

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

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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, 2012**

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2012

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

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**YEAR ENDED SEPTEMBER 30, 2012**

## **INDEPENDENT AUDITORS' REPORT**

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

We have audited the accompanying financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Pohnpei (the State) as of and for the year ended September 30, 2012, which collectively comprise the State's basic financial statements as set forth in Section II of the foregoing table of contents. These financial statements are the responsibility of the management of the State. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Pohnpei Transportation Authority and the Small Business Guarantee and Finance Corporation, which represents 4%, 1% and 3%, respectively, of the assets, net assets and operating revenues of the State's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the Pohnpei Transportation Authority and the Small Business Guarantee and Finance Corporation, is based on the reports of the other auditors.

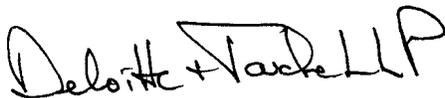
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and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

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to previously present fairly, in all material respects, the respective financial position of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Pohnpei as of September 30, 2012, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 21, 2013, on our consideration of the State's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, on pages 3 through 10, 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, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State's financial statements. The combining and individual fund financial statements, as set forth in Section IV of the foregoing table of contents, are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining and individual fund financial statements, as set forth in Section IV of the foregoing table of contents, are fairly stated in all material respects in relation to the financial statements as a whole.

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

June 21, 2013

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis  
September 30, 2012

This section of the Pohnpei State's financial report presents our Management's Discussion and Analysis (MD&A) for the fiscal year ended September 30, 2012. This MD&A is prepared in compliance with the GASB 34 requirement. Readers are requested to read this MD&A in conjunction with the State's financial statements, which follow this section.

**FINANCIAL HIGHLIGHTS**

- The Pohnpei State's primary government's total net assets for this year are \$40,468,564.
- The net change in government fund balance is an increase of \$1,460,938. Total revenues reported are \$35,789,452 against total expenditures of \$34,328,514.
- Actual revenues for the general fund were \$417,743 higher than budgeted revenues. The total expenditures-budgetary basis showed a favorable variance of \$1,974,910. The general fund reported an unassigned fund balance that increased to \$1,989,891 at the end of the fiscal year.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

The annual report consists of four parts – management's discussion and analysis (this section), the basic financial statements, required supplemental information and the notes to the financial statements.

The basic financial statements include two kinds of statements that present different views of the State:

Government-Wide Financial Statements

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

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

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

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

Fund Financial Statements

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

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis  
September 30, 2012

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

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

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

	Government Activities			
	<u>2012</u>	<u>2011</u>	<u>Change</u>	<u>%</u>
Current and other assets	\$ 11,276,027	\$ 13,147,163	\$ (1,871,136)	(14.23)
Capital assets	23,717,437	25,021,890	(1,304,453)	(5.21)
Other noncurrent assets	<u>15,953,318</u>	<u>13,811,519</u>	<u>2,141,799</u>	15.51
Total assets	<u>50,946,782</u>	<u>51,980,572</u>	<u>(1,033,790)</u>	(2.74)
Current liabilities	4,502,714	5,693,761	(1,191,047)	(20.92)
Long-term debt and other liabilities	<u>5,975,504</u>	<u>6,304,258</u>	<u>(328,754)</u>	(5.21)
Total liabilities	<u>10,478,218</u>	<u>11,998,019</u>	<u>(1,519,801)</u>	(12.67)
Net assets:				
Invested in capital assets	23,717,437	25,021,890	(1,304,453)	(5.21)
Restricted	18,798,379	19,002,982	(204,603)	(1.08)
Unrestricted fund balance	<u>(2,047,252)</u>	<u>(4,042,319)</u>	<u>1,995,067</u>	(49.35)
Total net assets	<u>\$ 40,468,564</u>	<u>\$ 39,982,553</u>	<u>\$ 486,011</u>	0.24

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

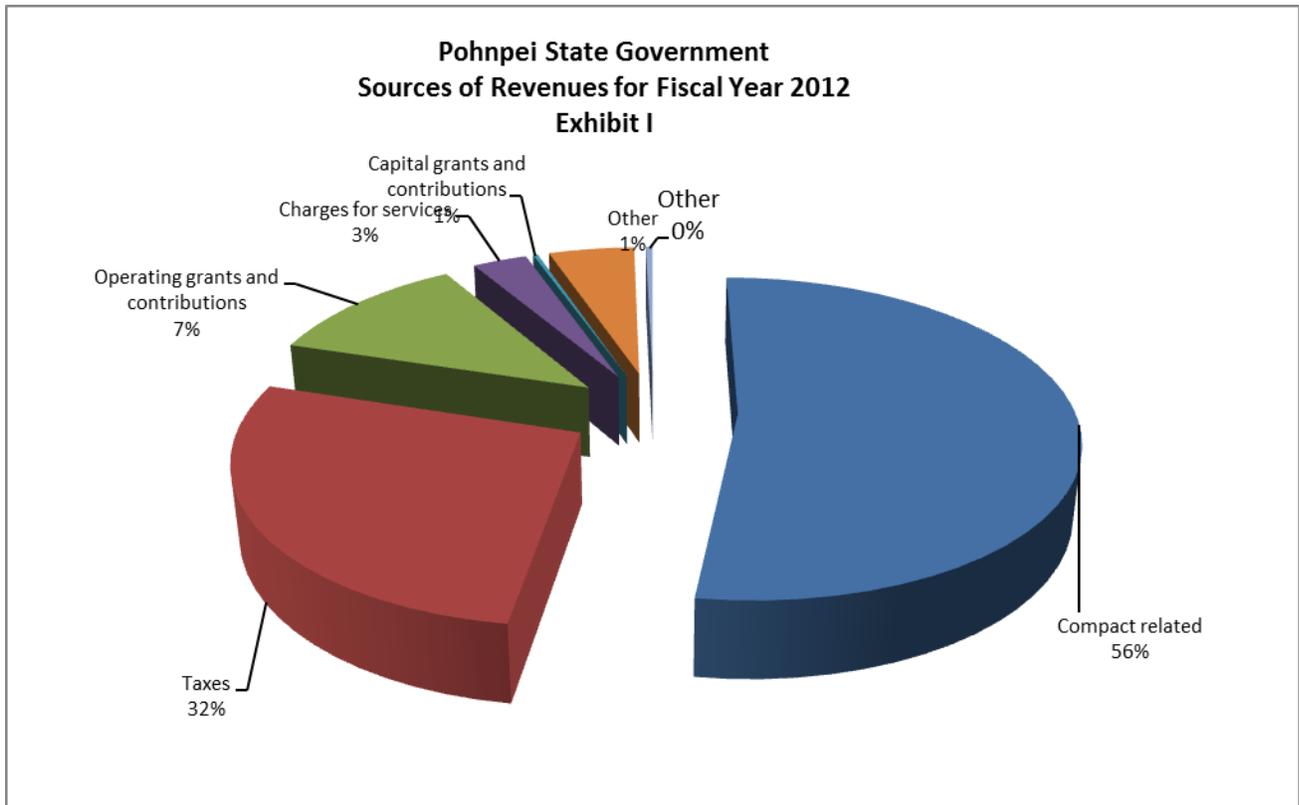
	Government Activities			
	<u>2012</u>	<u>2011</u>	<u>Change</u>	<u>%</u>
Revenues:				
Program revenues:				
Charges for services	\$ 1,089,477	\$ 1,037,338	\$ 52,139	5.03
Operating grants and contributions	2,396,357	2,158,214	238,143	11.03
Compact related	18,326,362	17,421,510	904,852	5.19
Capital grants and contributions	688,059	239,825	448,234	186.90
General revenues:				
Taxes	9,717,667	9,890,775	(173,108)	(1.75)
Investment earnings	1,692,662	(99,063)	1,791,725	1808.67
Other	<u>161,562</u>	<u>163,735</u>	<u>(2,173)</u>	(1.33)
Total revenues	<u>34,072,146</u>	<u>30,812,334</u>	<u>3,259,812</u>	10.58

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis  
September 30, 2012

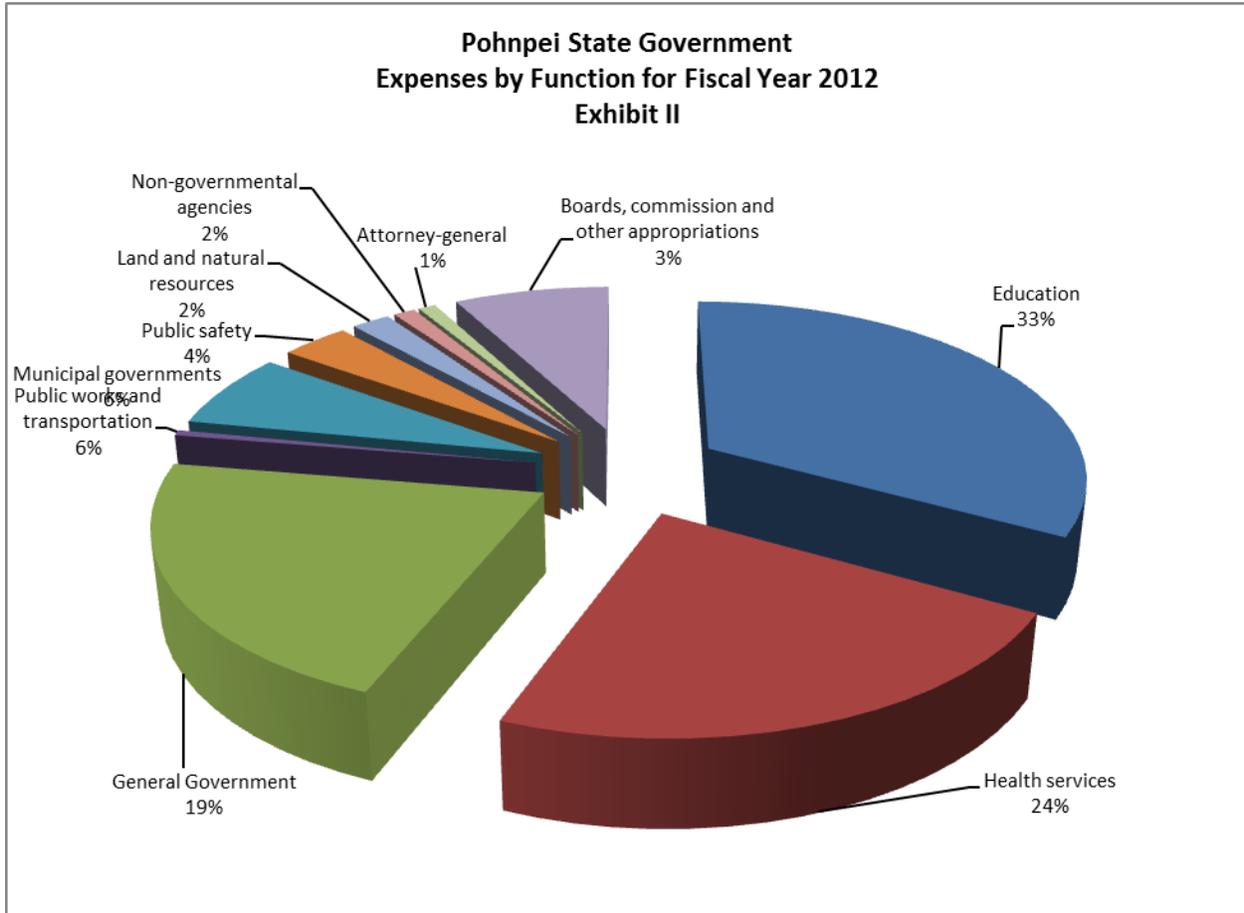
Expenses:				
General Government	7,655,137	6,537,413	1,117,724	17.10
Education	11,683,373	11,447,386	235,987	2.06
Health services	8,053,522	8,162,052	(108,530)	(1.33)
Land and natural resources	679,160	740,744	(61,584)	(8.31)
Public works and transportation	173,954	2,181,453	(2,007,499)	(92.03)
Public safety	1,210,705	1,323,370	(112,665)	(8.51)
Boards, commission and other appropriations	<u>5,847,590</u>	<u>4,160,429</u>	<u>1,687,161</u>	40.55
 Total expenses	 <u>35,303,441</u>	 <u>34,552,847</u>	 <u>750,594</u>	 2.17
 Contributions to permanent funds	 <u>1,717,306</u>	 -	 <u>1,717,306</u>	
 Increase (decrease) in net assets	 \$ <u>486,011</u>	 \$ <u>(3,740,513)</u>	 \$ <u>4,226,524</u>	 112.99

Exhibit I, below, showed that 56% of the State's revenues were derived from Compact II while 32% came from taxes and licenses. Exhibit II, next page, illustrated that Education represented 33% of the State's total expenses followed by Health Services at 24%.



**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis  
September 30, 2012



**FINANCIAL ANALYSIS OF THE STATE GOVERNMENTAL FUNDS**

The State's governmental fund changes in fund balances for the years ended September 30, 2012 and 2011 are shown below.

	General Fund		Grants Assistance		Compact Trust		Other Funds	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Revenues:								
Taxes	\$ 9,133,942	\$ 9,313,288	\$ -	\$ -	\$ -	\$ -	\$ 583,725	\$ 577,487
Compact	-	-	18,528,079	17,421,510	-	-	389,421	-
Other/transfers in	<u>3,886,842</u>	<u>158,154</u>	<u>2,559,686</u>	<u>2,651,076</u>	<u>1,717,306</u>	<u>(113,182)</u>	<u>1,045,279</u>	<u>1,420,543</u>
Total revenues	13,020,784	9,471,442	21,087,765	20,072,586	1,717,306	(113,182)	1,918,425	1,998,030
Expenditures/transfers out	<u>11,105,785</u>	<u>11,079,734</u>	<u>23,191,929</u>	<u>20,082,302</u>	-	-	<u>1,985,628</u>	<u>2,893,931</u>
Net change in fund balances	<u>\$ 1,914,999</u>	<u>\$(1,608,292)</u>	<u>\$(2,104,164)</u>	<u>\$(9,716)</u>	<u>\$1,717,306</u>	<u>\$(113,182)</u>	<u>\$(67,203)</u>	<u>\$(895,901)</u>

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis  
September 30, 2012

**General Fund**

Revenues increased by \$1,594,514 or 16% compared to fiscal year 2011. The increase was caused mainly by the net change in the fair value of investments of \$1,692,662. Expenditures increased just by \$26,051 or 0.1% compared to fiscal year 2011; the State recorded transfers out of \$322,932 in 2012 to the recycling fund and the IMF fund compared to transfers out of \$308,981 for local match under the Compact IMF program in 2011. Transfers in relate to the Compact Capital I funds that reverted to the general fund during the year.

**Grant Assistance Fund**

As mentioned in the preceding paragraph, Compact II/Sector Grants were the major sources of Pohnpei State's operating grants for fiscal year 2012. The total Compact II/Sector funding amounted to \$18,528,079 while total expenditures are in the amount of \$18,528,079, which is discussed below:

- The education sector grant that shall support and improve the educational system of the Federated States of Micronesia, including, without limitation, the systems for primary, secondary, and post-secondary education. The total revenues are \$7,516,224 against total expenditures of the same amount, a decrease of \$132,842 or 1% compared to fiscal year 2011.
- The health sector grant that shall support and improve the delivery of preventive, curative and environmental care, and develop the human and material resources necessary for the Federated States of Micronesia to perform these services. The total funding equals the total expenditures in the amount of \$6,797,475, an increase of \$927,895 or 15% compared to fiscal year 2011.
- The sector grant for private sector development shall support the efforts of the Federated States of Micronesia to attract new foreign investment and increase indigenous business activity. Priorities will be in advancing the private development of fisheries, tourism and agriculture; employing new telecommunications technologies; and analyzing and developing new systems, laws, and policies to foster private sector development, to facilitate investment by potential private investors, and develop business and entrepreneurial skills. Total revenues are \$86,477 with similar total of expenditures, compared with none in fiscal year 2011.
- The sector for capacity building shall support the efforts of the Federated States of Micronesia to build effective, accountable and transparent national and local government and other public sector institutions and systems. The total grant revenues and expenditures are \$433,049, a decrease of \$24,605 or 5% compared to fiscal year 2011.
- The environment sector shall support the efforts of the Federated States of Micronesia to protect the Nation's land and marine environment and to conserve and achieve sustainable use of its natural resources. The total revenue is \$467,700 with the same total of expenditures, an increase of \$33,929 or 7% compared to fiscal year 2011.
- Public Infrastructure grant shall give priority to primary and secondary education capital projects and programs that directly affect health and safety including water and wastewater projects, solid waste disposal projects and health care facilities. The total revenue is \$298,638 with the same total of expenditures, compared with just \$1,751 in prior year.

**STATE OF POHNPEI  
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Management's Discussion and Analysis  
September 30, 2012

- The Supplemental Education Grant (SEG) is considered the seventh-sector grant. SEG has been offered in lieu of grants that were formerly available from various federal agencies. The federal programs that were incorporated into SEG are Territories & Freely Associated States Education Grant (T&FASEG), Adult Education & Family Literacy, Workforce Investment Act, Pacific Vocational Education Improvement Program and Early Childhood Program (formerly Head Start). For the year, the total expenditures incurred were \$2,929,680, a decrease of \$80,008 or 2% compared to fiscal year 2011.

Another major source of funding under the Grants Assistance Fund is the US Federal Grants which supported \$2,322,476 of expenditures of the State, a decrease of \$57,526 or 2% compared to fiscal year 2011.

### **General Fund Budgetary Highlights**

During the year, the State revised its budget several times in the aggregate amount of \$4,287,611 to accommodate supplemental funding for departments and offices requiring increases in appropriations to avoid budget overruns. These matters are not believed to have a significant effect on future services. The State conforms to the most appropriate measures of utilizing its net assets due to inflationary adjustments.

The net decrease in the State's general fund unassigned fund balance of \$431,725 compared with net decrease of \$2,105,956 in fiscal year 2011.

### **CAPITAL ASSET AND DEBT ADMINISTRATION**

#### Capital Assets

The State's capital assets at the end of fiscal year 2012 consist basically of equipment, buildings, roads and bridges. Increase in capital assets was due to purchases of machinery, equipment and others under the Infrastructure Account. The summary of capital assets at the end of September 30 is shown below:

	Primary Government Governmental Activities			
	<u>2012</u>	<u>2011</u>	<u>Change</u>	<u>%</u>
Buildings	\$ 13,728,473	\$ 13,728,473	\$ -	0.00
Infrastructure	52,786,727	52,446,727	340,000	0.65
Machinery	<u>22,750,503</u>	<u>22,199,300</u>	<u>551,203</u>	2.48
Total	\$ <u>89,265,703</u>	\$ <u>88,374,500</u>	\$ <u>891,203</u>	1.01

Note 5 to the Notes to Financial Statements presents more information about the State's capital assets.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis  
September 30, 2012

Long-term Debt

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

	<u>Government Activities</u>			
	<u>2012</u>	<u>2011</u>	<u>Change</u>	<u>%</u>
Asian Development Bank loans	\$ <u>5,643,537</u>	\$ <u>5,815,013</u>	\$ <u>(171,476)</u>	(2.95)

Notes 6 and 8 to the financial statements presents more information about the State's long-term debt.

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

Funding for the operations of most of the government services in fiscal year 2013 will still come from the Compact II.

Fiscal year 2013 is the tenth year of the implementation of the economic assistance under the Compact II/Sector Grant. Sector funding replaces the funding sources from the old Compact I. Under the Compact II/Sector grant, the annual budget approved by JEMCO for fiscal year 2013 is as follows:

- For Education Sector Grant, which continues to be the funding priority, the annual budget is \$7,349,356.
- The Health Sector Grant's budget is \$5,768,196.
- The Private Sector Development Sector Grant's budget is \$157,000.
- The Public Sector Capacity Building Sector Grant budget is \$421,057.
- The Environment Sector Grant is \$447,986.
- The Enhanced Reporting and Accounting Sector Grant budget is \$288,645. This is a new grant in 2013.
- The cumulative grants for the Public Infrastructure from fiscal years 2005 through 2012 is more than \$40,000,000. Priority projects are education, health related and private sector development. It is required that 5% of the total grant be allocated to the Infrastructure Maintenance fund for the maintenance of the existing and new projects. Local matching of the same amount is required.
- In the case of the Supplemental Education Grant (SEG), the total funding for fiscal year 2013 is \$2,969,879. The programs covered in the funding are Early Childhood Education, Education Improvement Programs, Workforce Development/Skill Training, Vocational Education and Staff Development.

**STATE OF POHNPEI  
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Management's Discussion and Analysis  
September 30, 2012

For fiscal year 2013, the locally generated revenues, investment income and the revenue shares from the FSM National Government are projected at about \$10,552,161. These projected revenues were \$513,795 less compared with fiscal year 2012 revenues. The net decrease is due mainly to projected decrease in investment income of about \$1.3 million and that decrease shall be offset by an increase in shared revenue. In its effort to close possible shortage, the Department of Treasury and Administration will continue to intensify its collection effort to raise more revenues in the ensuing year. In addition, the revenue shall be monitored in order that the expenditures shall be adjusted accordingly. Finally, the final carry-over balances from the Compact II may be authorized to be used to fund other operations of the government.

**FINANCIAL CONTACT**

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

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Statement of Net Assets  
September 30, 2012

	Primary Government	Component Units
<b><u>ASSETS</u></b>		
Current assets:		
Cash and cash equivalents	\$ 22,738	\$ 4,140,635
Time certificate of deposit	-	41,951
Investments	6,736,095	174,257
Receivables, net	3,868,555	3,819,564
Advances	194,493	39,151
Inventories	29,947	1,271,987
Due from component units	200,000	-
Other current assets	-	85,760
Restricted assets:		
Cash and cash equivalents	224,199	840,224
Total current assets	11,276,027	10,413,529
Noncurrent assets:		
Capital assets:		
Nondepreciable capital assets	-	8,323,976
Capital assets, net of accumulated depreciation	23,717,437	23,603,099
Investments	1,500,000	-
Receivables	-	1,032,994
Other noncurrent assets	-	585,967
Restricted assets:		
Cash and cash equivalents	-	495,815
Investments	14,453,318	-
Total noncurrent assets	39,670,755	34,041,851
Total assets	\$ 50,946,782	\$ 44,455,380
<b><u>LIABILITIES</u></b>		
Current liabilities:		
Current portion of long-term obligations	\$ 169,987	\$ 850,835
Current portion of compensated absences payable	400,000	-
Short-term debt	-	190,000
Accounts payable	1,799,326	1,272,108
Other liabilities and accruals	1,077,268	881,594
Due to primary government	-	1,853,486
Deferred revenues	1,056,133	151,572
Total current liabilities	4,502,714	5,199,595
Noncurrent liabilities:		
Long-term obligations, net of current portion	5,473,550	8,601,488
Compensated absences payable, net of current portion	290,986	-
Claims and judgments payable	210,968	-
Total noncurrent liabilities	5,975,504	8,601,488
Total liabilities	10,478,218	13,801,083
Contingencies and commitments		
<b><u>NET ASSETS</u></b>		
Invested in capital assets, net of related debt	23,717,437	23,054,543
Restricted for:		
Nonexpendable:		
Future operations	10,838,268	-
Expendable:		
Compact related	93,676	-
Debt service	3,615,050	-
Other purposes	4,251,385	4,263,978
Unrestricted	(2,047,252)	3,335,776
Total net assets	40,468,564	30,654,297
Total liabilities and net assets	\$ 50,946,782	\$ 44,455,380

See accompanying notes to financial statements.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Statement of Activities  
Year Ended September 30, 2012

	Program Revenues			Net (Expenses) Revenues and Changes in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government	Component Units
<b><u>Functions/Programs</u></b>						
Primary government:						
Governmental activities:						
General government	\$ 7,655,137	430,722	\$ 1,156,864	\$ 688,059	\$ (5,379,492)	\$ -
Land and natural resources	679,160	63,292	142,488	-	(473,380)	-
Education	11,683,373	-	11,567,043	-	(116,330)	-
Health services	8,053,522	548,775	7,856,324	-	351,577	-
Public safety	1,210,705	46,688	-	-	(1,164,017)	-
Attorney-general	310,577	-	-	-	(310,577)	-
Public works and transportation	173,954	-	-	-	(173,954)	-
Non-governmental agencies	383,349	-	-	-	(383,349)	-
Boards, commissions and others	2,709,848	-	-	-	(2,709,848)	-
Municipal governments	2,394,925	-	-	-	(2,394,925)	-
Unallocated interest on long-term debt	48,891	-	-	-	(48,891)	-
<b>Total primary government</b>	<b>\$ 35,303,441</b>	<b>\$ 1,089,477</b>	<b>\$ 20,722,719</b>	<b>\$ 688,059</b>	<b>(12,803,186)</b>	<b>-</b>
Component units:						
Pohnpei Utilities Corporation	\$ 16,672,725	\$ 14,781,304	\$ -	\$ -	-	(1,891,421)
Pohnpei Port Authority	2,234,041	2,462,889	-	-	-	228,848
Pohnpei Transportation Authority	576,987	355,945	-	-	-	(221,042)
Small Business Guarantee and Finance Corporation	177,291	104,292	-	-	-	(72,999)
Pohnpei State Housing Authority	129,540	219,506	-	-	-	89,966
<b>Total component units</b>	<b>\$ 19,790,584</b>	<b>\$ 17,923,936</b>	<b>\$ -</b>	<b>\$ -</b>	<b>-</b>	<b>(1,866,648)</b>
General revenues:						
Taxes:						
FSM revenue sharing:						
Gross revenue taxes					2,209,724	-
Import taxes					2,370,570	-
Income taxes					1,925,080	-
Other taxes					353,795	-
State taxes					2,858,498	-
Unrestricted investment earnings					1,692,662	-
Other					161,562	921,988
<b>Total general revenues</b>					<b>11,571,891</b>	<b>921,988</b>
Contributions to permanent fund					1,717,306	-
<b>Change in net assets</b>					<b>486,011</b>	<b>(944,660)</b>
Net assets at the beginning of the year					39,982,553	31,598,957
<b>Net assets at the end of the year</b>					<b>\$ 40,468,564</b>	<b>\$ 30,654,297</b>

See accompanying notes to financial statements.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Balance Sheet  
Governmental Funds  
September 30, 2012

	General	Special Revenue Grants Assistance	Permanent Compact Trust	Other Governmental Funds	Total
<b>ASSETS</b>					
Cash and cash equivalents	\$ 22,738	\$ -	\$ -	\$ -	\$ 22,738
Investments	8,236,095	-	-	-	8,236,095
Receivables, net:					
Taxes	1,865,426	-	-	-	1,865,426
Federal agencies	-	-	-	389,421	389,421
Due from FSM National Government	-	1,037,489	-	-	1,037,489
Other	566,549	3,928	-	5,742	576,219
Due from component units	200,000	-	-	-	200,000
Due from other funds	1,299,972	1,692,886	-	4,240,060	7,232,918
Advances	84,693	104,720	-	5,080	194,493
Inventories	-	-	-	29,947	29,947
Restricted assets:					
Cash and cash equivalents	216,499	7,700	-	-	224,199
Investments	3,615,050	-	10,838,268	-	14,453,318
Total assets	<u>\$ 16,107,022</u>	<u>\$ 2,846,723</u>	<u>\$ 10,838,268</u>	<u>\$ 4,670,250</u>	<u>\$ 34,462,263</u>
<b>LIABILITIES AND FUND BALANCES</b>					
Liabilities:					
Accounts payable	\$ 1,109,366	\$ 678,690	\$ -	\$ 11,270	\$ 1,799,326
Other liabilities and accruals	840,821	230,620	-	5,827	1,077,268
Deferred revenues	-	1,056,133	-	-	1,056,133
Due to other funds	5,932,946	898,204	-	401,768	7,232,918
Total liabilities	<u>7,883,133</u>	<u>2,863,647</u>	<u>-</u>	<u>418,865</u>	<u>11,165,645</u>
Fund balances:					
Non-spendable	1,784,693	104,720	10,838,268	34,028	12,761,709
Restricted	3,800,942	106,445	-	-	3,907,387
Committed	357,189	-	-	4,104,868	4,462,057
Assigned	291,174	-	-	129,573	420,747
Unassigned:					
General fund	1,989,891	-	-	-	1,989,891
Special revenue funds	-	(228,089)	-	(17,084)	(245,173)
Total fund balances	<u>8,223,889</u>	<u>(16,924)</u>	<u>10,838,268</u>	<u>4,251,385</u>	<u>23,296,618</u>
Total liabilities and fund balances	<u>\$ 16,107,022</u>	<u>\$ 2,846,723</u>	<u>\$ 10,838,268</u>	<u>\$ 4,670,250</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					
					23,717,437
Long-term liabilities, including loans payable, are not due and payable in the current period and, therefore, are not reported in the funds. The liabilities include:					
				(5,643,537)	
				(690,986)	
				(210,968)	
					<u>(6,545,491)</u>
Net assets of governmental activities					<u>\$ 40,468,564</u>

See accompanying notes to financial statements.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures, and Changes in Fund Balances  
Governmental Funds  
Year Ended September 30, 2012

	General	Special Revenue	Permanent	Other	Total
		Grants Assistance	Compact Trust	Governmental Funds	
<b>Revenues:</b>					
Compact funding	\$ -	\$ 18,528,079	\$ -	\$ -	\$ 18,528,079
Net change in the fair value of investments	1,692,662	-	1,717,306	-	3,409,968
CFSM grants	-	96,921	-	-	96,921
Federal contributions and other grants	-	2,396,357	-	389,421	2,785,778
FSM revenue sharing	6,859,169	-	-	-	6,859,169
State taxes	2,274,773	-	-	583,725	2,858,498
Fees and charges	144,198	-	-	945,279	1,089,477
Other	95,154	66,408	-	-	161,562
<b>Total revenues</b>	<b>11,065,956</b>	<b>21,087,765</b>	<b>1,717,306</b>	<b>1,918,425</b>	<b>35,789,452</b>
<b>Expenditures:</b>					
<b>Current:</b>					
General government	4,214,944	1,671,246	-	1,862,421	7,748,611
Land and natural resources	485,825	142,488	-	-	628,313
Education	2,318	11,567,043	-	-	11,569,361
Health services	-	7,856,324	-	446,139	8,302,463
Public safety	1,187,570	-	-	-	1,187,570
Office of the Attorney-General	310,577	-	-	-	310,577
Public works	513,954	-	-	-	513,954
Payments to non-governmental agencies	383,349	-	-	-	383,349
Boards, commissions and other	1,069,024	-	-	-	1,069,024
Grants to local governments	2,394,925	-	-	-	2,394,925
Debt service	220,367	-	-	-	220,367
<b>Total expenditures</b>	<b>10,782,853</b>	<b>21,237,101</b>	<b>-</b>	<b>2,308,560</b>	<b>34,328,514</b>
Excess (deficiency) of revenues over (under) expenditures	283,103	(149,336)	1,717,306	(390,135)	1,460,938
<b>Other financing sources (uses):</b>					
Operating transfers in	1,954,828	-	-	322,932	2,277,760
Operating transfers out	(322,932)	(1,954,828)	-	-	(2,277,760)
<b>Total other financing sources (uses), net</b>	<b>1,631,896</b>	<b>(1,954,828)</b>	<b>-</b>	<b>322,932</b>	<b>-</b>
<b>Net change in fund balances</b>	<b>1,914,999</b>	<b>(2,104,164)</b>	<b>1,717,306</b>	<b>(67,203)</b>	<b>1,460,938</b>
Fund balances at the beginning of the year	6,308,890	2,087,240	9,120,962	4,318,588	21,835,680
<b>Fund balances at the end of the year</b>	<b>\$ 8,223,889</b>	<b>\$ (16,924)</b>	<b>\$ 10,838,268</b>	<b>\$ 4,251,385</b>	<b>\$ 23,296,618</b>

See accompanying notes to financial statements.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Reconciliation of the Statement of Revenues, Expenditure, and Changes in Fund  
Balances of Governmental Funds to the Statement of Activities  
Year Ended September 30, 2012

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

Net change in fund balances - total governmental funds \$ 1,460,938

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation exceeded capital outlays in the current period (1,304,453)

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. For the current year, these amounts consist of:

Repayment of ADB Loans 171,476

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. For the current year, these activities consist of:

Change in compensated absences payable 158,050

Change in net assets of governmental activities \$ 486,011

See accompanying notes to financial statements.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Combining Statement of Net Assets (Deficiency)  
Component Units  
September 30, 2012

	Pohnpei Utilities Corporation	Pohnpei Port Authority	Pohnpei Transportation Authority	Small Business Guarantee and Finance Corporation	Pohnpei State Housing Authority	Total
<b>ASSETS</b>						
Current assets:						
Cash and cash equivalents	\$ 452,169	\$ 3,405,937	\$ -	\$ 300	\$ 282,229	\$ 4,140,635
Time certificate of deposit	41,951	-	-	-	-	41,951
Investments	174,257	-	-	-	-	174,257
Receivables, net	1,331,304	207,706	2,924	49,923	2,227,707	3,819,564
Inventories	1,253,631	-	18,356	-	-	1,271,987
Advances	-	38,214	-	937	-	39,151
Other current assets	80,121	4,211	-	-	1,428	85,760
Restricted assets:	-	-	-	-	-	-
Cash and cash equivalents	-	-	-	840,224	-	840,224
Total current assets	<u>3,333,433</u>	<u>3,656,068</u>	<u>21,280</u>	<u>891,384</u>	<u>2,511,364</u>	<u>10,413,529</u>
Noncurrent assets:						
Receivables, net	-	229,868	-	803,126	-	1,032,994
Capital assets:						
Nondepreciable capital assets	5,318,883	3,005,093	-	-	-	8,323,976
Capital assets, net of accumulated depreciation	20,197,101	3,219,160	-	79,955	106,883	23,603,099
Long-term deposits	576,213	-	-	-	-	576,213
Restricted:						
Cash and cash equivalents	495,815	-	-	-	-	495,815
Other noncurrent assets	-	9,754	-	-	-	9,754
Total noncurrent assets	<u>26,588,012</u>	<u>6,463,875</u>	<u>-</u>	<u>883,081</u>	<u>106,883</u>	<u>34,041,851</u>
Total assets	<u>\$ 29,921,445</u>	<u>\$ 10,119,943</u>	<u>\$ 21,280</u>	<u>\$ 1,774,465</u>	<u>\$ 2,618,247</u>	<u>\$ 44,455,380</u>
<b>LIABILITIES</b>						
Current liabilities:						
Current portion of long-term debt	\$ 850,835	\$ -	\$ -	\$ -	\$ -	\$ 850,835
Note payable	190,000	-	-	-	-	190,000
Accounts payable	1,126,070	71,001	57,104	-	17,933	1,272,108
Other liabilities and accruals	213,176	199,721	13,967	5,714	449,016	881,594
Due to primary government	200,000	-	1,653,486	-	-	1,853,486
Deferred revenue	148,398	-	3,174	-	-	151,572
Total current liabilities	<u>2,728,479</u>	<u>270,722</u>	<u>1,727,731</u>	<u>5,714</u>	<u>466,949</u>	<u>5,199,595</u>
Noncurrent liabilities:						
Noncurrent portion of long-term debt	8,601,488	-	-	-	-	8,601,488
Total liabilities	<u>11,329,967</u>	<u>270,722</u>	<u>1,727,731</u>	<u>5,714</u>	<u>466,949</u>	<u>13,801,083</u>
<b>NET ASSETS (DEFICIENCY)</b>						
Invested in capital assets, net of related debt	16,643,452	6,224,253	-	79,955	106,883	23,054,543
Restricted	576,213	-	-	1,643,350	2,044,415	4,263,978
Unrestricted	1,371,813	3,624,968	(1,706,451)	45,446	-	3,335,776
Total net assets (deficiency)	<u>18,591,478</u>	<u>9,849,221</u>	<u>(1,706,451)</u>	<u>1,768,751</u>	<u>2,151,298</u>	<u>30,654,297</u>
	<u>\$ 29,921,445</u>	<u>\$ 10,119,943</u>	<u>\$ 21,280</u>	<u>\$ 1,774,465</u>	<u>\$ 2,618,247</u>	<u>\$ 44,455,380</u>

See accompanying notes to financial statements.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Combining Statement of Revenues, Expenses, and Changes in Net Assets (Deficiency)  
Component Units  
Year Ended September 30, 2012

	Pohnpei Utilities Corporation	Pohnpei Port Authority	Pohnpei Transportation Authority	Small Business Guarantee and Finance Corporation	Pohnpei State Housing Authority	Total
Operating revenues:						
Charges for services	\$ 14,210,389	\$ 2,462,889	\$ 355,945	\$ 104,292	\$ 219,506	\$ 17,353,021
Sales	570,915	-	-	-	-	570,915
Total operating revenues	<u>14,781,304</u>	<u>2,462,889</u>	<u>355,945</u>	<u>104,292</u>	<u>219,506</u>	<u>17,923,936</u>
Operating expenses:						
Cost of services	11,631,683	-	-	-	-	11,631,683
Administration costs	2,988,251	1,805,858	571,426	154,618	112,134	5,632,287
Depreciation and amortization	2,052,791	428,183	5,561	22,673	17,406	2,526,614
Total operating expenses	<u>16,672,725</u>	<u>2,234,041</u>	<u>576,987</u>	<u>177,291</u>	<u>129,540</u>	<u>19,790,584</u>
Operating income (loss)	<u>(1,891,421)</u>	<u>228,848</u>	<u>(221,042)</u>	<u>(72,999)</u>	<u>89,966</u>	<u>(1,866,648)</u>
Nonoperating revenues (expenses):						
Contributions from the primary government	880,143	-	-	110,000	89,948	1,080,091
Interest income (expense)	(171,354)	5,591	-	3,151	-	(162,612)
Other	31,943	-	(7,322)	(31,533)	11,421	4,509
Total nonoperating revenues (expenses), net	<u>740,732</u>	<u>5,591</u>	<u>(7,322)</u>	<u>81,618</u>	<u>101,369</u>	<u>921,988</u>
Change in net assets	<u>(1,150,689)</u>	<u>234,439</u>	<u>(228,364)</u>	<u>8,619</u>	<u>191,335</u>	<u>(944,660)</u>
Net assets (deficiency) at the beginning of the year	<u>19,742,167</u>	<u>9,614,782</u>	<u>(1,478,087)</u>	<u>1,760,132</u>	<u>1,959,963</u>	<u>31,598,957</u>
Net assets (deficiency) at the end of the year	<u>\$ 18,591,478</u>	<u>\$ 9,849,221</u>	<u>\$ (1,706,451)</u>	<u>\$ 1,768,751</u>	<u>\$ 2,151,298</u>	<u>\$ 30,654,297</u>

See accompanying notes to financial statements.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(1) Summary of Significant Accounting Policies

The State of Pohnpei (the State) was constituted on November 8, 1984, under the provisions of the Pohnpei State Constitution (the Constitution) as approved by the people of Pohnpei. The Constitution provides for the separation of powers of the executive, legislative, and judicial branches of the government.

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

A. Reporting Entity

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

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

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

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

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

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

Discretely Presented Component Units:

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

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

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

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

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

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

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

Discretely Presented Component Units, Continued:

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

P.O. Box 370  
Kolonias, Pohnpei, FSM 96941

B. Government-Wide Financial Statements

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

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

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

- Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets.
- Restricted net assets - nonexpendable consists of permanent funds in which donors or other outside sources have stipulated that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to the principal.
- Restricted net assets - expendable consists of resources in which the State is legally or contractually obligated to spend resources in accordance with restrictions either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

- 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 \$18,845,913 of restricted net assets, of which \$4,251,385 is restricted by enabling legislation.

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

C. Fund Financial Statements

The fund financial statements present a balance sheet and a statement of revenues, expenditures, and changes in fund balances for its major and aggregated non-major funds. Major individual governmental funds are reported as separate columns in the fund financial statements pursuant to GASB reporting standards, with nonmajor governmental funds being combined into a single column.

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

D. Measurement Focus and Basis of Accounting

Government-Wide Financial Statements:

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

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

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

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

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

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

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 State reports the following major funds:

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

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Grants Assistance Fund - a Special Revenue Fund that accounts for funds received under sector grants pursuant to the amended Compact of Free Association; all financial transactions of federally assisted funds, which are subgranted to the State, as well as other direct federal grants that the State received from the United States government, and foreign assistance grants.

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

E. Reporting Standards

As allowed by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the State's discretely presented component units follow all GASB pronouncements and those Financial Accounting Standards Board (FASB) 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 of the primary government and the discretely presented component units include cash held in demand accounts as well as short-term investments with maturity dates within three months of the date acquired by the State. Deposits maintained in time certificates of deposit with original maturity dates greater than ninety days are separately classified on the statement of net assets/balance sheet.

G. Investments

Investments and related investment earnings of the primary government and the discretely presented component units are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Investments in the equity of companies are carried at cost if less than twenty percent of the companies' total equity, on the equity method if greater than twenty percent and less than fifty percent and on a consolidated basis if greater than fifty percent.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

H. Receivables

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

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

I. Prepaid Items

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

J. Interfund Receivables/Payables

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

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

K. Inventories

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

Inventories of the discretely presented component units are comprised of materials and diesel fuel and are valued at the lower of cost (FIFO) or market.

L. Restricted Assets

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through enabling legislation and loan agreements. Specifically, the State has collateralized investments in the amount of \$3,615,050 for the Pohnpei State Early Retirement Scheme. Furthermore, investments recorded in the Compact Trust Fund of \$10,838,268 are restricted in that they are not available to be used in current operations.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

L. Restricted Assets, Continued

As of September 30, 2012, cash and cash equivalents were restricted for the following uses:

Primary Government:

Deposits with a local bank restricted for the purchase of medical supplies for the State hospital.	\$ 6,859
Savings accounts established in accordance with Section 211(d)(2) of the Compact of Free Association, as amended, for the purpose of funding the State's infrastructure maintenance plan	7,811
Deposit accounts established for the purpose of receiving payments pursuant to the Compact of Free Association, as amended	9,048
Small Business Development Center deposit account	14,589
Loan Guarantee Escrow Account established for the sole purpose of loan collateralization made through the USDA Rural Development. The escrow account may be drawn down in the event of a borrower's default on the obligation under the terms of the promissory note and the deed of trust security instrument supporting such note and for which such note is guaranteed by the Pohnpei State Housing Authority, the trustee of the Loan Guarantee Escrow Account.	<u>185,892</u>
	\$ <u>224,199</u>

Discretely Presented Component Units:

Pohnpei Utilities Corporation:

Deposit accounts collateralizing loans payable to the FSM Development Bank and the Bank of the FSM	\$ 495,815
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Small Business Guarantee and Finance Corporation:

Deposit accounts restricted for various operations of the Small Business Guarantee and Finance Corporation	<u>840,224</u>
	\$ <u>1,336,039</u>

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

M. Capital Assets

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

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

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

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

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

O. Compensated Absences

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

P. 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 financial statements has primarily resulted as federal funds are received in advance of eligible expenditures.

Q. Fund Balance

Fund balance classifications are 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 and are 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.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

Q. Fund Balance, Continued

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

S. New Accounting Standards

During fiscal year 2012, the State 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.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

S. New Accounting Standards, Continued

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, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

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 State.

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 FASB and American Institute of Certified Public Accountants (AICPA) pronouncements. The provisions of this statement are effective for periods beginning after December 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

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 the State.

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 the State.

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 the State.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

S. New Accounting Standards, Continued

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 the State.

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

U. Total Columns

Total columns are presented primarily to facilitate financial analysis. The Management's Discussion and Analysis includes certain prior year summarized comparative information in total. Such information does not include sufficient detail to constitute a full comparative presentation. Accordingly, such information should be read in conjunction with the State's financial statements for the year ended September 30, 2011 from which summarized information was derived.

(2) Deposits and Investments

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

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

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(2) Deposits and Investments, Continued

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

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

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

A. Deposits

Custodial credit risk is the risk that in the event of a bank failure, the State's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. The State does not have a deposit policy for custodial credit risk.

As of September 30, 2012, the carrying amount of the primary government's total cash and cash equivalents were \$246,937 and the corresponding bank balances were \$921,798, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2012, bank deposits were fully FDIC insured.

As of September 30, 2012, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit was \$5,022,810 and the corresponding bank balances were \$5,692,231, which were maintained in financial institutions subject to FDIC insurance. As of September 30, 2012, bank deposits in the amount of \$1,532,229 were FDIC insured. The component units do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Therefore, these deposits are exposed to custodial credit risk.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(2) Deposits and Investments, Continued

**B. Investments**

Primary Government:

As of September 30, 2012, the State's investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ 731,607
Other investments:	
Domestic equities	14,884,396
Cash management account	<u>5,573,410</u>
	<u>\$ 21,189,413</u>

As of September 30, 2012, the State's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

<u>Investment Type</u>	<u>Investment Maturities (In Years)</u>					<u>Credit Ratings</u>
	<u>Fair Value</u>	<u>Current</u>	<u>1-5</u>	<u>6-10</u>	<u>Over 10</u>	
U.S. Treasury Notes and Bonds	\$ 40,708	\$ 22,644	\$ 4,388	\$ 13,676	\$ -	Aaa/AAA
U.S. Government Agencies Obligations:						
Federal Home Loan Mortgage Corporation	126,228	-	1,035	29,977	95,216	AAA
Government National Mortgage Association	15,660	12,901	-	-	2,759	AAA
Federal National Mortgage Association	97,045	-	13,193	-	83,852	AAA
Tennessee Valley Authority Fed Book Notes	27,346	-	-	14,385	12,961	AAA
Housing Urban Development	20,276	-	20,276	-	-	No rating
AID-Tunisia	29,728	-	14,007	15,721	-	AAA
Municipal Obligations	8,660	-	-	-	8,660	A2
Municipal Obligations	36,379	-	5,855	18,516	12,008	Aa1
Municipal Obligations	10,305	-	-	-	10,305	Aa2
Municipal Obligations	14,680	14,680	-	-	-	No rating
Municipal Obligations	7,047	7,047	-	-	-	WR
Corporate Bonds	17,804	-	-	-	17,804	A1
Corporate Bonds	25,904	-	25,904	-	-	A2
Corporate Bonds	45,924	10,923	35,001	-	-	A3
Corporate Bonds	21,739	17,720	-	4,019	-	Aa1
Corporate Bonds	45,589	-	23,286	7,232	15,071	Aa2
Corporate Bonds	62,994	6,404	21,695	13,426	21,469	Aaa
Corporate Bonds	31,632	13,404	18,228	-	-	Baa1
Corporate Bonds	14,964	-	7,353	-	7,611	Baa2
Corporate Bonds	<u>30,995</u>	<u>13,672</u>	<u>-</u>	<u>17,323</u>	<u>-</u>	No rating
	<u>\$ 731,607</u>	<u>\$ 119,395</u>	<u>\$ 190,221</u>	<u>\$ 134,275</u>	<u>\$ 287,716</u>	

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued:

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

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the State will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The State's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the State's name by the State's custodial financial institutions at September 30, 2012.

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, 2012, the State did not hold an investment in any one issuer that represented more than 5% of the State's total investments.

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

As of September 30, 2012, the General Fund holds 5.4% of the outstanding shares of the Bank of the Federated States of Micronesia in the amount of \$500,000 and 19% of the outstanding shares of the Pacific Islands Development Bank in the amount of \$1,000,000. As the fair market value of these investments is not readily available, such have been recorded at cost. Additionally, the State acquired an interest in an airline during fiscal year 2004 and recorded an impairment of such investment in the same period. Financial statements from the investee are not currently available.

Discretely Presented Component Units:

Investments of the discretely presented component units at fair value are as follows:

Pohnpei Utilities Corporation:	
Mutual funds	\$ <u>174,257</u>

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

**(3) Receivables**

**Primary Government:**

Receivables as of September 30, 2012, for the primary government's individual major governmental funds, and nonmajor governmental funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	<u>General</u>	<u>Grants Assistance</u>	<u>Compact Trust</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Receivables:					
Taxes	\$ 1,892,905	\$ -	\$ -	\$ -	\$ 1,892,905
Federal agencies	-	-	-	389,421	389,421
Due from FSM National Government	-	1,491,087	-	-	1,491,087
Other	<u>2,977,603</u>	<u>3,928</u>	<u>-</u>	<u>567,945</u>	<u>3,549,476</u>
	4,870,508	1,495,015	-	957,366	7,322,889
Allowance for uncollectible accounts	<u>(2,438,533)</u>	<u>(453,598)</u>	<u>-</u>	<u>(562,203)</u>	<u>(3,454,334)</u>
	<u>\$ 2,431,975</u>	<u>\$ 1,041,417</u>	<u>\$ -</u>	<u>\$ 395,163</u>	<u>\$ 3,868,555</u>

**Discretely Presented Component Units:**

Receivables as of September 30, 2012, for the discretely presented component units, including applicable allowances for uncollectible accounts, are as follows:

	<u>Pohnpei Utilities Corporation</u>	<u>Pohnpei Port Authority</u>	<u>Pohnpei Transportation Authority</u>	<u>Small Business Guarantee and Finance Corporation</u>	<u>Pohnpei State Housing Authority</u>	<u>Total</u>
Loans	\$ -	\$ -	\$ -	\$ 863,814	\$ 7,747,070	\$ 8,610,884
General	5,136,110	1,903,035	853,313	-	-	7,892,458
Other	<u>182,861</u>	<u>229,868</u>	<u>-</u>	<u>49,923</u>	<u>52,530</u>	<u>515,182</u>
	5,318,971	2,132,903	853,313	913,737	7,799,600	17,018,524
Less: allowance for uncollectibles	<u>(3,987,667)</u>	<u>(1,695,329)</u>	<u>(850,389)</u>	<u>(60,688)</u>	<u>(5,571,893)</u>	<u>(12,165,966)</u>
	<u>\$ 1,331,304</u>	<u>\$ 437,574</u>	<u>\$ 2,924</u>	<u>\$ 853,049</u>	<u>\$ 2,227,707</u>	<u>\$ 4,852,558</u>

Loans receivable consist of the following:

**Small Business Guarantee and Finance Corporation**

Loans to qualified businesses under Micro Loan and Loan Guarantee Programs with interest at 9% per annum. \$ 863,814

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Notes to Financial Statements  
September 30, 2012

(3) Receivables, Continued

Discretely Presented Component Units, Continued:

Pohnpei State Housing Authority (PSHA)

PSHA's loan portfolio is derived from three sources: (1) capital contributions of Compact of Free Association Capital Account Funds - Capital Projects by Pohnpei State to fund the Housing Development Loan Fund; (2) Housing Preservation Grant (HPG) loans from a grant extended by the United States Department of Agriculture (USDA) Rural Development through the Housing and Community Facilities Program; and (3) Rural Development loans under the USDA funded Direct Single Family Housing 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 collectability of loans. The allowance for loan losses are reported based on certain assumptions pertaining to PSHA's periodic review and evaluation of the loan portfolio, which is subject to change. A summary of loans receivable as of September 30, 2012 are presented below:

Pohnpei State Housing Authority loans	\$ 6,473,314
HPG loans	298,129
USDA Rural Development loans	<u>975,627</u>
	7,747,070
Less allowance for loan losses	<u>(5,571,893)</u>
Loans receivable, net	\$ <u>2,175,177</u>

All loans, other than USDA Rural Development loans, 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.

(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, 2012, are summarized as follows:

Receivable Fund	Payable Fund	Amount
Grants Assistance	General	\$ 1,692,886
Nonmajor governmental funds	General	4,240,060
General	Grants Assistance	898,204
General	Nonmajor governmental funds	<u>401,768</u>
		\$ <u>7,232,918</u>

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Notes to Financial Statements  
September 30, 2012

(4) Interfund Receivables and Payables, Continued

Receivables and payables between funds reflected as due to/due from components in the Statement of Net Assets at September 30, 2012, are summarized as follows:

	<u>Due From</u>	<u>Due To</u>
Primary Government:		
General Fund:		
Pohnpei Utilities Corporation	\$ <u>200,000</u>	\$ <u>      -</u>

The amount recorded as due from component units of the primary government of \$200,000 does not equal the corresponding due to primary government of the discretely presented component units of \$1,853,486 due to an allowance for doubtful accounts recorded by the General Fund of \$1,653,486.

(5) Capital Assets

Capital asset activities for the year ended September 30, 2012, are as follows:

Primary Government:

	<u>Balance October 1, 2011</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance September 30, 2012</u>
Governmental activities:				
Capital assets, being depreciated:				
Buildings	\$ 13,728,473	\$ -	\$ -	\$ 13,728,473
Machinery, equipment and others	22,199,300	551,203	-	22,750,503
Infrastructure	<u>52,446,727</u>	<u>340,000</u>	<u>      -</u>	<u>52,786,727</u>
Total capital assets, being depreciated	<u>88,374,500</u>	<u>891,203</u>	<u>      -</u>	<u>89,265,703</u>
Less accumulated depreciation for:				
Buildings	(4,789,565)	(209,870)	-	(4,999,435)
Machinery, equipment and others	(20,819,192)	(351,888)	-	(21,171,080)
Infrastructure	<u>(37,743,853)</u>	<u>(1,633,898)</u>	<u>      -</u>	<u>(39,377,751)</u>
	<u>(63,352,610)</u>	<u>(2,195,656)</u>	<u>      -</u>	<u>(65,548,266)</u>
Governmental activities capital assets, net	\$ <u>25,021,890</u>	\$ <u>(1,304,453)</u>	\$ <u>      -</u>	\$ <u>23,717,437</u>

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

General government	\$ 116,381
Land and natural resources	50,847
Education	212,634
Health services	151,835
Public safety	23,135
Public works and transportation	<u>1,640,824</u>
	<u>\$ 2,195,656</u>

**STATE OF POHNPEI  
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Notes to Financial Statements  
September 30, 2012

(5) Capital Assets, Continued

Discretely Presented Component Units:

	Balance October <u>1, 2011</u>	<u>Additions</u>	<u>Retirements</u>	Balance September <u>30, 2012</u>
Depreciable assets:				
Buildings	\$ 15,045,131	\$ 442,173	\$ -	\$ 15,045,131
Utility plant	55,220,436	1,352,020	-	56,572,456
Machinery, equipment and others	<u>6,541,922</u>	<u>50,212</u>	<u>(9,799)</u>	<u>6,582,335</u>
Total capital assets, being depreciated	76,807,489	1,844,405	(9,799)	78,642,095
Less accumulated depreciation	<u>(52,512,382)</u>	<u>(2,526,614)</u>	<u>-</u>	<u>(55,038,996)</u>
	<u>24,295,107</u>	<u>(682,209)</u>	<u>(9,799)</u>	<u>23,603,099</u>
Nondepreciable assets:				
Land	2,776,034	-	-	2,776,034
Construction work-in-progress	<u>4,906,525</u>	<u>905,490</u>	<u>(264,073)</u>	<u>5,547,942</u>
	<u>7,682,559</u>	<u>905,490</u>	<u>(264,073)</u>	<u>8,323,976</u>
	<u>\$ 31,977,666</u>	<u>\$ 223,281</u>	<u>\$ (273,872)</u>	<u>\$ 31,927,075</u>

(6) Long-Term Obligations

Primary Government:

The State implemented an Early Retirement Scheme (ERS) in which employees holding certain nonessential positions as identified by the State were retired early with a payout of the equivalent of two-years wages. This ERS program is funded by a \$4,200,000 loan from the ADB (Loan Number 1520 (SF)) through the FSM National Government, non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The activities of the ERS Program are recorded in the General Fund.

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

Funds for the repayment of the ADB loan are expected to be derived from the annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The Financing Agreement requires the State to continue to appropriate salaries for the abolished positions and deposit the appropriate funds into the ERS Trust Account. These funds had not been deposited to the Trust Account as of September 30, 2002. Of the required \$4,200,000 identified for future debt service payments, \$3,615,050 is deposited in an investment account held jointly with the FSM National Government. That investment account is restricted for the repayment of this debt. As of September 30, 2012, the balance payable on this loan amounted to \$4,368,107.

**STATE OF POHNPEI  
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Notes to Financial Statements  
September 30, 2012

(6) Long-Term Obligations, Continued

Primary Government, Continued:

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Program Loans with ADB (Loan Number 1873 (SF) and Loan Number 1874 FSM (SF)) for the purpose of promoting private sector development in Pohnpei, with interest at 1% to 1.5% per annum. Principal payments shall be made in 32 equal semi-annual payments with the first payment due on May 15, 2010 and the last payment on November 15, 2025. As of September 30, 2012, the balances payable on these loans amounted to \$493,061 and \$782,369, respectively.

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

<u>Year Ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2013	\$ 169,987	\$ 62,813	\$ 232,800
2014	169,987	60,748	230,735
2015	169,987	58,684	228,671
2016	169,987	56,619	226,606
2017	169,987	54,555	224,542
2018-2022	1,335,311	230,158	1,565,469
2023-2027	1,280,527	156,494	1,437,021
2028-2032	1,152,696	89,928	1,242,624
2033-2037	<u>1,025,068</u>	<u>30,201</u>	<u>1,055,269</u>
	\$ <u>5,643,537</u>	\$ <u>800,200</u>	\$ <u>6,443,737</u>

Discretely Presented Component Units:

Pohnpei Utilities Corporation (PUC)

Loan payable to the State, facilitated by an Asian Development Bank (ADB) loan (Loan Number 1459-FSM (SF)) to the FSM National Government, in the original amount of \$2,118,767 due in semi-annual installments of \$33,500 from February 2007 to August 2044. The State has not imposed collateralization on PUC and has waived its rights to receive 6.82% in interest. The loan includes a 1% per annum service charge to be added to the principal until installment payments commence. This service charge was paid by the State during the year ended September 30, 2012. During 2012, an additional \$294,720 was allocated to PUC which extended the maturity date to February 2052.

\$ 2,487,450

Loan payable to United States Department of Agriculture, Rural Utilities Service (RUS), in the original amount of \$578,000, interest at 4.5% per annum, with principal and interest payable commencing October 2006 of \$2,654 through July 2044. The loan is collateralized by a revenue pledge.

535,507

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(6) Long-Term Obligations, Continued

Discretely Presented Component Units, Continued:

Pohnpei Utilities Corporation (PUC), Continued

Loan payable to bank in the original amount of \$773,122, interest at 9% per annum, with principal and interest payable commencing September 2008 of \$9,794 through August 2013, collateralized by a diesel power comprehensive generator plant, two Daihatsu model 12D532 engines, building and materials, and existing and future receivables. 542,757

Loan payable to FSM Development Bank (FSMDB) in the original amount of \$481,701, interest at 9% per annum, with principal and interest payable commencing December 31, 2011 in monthly installments of \$9,807, collateralized by a \$150,000 time certificate of deposit, receivables, inventory and property, plant and equipment. 405,799

Loan payable to the State, facilitated by an ADB loan (Loan Number 2099-FSM) to the FSM National Government, in the original amount of \$3,752,000 due in semi-annual installments of \$85,883 from January 15, 2013 to July 15, 2036. Interest is payable at 1% per annum during the grace period and at 1.5% per annum thereafter. Proceeds were used to fund the overhaul of sewage pumps, extension of sewage lines, and treatment plants. 4,222,128

Loan payable to the State, facilitated by an ADB loan (Loan Number 2100-FSM) to the FSM National Government, in the original amount of \$2,000,000, due in semi-annual installments of varying amounts through January 15, 2019. Interest is payable at LIBOR plus 0.6% per annum (2.1% at September 30, 2012). Proceeds were used to fund the overhaul of sewage pumps, extension of sewage lines, and treatment plants. 1,129,730

Loan payable to bank in the original amount of \$140,000, interest at 2% per annum, with principal and interest payable commencing May 30, 2012 in monthly installments of \$3,039 through April 30, 2016, collateralized by a savings account of \$140,000. 128,952

\$ 9,452,323

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(6) Long-Term Obligations, Continued

Discretely Presented Component Units, Continued:

Pohnpei Utilities Corporation (PUC), Continued

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

<u>Year Ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2013	\$ 850,835	\$ 205,861	\$ 1,056,696
2014	318,716	155,623	474,339
2015	333,799	143,220	477,019
2016	337,671	130,029	467,700
2017	224,215	119,817	344,032
2018-2022	1,153,905	545,474	1,699,379
2023-2027	1,399,039	442,734	1,841,773
2028-2032	1,282,350	323,080	1,605,430
2033-2037	1,123,403	229,063	1,352,466
2038-2042	1,221,826	130,640	1,352,466
2043-2047	481,195	48,042	529,237
2048-2052	305,624	29,376	335,000
2053-2057	321,210	13,790	335,000
2058-2059	<u>98,535</u>	<u>1,965</u>	<u>100,500</u>
	\$ <u>9,452,323</u>	\$ <u>2,518,714</u>	\$ <u>11,971,037</u>

(7) Short-term Debt

Discretely Presented Component Units:

Pohnpei Utilities Corporation (PUC)

Line of credit with a bank in the original amount of \$190,000, interest at 5% over the TCD rate (5.5% per annum at September 30, 2012), collateralized by a time certificate of deposit (TCD) with the bank, and expires on May 13, 2013.

Short-term activity for the year ended September 30, 2012, was as follows:

	Balance October 1, <u>2011</u>	<u>Additions</u>	<u>Reductions</u>	Balance September <u>30, 2012</u>
Note payable:				
PUC	\$ <u>190,000</u>	\$ <u>190,000</u>	\$ <u>(190,000)</u>	\$ <u>190,000</u>

**STATE OF POHNPEI  
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Notes to Financial Statements  
September 30, 2012

(8) Change in Long-Term Obligations

Primary Government:

Long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2012, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net assets:

	Balance October 1, 2011	<u>Additions</u>	<u>Reductions</u>	Balance September 30, 2012	Due Within <u>One Year</u>
Loans payable:					
ADB loans:					
Loan 1520	\$ 4,457,140	\$ -	\$ (89,033)	\$ 4,368,107	\$ 97,075
Loan 1873	550,989	-	(57,928)	493,061	36,523
Loan 1874	<u>806,884</u>	<u>-</u>	<u>(24,515)</u>	<u>782,369</u>	<u>36,389</u>
	5,815,013	-	(171,476)	5,643,537	169,987
Other:					
Compensated absences	849,036	544,341	(702,391)	690,986	400,000
Claims	<u>210,968</u>	<u>-</u>	<u>-</u>	<u>210,968</u>	<u>-</u>
	<u>\$ 6,875,017</u>	<u>\$ 544,341</u>	<u>\$ (873,867)</u>	<u>\$ 6,545,491</u>	<u>\$ 569,987</u>

Discretely Presented Component Units:

During the year ended September 30, 2012, the following changes occurred in long-term obligations of the discretely presented component units:

	Balance October 1, 2011	<u>Additions</u>	<u>Reductions</u>	Balance September 30, 2012	Due Within <u>One Year</u>
Loans payable:					
Pohnpei Utilities Corporation	\$ <u>8,634,409</u>	\$ <u>1,029,593</u>	\$ <u>(211,679)</u>	\$ <u>9,452,323</u>	\$ <u>850,835</u>

(9) Interfund/Intrafund Transactions

Operating transfers in/out for each major governmental fund and nonmajor governmental funds in the aggregate, for the year ended September 30, 2012, are as follows:

	<u>Transfers Out</u>	<u>Transfers In</u>
General Fund:		
Grants Assistance Fund	\$ -	\$ 1,954,828
Nonmajor governmental funds	<u>322,932</u>	<u>-</u>
	<u>322,932</u>	<u>1,954,828</u>
Grants Assistance Fund:		
General Fund	<u>1,954,828</u>	<u>-</u>
Nonmajor governmental funds:		
General Fund	<u>-</u>	<u>322,932</u>
	<u>\$ 2,277,760</u>	<u>\$ 2,277,760</u>

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(9) Interfund/Intrafund Transactions, Continued

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. Specifically, the State transferred \$322,932 from the General Fund to the Nonmajor Governmental Funds to primarily finance infrastructure maintenance and recycling programs; and \$1,954,828 from the Grants Assistance Fund to the General Fund representing reduction in interfund balances.

(10) Contingencies and Commitments

Sick Leave

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

Encumbrances

The State utilizes encumbrance accounting to identify fund obligations. Encumbrances represent commitments related to unperformed contracts for goods. At September 30, 2012, the State has significant encumbrances summarized as follows:

	<u>General</u>	<u>Grants Assistance</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Encumbrances	\$ <u>239,965</u>	\$ <u>1,192,550</u>	\$ <u>215,062</u>	\$ <u>1,647,577</u>

Federal Grants

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

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

Loan Guarantees

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

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

(10) Contingencies and Commitments, Continued

Loan Guarantees, Continued

The Authority's management is of the opinion that the primary government will become ultimately liable for such defaulted liabilities to USDA Rural Development. Therefore, such loans and related liability are not recorded by the Authority in the accompanying financial statements. The State is of the opinion that these loans have not been communicated timely in accordance with the underlying agreement and therefore, does not believe that it is liable for the balance.

Litigation

The State is party to several legal proceedings arising from governmental operations. Claims are filed with the State's Attorney General. Approved claims are usually paid under general appropriations to the affected government agency. The State Attorney General is of the opinion that the probable outcome of suits existing at September 30, 2012, is not predictable but could have a material impact on the accompanying financial statements. Such impact has currently been estimated to approximate \$210,968.

Insurance Coverage

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

Other

The State Legislature has authorized various Compact Infrastructure and Infrastructure Maintenance projects. However, the State Legislature has required that additional approvals be provided by that body prior to these projects being expended. As a result, no continuing appropriation has been recorded or will be recorded for these authorizations until such time as the additional requirements have been satisfied. State law mandates that 30% of fishing fines be shared with applicable municipalities. Given the lack of certain legal clarifications, no specific dollar amount can be determined to be recorded as either a continuing appropriation or as a liability due to the municipalities.

(11) Self-Insurance Fund - Component Units

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

Pohnpei Port Authority (PPA) purchase insurance to cover workmen's compensation and life insurance risks but is substantially self-insured for all other risks. Management of PPA is of the opinion that no material losses have been sustained as a result of this practice.

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

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2012

**(12) 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 Fund	Grants Assistance Fund	Compact Trust Fund	Nonmajor Funds	Total Governmental Funds
Non-spendable:					
General government	\$ 84,693	\$ 53,498	\$ -	\$ -	\$ 138,191
Economic development	-	-	-	34,028	34,028
Education	-	43,469	-	-	49,469
Health services	-	7,753	-	-	7,753
Pohnpei Utilities Corporation loan	200,000	-	-	-	200,000
Pacific Islands Development Bank	1,000,000	-	-	-	1,000,000
Bank of the FSM	500,000	-	-	-	500,000
Permanent fund principal	-	-	10,838,268	-	10,838,268
Restricted for:					
Debt service	3,615,050	-	-	-	3,615,050
USDA development loans	185,892	-	-	-	185,892
Education	-	44,188	-	-	44,188
Health services	-	7,700	-	-	7,700
Infrastructure maintenance	-	18,969	-	-	18,969
Other Compact I	-	35,588	-	-	35,588
Committed:					
General government	148,716	-	-	1,988,196	2,136,912
Economic development	-	-	-	240,091	240,091
Environment protection	-	-	-	19,769	19,769
Health services	-	-	-	1,847,610	1,847,610
Boards, commissioner, others	-	-	-	9,202	9,202
ADB private sector development	208,473	-	-	-	208,473
Assigned	291,174	-	-	129,573	420,747
Unassigned	<u>1,989,891</u>	<u>(228,089)</u>	<u>-</u>	<u>(17,084)</u>	<u>1,744,718</u>
	<u>\$ 8,223,889</u>	<u>\$ (16,924)</u>	<u>\$ 10,838,268</u>	<u>\$ 4,251,385</u>	<u>\$ 23,296,618</u>

**(13) Budgetary Compliance**

For the year ended September 30, 2012, expenditures exceeded appropriations within the General Fund for the following:

General Government	\$ 351,475
Recycling Revolving Fund	\$ 100,000
Infrastructure Maintenance Fund	\$ 222,932

These over-expenditures of the General Fund have not been funded by legislative authorization.

**(14) FSM Development Bank Loan Funds**

Compact Capital Account funds in an aggregate amount of \$1.7 million were transferred to the control of the FSM Development Bank (FSMDB) (a component unit of the FSM National Government) to be loaned out to borrowers from the State mainly for economic development projects. The loan fund is administered by FSMDB in a Trust capacity. All loan decisions are made by management of the State. These loans are not controlled by the State and are not currently recorded in the accompanying financial statements. As of December 31, 2012 (FSMDB fiscal year end), the outstanding fund balance aggregated \$730,994.

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

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**YEAR ENDED SEPTEMBER 30, 2012**

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual  
General Fund  
Year Ended September 30, 2012

	Budgeted Amounts		Actual - Budgetary	Variance with Final Budget -
	Original	Final	Basis (see Note 1)	
<b>Revenues:</b>				
FSM revenue sharing	\$ 7,120,697	\$ 7,120,697	\$ 6,859,169	\$ (261,528)
State taxes	2,628,588	2,628,588	2,274,773	(353,815)
Fees and charges	43,321	43,321	144,198	100,877
Net change in the fair value of investments	603,564	603,564	1,692,662	1,089,098
Other	252,043	252,043	95,154	(156,889)
Total revenues	<u>10,648,213</u>	<u>10,648,213</u>	<u>11,065,956</u>	<u>417,743</u>
<b>Expenditures:</b>				
<b>Current:</b>				
General government	2,000	4,162,437	4,513,912	(351,475)
Department of Land and Natural Resources	442,807	500,344	490,611	9,733
Department of Education	8,281	8,281	963	7,318
Department of Health Services	13	13	13	-
Department of Public Safety	1,220,255	1,225,693	1,197,132	28,561
Office of the Attorney-General	362,504	351,686	325,220	26,466
Department of Public Works	798,608	747,144	626,575	120,569
Boards, Commissions and Other	1,100,932	1,105,413	1,086,204	19,209
Payments to Non-governmental Agencies	344,819	466,819	387,263	79,556
Grants to local governments	2,422,301	2,422,301	2,394,925	27,376
Total expenditures	<u>6,702,520</u>	<u>10,990,131</u>	<u>11,022,818</u>	<u>(32,687)</u>
Excess (deficiency) of revenues over (under) expenditures	<u>3,945,693</u>	<u>(341,918)</u>	<u>43,138</u>	<u>385,056</u>
<b>Other financing sources (uses):</b>				
Operating transfers in	-	-	1,954,828	1,954,828
Operating transfers out	-	-	(322,932)	(322,932)
Total other financing sources (uses), net	<u>-</u>	<u>-</u>	<u>1,631,896</u>	<u>1,631,896</u>
Net change in fund balance	<u>3,945,693</u>	<u>(341,918)</u>	<u>1,675,034</u>	<u>2,016,952</u>
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary purposes but in the year the supplies are received for financial reporting purposes	282,007	282,007	239,965	(42,042)
	<u>4,227,700</u>	<u>(59,911)</u>	<u>1,914,999</u>	<u>1,974,910</u>
Fund balance at the beginning of the year	<u>6,308,890</u>	<u>6,308,890</u>	<u>6,308,890</u>	<u>-</u>
Fund balance at the end of the year	<u>\$ 10,536,590</u>	<u>\$ 6,248,979</u>	<u>\$ 8,223,889</u>	<u>\$ 1,974,910</u>

See accompanying notes to required supplementary information - budgetary reporting.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Required Supplementary Information – Budgetary Reporting  
September 30, 2012

(1) Budgetary Information

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

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

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.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

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**OTHER SUPPLEMENTARY INFORMATION**

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**YEAR ENDED SEPTEMBER 30, 2012**

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Combining Schedule of Expenditures by Account  
Governmental Funds  
Year Ended September 30, 2012

	General	Special Revenue	Permanent	Other Governmental Funds	Total
		Grants Assistance	Compact Trust		
Expenditures:					
Salaries and wages					
Regular	\$ 4,383,279	\$ 9,739,269	\$ -	\$ 317,528	\$ 14,440,076
Overtime	157,483	155,428	-	8,578	321,489
Fringe benefits	862,140	2,082,122	-	40,382	2,984,644
Travel and transportation	249,502	725,473	-	4,752	979,727
Books and instructional materials	-	601,801	-	-	601,801
Communications	112,752	115,150	-	11,298	239,200
Customs and taxes	-	8,087	-	179	8,266
Dues, membership, and subscriptions	13,224	10,084	-	-	23,308
Food stuffs	115,755	624,966	-	941	741,662
Port charges	934	41,816	-	15,955	58,705
Non-capitalized equipment	45,159	98,025	-	-	143,184
Capital outlays	78,352	878,597	-	-	956,949
Office supplies and materials	270,284	469,620	-	204,764	944,668
POL	237,350	279,033	-	31,897	548,280
Printing and reproduction	60,616	26,223	-	3,468	90,307
Rental services	17,614	30,966	-	118	48,698
Repairs and maintenance	33,661	56,270	-	5,048	94,979
Utilities	346,322	975,609	-	37,317	1,359,248
Miscellaneous goods and services	20,472	13,021	-	201	33,694
Subsidies and contributions	318,230	68,260	-	-	386,490
Medical referrals	-	465,916	-	-	465,916
Medical supplies	-	1,930,369	-	423,900	2,354,269
Contractual services	328,958	876,736	-	1,199,474	2,405,168
Housing allowance	56,367	334,690	-	-	391,057
Non-payroll compensation	94,130	46,815	-	-	140,945
Court settlements	4,515	-	-	-	4,515
Scholarships and allowances	-	554,311	-	-	554,311
Insurance	32,939	-	-	-	32,939
Official allowance	115,440	-	-	-	115,440
Meeting allowance	3,600	18,906	-	2,760	25,266
Leased housing, buildings and land	2,318	-	-	-	2,318
Principal repayment	171,476	-	-	-	171,476
Interest payments	48,891	-	-	-	48,891
Payments to municipalities	2,394,925	-	-	-	2,394,925
Bad debt	154,482	-	-	-	154,482
Miscellaneous	2	9,505	-	-	9,507
Bank charges	51,681	33	-	-	51,714
	<u>\$ 10,782,853</u>	<u>\$ 21,237,101</u>	<u>\$ -</u>	<u>\$ 2,308,560</u>	<u>\$ 34,328,514</u>

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balance  
General Fund  
Year Ended September 30, 2012  
(with comparative totals for the year ended September 30, 2011)

	2012	2011
Revenues:		
FSM revenue sharing:		
Gross revenue taxes	\$ 2,209,724	\$ 2,214,811
Import taxes	2,370,570	2,268,381
Income taxes	1,925,080	1,976,616
Other taxes	353,795	331,258
	6,859,169	6,791,066
State taxes:		
Sales tax	2,197,348	2,438,271
Hotel tax	77,425	83,951
	2,274,773	2,522,222
Fees and charges:		
Licenses and fees:	144,198	233,337
Net change in the fair value of investments	1,692,662	(99,063)
Other revenues	95,154	23,880
Total revenues	11,065,956	9,471,442
Expenditures:		
Current:		
General government:		
Governor and Staff	603,178	645,588
Department of Treasury and Administration	1,123,364	961,774
Office of Pohnpei Public Auditor	3,298	1,802
Judiciary Branch	737,484	702,593
Legislative Branch	1,747,620	1,645,376
	4,214,944	3,957,133
Department of Land and Natural Resources:		
Office of the Director	88,174	83,839
Division of Public Land	21,812	57,392
Land Use Planning and Zoning Commission	-	(165)
Division of Surveying and Mapping	168,264	179,652
Division of Forestry and Marine Conservation	87,972	124,450
Division of Historic Preservation	119,603	66,417
Division of Parks and Recreation	-	74,750
	485,825	586,335
Department of Education:		
Division of Primary Education	2,318	2,318
Department of Health:		
Medical referrals	-	820
Department of Public Safety:		
Office of the Director	72,347	85,218
Search and Rescue	2,488	32,030
Hazard Mitigation	-	1,000
Fish & Wildlife	151	42,163
Police Commission	26,811	24,987
Division of Police and Security	837,703	936,496
Division of Correction and Rehabilitation	248,070	256,035
	1,187,570	1,377,929
Office of the Attorney-General	310,577	409,350
Public Works	513,954	535,950

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balance, Continued  
General Fund  
Year Ended September 30, 2012  
(with comparative totals for the year ended September 30, 2011)

	2012	2011
Expenditures, continued:		
Current:		
Boards, Commissions and Other:		
Office of Economic Affairs	337,126	308,166
Office of Social Affairs	99,847	113,729
Election Commissioner's Office	198,442	57,891
Pohnpei Public Broadcasting Corporation	116,450	106,199
Foreign Investment Board	55,330	60,399
Pohnpei Housing Authority	128,766	130,000
Sports and Recreation	129,275	118,517
Office of Fisheries and Aquaculture	3,788	120,023
	1,069,024	1,014,924
Payments to Non-governmental Agencies:		
Small Business Guarantee and Finance Corporation	110,000	117,000
Pohnpei Public Library	58,000	58,000
Micronesia Legal Services Corporation	38,280	38,280
U.S.D.A. Rural Development	92,559	93,267
Pohnpei Visitors' Bureau	1,445	130,840
Pahap Power Extension	10,500	-
Small Business Development	52,000	50,000
Island Food Community	20,000	-
Constitutional Convention	-	597
Other	565	2,631
	383,349	490,615
Grants to local governments	2,394,925	2,165,719
Pohnpei Transportation Authority	-	24,771
Debt Service:		
Principal payments	171,476	149,839
Interest charges	48,891	55,050
	220,367	204,889
Total expenditures	10,782,853	10,770,753
Excess (deficiency) of revenues over (under) expenditures	283,103	(1,299,311)
Other financing sources (uses):		
Operating transfers in	1,954,828	-
Operating transfers out	(322,932)	(308,981)
Total other financing sources (uses), net	1,631,896	(308,981)
Net change in fund balance	1,914,999	(1,608,292)
Fund balance at the beginning of the year	6,308,890	7,917,182
Fund balance at the end of the year	\$ 8,223,889	\$ 6,308,890

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures by Function and Changes in Fund Balance  
Budget and Actual - General Fund  
Year Ended September 30, 2012

	Budgeted Amounts		Actual - Budgetary Basis (see Note 1)	Variance with Final Budget - Positive (Negative)
	Original	Final		
<b>Revenues:</b>				
FSM revenue sharing	\$ 7,120,697	\$ 7,120,697	\$ 6,859,169	\$ (261,528)
<b>State taxes:</b>				
Sales tax	2,546,523	2,546,523	2,197,348	(349,175)
Hotel tax	82,065	82,065	77,425	(4,640)
	<u>2,628,588</u>	<u>2,628,588</u>	<u>2,274,773</u>	<u>(353,815)</u>
<b>Fees and charges:</b>				
Licenses and fees	43,321	43,321	144,198	100,877
Net change in the fair value of investments	603,564	603,564	1,692,662	1,089,098
Other	252,043	252,043	95,154	(156,889)
Total revenues	<u>10,648,213</u>	<u>10,648,213</u>	<u>11,065,956</u>	<u>417,743</u>
<b>Expenditures:</b>				
<b>Current:</b>				
<b>General government:</b>				
Governor and Staff	-	624,894	647,352	(22,458)
Department of Treasury and Administration	-	874,777	1,316,764	(441,987)
Office of the Pohnpei Public Auditor	2,000	3,300	3,298	2
Judiciary Branch	-	784,366	762,758	21,608
Legislative Branch	-	1,875,100	1,783,740	91,360
	<u>2,000</u>	<u>4,162,437</u>	<u>4,513,912</u>	<u>(351,475)</u>
<b>Department of Land and Natural Resources:</b>				
Office of the Director	89,608	89,408	88,194	1,214
Division of Public Land	22,665	22,665	22,732	(67)
Land Use Planning and Zoning Commission	1,000	1,000	-	1,000
Division of Surveying and Mapping	177,537	168,685	168,025	660
Division of Forestry and Marine Conservation	83,028	82,849	90,826	(7,977)
Division of Historic Preservation	68,821	65,684	120,834	(55,150)
Division of Parks and Recreation	148	70,053	-	70,053
	<u>442,807</u>	<u>500,344</u>	<u>490,611</u>	<u>9,733</u>
<b>Department of Education:</b>				
Division of Primary Education	8,281	8,281	963	7,318
<b>Department of Health Services:</b>				
Division of Medical Services	13	13	13	-
<b>Department of Public Safety:</b>				
Office of the Director	145,791	156,527	76,474	80,053
Search and Rescue	5,000	4,750	2,488	2,262
Police Commission	27,380	26,170	26,811	(641)
Division of Police and Security	785,331	783,387	839,966	(56,579)
Division of Correction and Rehabilitation	255,937	254,043	250,652	3,391
Fish and Wildlife	226	226	151	75
Hazard Mitigation Project	590	590	590	-
	<u>1,220,255</u>	<u>1,225,693</u>	<u>1,197,132</u>	<u>28,561</u>
Office of the Attorney-General	362,504	351,686	325,220	26,466
<b>Department of Public Works:</b>				
Office of Transportation and Infrastructure	798,608	747,144	626,575	120,569

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures by Function and Changes in Fund Balance, Continued  
Budget and Actual - General Fund  
Year Ended September 30, 2012

	Budgeted Amounts		Actual - Budgetary Basis (see Note 1)	Variance with Final Budget - Positive (Negative)
	Original	Final		
Expenditures, continued:				
Boards, Commissions and Other:				
Office of Economic Affairs	325,121	325,121	340,615	(15,494)
Office of Social Affairs	101,540	101,540	99,867	1,673
Election Commissioner's Office	201,331	201,331	200,592	739
Pohnpei Public Broadcasting Corporation	142,280	135,264	116,609	18,655
Foreign Investment Board	58,115	55,311	55,330	(19)
Pohnpei Housing Authority	125,630	119,588	129,897	(10,309)
Sports & Recreation	10,183	135,651	138,205	(2,554)
Pohnpei Sports Commission	131,625	-	-	-
Economic Planning Conference	-	26,500	-	26,500
Office of Fisheries and Aquaculture	5,107	5,107	5,089	18
	<u>1,100,932</u>	<u>1,105,413</u>	<u>1,086,204</u>	<u>19,209</u>
Payments to Non-Governmental Agencies:				
Small Business Guarantee and Finance Corporation				
Small Business Development Center	100,000	100,000	110,000	(10,000)
Pohnpei Public Library	50,000	52,000	52,000	-
Micronesian Legal Services Corporation	58,000	58,000	58,000	-
U.S.D.A. Rural Development	38,280	38,280	38,280	-
Pohnpei Visitors Bureau	95,483	95,483	95,242	241
Constitutional Convention	2,685	2,685	2,305	380
Other	-	-	371	(371)
	371	120,371	31,065	89,306
	<u>344,819</u>	<u>466,819</u>	<u>387,263</u>	<u>79,556</u>
Grants to local governments	2,422,301	2,422,301	2,394,925	27,376
Total expenditures	<u>6,702,520</u>	<u>10,990,131</u>	<u>11,022,818</u>	<u>(32,687)</u>
Excess (deficiency) of revenues over (under) expenditures	<u>3,945,693</u>	<u>(341,918)</u>	<u>43,138</u>	<u>385,056</u>
Other financing sources (uses):				
Operating transfers in	-	-	1,954,828	1,954,828
Operating transfers out	-	-	(322,932)	(322,932)
Total other financing sources (uses), net	-	-	<u>1,631,896</u>	<u>1,631,896</u>
Net change in fund balance	3,945,693	(341,918)	1,675,034	2,016,952
Other changes in unreserved fund balance:				
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary purposes but in the year the supplies are received for financial reporting purposes				
	282,007	282,007	239,965	(42,042)
	4,227,700	(59,911)	1,914,999	1,974,910
Fund balance at the beginning of the year	<u>6,308,890</u>	<u>6,308,890</u>	<u>6,308,890</u>	<u>-</u>
Fund balance at the end of the year	<u>\$ 10,536,590</u>	<u>\$ 6,248,979</u>	<u>\$ 8,223,889</u>	<u>\$ 1,974,910</u>

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

**NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS**

Combining Balance Sheet  
September 30, 2012

	Alien Registration Revolving	Pohnpei State Farmers' Revolving	Fisheries Enforcement and Development	Recycling Revolving	Paved Road Maintenance	Medical Supplies Revolving	Public Broadcasting Corporation	Health Care Premium	Department of Public Safety Fees	Environmental Quality	Infrastructure Maintenance	Public Lands Trust	Total
<b>ASSETS</b>													
Receivables:													
Federal agencies	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 389,421	\$ -	\$ 389,421
Other	-	-	-	-	-	-	-	5,742	-	-	-	-	5,742
Due from other funds	203,000	-	254,942	17,064	1,718,417	46,725	9,940	1,841,868	44,644	2,165	-	101,295	4,240,060
Advances	-	-	4,081	-	-	-	-	-	-	-	999	-	5,080
Inventories	-	29,947	-	-	-	-	-	-	-	-	-	-	29,947
Total assets	<u>\$ 203,000</u>	<u>\$ 29,947</u>	<u>\$ 259,023</u>	<u>\$ 17,064</u>	<u>\$ 1,718,417</u>	<u>\$ 46,725</u>	<u>\$ 9,940</u>	<u>\$ 1,847,610</u>	<u>\$ 44,644</u>	<u>\$ 2,165</u>	<u>\$ 390,420</u>	<u>\$ 101,295</u>	<u>\$ 4,670,250</u>
<b>LIABILITIES AND FUND BALANCES</b>													
Liabilities:													
Accounts payable	\$ -	\$ 5,196	\$ 4,508	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,107	\$ -	\$ -	\$ 459	\$ 11,270
Other liabilities and accruals	-	-	-	-	-	-	-	-	4,135	-	-	1,692	5,827
Due to other funds	-	11,348	-	-	-	-	-	-	-	-	390,420	-	401,768
Total liabilities	<u>-</u>	<u>16,544</u>	<u>4,508</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>5,242</u>	<u>-</u>	<u>390,420</u>	<u>2,151</u>	<u>418,865</u>
Fund balances:													
Non-spendable	-	29,947	4,081	-	-	-	-	-	-	-	-	-	34,028
Committed	203,000	-	240,091	17,604	1,603,421	46,725	9,202	1,847,610	36,230	2,165	-	98,820	4,104,868
Assigned	-	-	10,343	-	114,996	-	738	-	3,172	-	-	324	129,573
Unassigned	-	(16,544)	-	(540)	-	-	-	-	-	-	-	-	(17,084)
Total fund balances	<u>203,000</u>	<u>13,403</u>	<u>254,515</u>	<u>17,064</u>	<u>1,718,417</u>	<u>46,725</u>	<u>9,940</u>	<u>1,847,610</u>	<u>39,402</u>	<u>2,165</u>	<u>-</u>	<u>99,144</u>	<u>4,251,385</u>
Total liabilities and fund balances	<u>\$ 203,000</u>	<u>\$ 29,947</u>	<u>\$ 259,023</u>	<u>\$ 17,064</u>	<u>\$ 1,718,417</u>	<u>\$ 46,725</u>	<u>\$ 9,940</u>	<u>\$ 1,847,610</u>	<u>\$ 44,644</u>	<u>\$ 2,165</u>	<u>\$ 390,420</u>	<u>\$ 101,295</u>	<u>\$ 4,670,250</u>

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

**NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS**

Combining Statement of Revenues, Expenditures By Function,  
and Changes in Fund Balances (Deficit)  
Year Ended September 30, 2012

	Alien Registration Revolving	Pohnpei State Farmers' Revolving	Fisheries Enforcement and Development	Recycling Revolving	Paved Road Maintenance	Medical Supplies Revolving	Public Broadcasting Corporation	Health Care Premium	Department of Public Safety Fees	Environmental Quality	Infrastructure Maintenance	Public Lands Trust	Total
Revenues:													
Federal grants	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 389,421	\$ -	\$ 389,421
Excise tax	-	-	-	-	496,529	-	-	87,196	-	-	-	-	583,725
Fees and charges	57,925	63,292	100,000	18,970	-	548,775	19,382	-	46,688	-	-	90,247	945,279
Total revenues	57,925	63,292	100,000	18,970	496,529	548,775	19,382	87,196	46,688	-	389,421	90,247	1,918,425
Expenditures by function:													
Current:													
General government	-	86,985	250,737	124,805	371,100	-	13,969	-	147,750	9,525	778,843	78,707	1,862,421
Health services	-	-	-	-	-	446,139	-	-	-	-	-	-	446,139
Total expenditures	-	86,985	250,737	124,805	371,100	446,139	13,969	-	147,750	9,525	778,843	78,707	2,308,560
Excess (deficiency) of revenues over (under) expenditures	57,925	(23,693)	(150,737)	(105,835)	125,429	102,636	5,413	87,196	(101,062)	(9,525)	(389,422)	11,540	(390,135)
Other financing sources:													
Operating transfers in	-	-	-	100,000	-	-	-	-	-	-	222,932	-	322,932
Total other financing sources	-	-	-	100,000	-	-	-	-	-	-	222,932	-	322,932
Net change in fund balances (deficit)	57,925	(23,693)	(150,737)	(5,835)	125,429	102,636	5,413	87,196	(101,062)	(9,525)	(166,490)	11,540	(67,203)
Fund balances (deficit) at the beginning of the year	145,075	37,096	405,252	22,899	1,592,988	(55,911)	4,527	1,760,414	140,464	11,690	166,490	87,604	4,318,588
Fund balances at the end of the year	\$ 203,000	\$ 13,403	\$ 254,515	\$ 17,064	\$ 1,718,417	\$ 46,725	\$ 9,940	\$ 1,847,610	\$ 39,402	\$ 2,165	\$ -	\$ 99,144	\$ 4,251,385

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

**NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS**

Combining Statement of Revenues, Expenditures By Account,  
and Changes in Fund Balances (Deficit)  
Year Ended September 30, 2012

	Alien Registration Revolving	Pohnpei State Farmers' Revolving	Fisheries Enforcement and Development	Recycling Revolving	Paved Road Maintenance	Medical Supplies Revolving	Public Broadcasting Corporation	Health Care Premium	Department of Public Safety Fees	Environmental Quality	Infrastructure Maintenance	Public Lands Trust	Total
<b>Revenues:</b>													
Federal grants	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 389,421	\$ -	\$ 389,421
Excise tax	-	-	-	-	496,529	-	-	87,196	-	-	-	-	583,725
Fees and charges	57,925	63,292	100,000	18,970	-	548,775	19,382	-	46,688	-	-	90,247	945,279
Total revenues	57,925	63,292	100,000	18,970	496,529	548,775	19,382	87,196	46,688	-	389,421	90,247	1,918,425
<b>Expenditures by account:</b>													
Salaries and wages:													
Regular	-	-	137,267	-	-	-	-	-	114,104	-	-	66,157	317,528
Overtime	-	-	81	-	-	-	-	-	-	8,497	-	-	8,578
Fringe benefits	-	-	16,104	-	-	-	-	-	14,438	817	-	9,023	40,382
Travel	-	-	4,752	-	-	-	-	-	-	-	-	-	4,752
Communications	-	5,208	2,499	-	-	-	3,391	-	200	-	-	-	11,298
Custom and tax	-	179	-	-	-	-	-	-	-	-	-	-	179
Food stuff	-	-	941	-	-	-	-	-	-	-	-	-	941
Port charges	-	842	389	-	-	14,724	-	-	-	-	-	-	15,955
Office supplies and materials	-	63,088	5,462	124,805	-	7,515	337	-	2,792	-	-	765	204,764
POL	-	9,746	6,152	-	-	-	-	-	15,788	211	-	-	31,897
Printing and reproduction	-	473	2,815	-	-	-	-	-	78	-	-	102	3,468
Rental	-	105	13	-	-	-	-	-	-	-	-	-	118
Repairs and maintenance	-	1,618	2,480	-	-	-	900	-	50	-	-	-	5,048
Utilities	-	5,525	30,492	-	-	-	1,000	-	300	-	-	-	37,317
Miscellaneous goods and services	-	201	-	-	-	-	-	-	-	-	-	-	201
Medical supplies	-	-	-	-	-	423,900	-	-	-	-	-	-	423,900
Contractual services	-	-	41,290	-	371,100	-	8,241	-	-	-	778,843	-	1,199,474
Meeting allowance	-	-	-	-	-	-	100	-	-	-	-	2,660	2,760
Total expenditures	-	86,985	250,737	124,805	371,100	446,139	13,969	-	147,750	9,525	778,843	78,707	2,308,560
Excess (deficiency) of revenues over (under) expenditures	57,925	(23,693)	(150,737)	(105,835)	125,429	102,636	5,413	87,196	(101,062)	(9,525)	(389,422)	11,540	(390,135)
<b>Other financing sources:</b>													
Operating transfers in	-	-	-	100,000	-	-	-	-	-	-	222,932	-	322,932
Total other financing sources	-	-	-	100,000	-	-	-	-	-	-	222,932	-	322,932
Net change in fund balances (deficit)	57,925	(23,693)	(150,737)	(5,835)	125,429	102,636	5,413	87,196	(101,062)	(9,525)	(166,490)	11,540	(67,203)
Fund balances (deficit) at the beginning of the year	145,075	37,096	405,252	22,899	1,592,988	(55,911)	4,527	1,760,414	140,464	11,690	166,490	87,604	4,318,588
Fund balances at the end of the year	\$ 203,000	\$ 13,403	\$ 254,515	\$ 17,064	\$ 1,718,417	\$ 46,725	\$ 9,940	\$ 1,847,610	\$ 39,402	\$ 2,165	\$ -	\$ 99,144	\$ 4,251,385

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

**GRANTS ASSISTANCE FUNDS**

Combining Balance Sheet  
September 30, 2012

	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	Section 211(a)(1) Supplemental Education	Section Infrastructure Maintenance	Section 221(b) Special Block Grant	Compact I Other Grants	U.S. Federal Grants	Non-U.S. Grants	CFSM Grants	Compact I Capital Grant	Total
<b>ASSETS</b>														
Receivables:														
Due from FSM National Government	\$ -	\$ -	\$ 32,182	\$ -	\$ -	\$ 478,924	\$ 300,389	\$ -	\$ -	\$ 191,846	\$ 8,750	\$ 25,398	\$ -	\$ 1,037,489
Other	-	-	-	-	-	-	-	-	-	-	-	3,928	-	3,928
Due from other funds	851,322	574,582	-	93,563	93,643	-	-	44,188	35,588	-	-	-	-	1,692,886
Advances	9,838	7,752	288	1,760	41,647	9,243	-	-	-	24,388	4,270	5,534	-	104,720
Restricted cash	-	7,700	-	-	-	-	-	-	-	-	-	-	-	7,700
	<u>\$ 861,160</u>	<u>\$ 590,034</u>	<u>\$ 32,470</u>	<u>\$ 95,323</u>	<u>\$ 135,290</u>	<u>\$ 488,167</u>	<u>\$ 300,389</u>	<u>\$ 44,188</u>	<u>\$ 35,588</u>	<u>\$ 216,234</u>	<u>\$ 13,020</u>	<u>\$ 34,860</u>	<u>\$ -</u>	<u>\$ 2,846,723</u>
<b>LIABILITIES AND FUND BALANCES</b>														
<b>(DEFICIT)</b>														
Liabilities:														
Accounts payable	\$ 166,130	\$ 324,862	\$ 9,855	\$ 2,653	\$ 10,681	\$ 113,221	\$ 6,312	\$ -	\$ -	\$ 38,643	\$ 6,067	\$ 266	\$ -	\$ 678,690
Other liabilities and accruals	114,947	48,146	4,805	-	4,286	24,160	-	-	-	33,604	-	672	-	230,620
Deferred revenue	572,967	212,239	-	92,133	119,139	-	-	-	-	-	59,655	-	-	1,056,133
Due to other funds	-	-	43,996	-	-	343,293	275,108	-	-	143,987	57,898	33,922	-	898,204
Total liabilities	<u>854,044</u>	<u>585,247</u>	<u>58,656</u>	<u>94,786</u>	<u>134,106</u>	<u>480,674</u>	<u>281,420</u>	<u>-</u>	<u>-</u>	<u>216,234</u>	<u>123,620</u>	<u>34,860</u>	<u>-</u>	<u>2,863,647</u>
Fund balances (deficit):														
Non-spendable	9,838	7,752	288	1,760	41,647	9,243	-	-	-	24,388	4,270	5,534	-	104,720
Restricted	-	7,700	-	-	-	-	18,969	44,188	35,588	-	-	-	-	106,445
Unassigned	(2,722)	(10,665)	(26,474)	(1,223)	(40,463)	(1,750)	-	-	-	(24,388)	(114,870)	(5,534)	-	(228,089)
Total fund balances (deficit)	<u>7,116</u>	<u>4,787</u>	<u>(26,186)</u>	<u>537</u>	<u>1,184</u>	<u>7,493</u>	<u>18,969</u>	<u>44,188</u>	<u>35,588</u>	<u>-</u>	<u>(110,600)</u>	<u>-</u>	<u>-</u>	<u>(16,924)</u>
Total liabilities and fund balances (deficit)	<u>\$ 861,160</u>	<u>\$ 590,034</u>	<u>\$ 32,470</u>	<u>\$ 95,323</u>	<u>\$ 135,290</u>	<u>\$ 488,167</u>	<u>\$ 300,389</u>	<u>\$ 44,188</u>	<u>\$ 35,588</u>	<u>\$ 216,234</u>	<u>\$ 13,020</u>	<u>\$ 34,860</u>	<u>\$ -</u>	<u>\$ 2,846,723</u>

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

**GRANTS ASSISTANCE FUNDS**

**Combining Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balances (Deficit)  
Year Ended September 30, 2012**

	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	Section 211(a)(1) Supplemental Education	Section Infrastructure Maintenance	Section 221(b) Special Block Grant	Compact I Other Grants	U.S. Federal Grants	Non-U.S. Grants	CFSM Grants	Compact I Capital Grant	Total
<b>Revenues:</b>														
Compact funding	\$ 7,516,224	\$ 6,797,475	\$ 467,700	\$ 86,477	\$ 433,049	\$ 2,928,516	\$ 298,638	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 18,528,079
CFSM grants	-	-	-	-	-	-	-	-	-	-	-	96,921	-	96,921
Federal contributions and other grants	-	-	-	-	-	-	-	-	-	2,322,476	73,881	-	-	2,396,357
Other	-	-	-	-	-	1,164	-	-	-	-	65,244	-	-	66,408
	<u>7,516,224</u>	<u>6,797,475</u>	<u>467,700</u>	<u>86,477</u>	<u>433,049</u>	<u>2,929,680</u>	<u>298,638</u>	<u>-</u>	<u>-</u>	<u>2,322,476</u>	<u>139,125</u>	<u>96,921</u>	<u>-</u>	<u>21,087,765</u>
<b>Expenditures by function:</b>														
<b>Current:</b>														
General government	-	-	467,700	86,477	433,049	-	298,638	(200)	-	-	288,661	96,921	-	1,671,246
Land and natural resources	-	-	-	-	-	-	-	-	-	142,488	-	-	-	142,488
Education	7,516,224	-	-	-	-	2,929,680	-	-	-	1,121,139	-	-	-	11,567,043
Health services	-	6,797,475	-	-	-	-	-	-	-	1,058,849	-	-	-	7,856,324
Total expenditures	<u>7,516,224</u>	<u>6,797,475</u>	<u>467,700</u>	<u>86,477</u>	<u>433,049</u>	<u>2,929,680</u>	<u>298,638</u>	<u>(200)</u>	<u>-</u>	<u>2,322,476</u>	<u>288,661</u>	<u>96,921</u>	<u>-</u>	<u>21,237,101</u>
Excess (deficiency) of revenues over (under) expenditures	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>200</u>	<u>-</u>	<u>-</u>	<u>(149,536)</u>	<u>-</u>	<u>-</u>	<u>(149,336)</u>
<b>Other financing uses:</b>														
Operating transfers out	-	-	-	-	-	-	-	-	-	-	-	-	(1,954,828)	(1,954,828)
Net change in fund balances (deficit)	-	-	-	-	-	-	-	200	-	-	(149,536)	-	(1,954,828)	(2,104,164)
Fund balances (deficit) at the beginning of the year	<u>7,116</u>	<u>4,787</u>	<u>(26,186)</u>	<u>537</u>	<u>1,184</u>	<u>7,493</u>	<u>18,969</u>	<u>43,988</u>	<u>35,588</u>	<u>-</u>	<u>38,936</u>	<u>-</u>	<u>1,954,828</u>	<u>2,087,240</u>
Fund balances (deficit) at the end of the year	<u>\$ 7,116</u>	<u>\$ 4,787</u>	<u>\$ (26,186)</u>	<u>\$ 537</u>	<u>\$ 1,184</u>	<u>\$ 7,493</u>	<u>\$ 18,969</u>	<u>\$ 44,188</u>	<u>\$ 35,588</u>	<u>\$ -</u>	<u>\$ (110,600)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (16,924)</u>

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

**GRANTS ASSISTANCE FUNDS**

**Combining Statement of Revenues, Expenditures by Account,  
and Changes in Fund Balances (Deficit)  
Year Ended September 30, 2012**

	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	Section 211(a)(1) Supplemental Education	Section 221(b) Special Block Grant	Section 221(b) Special Block Grant	Compact I Other Grants	U.S. Federal Grants	Non-U.S. Grants	CFSM Grants	Compact I Capital Grant	Total
<b>Revenues:</b>														
Compact funding	\$ 7,516,224	\$ 6,797,475	\$ 467,700	\$ 86,477	\$ 433,049	\$ 2,928,516	\$ 298,638	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 18,528,079
CFSM grants	-	-	-	-	-	-	-	-	-	-	-	96,921	-	96,921
Federal contributions and other grants	-	-	-	-	-	-	-	-	-	2,322,476	73,881	-	-	2,396,357
Other	-	-	-	-	-	1,164	-	-	-	-	65,244	-	-	66,408
	<u>7,516,224</u>	<u>6,797,475</u>	<u>467,700</u>	<u>86,477</u>	<u>433,049</u>	<u>2,929,680</u>	<u>298,638</u>	<u>-</u>	<u>-</u>	<u>2,322,476</u>	<u>139,125</u>	<u>96,921</u>	<u>-</u>	<u>21,087,765</u>
<b>Expenditures by account:</b>														
Salaries and wages:														
Regular	4,868,014	2,119,080	208,249	32,225	172,491	1,012,555	-	-	-	1,309,275	-	17,380	-	9,739,269
Overtime	56	65,332	11,803	-	17,000	106	-	-	-	52,496	-	8,635	-	155,428
Fringe benefits	1,073,999	389,727	45,434	6,841	26,667	251,086	-	-	-	282,631	-	5,737	-	2,082,122
Travel and transportation	25,551	111,471	-	7,528	173,123	79,631	-	-	-	259,650	34,191	34,328	-	725,473
Communications	26,751	23,727	4,616	4,585	4,112	40,374	-	-	-	8,479	399	2,107	-	115,150
Dues, membership, and subscriptions	-	-	-	-	3,479	2,255	-	-	-	4,350	-	-	-	10,084
Food stuffs	261,994	95,178	37	603	-	229,292	-	-	-	1,129	23,846	12,887	-	624,966
Port charges	11,356	27,061	-	-	-	1,418	-	-	-	870	1,065	46	-	41,816
Custom and tax	-	8,052	-	-	-	-	-	-	-	-	35	-	-	8,087
Capital outlays	115,130	484,159	14,869	-	3,785	117,739	-	-	-	76,000	66,915	-	-	878,597
Office supplies and materials	99,843	111,609	25,946	4,042	10,959	80,087	-	-	-	92,926	35,163	9,045	-	469,620
Books and instructional supplies	313,847	-	-	-	-	265,098	-	-	-	22,856	-	-	-	601,801
POL	88,933	21,383	5,007	827	2,109	85,864	-	-	-	64,195	7,145	3,570	-	279,033
Printing and reproduction	90	11,683	526	3,456	2,147	931	-	-	-	2,680	4,710	-	-	26,223
Rental services	135	3,732	-	-	5	2,532	-	-	-	12,887	11,675	-	-	30,966
Repairs and maintenance	17,632	3,001	1,478	408	3,330	21,827	-	-	-	6,029	-	2,565	-	56,270
Utilities	154,250	735,174	10,216	2,825	7,000	36,430	-	-	-	27,145	2,569	-	-	975,609
Subsidies and contributions	68,260	-	-	-	-	-	-	-	-	-	-	-	-	68,260
Medical referrals	-	465,916	-	-	-	-	-	-	-	-	-	-	-	465,916
Medical supplies	-	1,848,669	-	-	-	1,330	-	-	-	15,059	65,311	-	-	1,930,369
Contractual services	35,750	147,976	138,839	23,137	5,436	161,813	298,638	-	-	49,262	15,885	-	-	876,736
Scholarships and allowances	272,830	-	-	-	-	281,681	-	(200)	-	-	-	-	-	554,311
Housing allowance	-	87,000	-	-	-	240,158	-	-	-	7,532	-	-	-	334,690
Meeting allowance	720	3,160	680	-	-	1,700	-	-	-	11,366	1,280	-	-	18,906
Non-capital equipment and furnitures	67,398	18,341	-	-	1,406	6,798	-	-	-	3,496	-	586	-	98,025
Non-payroll compensation	13,685	10,740	-	-	-	8,975	-	-	-	7,690	5,725	-	-	46,815
Miscellaneous goods and services	-	848	-	-	-	-	-	-	-	4,473	7,665	35	-	13,021
Bank charges	-	-	-	-	-	-	-	-	-	-	33	-	-	33
Miscellaneous	-	4,456	-	-	-	-	-	-	-	-	5,049	-	-	9,505
Total expenditures	<u>7,516,224</u>	<u>6,797,475</u>	<u>467,700</u>	<u>86,477</u>	<u>433,049</u>	<u>2,929,680</u>	<u>298,638</u>	<u>(200)</u>	<u>-</u>	<u>2,322,476</u>	<u>288,661</u>	<u>96,921</u>	<u>-</u>	<u>21,237,101</u>
Excess (deficiency) of revenues over (under) expenditures	-	-	-	-	-	-	-	200	-	-	(149,536)	-	-	(149,336)
<b>Other financing uses:</b>														
Operating transfers out	-	-	-	-	-	-	-	-	-	-	-	-	(1,954,828)	(1,954,828)
Net change in fund balances (deficit)	-	-	-	-	-	-	-	200	-	-	(149,536)	-	(1,954,828)	(2,104,164)
Fund balances (deficit) at the beginning of the year	7,116	4,787	(26,186)	537	1,184	7,493	18,969	43,988	35,588	-	38,936	-	1,954,828	2,087,240
Fund balances (deficit) at the end of the year	\$ 7,116	\$ 4,787	\$ (26,186)	\$ 537	\$ 1,184	\$ 7,493	\$ 18,969	\$ 44,188	\$ 35,588	\$ -	\$ (110,600)	\$ -	\$ -	\$ (16,924)

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**

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

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Pohnpei as of and for the year ended September 30, 2012, which collectively comprise the State of Pohnpei's basic financial statements and have issued our report thereon dated June 21, 2013. Our report includes a reference to other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of the Pohnpei Transportation Authority and the Small Business Guarantee and Finance Corporation, as described in our report on the State of Pohnpei's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those 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 Pohnpei Utilities Corporation, the Pohnpei Port Authority, and the Pohnpei State Housing Authority, which were all audited by us. We have issued separate reports on our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters for these entities. Other auditors issued separate reports 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 the Pohnpei Transportation Authority and the Small Business Guarantee and Finance Corporation. The findings, if any, included in those reports are not included herein.

**Internal Control Over Financial Reporting**

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

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.

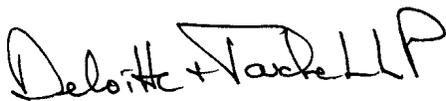
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined previously. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying Schedule of Findings and Questioned Costs (pages 70 and 71) as item 2012-1 that we consider to be significant deficiencies in internal control over financial reporting. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weaknesses, yet important enough to merit attention by those charged with governance.

#### Compliance and Other Matters

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

The State of Pohnpei's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the State of Pohnpei's response and, accordingly, we express no opinion on it.

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



June 21, 2013

**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**

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

Compliance

We have audited the State of Pohnpei'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 State of Pohnpei's major federal programs for the year ended September 30, 2012. The State of Pohnpei's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (pages 70 and 71). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the State of Pohnpei's management. Our responsibility is to express an opinion on the State of Pohnpei's compliance based on our audit.

As discussed in Note 2B to the Schedule of Expenditures of Federal Awards, the State of Pohnpei's basic financial statements include the operations of certain entities whose federal awards are not included in the Schedule of Expenditures of Federal Awards for the year ended September 30, 2012. Our audit, described below, did not include the operations of the entities identified in Note 2B as these entities conducted separate audits in accordance with OMB Circular A-133, if required.

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

In our opinion, the State of Pohnpei complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2012. However, the results of our auditing procedures disclosed 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 item 2012-1.

## Internal Control Over Compliance

Management of the State of Pohnpei is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the State of Pohnpei's internal control over compliance with the requirements that could have a direct and material effect on a major federal program 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 State of Pohnpei's internal control over compliance.

*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.

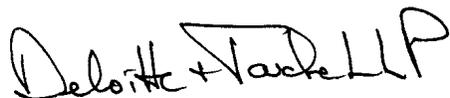
Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies as described in the accompanying Schedule of Findings and Questioned Costs as item 2012-1. *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.

## Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Pohnpei as of and for the year ended September 30, 2012, and have issued our report thereon dated June 21, 2013, which contained an unqualified opinion on those financial statements. Our report includes a reference to other auditors. Our audit was conducted for the purpose of forming our opinions on the financial statements that collectively comprise the State of Pohnpei's financial statements. We did not audit the financial statements of the Pohnpei Transportation Authority and the Small Business Guarantee and Finance Corporation which represent 4%, 1% and 3%, respectively, of the assets, net assets and operating revenues of the discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the Pohnpei Transportation Authority and the Small Business Guarantee and Finance Corporation is based on the reports of the other auditors. The accompanying Schedule of Expenditures of Federal Awards (pages 65 through 68) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of Federal Awards is fairly stated in all material respects in relation to the financial statements as a whole.

The State of Pohnpei's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the State of Pohnpei's response and, accordingly, we express no opinion on the response.

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

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

June 21, 2013

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Summary Schedule of Expenditures of Federal Awards, by Grantor  
Year Ended September 30, 2012

Agency/Program	Expenditures
U.S. Department of Agriculture	\$ 54,379
U.S. Department of the Interior	19,065,730
U.S. Department of Homeland Security	-
U.S. Department of Education	1,121,139
U.S. Department of Health and Human Services	999,692
GRAND TOTAL	\$ 21,240,940

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

Direct from the U.S. Department of Health and Human Services:

Consolidated Health Centers (Community Health Centers, Migrant  
Health Centers, Health Care for the Homeless, Public Housing  
Primary Care and School Based Health Centers)

93.224      \$ 286,855

Reconciliation to the basic financial statements:

Other Nonmajor Funds	\$ 2,308,560
Grants Assistance Fund	21,237,101
Less:	
Non-U.S. Grants	(288,661)
CFSM Grants	(96,921)
Non-federal	(1,919,139)
	\$ 21,240,940

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2012

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF AGRICULTURE		
US Grants Forest Invasive Species FY07	10.660	\$ -
Cooperative Forestry Assistance	10.664	54,379
Community Facilities Loans and Grants	10.766	<u>-</u>
U.S. DEPARTMENT OF AGRICULTURE TOTAL		<u>\$ 54,379</u>
U.S. DEPARTMENT OF THE INTERIOR		
Economic, Social and Political Development of the Territories:	15.875	
Compact of Free Association Sector Grants:		
Compact II Education Sector		\$ 7,516,224
Compact II Health Sector		6,797,475
Compact II Capacity Building Sector		433,049
Compact II Environment Sector		467,700
Compact II Private Sector		86,477
Compact II Supplemental Education		2,929,680
Compact II Infrastructure Fund		298,638
Compact II Infrastructure Maintenance		389,421
Section 221b Special Block Grant		(200)
Technical Assistance:		
Survey and Mapping		4,778
Historic Preservation Fund Grants-In-Aid	15.904	<u>142,488</u>
U.S. DEPARTMENT OF THE INTERIOR TOTAL		<u>\$ 19,065,730</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2012

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF HOMELAND SECURITY		
Disaster Grants - Public Assistance (Presidentially Declared Disasters)	97.036	\$ <u>          -</u>
U.S. DEPARTMENT OF HOMELAND SECURITY		\$ <u><u>          -</u></u>
See accompanying notes to Schedule of Expenditures of Federal Awards.		
U.S. DEPARTMENT OF EDUCATION		
Special Education - Grants to States	84.027	\$ <u>      1,121,139</u>
U.S. DEPARTMENT OF EDUCATION TOTAL		\$ <u><u>      1,121,139</u></u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2012

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES		
Affordable Care Act (ACA) Personal Responsibility Education Program	93.092	\$ 8,110
Project Grants and Cooperative Agreements for Tuberculosis		
Control Programs	93.116	35,727
Technical and Non-Financial Assistance to Health Centers	93.129	4,116
Family Planning - Services	93.217	56,472
Consolidated Health Centers	93.224	286,855
Substance Abuse and Mental Health Services - Projects of Regional and National Significance	93.243	-
Universal Newborn Screening	93.251	25,082
Immunization Cooperative Agreements	93.268	116,522
ACA: CDC & Prevention-Investigations & Technical Assistance	93.283	99,529
ARRA Grants to Health Center Programs	93.703	31,946
HIV Care Formula Grants	93.917	1,591
HIV Prevention Activities-Health Department Based	93.940	93,903
HIV/AIDS Surveillance	93.944	967
Block Grants for Prevention and Treatment of Substance Abuse	93.959	113,470
Preventive Health Services - Sexually Transmitted Diseases Control Grants	93.977	-
Cooperative Agreements for State-Based Diabetes Control		
Programs and Evaluation of Surveillance Systems	93.988	12,246
Preventive Health and Health Services Block Grant	93.991	3,441
Maternal and Child Health Services Block Grant to the States	93.994	82,590
CCPI Cancer Program	93.999	21,884
Others	N/A	<u>5,241</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES TOTAL		<u>\$ 999,692</u>
GRAND TOTAL		<u>\$ 21,240,940</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2012

1. Scope

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

A. Programs Subject to Single Audit

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

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

2. Summary of Significant Accounting Policies

A. Basis of Accounting

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

B. Reporting Entity

For purposes of complying with The Single Audit Act of 1984, as amended in 1996, the State's reporting entity is defined in Note 1A to its September 30, 2012 basic financial statements; and all of the discretely presented component units are excluded. Accordingly, the accompanying Schedule of Expenditures of Federal Awards presents the federal award programs administered by the State, as defined above, for the year ended September 30, 2012.

C. Subgrantees

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

D. Indirect Cost Allocation

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

E. CFDA #15.875

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

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2012

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

*Financial Statements*

- |  |             |
|--|-------------|
| 1. Type of auditors' report issued:                      | Unqualified |
| Internal control over financial reporting:               |             |
| 2. Material weakness(es) identified?                     | No          |
| 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?  | No          |
| 6. Significant deficiency(ies) identified?  | Yes         |
| 7. Type of auditors' report issued on compliance for major programs   | Unqualified |
| 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>Name of Federal Program or Cluster</u>	<u>CFDA Numbers</u>
Economic, Social and Political Development of the Territories – Compact of Free Association Compact Sector Grants	15.875
Historic Preservation Grants-in-Aid	15.904
Special Education – Grants to States	84.027

- |  |           |
|--|-----------|
| 10. Dollar threshold used to distinguish between Type A and Type B Programs: | \$637,228 |
| 11. Auditee qualified as low-risk auditee?                                   | Yes       |

**Part II – Financial Statements Findings Section**

<u>Finding #</u>	<u>Finding</u>
2012-1	Equipment and Real Property Management

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

<u>Finding #</u>	<u>CFDA #</u>	<u>Finding</u>	<u>Questioned Costs</u>
2012-1	15.875	Equipment and Real Property Management	\$ -

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2012

Finding No.: 2012-1  
Federal Agency: U.S. Department of the Interior  
CFDA Program: 15.875 Economic, Social and Political Development of the Territories  
Grant Number: Compact Sector Grants  
Requirement: Equipment and Real Property Management  
Questioned Cost: \$0

Criteria: Management should periodically review asset maintenance activities to facilitate compliance with program objectives and requirements.

Condition: No documented procedures are currently in place requiring that fixed assets undergo required maintenance.

Cause: This appears to be a weakness in internal control requiring that fixed assets be periodically maintained.

Effect: The expected life of fixed assets may be lessened. However, no questioned costs result from this finding as no specific instances came to our attention in fiscal year 2012 of unnecessary expenditures that occurred due to this condition.

Prior Year Status: Noncompliance with maintenance of fixed assets was reported in prior Single Audits as items 2007-4, 2008-2, 2009-1, 2010-1, and 2011-1.

Recommendation: We recommend that the State strengthen internal control requiring that periodic reviews be performed and that asset maintenance activities be documented and monitored.

Auditee Response and Corrective Action Plan: Similar with previous years, this year's maintenance plan of fixed assets is documented in every purchase of fixed asset, and without it, the purchase will not be approved. The maintenance plan includes schedule of maintenance, frequency of maintenance, type of maintenance/repair and often the assigned individual who should be responsible for the maintenance. We intensify our plan by ensuring that every department should follow through their maintenance schedule as planned for the newly purchased assets as well as those operational because obviously each department has their responsibility to ensure maintenance/repair takes place. As a result, a number preventive/repair maintenance schedules were provided to us by the various departments such as the Department of Health and Services, etc. In the report, maintenance procedures were performed by in-house staff or paid individuals; and also included in the report was the estimated annual service cost. We agree that the lack of budget is an obstacle why a number of fixed assets were not repaired however we extensively utilize our in-house maintenance staff to overcome this. For example, regular computer check-ups are done by in-house IT staff (as a result computers were maintained to withstand wear and tear and virus attack), vehicle checks – change oil, water level check-up – were done also by maintenance staff. Building repairs were regularly performed by staff – for example, the tiles at the Governor's office building which are being chipped off are being repaired on a regular basis. And other medical equipments are regularly maintained because they are still under warranty.

Should Deloitte would want to see a maintenance for specific fixed asset – such that individual service schedule is attached to each vehicle and assets - we don't think that's practical considering our limited resources.

**STATE OF POHNPEI  
FEDERATED STATES OF MICRONESIA**

Schedule of Prior Audit Findings  
Year Ended September 30, 2012

Prior Audit Findings

The status of unresolved prior audit findings is disclosed within the Schedule of Findings and Questioned Costs section of this report (pages 70 and 71).