

**POHNPEI STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF POHNPEI)**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2012 AND 2011

POHNPEI STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Table of Contents
Years Ended September 30, 2012 AND 2011

	<u>Page No.</u>
I. FINANCIAL STATEMENTS	
Independent Auditors' Report	1
Management's Discussion and Analysis	3
Statements of Net Assets	7
Statements of Revenues, Expenses, and Changes in Net Assets	8
Statements of Cash Flows	9
Notes to Financial Statements	10
II. INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS	
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 <i>Government Auditing Standards</i>	17
Unresolved Prior Year Findings	19

INDEPENDENT AUDITORS' REPORT

Board of Directors
Pohnpei State Housing Authority:

We have audited the accompanying statements of net assets of the Pohnpei State Housing Authority (the Authority), a component unit of the State of Pohnpei, as of September 30, 2012 and 2011 and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

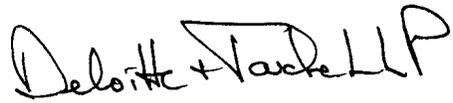
We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan 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 Authority'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 audits provide reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Pohnpei State Housing Authority as of September 30, 2012 and 2011, and the changes in its net assets and its cash flows for the years then ended in conformity with the accounting principles generally accepted in the United States of America.

As discussed in Note 5 to the financial statements, certain loan obligations are not recorded by the Authority.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 20, 2013, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis on pages 3 through 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Authority's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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

June 20, 2013

POHNPEI STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Management's Discussion and Analysis
September 30, 2012 and 2011

Our discussion and analysis of the Pohnpei State Housing Authority's financial performance provides an overview of the authority's financial activities for the fiscal year ended September 30, 2012 and 2011. Please read it in conjunction with the Authority's financial statements, which follows this section.

Financial Highlights

- For fiscal year ended September 30, 2012, the Authority's total operating revenues were almost flat at \$219,506 when compared to prior year (\$217,941).
- During the year, the Authority's total expenses decreased by \$15,647 or 10% from prior year.
- For fiscal year 2012, the Authority collected an aggregate amount of \$187,759 representing the actual interest and fees paid by customers on loans.

Overview of the Financial Statements

The financial statements presented herein include all of the activities of the Housing Authority. Included in this report are the statement of net assets and the statement of revenues, expenses, and changes in net assets and the statement of cash flows. These financial statements present the complete financial picture of the Authority from the economic measurement focus substantially using the accrual basis of accounting. It can be determined from these statements whether the Authority is solvent, liquid, stable or profitable.

The Authority operates on an annual budget appropriated by the Legislature, which is accounted for by the Pohnpei State Department of Treasury.

Financial Analysis

Net Assets

The statement of net assets presents the financial position or condition of the Authority and it shows the information on all of the authority's assets and liabilities, with the difference between the two reported as net assets. This financial statement communicates the lending ability of the Authority through the turn over of its receivables. The passage of time and/or increases or decreases in net assets may serve as a usual indicator whether the financial position of the authority is improving or deteriorating.

The following table summarizes the changes in net assets for FY2012, FY2011 and FY2010.

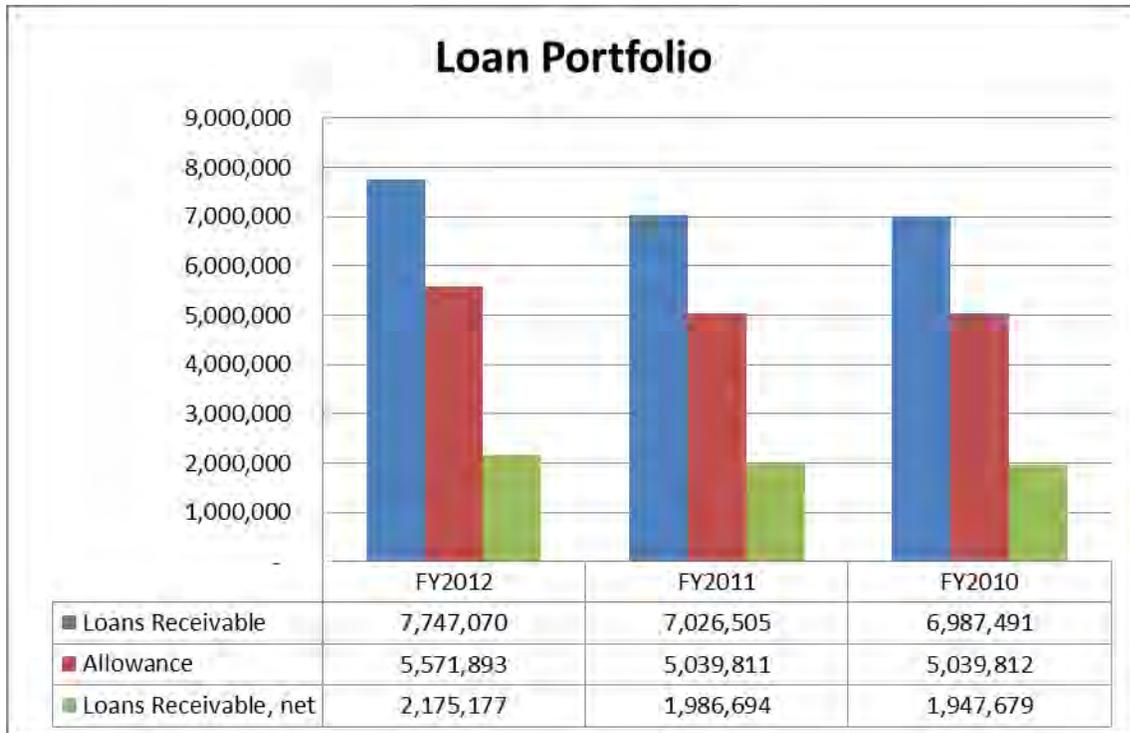
	<u>2012</u>	<u>2011</u>	<u>2010</u>
Current assets	\$ 2,511,364	\$ 2,355,421	\$ 2,200,532
Capital assets, net	<u>106,883</u>	<u>122,066</u>	<u>60,837</u>
Total assets	\$ <u>2,618,247</u>	\$ <u>2,477,487</u>	\$ <u>2,261,369</u>
Liabilities	\$ <u>506,103</u>	\$ <u>506,103</u>	\$ <u>543,307</u>
Net Assets:			
Invested in capital assets	106,883	122,066	60,837
Restricted	<u>2,044,415</u>	<u>1,849,318</u>	<u>1,657,225</u>
Total net assets	<u>2,151,298</u>	<u>1,971,384</u>	<u>1,718,062</u>
Total liabilities and net assets	\$ <u>2,618,247</u>	\$ <u>2,477,487</u>	\$ <u>2,261,369</u>

**POHNPEI STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF POHNPEI)**

Management's Discussion and Analysis
September 30, 2012 and 2011

Total net assets increased by \$179,914 or 9% during fiscal year 2012 compared to prior year due to higher loan revenue. In addition, other major account changes compared, to prior year were as follows: Current assets increased by \$155,943 or 6% due to higher loan availed by customers, and capital assets decreased by \$15,183 or 12% due mainly to depreciation. For more information concerning capital assets, please refer to note 4 to the financial statements.

The following is a graphical presentation showing the 3-year trend loan portfolio of PSHA:



Changes in Net Assets

The statement of revenues, expenses, and changes in net assets shows the results of operation of the Authority. It reports the revenues earned and expenses incurred and it indicates the effect on the net assets of the Authority.

**POHNPEI STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF POHNPEI)**

Management's Discussion and Analysis
September 30, 2012 and 2011

The table below shows the changes in net assets for the years ended September 30, 2012, 2011 and 2010.

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Operating Revenues:			
Interest and fees on loans	\$ 218,393	\$ 210,788	\$ 213,868
Other	<u>1,113</u>	<u>7,153</u>	<u>33,411</u>
	<u>219,506</u>	<u>217,941</u>	<u>247,279</u>
Provision for loan losses	<u>-</u>	<u>-</u>	<u>(83,575)</u>
Operating Expenses:			
Salaries	88,603	90,663	91,756
Contractual services	7,434	21,803	14,921
Miscellaneous and others	1,504	6,113	12,709
Depreciation	17,406	11,090	5,248
Communication	4,854	4,710	5,150
Utilities	6,538	4,765	4,950
Supplies and materials	2,893	3,992	3,908
Transportation and travel	-	-	2,192
Repairs and maintenance	<u>308</u>	<u>2,051</u>	<u>-</u>
Total operating expenses	<u>129,540</u>	<u>145,187</u>	<u>140,834</u>
Operating income	89,966	72,754	22,870
Non-operating revenues:			
Operating subsidy from PSG	89,948	130,590	130,845
Capital contribution	<u>-</u>	<u>49,978</u>	<u>-</u>
Total non-operating revenues and capital contributions	<u>89,948</u>	<u>180,568</u>	<u>130,845</u>
Increase in net assets	\$ <u>179,914</u>	\$ <u>253,322</u>	\$ <u>153,715</u>

Economic Outlook

It is the Authority's goal to ensure that a major decrease in delinquent accounts is seen in 2013. The Authority shall continuously pursue aggressive collection to reduce delinquent accounts to an acceptable level although some cases were already filed in court to foreclose on related collateral. In addition, we are also in talks with a few borrowers to restructure their loans to make them current.

Contacting the PSHA's Financial Management

This Management's Discussion and Analysis is designed to provide our citizens, taxpayers, customers, creditors, and other interested parties, with a general overview of the Pohnpei State Housing Authority's finances and to demonstrate PSHA's accountability and transparency for the appropriations it receives. Questions concerning any of the information provided in this discussion and analysis or requests for additional information should be addressed to the Executive Director, Pohnpei State Housing Authority P.O. Box 1109 Kolonia, Pohnpei, FM 96941, or call (691) 320-4225 or (691) 320-2582.

Management's Discussion and Analysis for the year ended September 30, 2011, is set forth in the Authority's report on the audit of financial statements, which is dated June 27 2012. That Discussion and Analysis explains the major factors impacting the 2011 financial statements and can be viewed at the FSM Office of the National Public Auditors' website at www.fsmopa.fm.

**POHNPEI STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF POHNPEI)**

Statements of Net Assets
September 30, 2012 and 2011

<u>ASSETS</u>	<u>2012</u>	<u>2011</u>
Cash	\$ 282,229	\$ 305,591
Employee advances, net of an allowance for doubtful accounts \$155,249 in 2012 and 2011	-	-
Due from primary government	30,772	39,950
Loans receivable, net	2,175,177	1,986,694
Interest receivable	21,758	21,758
Prepays	1,428	1,428
Property and equipment, net	<u>106,883</u>	<u>122,066</u>
	<u>\$ 2,618,247</u>	<u>\$ 2,477,487</u>
 <u>LIABILITIES AND NET ASSETS</u> 		
Liabilities:		
Accrued liabilities	\$ 17,933	\$ 12,746
Due to primary government	<u>449,016</u>	<u>493,357</u>
Total liabilities	<u>466,949</u>	<u>506,103</u>
Commitments and contingencies		
Net assets:		
Invested in capital assets	106,883	122,066
Restricted	<u>2,044,415</u>	<u>1,849,318</u>
Total net assets	<u>2,151,298</u>	<u>1,971,384</u>
	<u>\$ 2,618,247</u>	<u>\$ 2,477,487</u>

See accompanying notes to financial statements.

POHNPEI STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating revenues:		
Interest and fees on loans	\$ 218,393	\$ 210,788
Other	<u>1,113</u>	<u>7,153</u>
Total operating revenues	<u>219,506</u>	<u>217,941</u>
Operating expenses:		
Salaries	88,603	90,663
Depreciation	17,406	11,090
Contractual services	7,434	21,803
Utilities	6,538	4,765
Communication	4,854	4,710
Supplies and materials	2,893	3,992
Repairs and maintenance	308	2,051
Miscellaneous and others	<u>1,504</u>	<u>6,113</u>
Total operating expenses	<u>129,540</u>	<u>145,187</u>
Operating income	89,966	72,754
Nonoperating revenues:		
Operating subsidy from primary government	<u>89,948</u>	<u>130,590</u>
Net income	179,914	203,344
Capital contribution from the FSM National Government	<u>-</u>	<u>49,978</u>
Change in net assets	179,914	253,322
Net assets at beginning of year	<u>1,971,384</u>	<u>1,718,062</u>
Net assets at end of year	<u>\$ 2,151,298</u>	<u>\$ 1,971,384</u>

See accompanying notes to financial statements.

POHNPEI STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Statements of Cash Flows
Years Ended September 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Cash received from customers	\$ 219,506	\$ 206,520
Cash paid to suppliers for goods and services	(18,344)	(43,049)
Cash paid to employees	(88,603)	(90,663)
	<u>112,559</u>	<u>72,808</u>
Net cash provided by operating activities		
Cash flows from noncapital financing activities:		
Operating subsidy received from primary government	89,948	128,446
Repayment to primary government	(35,163)	(38,974)
	<u>54,785</u>	<u>89,472</u>
Net cash provided by noncapital financing activities		
Cash flows from capital and related financing activities:		
Capital contribution from the FSM National Government	-	49,978
Acquisition of fixed assets	(2,223)	(72,319)
	<u>(2,223)</u>	<u>(22,341)</u>
Net cash used in capital and related financing activities		
Cash flows from investing activities:		
Loan originations and principal collections, net	(188,483)	(39,015)
Net change in cash	(23,362)	100,924
Cash at beginning of year	305,591	204,667
Cash at end of year	<u>\$ 282,229</u>	<u>\$ 305,591</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 89,966	\$ 72,754
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	17,406	11,090
Decrease (increase) in assets:		
Interest receivable	-	(11,421)
Prepays	-	(1,385)
Decrease in liabilities:		
Accrued liabilities	5,187	1,770
Net cash provided by operating activities	<u>\$ 112,559</u>	<u>\$ 72,808</u>

See accompanying notes to financial statements.

**POHNPEI STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF POHNPEI)**

Notes to Financial Statements
September 30, 2012 and 2011

(1) Organization and Summary of Significant Accounting Policies

Organization

The Pohnpei State Housing Authority (the Authority) was established in 1988 by Pohnpei State Public Law 2L-81-88. The purpose of the Authority is to facilitate, through low-interest loans, the construction of safe and sanitary residential housing for low income families of Pohnpei State. Additionally, the Authority monitors Housing Preservation Grant (HPG) loan funds extended by the United States Department of Agriculture Rural Development through the Housing and Community Facilities Program.

The affairs of the Authority are managed by a five-member Board of Directors, consisting of representatives of the Pohnpei State Government appointed by the Governor to four-year terms. Daily operation of the Authority is delegated to an executive director, who is also appointed by the Governor and serves at the pleasure of the Board.

The Authority's financial statements are incorporated into the financial statements of the Pohnpei State Government as a component unit.

Basis of Accounting

The accounting policies of the Authority conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The Authority has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by Statement No. 37, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments: Omnibus*, and modified by Statement No. 38, *Certain Financial Statement Note Disclosures*, establishes financial reporting standards for governmental entities which require that management's discussion and analysis of the financial activities be included with the basic financial statements and notes and modifies certain other financial statement disclosure requirements.

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statements of net assets. Proprietary fund operating statements present increases and decreases in net assets. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The Authority considers interest income and costs that are directly related to lending operations to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

**POHNPEI STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF POHNPEI)**

Notes to Financial Statements
September 30, 2012 and 2011

(1) Organization and Summary of Significant Accounting Policies, Continued

Net Assets

Net assets represent the residual interest in the Authority's assets after liabilities are deducted and consist of three sections: invested in capital assets, net of related debt; restricted and unrestricted. Net assets classified as invested in capital assets net of debt, include capital assets, restricted and unrestricted, net of accumulated depreciation and reduced by outstanding debt net of debt service reserve. Net assets are reported as restricted when constraints are imposed by third parties or enabling legislation. The Authority's restricted assets are expendable, and are restricted for loan programs.

Budget

The Authority operates on an annual budget appropriated by the Legislature which is accounted for by the Pohnpei State Department of Treasury. Appropriation Acts require that funds be administered in accordance with the provisions of the Financial Management Act. The enabling legislation does provide the Authority the power to expend revenues generated by projects maintained by the Authority. Such expenditures must, however, be in accordance with the provisions of the Financial Management Act and other applicable laws and regulations.

Management Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses.

Cash

Custodial credit risk is the risk that in the event of a bank failure, the Authority'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 Authority does not have a deposit policy for custodial credit risk.

For the purposes of the statements of net assets and cash flows, cash is defined as cash in checking accounts, savings accounts and cash on hand. As of September 30, 2012 and 2011, cash was \$282,229 and \$305,591, respectively, which approximated corresponding bank balances maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2011, bank deposits were fully FDIC insured. As of September 30, 2012, \$328,749 in total banks deposits were FDIC insured.

**POHNPEI STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF POHNPEI)**

Notes to Financial Statements
September 30, 2012 and 2011

(1) Organization and Summary of Significant Accounting Policies, Continued

Property and Equipment

Property and equipment are stated at cost. Depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the respective assets, which range from three to ten years. The Authority capitalizes all fixed assets, irrespective of value, that have estimated useful lives of more than one year.

Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and liability as the benefit accrues to employees. No liability is recorded for nonvesting accumulating rights to receive sick leave pay benefits. The related sick leave pay expense is recorded when the benefit is actually taken.

New Accounting Standards

During the year ended September 30, 2012, PSHA implemented the following pronouncements:

- GASB 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 the frequency and timing of measurements for actuarial valuations first used to report funded status information in OPEB plan financial statements. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.
- GASB 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 implementation of this pronouncement did not have a material effect on the accompanying financial statements.

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 PSHA.

POHNPEI STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Notes to Financial Statements
September 30, 2012 and 2011

(1) Organization and Summary of Significant Accounting Policies, Continued

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 PSHA.

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 PSHA.

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 has not yet determined the effect of implementation of this statement on the financial statements of PSHA.

In April 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of PSHA.

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of PSHA.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements on the financial statements of PSHA.

**POHNPEI STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF POHNPEI)**

Notes to Financial Statements
September 30, 2012 and 2011

(2) Due From Primary Government

Due from primary government represents the accumulation of the unobligated portion of the State's annual operating subsidy, which under the Authority's enabling legislation (Pohnpei State Public Law 5-37) is to be transferred to the Authority's loan fund.

(3) Loans Receivable

The Authority's loan portfolio is comprised of two loan funds, Pohnpei State Housing Authority (PSHA) loan fund and the Housing Preservation Grant (HPG) loan fund.

The PSHA loans derive from the capital contributions of Compact of Free Association Capital Account Funds - Capital Projects by Pohnpei State to fund the Housing Development Loan Fund. The HPG loans are from a grant extended by the United States Department of Agriculture (USDA) Rural Development through the Housing and Community Facilities Program. Loans are stated at face value, net of an allowance for loan losses. The allowance represents an amount which, in management's judgment, will be adequate to absorb possible losses on existing loans that may become uncollectible. Management's judgment in determining the adequacy of the allowance is based on evaluations of the collectibility of loans. The allowance for loan losses are reported based on certain assumptions pertaining to the Authority's periodic review and evaluation of the loan portfolio, which is subject to change. Due to uncertainties inherent in the estimations and assumptions process, it is at least reasonably possible that changes in the estimates and assumptions in the near term would be material to the financial statements. A summary of loans receivable as of September 30, 2012 and 2011, are presented below:

	<u>2012</u>	<u>2011</u>
Pohnpei State Housing Authority loans	\$ 6,473,314	\$ 6,246,264
HPG loans	298,129	298,129
USDA Rural Development loans	<u>975,627</u>	<u>1,014,194</u>
	7,747,070	7,558,587
Less allowance for loan losses	<u>(5,571,893)</u>	<u>(5,571,893)</u>
Loans receivable, net	\$ <u>2,175,177</u>	\$ <u>1,986,694</u>

Movements in the allowance for loan losses for the years ended September 30, 2012 and 2011 are as follows:

	<u>2012</u>	<u>2011</u>
Balance at beginning of year	\$ 5,571,893	\$ 5,039,812
Write-off during the year	<u>-</u>	<u>532,081</u>
	\$ <u>5,571,893</u>	\$ <u>5,571,893</u>

All loans, other than USDA Rural Development, are at fixed rates (substantially 4.5%) and the loan terms range from 3 to 25 years. The USDA Rural Development loans are non-interest bearing.

During the year ended September 30, 2009, the State of Pohnpei transferred to the Authority USDA Rural Development defaulted loans, which the State had guaranteed, in the aggregate amount of \$581,711. The Authority bears responsibility for collection and returning the collections to Pohnpei State Government.

POHNPEI STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Notes to Financial Statements
September 30, 2012 and 2011

(3) Loans Receivable, Continued

Future maturities of loans receivable, due to existing nonrepayment cases, will not represent predictive information and therefore, such is not presented.

(4) Property and Equipment

Capital asset activity for the years ended September 30, 2012 and 2011, was as follows:

		2012			
	Estimated Useful Life	Balance at October 1, 2011	Additions and Transfers	Deletions and Transfers	Balance at September 30, 2012
Depreciable:					
Building	10 years	\$ 126,408	\$ -	\$ -	126,408
Machinery and equipment	3-5 years	184,447	-	-	184,447
Other equipment	2 years	10,186	2,223	-	12,409
Improvements	10 years	9,447	-	-	9,447
		330,488	2,223	-	332,711
Less accumulated depreciation		(208,422)	(17,406)	-	(225,828)
		\$ <u>122,066</u>	\$ <u>(15,183)</u>	\$ <u>-</u>	\$ <u>106,883</u>
		2011			
	Estimated Useful Life	Balance at October 1, 2010	Additions and Transfers	Deletions and Transfers	Balance at September 30, 2011
Depreciable:					
Building	10 years	\$ 26,061	\$ 100,347	\$ -	\$ 126,408
Machinery and equipment	3-5 years	173,688	10,759	-	184,447
Other equipment	2 years	10,186	-	-	10,186
Improvements	10 years	9,447	-	-	9,447
		219,382	111,106	-	330,488
Less accumulated depreciation		(197,332)	(11,090)	-	(208,422)
		<u>22,050</u>	<u>100,016</u>	<u>-</u>	<u>122,066</u>
Non-depreciable:					
Construction in progress		38,787	-	(38,787)	-
		\$ <u>60,837</u>	\$ <u>100,016</u>	\$ <u>(38,787)</u>	\$ <u>122,066</u>

(5) Commitments and Contingencies

Loan Commitments

The Authority has loan commitments aggregating \$182,726 and \$527,000 as of September 30, 2012 and 2011, respectively. These loan commitments represent the remaining balances of approved loans for housing projects.

**POHNPEI STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF POHNPEI)**

Notes to Financial Statements
September 30, 2012 and 2011

(5) Commitments and Contingencies, Continued

Litigation

The Authority is party to various legal proceedings. The Attorney General of the Pohnpei State Government is of the opinion that the probable outcome of such cases 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.

USDA Rural Development Loans

During the year ended September 30, 2010, additional defaulted loans in the aggregate amount of \$550,428 were turned over to the Authority. Of \$10,749,895 in outstanding loans as of September 30, 2012, \$5,225,272 was deemed delinquent by USDA. The Authority's management is of the opinion that the primary government will become ultimately liable for such liabilities to USDA Rural Development. Therefore, such loans and related liability are not recorded by the Authority in the accompanying financial statements.

Risk Management

The Authority is essentially self-insured for potential losses. Management is of the opinion that no material losses during the past three years have resulted from this practice.

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

The Board of Directors
Pohnpei State Housing Authority:

We have audited the financial statements of the Pohnpei State Housing Authority (the Authority) as of and for the year ended September 30, 2012, and have issued our report thereon dated June 20, 2013, which report included an explanatory paragraph emphasizing a particular matter. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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 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.

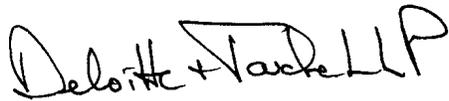
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority'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 Authority in a separate letter dated June 20, 2013.

This report is intended solely for the information and use of management, Board of Directors of the Authority, others within the entity, and the Office of the National Public Auditor and is not intended to be and should not be used by anyone other than these specified parties.

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

June 20, 2013

**POHNPEI STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF POHNPEI)**

Summary Schedule of Prior Year Findings
Year Ended September 30, 2012

There are no prior year findings unresolved as of September 30, 2012.