airport Improvement Program  
Grant Number: Various Airport Improvement Program

Requirement: Cash Management  
Questioned Costs: \$20,237

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

In accordance with the Fiscal Procedures Agreement on the Amended Compact Sector, all infrastructure projects and projects that are not funded by Operational Grants will be paid on the basis of Accrued Expenditures, provided the Government of the Federated States of Micronesia maintains procedures to minimize the time elapsing between the transfer of funds and their disbursement.

Condition:

1. For CFDA#20.106, the FSM National Government received cash in excess of immediate needs and an interest liability of \$20,237 results. For these items, the checks cleared three or more days after receipt of federal funds in the General Fund and/or AIP checking account
2. For CFDA #20.106, the FSM National Government made a drawdown for a retention payment for a project that had not received a certification of completion and as such does not represent a valid drawdown. The estimated interest liability for the period between the drawdown receipt and September 30, 2011 is \$210. It does not appear that a subsequent disbursement for the retention has occurred.
3. For CFDA#15.875, Infrastructure Grants, the FSM National Government received cash in excess of immediate needs and an interest liability of \$1,281 results. For these items, the expenditures were posted after the receipt of federal funds in the Compact sector checking account.
4. For CFDA #15.875, in 9 (or 9%) of 100 samples tested, there was insufficient or incomplete supporting drawdown documentation available. As we were unable to examine the supporting drawdown documentation, an amount cannot be identified and no questioned costs are presented for this condition.

Cause: For conditions 1, 3 and 4, either the entity drew down cash that was used for other purposes, did not locate the files, or there is gap in the systematic recordkeeping of cash management documents (receipts, drawdown confirmation, drawdown requests, expenditure report, etc.) to allow practicable verification.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-01, Continued  
Federal Agency: U.S. Department of the Interior  
CFDA Program: 15.875 Compact of Free Association, Compact Sector Grants  
Grant Number: Various Infrastructure Projects  
Questioned Costs: \$0

Federal Agency: U.S. Department of Transportation  
CFDA Program: 20.106 Airport Improvement Program  
Grant Number: Various Airport Improvement Program  
Questioned Costs: \$20,237

Requirement: Cash Management

Cause, Continued:

For condition 2, the FSM National Government did not monitor the completeness of the project prior to drawing down funds. However, the drawdown was not disbursed to the vendor, and the cash is included in the AIP checking account as of September 30, 2011.

Effect: For CFDA#20.106, the FSM National Government appears to be non-compliant with applicable cash management requirements. As a result of this condition the assessed interest liability for the program tested is more than \$10,000 and therefore, a questioned cost for the program exists.

The effect of the other conditions is potential interest liabilities and noncompliance with the criteria; however, since the projected interest liability does not exceed \$10,000, no questioned cost results.

Recommendation: The FSM National Government should comply with the criteria.

Auditee Response and Corrective Action Plan:

We agree with the finding. The auditors are using a three day clearance pattern. We are aware that Treasury has approved up to a fourteen day clearance pattern for the Government of Guam and the application of this pattern would resolve any questioned costs for FSM. We will petition the applicable agencies to parallel the pattern approved for the Government of Guam.”

Responsible Party: Rose N. Nakanaga-Acting Secretary of Finance and Administration.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.:	2011-02
CFDA Program:	US DOI 15.875 Compact of Free Association, Compact Sector Grants
CFDA Program:	US DOT 20.205 Airport Improvement Program
CFDA Program:	US ED 84.027 Special Education – Grants to States
Requirement:	Fixed Asset Reconciliation/Equipment and Real Property Management
Questioned Costs:	\$0

Criteria: Fixed asset records should be periodically reconciled and timely recorded. Property records must be maintained that include a description of the property, a serial number or other identification number, the source of property, who holds title, the acquisition date, and cost of the property, percentage of Federal participation in the cost of the property, the location use and condition of the property, and any ultimate disposition data including the date of disposal and sale price of the property.

Capitalized construction costs should be supported by Engineer’s certification reports as to completion and be regularly monitored as to status.

Capital assets should be reported at historical cost. The cost of a capital asset should include ancillary charges necessary to place the asset into its intended location and condition for use. Ancillary charges include costs that are directly attributable to asset acquisition—such as freight and transportation charges, site preparation costs, and professional fees.

Assets that are deeded to other governments should be subject to formal agreements and adequate maintenance of fixed assets should occur.

Condition:

1. The FSM National Government did not timely perform fixed asset reconciliations. Adjustments were provided in May 2012 as a result of audit inquiries.
2. In prior year, the FSM National Government transferred assets to the States and related component units. As a result, the States and related component units now bear responsibility for compliance with applicable grant terms and conditions. The grant terms and conditions were not specifically communicated to the States and related component units in the related transfer of assets and this has not been remedied in the current year. During the year, the FSM National Government reconciled the construction in progress account, and determined additional costs were to be capitalized, which resulted in a restatement of \$7,523,038. The revised project costs were not timely communicated to the corresponding state recording the asset.
3. Included in contract costs of Construction Managers (CM) or the Project Management Unit (PMU) are costs not directly related to construction, such as travel other than for site inspection and office costs (i.e. office rent, utilities, vehicle maintenance, etc). These unrelated charges are currently included in construction in progress, capitalized projects and in the portion transferred to the States. The FSM National Government allocated the administrative cost of contract CD0179 to projects based on project grant funding availability instead of estimating reasonable costs to be allocated to the project.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.:	2011-02, Continued
CFDA Program:	US DOI 15.875 Compact of Free Association, Compact Sector Grants
CFDA Program:	US DOT 20.205 Airport Improvement Program
CFDA Program:	US ED 84.027 Special Education – Grants to States
Requirement:	Fixed Asset Reconciliation/Equipment and Real Property Management
Questioned Costs:	\$0

Condition, Continued:

4. No formal maintenance procedures for equipment are established and we could not determine the manner in which maintenance responsibilities are carried out. Additionally, a physical count to survey the status of property and equipment was not completed in the last two years.
5. Per the terms of Contract CD0179, all equipment purchased is the property of the FSM National Government. Office equipment and vehicles purchased in the prior and current year through this Contract were not appropriately capitalized and tagged.

Cause:

For condition 1, it appears that communication and compilation of completed projects and construction-in-progress data, project engineer's estimates, project completion reports, and asset receiving reports were not sufficiently utilized to determine the appropriateness and accuracy of underlying financial reports.

For Condition 2, grant terms and conditions, including funding sources, were not specifically indicated in the Transfer of Property Document.

For condition 3, it has been a practice of the FSM National Government to capitalize all payments made to the CM or to the PMU based on funding availability. For capitalization, the FSM National Government has not developed a methodology to allocate these costs based on time and/or cost instead of available funding.

For condition 4, the absence of adequate maintenance procedures has been a recurring audit concern. Although plans have been made to conduct a physical count, such was not completed as of September 30, 2011.

For condition 5, the FSM National Government decided that it would not record the assets in the fixed asset register and represented such was agreed to by the Grantor agency. However, Finance is to maintain a separate record of these assets.

Effect: The effect of this condition is that inadequate accounting for fixed assets may occur and that complications between the FSM National Government and the States may result due to potential misunderstandings concerning compliance with grant terms related to capital assets. Noncompliance has resulted with federal compliance requirements applicable to equipment maintenance.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.:	2011-02, Continued
CFDA Program:	US DOI 15.875 Compact of Free Association, Compact Sector Grants
CFDA Program:	US DOT 20.205 Airport Improvement Program
CFDA Program:	US ED 84.027 Special Education – Grants to States
Requirement:	Fixed Asset Reconciliation/Equipment and Real Property Management
Questioned Costs:	\$0

Effect, Continued:

For assets not capitalized and tagged, this condition will detract from the monitoring and verification of existence, usage, condition and income derived from the disposal of equipment.

Additionally, a possible immaterial misstatement of capitalized costs could result from unrelated construction costs being included in construction in progress.

Prior Year Status: The conditions were cited in the 2010 Single Audit

Recommendation: The FSM National Government should adhere to federal compliance requirements governing capital assets. Periodic reconciliations and assessments of the status of construction in progress should occur. The reconciliation should also be subject to review and the review should be documented. A formal maintenance program that complies with federal maintenance requirements should also be developed. The FSM National Government should assess its current manpower level to determine if additional resources are required given the level of ongoing construction activities.

The grant terms and conditions should also be incorporated in the Transfer of Property Document to formally delineate responsibilities associated with the assets. Fixed assets owned by the FSM National Government should be completely accounted for in the fixed asset register.

For contract costs of the CM and/or PMU, the FSM National Government may consider assigning a unique expenditure code for the portion of contract costs that are non-construction related. Additionally, the FSM National Government should develop a methodology to reasonably allocate contract costs among projects.

Auditee Response and Corrective Action Plan:

Condition 1. We agree with this finding and recommendation. A Policy is in place in procuring asset that is no payment shall be made without tagging first the asset to ensure timely recording of the asset. The management will issue a memorandum to remind all departments and national treasury field offices to comply to this policy. The operations manager and procurement specialist will do a monthly reconciliation of assets to ensure compliance with the existing policy and timely recording of assets.

Condition 2. We agree with this finding and recommendation. The grant terms and conditions attributed to the transferred assets in prior years will be provided to the States Government and to its Component Units including additional costs if any. We will ensure that future transfer of assets will bear the complete and proper documentation of the assets.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.:	2011-02, Continued
CFDA Program:	US DOI 15.875 Compact of Free Association, Compact Sector Grants
CFDA Program:	US DOT 20.205 Airport Improvement Program
CFDA Program:	US ED 84.027 Special Education – Grants to States
Requirement:	Fixed Asset Reconciliation/Equipment and Real Property Management
Questioned Costs:	\$0

Auditee Response and Corrective Action Plan, Continued:

Condition 3 & 5. We agree with this finding and recommendation. We will work with the Department of TC&I to discuss the issue to come up with a workable solution in addressing this matter.

Condition 4. We agree with this finding and recommendation. We are in the process of doing the physical inventory to ensure compliance with the Financial Management Regulation and another physical inventory count is scheduled to be made in FY13. The target is to complete the physical inventory before December 2013.

Responsible Party: Juliet Jimmy-Assistant Secretary, National Treasury  
Jackson Jack-Operation manager  
Stoney Fritz-Procurement & Supply Specialist  
Noel Pascua- Financial Advisor

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-03  
 Federal Agency: U.S. Department of the Interior  
 CFDA Program: 15.875 Compact of Free Association, Compact Sector Grants  
 Grant Number: Disaster Assistance Emergency Fund  
 Requirement: Matching, Level of Effort, Earmarking  
 Questioned Costs: \$0

Criteria: Per –Agreement on the Establishment and Use of the Disaster Assistance Emergency Fund” (DAEF), beginning fiscal year 2005 and ending with a contribution on fiscal year 2023, the Government States of Micronesia (FSM) and the Government of the United States shall each deposit \$200,000 in a DAEF account established by the Government States of Micronesia. The funds contributed by the two parties shall be adjusted in accordance with the Section 211(d) of Title Two of the Compact as amended.

Condition: In fiscal year 2011, an appropriation was made by the FSM National Government for the \$200,000 match; however, the actual deposit to the DAEF account did not occur as of September 30, 2011. The Government of the United States deposited \$223,940 to the account in September 2011. Therefore, the applicable matching requirement was not met. Additionally, the FSM contribution was not adjusted in accordance with Section 211(d). The following depicts the total contributions to this fund.

<u>Year</u>	<u>US</u>	<u>FSM</u>
2007 & 2008	\$ -	\$400,000
2009	228,138	-
2010	222,648	-
2011	<u>223,940</u>	<u>-</u>
	<u>\$674,726</u>	<u>\$400,000</u>

Cause: The FSM National Government may have overlooked the timely deposit of the required match.

Effect: Possible noncompliance with the criteria could result from the condition.

Recommendation: Timely monitoring of the DAEF account should occur to comply with the criteria.

Auditee Response and Corrective Action Plan:

We agree with the finding and recommendation. The check for the Disaster Assistance Emergency Fund matching was disbursed in FY2011, however, deposit was made after 09/30/2011. We will ensure that timely deposit will be made for all future DAEF matching.

Responsible Party: Akiama George– Treasury Manager

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-04  
Federal Agency: U.S. Department of Transportation  
CFDA Program: 20.106 Airport Improvement Program  
Grant Number: Various Airport Improvement Projects

Requirement: Allowable Costs/ Cost Principles  
Questioned Costs: \$13,343

Requirement: Cash Management  
Questioned Costs: \$0

Criteria: Expenditures should be necessary and reasonable for program needs and should be in accordance with program requirements. Furthermore, financial and programmatic records should be maintained on file for at least three years.

Per the AIP Handbook, the sponsor (the FSM National Government) is required to provide adequate, competent and qualified engineering supervision and construction inspection during all stages of the work. If the sponsor engages the services of a qualified engineer or an engineering firm, the engineering agreement becomes the basis of FAA determination of adequate engineering services and reasonable costs.

Condition:

1. For 3 (or 5%) of 65 transactions tested, there was only partial financial and/or programmatic records (i.e., trip reports, invoices, boarding passes, etc.) on file to substantiate the allowability of the following transactions.

<i>Per Transaction Detail</i>							Question Cost
No	LABEL	Req #	Date	ref 1	PRG	YR	Amount
4	AIP	38	11/15/2010	CD0179	27321	07	\$ 2,037
6	AIP	55	08/12/2011	CD0179	27422	08	1,135
7	AIP	59	01/10/2011	CD0179	27515	08	<u>10,171</u>
							<u>\$13,343</u>

2. For 2 (or 3%) of 65 transactions tested, the expenditure was initially recorded without construction manager (CM) certification. Upon audit inquiry, the FSM National Government provided certification for a portion of the amount expended as of September 30, 2011. As a result, the FSM National Government provided an adjustment to reverse the portion of the billing that was not certified by the CM, which aggregated \$1,444,447. This amount was paid on September 27, 2011 and was subsequently certified by the CM in January 2012. No questioned costs result as of September 30, 2011 due to the immateriality of the amount but the ultimate interest liability in fiscal year 2012 appears to exceed \$15,000.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-04, Continued  
Federal Agency: U.S. Department of Transportation  
CFDA Program: 20.106 Airport Improvement Program  
Grant Number: Various Airport Improvement Projects

Requirement: Allowable Costs/ Cost Principles  
Questioned Costs: \$13,343

Requirement: Cash Management  
Questioned Costs: \$0

Condition, Continued:

3. For contract CC0180, billings include travel and miscellaneous reimbursements. There were no invoices or other documentation supporting the nature of the travel and miscellaneous items. We cannot determine if the non-professional fee portion of the billings (travel and miscellaneous) are allowable since the FSM National Government does not require support for these items. Therefore, no questioned cost is presented.
4. Travel for Government employees is included in the contract cost of CD0179. All billings to the CD0179 account are subject to fixed management costs; therefore, the FSM National Government incurs costs for government travel in addition to the costs that it would incur if it paid for the direct travel costs. This added cost could be eliminated if management of the travel budget was performed by the FSM National Government itself and not by the contractor.
5. The entity hired an engineering firm to oversee construction projects which is a PMU contractual function. Included in the contract scope is a requirement to determine the appropriateness of contractor billings. The requisite PMU review and approval of contractor billings was not clearly indicated on payment documents. However, we noted that all payments were duly authorized by the implementing Department. Therefore, no questioned cost is presented.

Cause: There appears to be a lack of controls over compliance with the criteria. Certain travel was charged to contracts that were not specifically identified in the approved budget proposals. Certain billings were paid without certification from construction management.

For condition 3, it is the FSM National Government's position that supporting documentation for the travel and miscellaneous portion of the billings is not required.

For condition 5, the current process does not incorporate documentation of PMU review.

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

Prior Year Status: These conditions were cited in the 2010 Single Audit

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-04, Continued  
Federal Agency: U.S. Department of Transportation  
CFDA Program: 20.106 Airport Improvement Program  
Grant Number: Various Airport Improvement Projects

Requirement: Allowable Costs/ Cost Principles  
Questioned Costs: \$13,343

Requirement: Cash Management  
Questioned Costs: \$0

Recommendation: The FSM National Government should require written engineering certifications prior to payment.

Additionally, budget proposals should be on file to support assessed billing rates.

The FSM National Government should also scrutinize the nature of travel and miscellaneous billings to determine if charges are appropriate.

Auditee Response and Corrective Action Plan:

We agree with the finding and recommendation.

Condition 1. The Department of Finance and Administration has requested the contractor, Lyons and Associates to provide the necessary documents to clear the finding such as the budget for travel for item No. 4 and 7 and supporting documents of the travel in item no. 6.

Condition 2-5. We will refer this finding to the Department of TC&I and to the Project Management Unit to address the issue. The Department of TC&I is the contracting party while the PMU administers the projects and both have authority to sign off on the contracts and on the certification of construction progress report.

Responsible Party: Jackson Jack-Operations Manager

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-05  
Federal Agency: U.S. Department of Transportation  
CFDA Program: 20.106 Airport Improvement Program  
Grant Number: Various Airport Improvement Projects  
Requirement: Reporting  
Question Costs: \$0

Criteria: The following criteria were excerpted from the AIP Handbook – part 3 (Order 5100.38c):

1220 (f). Final inspections should be conducted in the presence of the sponsor and contractor representatives, and the results recorded on FAA Form 5100-17, AIP Final Inspection Report, (Appendix 10). The region may waive final inspection if there is full assurance that the work has been completed totally and satisfactorily. The rationale supporting such a waiver shall be fully documented.

1313. ADMINISTRATIVE REQUIREMENTS FOR CLOSEOUT. Sponsors shall be required to submit the following items as part of the administrative closeout of the project:

- a. As-Built Plans. –As-built” plans for airport development projects involving construction must be submitted. At the FAA Airports Office’s discretion, certification from the sponsor that as-built plans have been received and will be retained for future use may be accepted. Another option, at the discretion of the FAA Airports Office, is to accept an electronic version of the as-built plans;
- b. Exhibit A, Property Map. Revised –Exhibit A” if any changes were made from the one submitted with the project application;
- c. Property Accountability. A sponsor rarely acquires equipment expressly to carry out a grant. However, if a sponsor does, an inventory of all equipment with a current per unit fair market value in excess of \$5,000, acquired with Federal funds and used to carry out the grant, must be submitted as part of the closeout package. Equipment no longer needed for airport purposes may be sold or retained by the sponsor. The Federal share of the current fair market value shall be deducted from the grant amount or reimbursed to FAA.

Condition: The following projects are reported as having been completed. The FAA Form 5100-17 or the FAA waiver (if any), were not available for verification. Documentation was also unavailable to determine compliance with administrative closeout requirements.

<u>Program No.</u>	<u>Project</u>
27522	YAP INTERNATIONAL AIRPOR-APRON RECON
27401	POHNPEI RUNWAY REHAB
27421-07	PNI REHABIL. RUNWAY-PHAS 1
27421-10	PNI REHABIL. RUNWAY-PHAS 2
27420-06	PNI REHABIL. RUNWAY-PHAS 1
27422-08	POHNPEI RUNWAY REHAB
27423-10	POHNPEI AIRPORT REHAB PHASE IV

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-05, Continued  
Federal Agency: U.S. Department of Transportation  
CFDA Program: 20.106 Airport Improvement Program  
Grant Number: Various Airport Improvement Projects  
Requirement: Reporting  
Question Costs: \$0

Condition, Continued:

<u>Program No.</u>	<u>Project</u>
2-27000-09	Chuuk sealinling/fencing (cf0202)
3-27000-09	Kosrae fencing (cf0343)
27515	YAP APRON REHABILITATE(Design and cm
74204	PNI REHAB RUNWAY
54-70204-09	PNI runway Project
52-70207-09	AIP SECURITY FENCE-Chuuk
53-70207-09	AIP SECURITY FENCE-Kosrae

Cause: Either the FSM National Government has not submitted the reports and close-out documentation or such cannot be located.

Effect: The effect of this condition is possible noncompliance with the criteria.

Recommendation:

The FSM National Government should submit required reports and maintain close-out documentation in accordance with applicable reporting requirements.

Auditee Response and Corrective Action Plan:

We agree with this finding and recommendation. For completed projects, the Certificate of Substantial Completion and FAA AIP Final Inspection Report were submitted to FAA but not on the FAA form 5100-17. It is our understanding that the project completion reports in lieu of the FAA form 5100-17 was accepted by the FAA. These documents were provided to the auditors but insisted on the FAA form 5100-17. We will work with the Department of TC&I to confirm from FAA if the Certificate of Substantial Completion and FAA AIP Inspection Report are sufficient in lieu of FAA form 5100-17.

Responsible Party: Noel Pascua-Financial Advisor



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No: 2011-06  
 Federal Agency: U.S. Department of Education  
 CFDA Program: 84.027 Special Education – Grants to States  
 Requirement: Period of Availability of Federal Funds  
 Questioned Costs: \$37,043

Criteria: The Government of the Federated States of Micronesia shall liquidate all obligations incurred under a grant not later than ninety days after the end of the funding period or as otherwise mutually agreed.

Condition: Expenditures were recorded in FY2011 under the FY09 Special Education grant number H027A080005A after the period of availability expired, as follows:

Last Date To Liquidate	Exp Posting Date	Exp Amount	Chk No.	Chk Date	Chk Clear	Obligation No.	Obligation Date
12/29/2010	01/04/2011	\$37,043	829061	01/18/2011	02/07/2011	CG0303	06/25/2010

The expenditure was liquidated after the period of availability specified in the related grant award ended.

Cause: There appears to be a lack of monitoring over compliance with period of availability requirements.

Effect: A questioned cost results from this potential noncompliance.

Recommendation: The FSM National Government should timely monitor compliance with period of availability requirements.

Auditee Response and Corrective Action Plan:

We agree with the finding and recommendation. The FSM Department of Education is communicating to the grantor agency to clear the finding. The Certification Manager and the Accounts Payable Manager have been instructed to be more vigilant and to focus on details most specially on the period of availability to avoid such citation. We will ensure that liquidation of contract will be made in timely manner.

Responsible Party: Jacobson Jacob-Certification Manager  
 Atilla Kinere-Accounts Payable Manager

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No: 2011-07  
Federal Agency: U.S. Department of Education  
CFDA Program: 84.027 Special Education – Grants to States  
Grant Number: H027A050005  
Requirement: Period of Availability (POA) of Federal Funds  
Questioned Costs: \$0

Criteria: Where a funding period is specified, a grantee may charge to the award only costs resulting from obligations of the funding period unless carryover of unobligated balances is permitted, in which case the carryover balances may be charged for costs resulting from obligation of subsequent funding period.

Condition: A period of availability questioned cost of \$104,113 was raised in the 2010 audit pertaining to expenditures against a 2006 grant award that was reimbursed during the fiscal year. However, the website report that shows the drawdown for each grant (EDCAPS G5), does not include a drawdown for the 2006 grant award as it is no longer available during the year. As such, it appears the FSM National Government drew down from another open grant for reimbursement of these costs.

Additionally, the drawdown reflected in the website (EDCAPS G5) does not reconcile to the application of the drawdown against the special education receivable sub-ledger. The drawdowns were not applied to the correct receivable sub-ledger, although all were applied within the special education sub-ledger accounts.

Cause: The expenditure was incurred past the POA and the 2006 grant was no longer available. Thus, reimbursement was drawn down from open grants.

In reconciling accounts receivable, the FSM National Government does not utilize website reports to determine the correct application of the drawdowns.

Effect: The FSM National Government appears to be in noncompliance with the criteria; however, no questioned costs result since this matter was already questioned in the 2010 audit.

The sub-ledger special education accounts may not be accurate but the net effect of the misapplication is not material and is below the \$10,000 threshold.

Prior Year Status: The POA condition was cited in the 2010 Single Audit.

Recommendation: The FSM National Government should comply with the criteria and monitor controls over funds availability.

Auditee Response and Corrective Action Plan:

We agree with this finding. The division of international and investment finance is responsible for drawdown and reimbursement. The staff doing the drawdown has been advised to draw funds to the appropriate grant and identify the proper program accounts where the drawdown was made for proper recording of drawdown.

Responsible Party: Melinda Irons- Investment Accountant

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-08  
 Federal Agency: U.S. Department of the Interior  
 CFDA Program: 15.875 Compact of Free Association, Compact Sector Grants  
 Grant Number: DOI Compact Sector  
 Requirement: Reporting  
 Questioned Costs: \$0

Criteria: In accordance with the Compact Subsidiary Agreement: (a) A Standard Form SF 269 or a reasonable facsimile thereof approved by the Government of the United States, shall be prepared quarterly and submitted within 30 days after the end of the quarter to which it applies. The report shall include accounting information and a status of progress for each project funded by the Grant; (b) A Federal Cash Transactions Report, or Standard Form SF 272 of the Government of the United States or a reasonable facsimile thereof approved by the Government of the United States, shall be submitted quarterly within 30 days of the end of the quarter to which it applies. Actual dates, project identification, and amounts of drawdowns for the quarter should be supplied in the "Remarks" section of the form. Additionally, submitted reports should reconcile with underlying records.

Condition:

1. Discrepancies were noted in comparing the 2010 Grant Final Closeout Report of the FSM National Government against the ledger, which covered the period to September 30, 2011. The FSM National Government included expenditures posted in 2012, which resulted in the difference. The grant has an extension to March 31, 2011; therefore, these expenditures were posted past the period of availability and do not appear authorized to be included in these grants.

2010 Cash Recon – National

	GRX0073 National Education	GRX0014 Health	GRX0023 Capacity	Total
Expenditure: Report	\$ -	\$622,244	\$576,815	\$ 1,199,059
GL		621,292	552,126	1,173,418
Difference	-	952	24,689	25,641
Encumbrance Report	-	-	17,143	17,143
GL	14,809	4,202	14,415	33,426
Difference	\$ (14,809)	\$ (4,202)	\$ 2,728	\$ (16,283)

2. Discrepancies were noted in comparing the Infrastructure reports against the ledger. The infrastructure reports do not indicate the corresponding fundware number (the recipient's identifying number) for each grant number (referenced to a GR number).
3. For Infrastructure grant GR970172, ADB matching for reported Pohnpei State expenditures include other expenditures associated with other ADB matching grants. The ADB matching grant has four GR numbers (one for each state); however, this was allotted to only one account number. Therefore, expenditures reported included the matching for other states.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-08, Continued  
Federal Agency: U.S. Department of the Interior  
CFDA Program: 15.875 Compact of Free Association, Compact Sector Grants  
Grant Number: DOI Compact Sector  
Requirement: Reporting  
Questioned Costs: \$0

Condition, Continued:

4. For the following grants, discrepancies in expenditures, encumbrances and allotments were noted when comparing the Federal Financial Report for the period ended September 30, 2011.

<u>Grant Award</u>
GRX0073
D11AF0035
GRX0014
D11AF00004
GR870025
GR970067
GRX0023
D11AF00009
D11AF00034
D11AF00057
GR970056
GRX0204

Cause: It appears that reconciliations between the general ledger and required reports did not occur prior to submission. Additionally, period of availability (grant extension date) may not have been considered for expenditures included in the report.

For the ADB Matching Grant, the grant with 4 GR numbers was allotted to one account number. Therefore, the amount reported includes other GR numbers.

Effect: Noncompliance with reporting requirements results from this condition. The 2010 Closed Out Report reported higher expenditures and unliquidated obligations or encumbrances than the ledger due to inclusion of 2012 expenditures and unliquidated encumbrances, which are past the grant's period of availability.

Erroneous carryover amounts and drawdowns may occur if the discrepancy is not reconciled to determine the appropriate amount to be reported.

Prior Year Status: A finding on reporting was raised due to unavailability of the reports in the 2010 Single Audit.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-08, Continued  
Federal Agency: U.S. Department of the Interior  
CFDA Program: 15.875 Compact of Free Association, Compact Sector Grants  
Grant Number: DOI Compact Sector  
Requirement: Reporting  
Questioned Costs: \$0

Recommendation: Reports submitted to the Grantor should be reconciled to underlying financial records including the Accounts receivable subsidiary ledgers. We recommend consideration of including the Fundware account number for the infrastructure report on each GR number. As reports are submitted per GR number, the FSM National Government should consistently assign a unique account number for each GR number. This will facilitate report preparation and submission.

For the ADB Matching Grant, it is our understanding that the FSM National Government plans to assign a different account number for each GR number for this grant. The FSM National Government, upon creation of the account number for each GR number, should also consider transferring related expenditures to the correct account number.

Auditee Response and Corrective Action Plan:

Condition 1. We disagree with this finding. The auditor is comparing the final close out report for grant nos. GRX0014 and GRX0023 covering the period up to 03/31/2012 against the general ledger for the period as of 09/30/2011. The difference of \$24,689 in grant GRX0014 are the expenditures recorded in October 2011 to March 2012 while the difference of \$952 in grant GRX0014 is the expenditures recorded in December 2011. These expenditures are properly reported and included in the FY08, FY09 and FY10 final close out reports as of March 31, 2012.

Conditions 2-4. We agree with this finding and recommendation. The next Infrastructure report will indicate the corresponding fundware number (the recipient's identifying number) for each grant number (referenced to a GR number). We will also discuss with SBOC Office to segregate the allotments for ADB matching grants.

Responsible Party: Juliet Jimmy- Assistant Secretary, National Treasury

Auditor Response: The FSM National Government should seek clarification from the Grantor Agency relative to the practice of drawdowns for invoices after the period of availability.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No: 2011-09  
Federal Agency: U.S. Department of the Interior  
CFDA Program: 15.875 Compact of Free Association, Compact Sector Grants  
Grant Number: Public Sector Capacity Grants/Environmental Sector Grant  
Project Name: 14026-08 FMIS Project, 14220-08 Sector Performance Reporting, 14045-08  
Financial Management Act, 12911-08 National Compact II Environmental Fund  
Requirement: Period of Availability of Federal Funds  
Questioned Costs: \$74,347

Criteria: The Government of the Federated States of Micronesia shall liquidate all obligations incurred under a grant after the end of the funding period or as otherwise mutually agreed.

Condition: Expenditures were recorded in FY2011 under the FY08 Public Sector Capacity Grant, the FY09 Public Sector Capacity Grant, and the FY08 Environmental Sector Grant programs past the period of availability, as follows:

<u>Program Number</u>	<u>Total Expenditure Amount</u>
12-12911-08	\$ 1,230
14-14220-08	1,118
14-14026-08	16,723
14-14045-08	5,408
14-91225-09	14,701
14-21360-09	15,571
14-91225-10	<u>19,596</u>
	\$ <u>74,347</u>

Cause: There appears to be a lack of monitoring over compliance with period of availability requirements.

Effect: Questioned costs result from this potential noncompliance.

Recommendation: The FSM National Government should comply with program requirements and timely monitor period of availability requirements.

Auditee Response and Corrective Action Plan:

We agree with this finding. We believe an extension of the grant was granted for grants FY08, 09, 10 for which the final close out was made covering up to March 31, 2012. We will obtain copy of the extension letter from the grantor to clear this finding.

Responsible Party: Juliet Jimmy- Assistant Secretary, National Treasury

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-10  
Federal Agency: U.S. Department of the Interior  
CFDA Program: 15.875 Compact of Free Association, Compact Sector Grants  
Grant Number: Compact Sector Grants  
Requirement: Cash Management  
Questioned Costs: \$0

Criteria: Reconciliation of accounts should occur timely and accurately. Grants drawdowns and deposits into the Holding Bank Account should be timely recorded and be readily accessible anytime by authorized users.

Condition: Upon audit inquiry, an adjustment was provided on May 2012 to record the correct ending balance of the Compact Sector holding account. It is not currently a process to record the transactions in the Compact Sector holding account in the accounting system other than to record a journal voucher to record the ending balance. Instead, a subsidiary ledger is maintained in a spreadsheet to account for the movement of the holding account. The manual spreadsheet contains sufficient information to allow performance of audit procedures. However, as the information resides in one individual's computer, information is not readily accessible for use by other affected parties.

Cause: It is not current procedure to account for sector holding transactions in Fundware.

Effect: The misstated account was corrected through subsequent adjustment. Information is not readily accessible to users. This condition also has the effect of not allowing a verifiable trail for movements in the holding account as changes can be made without an audit trail. However, if the transactions are recorded in Fundware, the system will reflect all changes.

Recommendation: The FSM National Government should maximize the functionality of Fundware and incorporate drawdowns and deposits in the specific grant account number. As all grants are issued with an account number by SBOC, the FSM National Government should consider utilizing these account numbers, including those of the States, in recording drawdowns and deposits. Recording the transactions against unique account numbers will also facilitate reporting processes.

Additionally, reconciliations of the accounts receivable sub-ledger maintained by Treasury against the Compact Sector drawdown records maintained by the Investment Division should regularly occur.

Auditee Response and Corrective Action Plan:

We agree with the finding and recommendation. A procedure of recording federal deposit and drawdown is in place for the federal holding account and we believe that using this procedure to record the grants drawdown and deposit for compact sector grants is also applicable.

Responsible Party: Delihda Lebeh- Investment Accountant  
Noel Pascua – Financial Advisor

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-11  
 Federal Agency: U.S. Department of the Interior  
 CFDA Program: 15.875 Compact of Free Association, Compact Sector Grants  
 Requirement: Allowable Costs/Cost Principles  
 Questioned Costs: \$47,213  
 Requirement: Procurement and Suspension and Debarment  
 Questioned Costs: \$108,831

Criteria: In accordance with applicable allowable costs/cost principles, expenditures should be necessary and reasonable for program needs and should be in accordance with program requirements. Furthermore, financial and programmatic records should be maintained on file for at least three years.

In accordance with applicable procurement requirements, procurements shall provide full and open competition among vendors, and allowable exceptions should be approved and documented in procurement files.

Condition:

- For 5 (or 5%) of 100 transactions tested, there was either partial or no financial and/or programmatic records (i.e., contracts, receiving reports, invoices, boarding passes, trip reports etc.) on file to substantiate certain transactions.
- For 2 (or 2%) of 100 transactions tested for the Compact Sector Programs, there was either insufficient documentation or none was provided to support competitive procurement requirements.

Per Transaction Detail							QUESTIONED COSTS	
No.	Label No	Date	Trns_No	ref_1	fd_prg_yr	Procurement	Allowable Cost	
1	CS 24	9/29/2011	80452	TH2352	10-10110-11	\$ -	\$ 1,804	
2	CS 27	2/24/2011	64499	JVH0076	14-14026-08	-	7,498	
3	CS 28	3/30/2011	66978	1034064	14-14026-11	-	30,142	
4	CS 39	7/26/2011	75503	CH0072	19-70020-10	-	6,119	
5	CS 41	3/30/2011	66947	CG0366	19-70208-09	51,459		
6	CS 42	8/26/2011	77882	CG0366	19-70208-09	<u>57,372</u>		
7	CS 85	1/18/2011	62152	1028636	19-74219-07		<u>1,650</u>	
						<u>\$108,831</u>	<u>\$47,213</u>	

- Expenditures of \$616,761 related to AIP matching for the Kosrae runway and overlay project were charged to the Infrastructure grant (fundware program number 70204-11). There was no grant award provided establishing the authorization for these expenditures; however, the nature of the expenditures is normally generally allowable in the Infrastructure program. No specific grantor approval was obtained for the use of these funds. However, no specific cash drawdown of grant funds occurred to fund this match, and the payable is still outstanding as of year-end. The match has been charged to Sector funds and therefore, if this match will not be paid, noncompliance with AIP requirements could result. Since no federal cash was drawn to fund this match, no questioned cost results.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-11, Continued  
Federal Agency: U.S. Department of the Interior  
CFDA Program: 15.875 Compact of Free Association, Compact Sector Grants  
Requirement: Allowable Costs/Cost Principles  
Questioned Costs: \$47,213  
Requirement: Procurement and Suspension and Debarment  
Questioned Costs: \$108,831

Condition, Continued:

4. For additional task orders on infrastructure projects, no documentation was available to show that price negotiation occurred between the FSM National Government and the contractor to document that an advantageous price proposal was negotiated.
5. The Infrastructure fund pays for the 5% matching cost of the AIP projects. Travel for Government employees is included in the contract cost of CD0179. All billings to the CD0179 account are subject to fixed management costs; therefore, the FSM National Government incurs additional costs on government travel in addition to the costs that it would incur if it paid for the direct costs of travel. This added cost could be eliminated if management of the travel budget was performed by the FSM National Government itself and not by the contractor.
6. Evidence of title, leasehold agreement, or other legal authority for use of the land upon which the capital improvement project(s) is to be constructed was not on file to support project expenditures.
7. Included in a prior year finding 2010-08 was a \$324,773 accrual for the use of the Infrastructure Maintenance fund (IMF) for certain maintenance projects of COM-FSM. This amount was paid during fiscal year 2011 using the local match of the IMF. Per a resolution dated September 2, 2010, JEMCO suspended payments of Compact-funded design and associated preliminary engineering work for certain College of Micronesia projects. There was no documentation provided by the FSM National Government to clarify that the IMF disbursement was not covered by the JEMCO resolution and the status of the JEMCO suspension. There is possible noncompliance, but no questioned cost will be raised since the local match was used in the disbursement.

Cause: The cause of the condition appears to be due to the process of maintaining documentation in many disparate locales and lack of documentation supporting resolution of these matters with the affected federal agency.

Effect: The effect of this condition is questioned costs and potential noncompliance with the criteria.

Recommendation: We recommend that necessary communications and documentation in support of the above be retained in file.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-11, Continued  
Federal Agency: U.S. Department of the Interior  
CFDA Program: 15.875 Compact of Free Association, Compact Sector Grants  
Requirement: Allowable Costs/Cost Principles  
Questioned Costs: \$47,213  
Requirement: Procurement and Suspension and Debarment  
Questioned Costs: \$108,831

Auditee Response and Corrective Action Plan:

Conditions 1 and 2. We agree with these findings. The Certification manager has been instructed to get the bid proposals of other contractors to support the selection of the winning contractor under contract No. CG0366. This is the remaining pending items for the procurement while staff at accounts payable section will work with the appropriate department to provide additional documentation that would support the expenditures. The financial advisor will schedule training to the Certification and Accounts payable sections on the required documentation prior to certifying and processing of payments to ensure a complete and proper documents are submitted before certification and processing of payments. The documents will be provided to the auditor on or before December 31, 2012.

Responsible Party:  
Jacobson Jacob-Certification Manager  
Atilla Kinere-Accounts Payable Manager

Condition 3. We agree with this finding. The request for payments were certified by the National Treasury due to the issuance of the allotment advice from SBOC Office without knowing that the infrastructure grant has not been approved. In FY2012, FSM Congress appropriated \$900,000 from the General Fund to fund AIP matching that includes the \$616,761 expenditures as per public law no. 17-52 Section 9(6)(c). On June 11, 2012, an advice of allotment has been issued by SBOC Office for the \$900,000 and on June 27, 2012, the Department of TC&I has requested for a change of program accounts from infrastructure fund to general fund to reflect the correct funding source. The National treasury will affect the changes in the program account and provide these documents to the auditor to resolve the audit finding.

Responsible party:  
Jackson Jack-Operations Manager

Conditions 4 -6. We agree with these findings. We will discuss these findings with the project Management Unit (PMU) Manager to address the issue.

Responsible Party:  
Juliet Jimmy-Assistant Secretary, National Treasury  
Noel Pascua-Financial Advisor

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-11, Continued  
Federal Agency: U.S. Department of the Interior  
CFDA Program: 15.875 Compact of Free Association, Compact Sector Grants  
Requirement: Allowable Costs/Cost Principles  
Questioned Costs: \$47,213  
Requirement: Procurement and Suspension and Debarment  
Questioned Costs: \$108,831

Auditee Response and Corrective Action Plan, Continued:

Condition 7. We do not agree with this finding. Per discussion with the representative of the US Department of the Interior regarding the JEMCO resolution No. 2010-05, the resolution has nothing to do with the Infrastructure Maintenance Fund (IMF). The JEMCO Resolution No. 2010-05 states that ~~r~~esolves that Compact-funded design and associated preliminary engineering work for the following College of Micronesia projects: 1) Chuuk Campus-College of Micronesia Phase 1; 2) Chuuk Campus-College of Micronesia phase 2; 3) National Campus-College of Micronesia Student Center; 4) Pohnpei Campus-College of Micronesia Vocational Center and Classroom Building; shall be suspended until FSM submits and JEMCO accepts the **Western Association of Schools and Colleges (WASC)-approved College of Micronesia restructuring plan**". He further indicated that he will send a communication to the Department of Finance and Administration to clarify this matter. Likewise, the College of Micronesia-FSM has indicated the same that the JEMCO Resolution No. 2010-05 does not relate to the IMF. We will follow up from the OIA to get the clarification to clear this matter.

Responsible Party: Juliet Jimmy-Assistant Secretary, Nat'l. Treasury

Auditor Response: The FSM National Government has yet to provide documentation that JEMCO's suspension does not include the IMF projects. Although the local share of the IMF was utilized, the usage of IMF should be in accordance with the FPA.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-12  
 Agency: U.S. Department of Transportation  
 CFDA Program: 20.106 – Airport Improvement Project  
 Grant #: Various  
 Requirement: Reporting  
 Questioned Costs: \$0

Criteria: Submitted reports should be accurately completed and submitted in accordance with grant terms and conditions. The report should reconcile with underlying records.

Condition:

1. The Government submits a Federal Financial Report (the Report) which reflects accumulated drawdowns and expenditures on an accrual basis per grant for a given period. For items 2 and 3, drawdowns reported do not agree with financial records underlying the general ledger. Reconciliations between financial records and the amount reported were not readily available
2. For items 1 and 2, in comparing accumulated cash receipts against expenditures net of retainage, the amount drawn down exceeded expenditures. Reconciliations between financial records and the amount reported were not readily available

	Per GL:				Per SF 425				Difference:	
	Expenditures To date	Retainage	Allowable Drawdown	Cash receipt	Cash receipts	Expenditure	Account number	Grant no.	Over draw down	Receipts under (over) reporting
1	\$ 1,597,704	\$ -	\$1,597,704	\$1,599,998	\$1,599,999	\$1,597,705	3-20-80-84-27321-07	3-64-0001-09	\$ 2,295	\$ -
2	3,500,000	0	3,500,000	3,500,004	3,491,908	3,499,999	3-20-80-81-27000-09	3-64-0001-10	-	8,096
3	14,330,168	0	14,330,168	14,169,743	14,169,943	14,330,169	1-20-80-84-27422-08	3-64-0002-11	-	(200)
4	5,200,000	465,491	4,734,509	5,200,000	5,200,000	5,200,000	1-20-80-84-27222-07	3-64-0003-10	465,491	---
									<u>\$651,850</u>	<u>\$7,896</u>

Cause: It appears that reconciliations of reports with financial records were not accurately performed.

Effect: Noncompliance with reporting requirements results from this condition. No questioned costs result as the amount of interest calculated on the excess draw is below threshold.

Prior Year Status: This condition was cited in the 2010 Single Audit.

Recommendation: The Government should comply with the criteria. Reports submitted to Grantors should be reconciled to underlying financial records. Additionally, the over drawdown should be applied to succeeding drawdown applications.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No.: 2011-12  
Agency: U.S. Department of Transportation  
CFDA Program: 20.106 – Airport Improvement Project  
Grant #: Various  
Requirement: Reporting  
Questioned Costs: \$0

Auditee Response and Corrective Action Plan:

We agree with this finding.

Item No. 1. The over-drawdown is properly reflected on the SF425 report submitted to FAA as of 09/30/2011. We will make an adjustment in the next drawdown.

Item no. 2. The under reporting of \$8,092 is the result of discrepancy between the FAA drawdown report against the Echo Web. We used the FAA drawdown report provided by FAA as a basis in preparing the SF425 however it appears that the FAA drawdown report contains incorrect information. The FAA drawdown report shows \$3,491,908 and this was the amount reported in the SF425 as of September 30, 2011. However, a certain drawdown made in March 2011 in the amount of \$8,092 per Echo web document is not included or part of the \$3,491,908 as of 09/30/2011. There appears to be discrepancy between the FAA drawdown report and the Echo Web. We will validate this transaction to FAA and will report the result accordingly.

Item No. 3. We will correct the over-reporting of \$200 in the next SF425 report.

Item No. 4. The over-drawdown was the result of improper submission of request for payment and drawdown from the Department of TC&I. In September 2011, the Department of Transportation submitted a request for final payment for certain contractor. This request was processed by the Department of Finance and Administration of which the drawdown from the grant was made and a check was disbursed to the contractor. However, after a few days, the department of TC&I determined that the project has not been completed and no certificate of substantial report has been issued so a cancellation was requested to cancel the check. Hence, the over draw down as of 09/30/2011. In June 2012, the project has been completed and the check payment has been re-issued to the contractor.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No. 2011-13 – Timely and Accurate Reconciliation, Record Maintenance

Criteria: Reconciliations of accounts should be performed timely and accurately.

Documentation supporting the allocation of loan payments should be on file.

Condition:

1. Audit adjustments were proposed in addition to several adjusting entries provided by the FSM National Government during May and June 2012 to correct and reconcile various accounts (including capital assets, expenditures, revenue).
2. The agreement entered into between the FSM National Government and ADB pertaining to the ADB Loan SDR adjustment effected in prior year is not available.

At the time of the allocation of the SDR on Loan Number 1873, loan drawdowns in the ADB cash holding account were not considered in the allocation. However, these were already subjected to SDR allocations by the ADB. The FSM National Government should revisit the allocation to consider the balance and movements in the ADB sector holding account. It is our understanding that the allocation was revisited upon our audit inquiry, and the FSM National Government plans to formally communicate changes to the States.

3. During the year, loan payments for ADB Loan Number 1816 FSM (SF) – Basic Social Services Program were made. The FSM National Government allocated these loans to three States and to the FSM National Government. Consequently, the FSM National Government may have an equitable share in the loan amortization. However, principal amortization has been paid solely by the States. The FSM National Government was not able to provide documentation as to the basis of this allocation. The project completion report provided by ADB did not specifically indicate the specific state beneficiary. Rather, the project appears to imply that the FSM as a whole is the beneficiary.
4. Certain loan drawdown documents supporting a recorded journal voucher were not available, and as such, we cannot verify the accuracy of the allocation of the respective loans among the States. However, the loan drawdown was confirmed by ADB.
5. As of September 30, 2011, there exist unidentified federal funds of \$279,122 that were drawn down from the Federal Holding Account in prior years that are included within General fund cash. Additionally, the FSM National Government has recorded \$146,050 of deferred revenue.

Cause: Reconciliations of the accounts were not accurately performed.

Relative to the ADB Loan 1816, it is the FSM National Government's understanding that related projects were for the benefit of the States and as such, the States bear responsibility for loan repayments. However, the report provided by ADB does not necessarily support this understanding.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No. 2011-13 – Timely and Accurate Reconciliation, Record Maintenance

Cause, Continued:

For condition 5, the unidentified cash resulted from a prior year unreconciled balance that was transferred in 2009 to the general fund. It does not appear that subsequent attempts to reconcile this balance have occurred. Additionally, there appears to be untimely monitoring of drawdowns against expenditures to ensure that drawdowns and applications of revenue are accurate and that cash is not drawn down prior to the incurrence of expenditures.

Effect: Accounts may be immaterially misstated.

For Condition 2 and 3, there could be erroneous loan repayments by the States.

For Condition 5, there is a potential liability of the FSM National Government to return the money to the U. S. Federal Government. A liability has been duly recorded for this possibility. This condition also has the effect of not allowing for the verification of the accuracy of the application of drawdowns against appropriate grant numbers.

Recommendation: We recommend that the FSM National Government perform account reconciliations on a monthly basis to promptly identify reconciling items and appropriate recording. Timely reconciliations should be reviewed by appropriate management.

For ADB Loan 1816, the FSM National Government may wish to consider obtaining a formal agreement with the States relative to repayment terms.

Auditee Response and Corrective Action Plan:

Condition 1. We agree with this finding. The accountants and financial advisor have been instructed to ensure that no recurring adjustment will be made after submission of final trial balance to Deloitte & Touche'. Monthly reconciliation shall be made and a checklist of accounts to be reconciled must be made to ensure that all accounts are reconciled prior to submission of the trial balance.

Condition 2-4. We agree with this finding. FSM Department of Finance and Administration will schedule a meeting to meet the respective FSM State Director of Finance and their Financial advisors to discuss the issues being raised in the audit finding. This will facilitate an agreement on the allocation of SDR adjustment as well as the payments of loans.

Condition 5. We agree with this finding. We will revisit the funding source of the federal funds and accordingly record to the appropriate payable.

Responsible Party: Rose Nakanaga-Acting Secretary of Finance and Adm.  
Delihda Lebehn- Investment Accountant  
Noel Pascua- Financial Advisor

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No. 2011-14 – Travel Advances

Criteria: In accordance with applicable Financial Management Regulations, the traveler must submit a travel claim voucher within 10 days of travel completion or of trip cancellation, and attach necessary receipts, trip reports and boarding passes or other evidence of the completion of travel. If the traveler does not liquidate the advance, alternative collection methods should be employed to recover the FSM National Government's funds. Furthermore, such records should be kept on file and be available for audit.

Condition:

1. In the course of testing the travel related advances and encumbrances, we noted untimely liquidation of travel advances.

There also appears to be lack of aggressive effort to collect travel advances. As noted in the comparative table below, travel advance balances decreased from prior year; however, collection efforts could improve.

Fiscal Year 2011

	Amount	Allowance	NRV
GF	\$1,516,706	\$1,516,706	\$ -
Sector	116,331	-	116,331
	<u>\$1,633,037</u>	<u>\$1,516,706</u>	<u>\$116,331</u>

Fiscal Year 2010

	Amount	Allowance	NRV
GF	\$2,448,582	\$2,197,195	251,387
Sector	145,298	-	145,298
	<u>\$2,593,880</u>	<u>42,197,195</u>	<u>396,685</u>

2. There were instances of authorized travelers not submitting travel reports.

Cause: It appears that additional effort is necessary to monitor travel advances and the completeness of documentation required upon trip completion.

Effect: Reported expenditures may be understated.

The FSM National Government has provided a sufficient allowance to cover these uncollectible advances and therefore, this matter does not appear to have a material impact on the financial statements.

Prior Year Status: This condition was cited in the 2010 Single Audit.

Recommendation: We recommend that compliance with the Financial Management Regulations occur with respect to the collection of travel advances. The FSM National Government should monitor and collect long outstanding travel advances.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No. 2011-14 – Travel Advances, Continued

Auditee Response and Corrective Action Plan:

We agree with this finding. A procedure has been in place in issuing travel advance. The procedure requires all travel authorization to be routed to the President's Office for approval along with verification from the Department of Finance and Administration on the travel history of the traveler. Any traveler with outstanding travel advance will be required to make an allotment prior to the approval of the travel authorization and this procedure significantly decrease the travel advance. The division of national treasury will continue to work with the department/s in aggressively pursuing collection to lessen the travel advance.

Responsible Party: Serra Ezekias-Travel Accountant

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Unresolved Prior Audit Findings and Questioned Costs  
Year Ended September 30, 2011

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

	Questioned Costs Set Forth in Prior Audit Report <u>2010</u>	Questioned Costs Resolved in Fiscal Year <u>2011</u>	Questioned Costs at <u>September 30, 2011</u>
Unresolved Questioned Costs FY 08	\$ 1,196,060	\$ 1,196,060	\$ -
Unresolved Questioned Costs FY 09	2,861,600	-	2,861,600
Unresolved Questioned Costs FY10	<u>2,049,222</u>	<u>-</u>	<u>2,049,222</u>
	\$ <u>6,106,882</u>	\$ <u>1,196,060</u>	4,910,822
Questioned Costs FY 11			<u>301,014</u>
			\$ <u>5,211,836</u>

The \$1,196,060 resolved during fiscal year 2011, was resolved per OMB Circular A-133, Section .315(b)(4).

The status of prior year findings is set forth in the accompanying Schedule of Findings and Questioned Costs (pages 94 through 124).