

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

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**REPORT ON THE AUDIT OF  
FINANCIAL STATEMENTS IN ACCORDANCE  
WITH THE UNIFORM GUIDANCE**

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**YEAR ENDED SEPTEMBER 30, 2016**

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2016

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**STATE OF KOSRAE  
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**INDEPENDENT AUDITORS' REPORT,  
FINANCIAL STATEMENTS  
AND ADDITIONAL INFORMATION**

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**YEAR ENDED SEPTEMBER 30, 2016**

## **INDEPENDENT AUDITORS' REPORT**

Honorable Lyndon Jackson  
Governor, State of Kosrae  
Federated States of Micronesia:

### **Report on the Financial Statements**

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 Kosrae (the State) as of and for the year ended September 30, 2016, and the related notes to the financial statements, which collectively comprise the State's basic financial statements as set forth in Section III of the foregoing table of contents.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

Our responsibility is to express opinions on these financial statements based on our audit. 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

## **Opinions**

In our opinion, the financial statements referred to above 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 Kosrae as of September 30, 2016, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

## **Emphasis-of-Matters**

### *New Accounting Pronouncements*

As described in Note 1 to the financial statements, the State adopted Governmental Accounting Standards Board (GASB) Statement No. 72, *Fair Value Measurement and Application*, effective October 1, 2015. As a result, the State has elected to restate the beginning net position of the governmental activities and the beginning fund balance of the General Fund for the effect of adopting this accounting pronouncement.

### *Restatement*

As discussed in Note 12 to the financial statements, the beginning net position of the governmental activities and the beginning fund balance of the General Fund have been restated to correct an error.

### *Receivables from the FSM National Government*

As discussed in Note 3 to the financial statements, the State is in discussions with the FSM National Government to determine the ultimate collectability of certain receivables due from the FSM National Government in consultation with federal grantor agencies arising from Compact sector grant transactions.

Our opinion is not modified with respect to these matters.

## **Other Matters**

### *Required Supplementary Information*

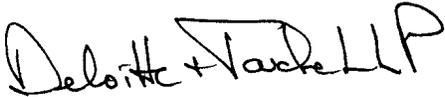
Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 10 as well as the Schedule of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual - General Fund and notes thereto, on pages 46 and 47, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the GASB 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.

## *Other Information*

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

## ***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated June 30, 2017, 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* in considering the State's internal control over financial reporting and compliance.

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

June 30, 2017

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis  
September 30, 2016

This analysis, prepared by the Department of Administration and Finance, offers readers of the Kosrae State Government's ("Kosrae State") financial statements a narrative overview of the activities of the government for the fiscal year ended September 30, 2016. We encourage readers to consider this information in conjunction with Kosrae State's financial statements, which follow. Fiscal year 2015 comparative information has been included, where appropriate. This analysis is required by the Governmental Accounting Standards Board (GASB) which provides guidelines on what must be included and excluded from this analysis.

**FINANCIAL HIGHLIGHTS**

- Kosrae State's total net position for the fiscal year ended September 30, 2016 increased by \$11.83 million (or 42%) from \$27.88 million in the prior year to \$39.71 million, as restated, in the current year. The increase is mainly due to a donated \$12.91 million bridge received from a foreign government.
- For fiscal year ended September 30, 2016, the State's General Fund unassigned fund deficit has increased to \$1.04 million from \$0.94 million, as restated, in the prior year or an increase of \$0.1 million. GASB defines unassigned fund balance as a residual fund balance that is not restricted, committed and assigned.
- For the year ended September 30, 2016, the General Fund total fund balance increased by \$0.52 million from \$1.40 million, as restated, in fiscal year 2015 to \$1.92 million in fiscal year 2016. The increase was due to the excess of revenues and other financing sources of \$4.23 million over expenditures of \$3.72 million.

Restatement

The beginning net position of the governmental activities and the beginning fund balance of the General Fund have been restated as the State (a) corrected an error as discussed in Note 12 to the financial statements and (b) adopted GASB Statement No. 72, *Fair Value Measurement and Application*, effective October 1, 2015 as described in Note 1 to the financial statements.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This discussion and analysis is intended to serve as an introduction to Kosrae State's basic financial statements. Kosrae State's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements.

This report also contains additional required supplementary information in the form of budgetary schedules, which are prepared on the budgetary basis of accounting, and other optional supplementary information, in addition to the basic financial statements themselves, which includes combining statements for governmental funds.

Government-Wide Financial Statements

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

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis  
September 30, 2016

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

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

The government-wide financial statements of Kosrae State are divided into two categories:

- Governmental activities- Most of Kosrae State's basic services are included here, such as education, health, special appropriations, finance, judiciary, and general administration. Compact sector and other federal grants finance most of these activities.
- Component Units-Kosrae State includes the operating results of the Kosrae Utilities Authority, Kosrae Port Authority and Kosrae Housing Authority in its report. Although separate, these "component units" are important because Kosrae State is financially accountable for them.

Fund Financial Statements

The fund financial statements provide more detailed information about Kosrae State's significant funds. Funds are accounting devices that Kosrae State uses to keep track of specific sources of funding and spending for particular services. The State uses fund accounting to comply with financial and related legal requirements. 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.

Most of Kosrae State's basic services are included in governmental funds, which focus on (1) how cash and other financial assets, which can be readily converted to cash, flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds financial statements provide a detailed short-term view that helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance Kosrae State programs. Because this information does not encompass the additional long-term focus of the government-wide statements, we provide additional information at the bottom of the governmental funds statements, or on the subsequent page, that explains and reconciles the relationship (or differences) between them.

The State maintains individual governmental funds, which are categorized as major and non-major. The major funds comprise the General Fund, the Grants Assistance Fund, and the Compact Trust Fund.

**FINANCIAL ANALYSIS OF KOSRAE STATE AS A WHOLE**

Kosrae State's assets at the end of fiscal year 2016 exceeded liabilities by \$39.71 million. The bulk of the amount is from net investment in capital assets, although \$6.92 million are restricted. Kosrae State uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although Kosrae State's net investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The following summary of Kosrae State's net position as of September 30, 2016, with comparable balances for the fiscal year 2015, discloses this relationship:

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis  
September 30, 2016

	Government Activities			
	2016	(As Restated) 2015	Change	%
<b>ASSETS</b>				
Current and other assets	\$ 10,203,861	\$ 10,049,540	\$ 154,321	2%
Capital assets	36,417,194	23,675,340	12,741,854	54%
Total assets	<u>\$ 46,621,055</u>	<u>\$ 33,724,880</u>	<u>\$ 12,896,175</u>	<u>38%</u>
<b>LIABILITIES</b>				
Long-term debt	\$ 4,454,355	\$ 3,944,367	\$ 509,988	13%
Current and other liabilities	2,452,065	1,898,010	554,055	29%
Total liabilities	<u>6,906,420</u>	<u>5,842,377</u>	<u>1,064,043</u>	<u>18%</u>
<b>NET POSITION</b>				
Net investment in capital assets	34,605,315	22,542,008	12,063,307	54%
Restricted	6,921,766	7,969,036	(1,047,270)	-13%
Unrestricted	<u>(1,812,446)</u>	<u>(2,628,541)</u>	<u>816,095</u>	<u>-31%</u>
Total Net Position	<u>\$ 39,714,635</u>	<u>\$ 27,882,503</u>	<u>\$ 11,832,132</u>	<u>42%</u>

At the end of fiscal year 2016, Kosrae State's unrestricted net position showed a deficit of \$1.81 million, a decrease of \$0.82 million as compared with the prior year. The increase in overall net position of \$11.83 million was due primarily to \$12.74 million net increase in capital assets. The unrestricted deficit, however, is the result of having current and long-term commitments that are greater than currently available resources. Specifically, Kosrae State did not include in past annual budgets the full amounts needed to finance its current liabilities to vendors and others or its long-term liabilities arising from Asian Development Bank (ADB) loans. Kosrae State will include these amounts in future year's budgets as funding permits.

The net position increased by \$11.83 million (or 42%) compared with prior year and the key elements of the differences from the prior year are shown in the following schedule.

	Governmental Activities			
	2016	(As Restated) 2015	Change	%
<b>Revenues:</b>				
Operating grants and contributions	\$ 10,156,647	\$ 8,888,152	\$ 1,268,495	14%
Capital grants and contributions	12,913,260	-	12,913,260	100%
Charges for services	501,941	454,830	47,111	10%
Revenue sharing	1,096,733	1,009,802	86,931	9%
Unrestricted investment earnings	187,313	205,688	(18,375)	-9%
Taxes	435,377	403,154	32,223	8%
Other	<u>791,536</u>	<u>55,606</u>	<u>735,930</u>	<u>1323%</u>
Total revenues	<u>26,082,807</u>	<u>11,017,232</u>	<u>15,065,575</u>	<u>137%</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

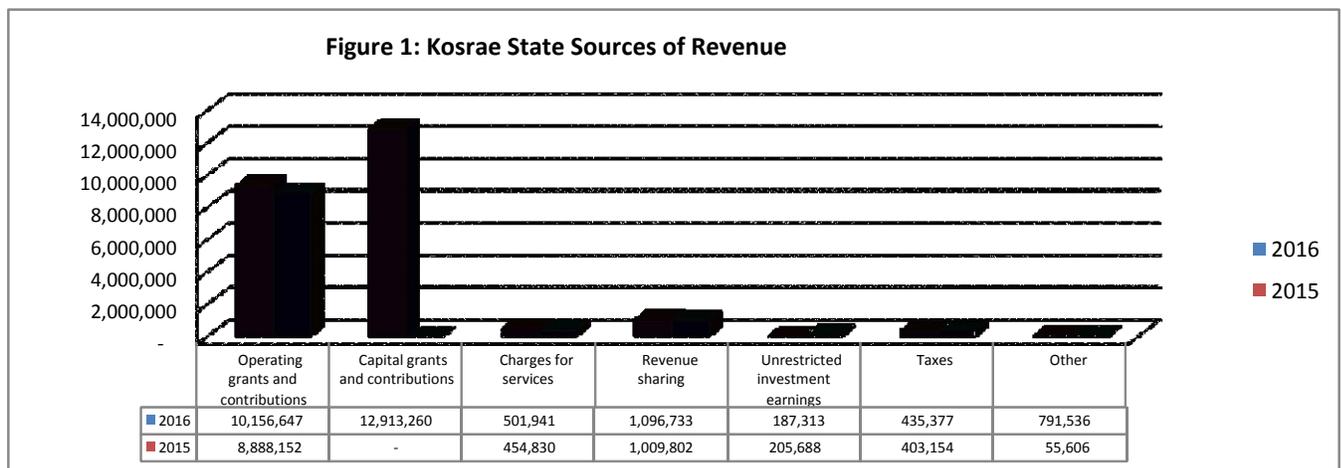
Management's Discussion and Analysis  
September 30, 2016

	Governmental Activities			
	2016	(As Restated) 2015	Change	%
Expenses:				
General government	1,933,644	1,798,590	135,054	8%
Education	4,878,720	4,710,620	168,100	4%
Health services	3,490,378	2,987,869	502,509	17%
Economic development	337,404	833,952	(496,548)	-60%
Boards, commissions and other	3,177,422	1,280,344	1,897,078	148%
Environment protection and sanitation	409,185	334,209	74,976	22%
Public order and safety	338,457	357,777	(19,320)	-5%
Unallocated interest	39,048	41,962	(2,914)	-7%
Total expenses	<u>14,604,258</u>	<u>12,345,323</u>	<u>2,258,935</u>	<u>18%</u>
Special item - SDR foreign exchange	(36,896)	643,534	(680,430)	-106%
Contributions to permanent fund	390,479	(205,087)	595,566	-290%
Change in net position	11,832,132	(889,644)	12,721,776	1430%
Net position at the beginning of the year	<u>27,882,503</u>	<u>28,772,147</u>	<u>(889,644)</u>	<u>-3%</u>
Net position at the end of the year	<u>\$ 39,714,635</u>	<u>\$ 27,882,503</u>	<u>\$ 11,832,132</u>	<u>42%</u>

Figure 1 below showed that the total revenues in fiscal year 2016 of \$26.08 million increased by \$15.07 million (or 137%) from the prior year's \$11.02 million. The increase was primarily due to capital grants and contributions this year of more than \$12.91 million. In fiscal year 2016, excluding the capital contributions, operating grants and contributions revenues comprised 77% of all Kosrae State funding sources whereas revenue sharing and local revenues comprised 23%.

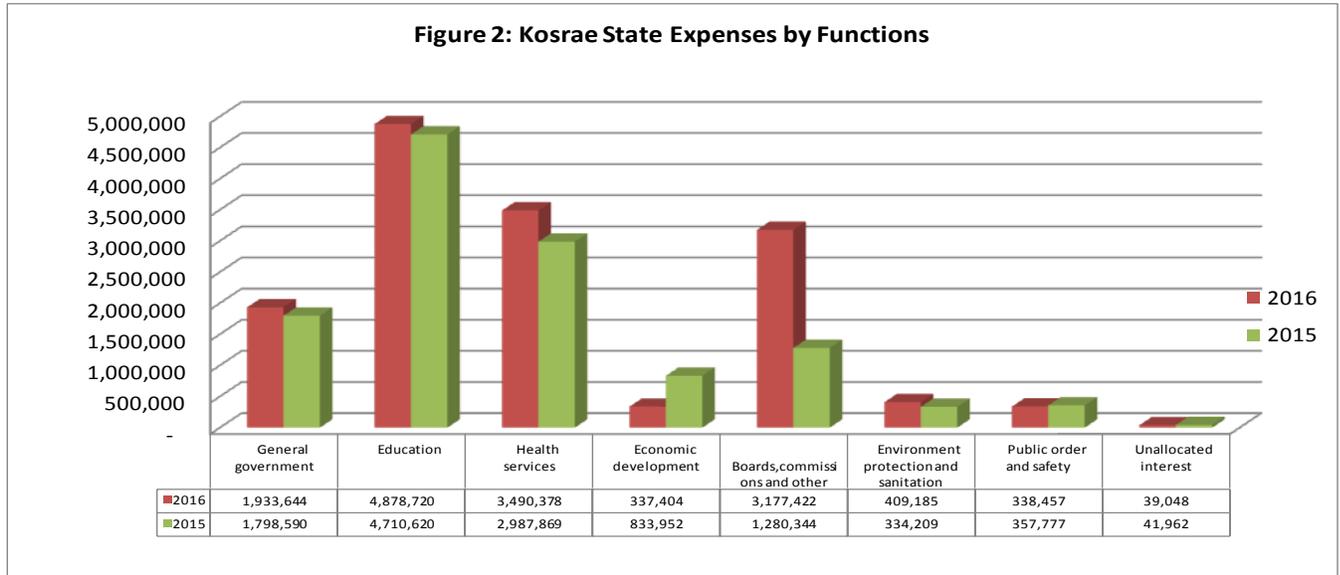
Figure 2 presents that total expenses of \$14.60 million reflected an 18% increase from prior year expenses of \$12.34 million.

The following graphs show the major components of revenues and expenses for the year ended September 30, 2016.



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis  
September 30, 2016



**FINANCIAL ANALYSIS OF KOSRAE STATE'S GOVERNMENTAL FUNDS**

As noted earlier, Kosrae State uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. As of the end of fiscal year 2016, Kosrae State governmental funds reported a combined fund balance of \$7.86 million, which represents a \$0.41 million decrease from the \$8.27 million, as restated, recorded at the end of fiscal 2015. The slight decrease was attributable mainly to the following: positive change in fund balances for General Fund of \$0.51 million and Compact Trust of \$0.39 million or a total of \$0.90 million against the combined negative changes in fund balances of Grants Assistance Fund and Other Governmental Funds of \$1.31 million resulting in a negative \$0.41 million. Taking into consideration the positive result of the implementation of GASB 72 of \$0.56 million; the resultant net effect was a decrease of \$0.41 million in fiscal year 2016. Of the total combined fund balance of \$7.86 million, \$6.51 million is designated as non-spendable fund balance; \$1.98 million is restricted fund balance; \$0.42 million is committed fund balance and (\$1.05 million) for unassigned fund deficit.

The General Fund is the main operating fund of the State. At the end of the current fiscal year, the unassigned fund deficit was \$1.04 million, which increased by \$0.1 million from \$0.94 million, as restated, in the prior year. Consequently, the total fund balance for the General Fund increased by \$0.52 million from \$1.4 million, as restated, in fiscal year 2015 to \$1.92 million in the current year. The net change in fund balance was a positive \$0.52 million, which was mainly due to the transfers-in from the Grants Assistance Fund of \$0.74 million.

The Grants Assistance Fund has a total fund balance of \$0.66 million. The net decrease in fund balance during the current year was \$0.72 million or (52%), which primarily was the result of the transfer out to the General Fund of \$0.74 million.

The Compact Trust Fund has a total fund balance of \$4.34 million, all of which is restricted for the funding of future operations of the primary government commencing in fiscal year 2023. The increase in fund balance during the current year was \$0.39 million or 9.88%, which corresponds to the net increase in the fair value of investments for the year.

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Management's Discussion and Analysis  
September 30, 2016

**GENERAL FUND BUDGETARY HIGHLIGHTS**

During the course of the fiscal year, management and elected officials of Kosrae State Government made several revisions to the General Fund budget. For the year ended September 30, 2016, General Fund revenues of \$2.73 million, excluding other financing sources, were deficient against expenditures of \$3.77 million. The deficiency was offset by other financing sources of \$1.5 million. These other financing sources were: operating transfers-in from the Grants Assistance Fund of \$0.74 million, and the proceeds of issuance of long-term debt of \$0.76 million. The net change in fund balance was a positive \$0.47 million.

**CAPITAL ASSET AND DEBT ADMINISTRATION**

Capital Assets

Kosrae State's net investment in capital assets for the primary government as of September 30, 2016 amounted to \$82.55 million, net of accumulated depreciation of \$46.13 million, resulting in a net book value of \$36.42 million. The net increase in capital assets of \$12.74 million was mainly due to contribution of infrastructure asset by the People's Republic of China in the amount of \$12.9 million.

The table below summarizes Kosrae State's capital assets:

	Governmental Activities			
	2016	(As Restated) 2015	Change	%
Buildings	\$ 12,020,345	\$ 12,606,217	\$ (585,872)	-5%
Infrastructure	22,642,811	9,185,559	13,457,252	147%
Machinery, equipment and others	1,754,038	1,883,564	(129,526)	-7%
	<u>\$ 36,417,194</u>	<u>\$ 23,675,340</u>	<u>\$ 12,741,854</u>	<u>54%</u>

Additional information on Kosrae State's capital assets can be found in note 5 to the financial statements.

Long-Term Debt

The following schedule shows Kosrae State's long-term debt obligations for fiscal year 2016 with comparative balances from fiscal year 2015.

	Governmental Activities			
	2016	2015	Change	%
ABD Loans	\$ 4,347,164	\$ 3,829,641	\$ 517,523	14%
Malem Water	107,191	114,726	(7,535)	-7%
	<u>\$ 4,454,355</u>	<u>\$ 3,944,367</u>	<u>\$ 509,988</u>	<u>13%</u>

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FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis  
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The State's long-term debt increased by \$0.51 million or 13% due primarily to additional loans for the OMIP Project of \$0.76 million made during the year less principal repayment of \$0.25 million. Additional information on Kosrae State's long-term debt obligations can be found in notes 6 and 7 to the financial statements.

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

General Fund

Revenues for the six months ending March 31, 2017 showed a slight increase of \$0.06 million or 8% as compared to the same period in fiscal year 2016. The expenditures however for the six months ending March 31, 2017 showed an increase of \$0.08 million or 10% compared to the same period in fiscal year 2016. This could result in a deficiency of revenues under expenditures at the end of fiscal year 2017.

The leaders of Kosrae State are aware of the current financial situation of the government and have taken steps for the implementation of the Long-Term Fiscal Framework (LTFF) through a task force created in the 2012 Kosrae Leadership Conference. The LTFF identified steps for reforms to remedy the financial burden of the State in the ensuing years. The LTFF has been implemented in FY 2014.

Other measures are also being considered to increase General Fund revenues.

Grant Assistance Funds

Grants Assistance Funds (specifically Compact funding) will continue to be the major funding source for Kosrae State in fiscal year 2017 with total approved funding of \$6,974,184 as follows:

Education Sector	\$2,430,379
Health Sector	\$2,041,835
Environment Sector	\$ 324,712
Private Sector	\$ 499,087
Capacity Building Sector	\$ 339,208
Supplemental Education Grant	\$1,145,032
Enhanced Reporting Accountability	\$ 193,931

In addition, the combined US Federal pass-through and direct grants for FY 2017 amounted to more than \$ 1 million.

**CONTACTING KOSRAE STATE'S FINANCIAL MANAGEMENT**

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors, a general overview of Kosrae State's finances to demonstrate its accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Director of Administration and Finance; P.O. Box 878, Kosrae, FM, 96944.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Statement of Net Position  
September 30, 2016

	Primary Government	Component Units
<b><u>ASSETS</u></b>		
Current assets:		
Cash and cash equivalents	\$ 417,446	\$ 831,096
Time certificate of deposit	-	166,225
Investments	-	319,286
Receivables, net	1,300,275	729,619
Inventories	-	198,445
Prepayments	124,907	15,015
Advances	50,844	-
Due from component units	50,000	-
Restricted assets:		
Cash and cash equivalents	583,024	-
Time certificate of deposit	-	200,000
Total current assets	2,526,496	2,459,686
Noncurrent assets:		
Capital assets:		
Nondepreciable capital assets	-	69,305
Capital assets, net of accumulated depreciation	36,417,194	19,009,354
Investments	1,139,176	-
Other noncurrent assets	820,000	252,800
Due from component units	46,296	-
Restricted assets:		
Time certificates of deposit	354,383	-
Investments	5,317,510	-
Total noncurrent assets	44,094,559	19,331,459
Total assets	\$ 46,621,055	\$ 21,791,145
<b><u>LIABILITIES</u></b>		
Current liabilities:		
Current portion of long-term obligations	\$ 209,223	\$ -
Accounts payable	274,270	189,588
Contracts payable	695,073	-
Other liabilities and accruals	327,379	136,265
Due to primary government	-	50,000
Unearned revenues	1,045,343	28,361
Total current liabilities	2,551,288	404,214
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	4,245,132	-
Due to primary government	-	46,296
Other noncurrent liabilities	110,000	-
Total noncurrent liabilities	4,355,132	46,296
Total liabilities	6,906,420	450,510
Commitments and contingencies		
<b><u>NET POSITION</u></b>		
Net investment in capital assets	34,605,315	19,078,659
Restricted for:		
Nonexpendable:		
Future operations	4,339,794	-
Expendable:		
Debt service	977,716	-
Compact related	48,979	-
Other purposes	1,555,277	90,000
Unrestricted	(1,812,446)	2,171,976
Total net position	39,714,635	21,340,635
Total liabilities and net position	\$ 46,621,055	\$ 21,791,145

See accompanying notes to financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Statement of Activities  
Year Ended September 30, 2016

Functions/Programs	Expenses	Program Revenues		Net (Expenses) Revenues and Changes in Net Position		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government	Component Units
Primary government:						
Governmental activities:						
General government	\$ 1,933,644	\$ 501,941	\$ 1,907,755	\$ -	\$ 476,052	\$ -
Economic development	337,404	-	370,362	-	32,958	-
Education	4,878,720	-	4,358,803	-	(519,917)	-
Health services	3,490,378	-	3,216,819	-	(273,559)	-
Public order and safety	338,457	-	-	-	(338,457)	-
Environment protection and sanitation	409,185	-	302,908	-	(106,277)	-
Boards, commissions and other	3,177,422	-	-	12,913,260	9,735,838	-
Unallocated interest on long-term debt	39,048	-	-	-	(39,048)	-
Total primary government	<u>\$ 14,604,258</u>	<u>\$ 501,941</u>	<u>\$ 10,156,647</u>	<u>\$ 12,913,260</u>	<u>8,967,590</u>	<u>-</u>
Component units:						
Kosrae Port Authority	\$ 1,211,179	\$ 435,106	\$ -	\$ -	-	(776,073)
Kosrae Utilities Authority	2,330,680	2,462,828	-	-	-	132,148
Kosrae Housing Authority	147,266	20,156	812,186	-	-	685,076
Total component units	<u>\$ 3,689,125</u>	<u>\$ 2,918,090</u>	<u>\$ 812,186</u>	<u>\$ -</u>	<u>-</u>	<u>41,151</u>
General revenues:						
Taxes:						
FSM revenue sharing:						
Gross revenue taxes					323,975	-
Import taxes					327,993	-
Income taxes					346,932	-
Other taxes					97,833	-
State taxes					435,377	-
Unrestricted investment earnings					187,313	21,953
Other					791,536	-
Total general revenues					<u>2,510,959</u>	<u>21,953</u>
Special item - loss on SDR foreign exchange					(36,896)	-
Contributions to permanent fund					390,479	-
Total general revenues, special item and contributions					<u>2,864,542</u>	<u>21,953</u>
Change in net position					<u>11,832,132</u>	<u>63,104</u>
Net position at the beginning of the year, as previously reported					26,567,441	21,277,531
Prior period adjustment (Notes 1 and 12)					1,315,062	-
Net position at the beginning of the year, as restated					<u>27,882,503</u>	<u>21,277,531</u>
Net position at the end of the year					<u>\$ 39,714,635</u>	<u>\$ 21,340,635</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Balance Sheet

Governmental Funds  
September 30, 2016

		Special Revenue	Permanent		
	General	Grants Assistance	Compact Trust	Other Governmental Funds	Total
<b>ASSETS</b>					
Cash and cash equivalents	\$ 417,446	\$ -	\$ -	\$ -	\$ 417,446
Investments	1,139,176	-	-	-	1,139,176
Receivables, net:					
General	3,462	-	-	30,346	33,808
Federal agencies	-	351,539	-	-	351,539
Due from FSM National Government	695,073	-	-	-	695,073
Taxes	189,855	-	-	-	189,855
Loans	30,000	-	-	-	30,000
Due from component units	96,296	-	-	-	96,296
Due from other funds	64,613	1,611,013	-	456,484	2,132,110
Prepaid items	104,022	10,624	-	10,261	124,907
Advances	34,532	16,312	-	-	50,844
Other assets	627,000	100,000	-	93,000	820,000
Restricted assets:					
Cash and cash equivalents	543,513	-	-	39,511	583,024
Time certificates of deposit	-	-	-	354,383	354,383
Investments	977,716	-	4,339,794	-	5,317,510
Total assets	<u>\$ 4,922,704</u>	<u>\$ 2,089,488</u>	<u>\$ 4,339,794</u>	<u>\$ 983,985</u>	<u>\$ 12,335,971</u>
<b>LIABILITIES AND FUND BALANCES</b>					
Liabilities:					
Accounts payable	\$ 95,738	\$ 156,061	\$ -	\$ 22,471	\$ 274,270
Contracts payable	695,073	-	-	-	695,073
Other liabilities and accruals	146,650	170,035	-	10,694	327,379
Due to other funds	2,067,497	53,914	-	10,699	2,132,110
Unearned revenues	-	1,045,310	-	33	1,045,343
Total liabilities	<u>3,004,958</u>	<u>1,425,320</u>	<u>-</u>	<u>43,897</u>	<u>4,474,175</u>
Fund balances:					
Non-spendable	1,981,025	100,000	4,339,794	93,000	6,513,819
Restricted	977,716	564,168	-	438,198	1,980,082
Committed	-	-	-	416,612	416,612
Unassigned:					
General fund	(1,040,995)	-	-	-	(1,040,995)
Special revenue funds	-	-	-	(7,722)	(7,722)
Total fund balances	<u>1,917,746</u>	<u>664,168</u>	<u>4,339,794</u>	<u>940,088</u>	<u>7,861,796</u>
Total liabilities and fund balances	<u>\$ 4,922,704</u>	<u>\$ 2,089,488</u>	<u>\$ 4,339,794</u>	<u>\$ 983,985</u>	

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

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds

36,417,194

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:

Long-term debt payable (4,454,355)  
Claims payable (110,000)

(4,564,355)

Net position of governmental activities

\$ 39,714,635

See accompanying notes to financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures, and Changes in Fund Balances  
Governmental Funds  
Year Ended September 30, 2016

	General	Special Revenue Grants Assistance	Permanent Compact Trust	Other Governmental Funds	Total
<b>Revenues:</b>					
Compact funding	\$ -	\$ 6,865,116	\$ -	\$ -	\$ 6,865,116
Net change in the fair value of investments	149,235	-	390,479	-	539,714
Federal contributions	-	1,737,341	-	-	1,737,341
FSM revenue sharing	1,096,733	-	-	-	1,096,733
State taxes	435,377	-	-	-	435,377
CFSM grants	-	-	-	558,241	558,241
Fees and charges	223,371	-	-	278,570	501,941
Other grants	-	235,246	-	-	235,246
Interest income	35,573	-	-	2,505	38,078
Other	791,536	-	-	-	791,536
Total revenues	<u>2,731,825</u>	<u>8,837,703</u>	<u>390,479</u>	<u>839,316</u>	<u>12,799,323</u>
<b>Expenditures:</b>					
<b>Current:</b>					
General government	1,261,582	572,267	-	46,296	1,880,145
Economic development	-	370,362	-	13,187	383,549
Education	83,963	4,358,803	-	-	4,442,766
Health services	-	3,216,819	-	276,641	3,493,460
Public order and safety	331,742	-	-	-	331,742
Environment protection and sanitation	-	302,908	-	106,277	409,185
Boards, commissions and other	1,714,099	-	-	988,156	2,702,255
Debt service	326,657	-	-	-	326,657
Total expenditures	<u>3,718,043</u>	<u>8,821,159</u>	<u>-</u>	<u>1,430,557</u>	<u>13,969,759</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(986,218)</u>	<u>16,544</u>	<u>390,479</u>	<u>(591,241)</u>	<u>(1,170,436)</u>
<b>Other financing sources (uses):</b>					
Operating transfers in	740,298	-	-	-	740,298
Operating transfers out	-	(740,298)	-	-	(740,298)
Proceeds from issuance of long-term debt	760,702	-	-	-	760,702
Total other financing sources (uses), net	<u>1,501,000</u>	<u>(740,298)</u>	<u>-</u>	<u>-</u>	<u>760,702</u>
Net change in fund balances	<u>514,782</u>	<u>(723,754)</u>	<u>390,479</u>	<u>(591,241)</u>	<u>(409,734)</u>
Fund balances at the beginning of the year, as previously reported	1,031,761	1,387,922	3,949,315	1,531,329	7,900,327
Prior period adjustment (Notes 1 and 12)	371,203	-	-	-	371,203
Fund balances at the beginning of the year, as restated	<u>1,402,964</u>	<u>1,387,922</u>	<u>3,949,315</u>	<u>1,531,329</u>	<u>8,271,530</u>
	<u>\$ 1,917,746</u>	<u>\$ 664,168</u>	<u>\$ 4,339,794</u>	<u>\$ 940,088</u>	<u>\$ 7,861,796</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE  
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, 2016

Amounts reported for governmental activities in the statement of activities are different from changes in fund balances because:

Net change in fund balances - total governmental funds	\$ (409,734)
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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 (\$1,621,709) exceeded capital outlays (\$1,450,303) in the current period.	(171,406)
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Some capital additions were donated by the People's Republic of China.	12,913,260
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Special item associated with loss on SDR foreign exchange adjustment.	(36,896)
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The incurrence 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 position. For the current year, these amounts consist of:

Proceeds from ADB loans	\$ (760,702)	
Repayment of ADB loans	280,075	
Repayment of RUS loan	<u>7,535</u>	
		(473,092)

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 claims payable	<u>10,000</u>
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Change in net position of governmental activities	\$ <u><u>11,832,132</u></u>
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See accompanying notes to financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Combining Statement of Net Position

Component Units  
September 30, 2016

<u>ASSETS</u>	Kosrae Port Authority	Kosrae Utilities Authority	Kosrae Housing Authority	Total
Current assets:				
Cash and cash equivalents	\$ 54,264	\$ 706,892	\$ 69,940	\$ 831,096
Time certificate of deposit	-	166,225	-	166,225
Investments	-	319,286	-	319,286
Time certificate of deposit - restricted	-	-	200,000	200,000
Receivables:				
General	123,629	214,488	-	338,117
Loan	-	-	1,960,576	1,960,576
	123,629	214,488	1,960,576	2,298,693
Allowance for doubtful debts	(74,286)	(49,728)	(1,445,060)	(1,569,074)
Net receivables	49,343	164,760	515,516	729,619
Inventories	-	198,445	-	198,445
Prepayments	-	15,015	-	15,015
Total current assets	<u>103,607</u>	<u>1,570,623</u>	<u>785,456</u>	<u>2,459,686</u>
Noncurrent assets:				
Deposit for fuel purchase contract	-	252,800	-	252,800
Capital assets:				
Nondepreciable capital assets	-	69,305	-	69,305
Capital assets, net of accumulated depreciation	<u>16,676,397</u>	<u>2,329,760</u>	<u>3,197</u>	<u>19,009,354</u>
Total assets	\$ <u>16,780,004</u>	\$ <u>4,222,488</u>	\$ <u>788,653</u>	\$ <u>21,791,145</u>
<u>LIABILITIES AND NET POSITION</u>				
Current liabilities:				
Accounts payable	\$ 24,417	\$ 164,502	\$ 669	\$ 189,588
Accrued liabilities	88,746	40,907	6,612	136,265
Due to primary government	-	-	50,000	50,000
Unearned revenues	-	28,361	-	28,361
Total current liabilities	<u>113,163</u>	<u>233,770</u>	<u>57,281</u>	<u>404,214</u>
Non-current liabilities:				
Due to primary government portion	-	-	46,296	46,296
Total liabilities	<u>113,163</u>	<u>233,770</u>	<u>103,577</u>	<u>450,510</u>
Net position:				
Net investment in capital assets	16,676,397	2,399,065	3,197	19,078,659
Restricted	-	90,000	-	90,000
Unrestricted	<u>(9,556)</u>	<u>1,499,653</u>	<u>681,879</u>	<u>2,171,976</u>
Total net position	<u>16,666,841</u>	<u>3,988,718</u>	<u>685,076</u>	<u>21,340,635</u>
Total liabilities and net position	\$ <u>16,780,004</u>	\$ <u>4,222,488</u>	\$ <u>788,653</u>	\$ <u>21,791,145</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Combining Statement of Revenues, Expenses, and Changes in Net Position

Component Units  
Year Ended September 30, 2016

	<u>Kosrae Port Authority</u>	<u>Kosrae Utilities Authority</u>	<u>Kosrae Housing Authority</u>	<u>Total</u>
Operating revenues:				
Charge for services	\$ <u>435,106</u>	\$ <u>2,462,828</u>	\$ <u>20,156</u>	\$ <u>2,918,090</u>
Operating expenses:				
Cost of services	-	1,267,662	-	1,267,662
Depreciation and amortization	799,184	328,475	799	1,128,458
Administration and general	<u>411,995</u>	<u>708,741</u>	<u>146,467</u>	<u>1,267,203</u>
Total operating expenses	<u>1,211,179</u>	<u>2,304,878</u>	<u>147,266</u>	<u>3,663,323</u>
Operating income (loss)	<u>(776,073)</u>	<u>157,950</u>	<u>(127,110)</u>	<u>(745,233)</u>
Nonoperating revenues (expenses):				
Asset impairment loss	-	(22,265)	-	(22,265)
Interest income	-	1,254	-	1,254
Net change in fair value of investments	-	20,699	-	20,699
Interest expense	-	(3,537)	-	(3,537)
Contributions from primary government	-	-	797,529	797,529
Subsidy from FSM National Government	<u>-</u>	<u>-</u>	<u>14,657</u>	<u>14,657</u>
Total nonoperating revenues (expenses), net	<u>-</u>	<u>(3,849)</u>	<u>812,186</u>	<u>808,337</u>
Change in net position	(776,073)	154,101	685,076	63,104
Net position at beginning of year	<u>17,442,914</u>	<u>3,834,617</u>	<u>-</u>	<u>21,277,531</u>
Net position at end of year	\$ <u>16,666,841</u>	\$ <u>3,988,718</u>	\$ <u>685,076</u>	\$ <u>21,340,635</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(1) Summary of Significant Accounting Policies

The State of Kosrae (the State) was constituted on January 11, 1984, under the provisions of the Kosrae State Constitution (the Constitution) as approved by the people of Kosrae. 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, Pohnpei and Yap. The State is a constitutional government comprised of three branches: the Legislative Branch, consisting of 14 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 KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(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:

**Kosrae Port Authority (KPA):** KPA was created by Kosrae State Law (KSL) No. 7-91 to operate, manage, equip, and maintain all ports of entry and to expand and improve upon services offered at the ports of entry. KPA is governed by a five-member Board of Directors, of which four members are appointed by the Governor subject to the advice and consent of the Legislature, and, ex-officio, the Director of the Department of Transportation and Infrastructure. The State has the ability to impose its will on KPA.

**Kosrae Utilities Authority (KUA):** KUA was created by KSL No. 5-38 and is responsible for operating and maintaining, on a commercially accepted basis, the State's electric power. KUA is governed by a five-member Board of Directors, of which four members are appointed by the Governor subject to the advice and consent of the Legislature and, ex-officio, the Director of the Department of Transportation and Infrastructure. The State has the ability to impose its will on KUA.

**Kosrae Housing Authority (KHA):** KHA was created by KSL No. 10-113 and is responsible for managing and investing funds of Kosrae Home Improvement Program and other funds of the Kosrae Housing Authority and lending money to qualified Kosraeans who wish to build and maintain residential homes in Kosrae. KHA is governed by a five-member Board of Directors, of which four members are appointed by the Governor subject to the advice and consent of the Legislature. The State has the ability to impose its will on KHA. KHA became a component unit of the state in October 2015. The State's Home Improvement Program Revolving Fund transferred \$513,387 of fund balance existing at September 30, 2015 and designated for the operations of KHA to the newly created KHA during the current year. Additionally, cash of \$96,296 resulted from the transfer, which the State has recorded as a receivable from KHA. This receivable will be repaid over a period of 15 months.

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 727  
Tofol, Kosrae, FSM 96944

B. Government-Wide Financial Statements

The Statement of Net Position 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.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

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 Position presents all of the reporting entity's non-fiduciary assets, deferred outflows of resources, liabilities, and deferred inflows of resources, with the difference reported as net position. Net position is reported in the following categories:

- Net investment in capital assets 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 position - 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 position- expendable consists of resources in which the State is legally or contractually obligated to spend resources in accordance with restrictions either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.
- Unrestricted net position consists of net position, which does not meet the definition of the three preceding categories. Unrestricted net position often is designated, (for example, internally restricted), to indicate that management does not consider such to be available for general operations.

The government-wide Statement of Net Position reports \$6,921,766 of restricted net position, of which \$1,555,277 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.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

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.

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.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

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.

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 Fund - 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. 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 a maturity date 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 position/balance sheet.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

F. Investments

Investments and related investment earnings of the primary government and the discretely presented component units are recorded at fair value using quoted market prices. Fair value is the price that would be received to sell an asset or paid to transfer a liability (ie., the exit price) in an orderly transaction between market participants at the date as of which the fair value of an asset or liability is determined.

The State categorizes its fair value measurements within the fair value hierarchy established by GAAP. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs. In certain instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy is based on the lowest level of input that is significant to the fair measurement. Investments not categorized under the fair value hierarchy are shown at either Net Asset Value (NAV) or amortized cost.

G. 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.

H. 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.

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

**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

J. 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 valued at the lower of cost (FIFO) or market.

K. Restricted Assets

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through loan agreements or enabling legislation. Specifically, the State has collateralized investments in the amount of \$977,716 for the Early Retirement Scheme. Furthermore, investments recorded in the Compact Trust Fund of \$4,339,794 are restricted in that they are not available to be used in current operations.

As of September 30, 2016, cash and cash equivalents and time certificates of deposit were restricted for the following uses:

Primary Government:

Deposit account established for the purpose of receiving payments pursuant to the Compact of Free Association, as amended.	\$ 543,513
Deposit account established for the Gifford scholarship fund.	39,511
Time certificate of deposit with a local bank restricted for scholarships for post-secondary students.	<u>354,383</u>
	\$ <u>937,407</u>

Discretely Presented Component Units:

Time certificate of deposit for the 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 State, the trustee of the Loan Guarantee Escrow Account.	\$ <u>200,000</u>
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L. Other Assets

The State holds approximately 9.1% of the outstanding shares of Pacific Islands Development Bank with a carrying value of \$820,000. This equity interest does not meet the definition of an investment as the asset is held primarily for economic development and is presented as other assets in the accompanying financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

M. Capital Assets

Capital assets, including property, plant, equipment and infrastructure (e.g. roads, bridges, ramps and other similar items), are reported in the governmental activity column of the government-wide financial statements. Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair market value at the date of donation. Singular pieces of machinery and equipment, other than vehicles, that equal or exceed \$50,000 are capitalized. Buildings and infrastructure projects with a cost that equals or exceeds \$100,000 are capitalized. The costs of normal maintenance and repairs that do not add to the value of assets or materially extend asset lives are not capitalized.

All vehicles have been grouped together regardless of cost and depreciated on a composite basis.

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	10 - 40 years
Infrastructure - roads and bridges	5 - 50 years
Machinery, equipment and others	5 - 10 years

N. Deferred Outflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. The State has no items that qualify for reporting in this category.

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 200 hours per year. All unused annual leave is cancelled at the end of each fiscal year. Accordingly, no liability is recorded for compensated absences in the accompanying financial statements.

P. Unearned Revenues

In the government-wide financial statements, unearned revenue is recognized when cash, receivables or other assets are recorded prior to their being earned. In the governmental fund financial statements, unearned 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 unearned revenue in the governmental fund financial statements has primarily resulted as federal funds are received in advance of eligible expenditures.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

Q. Deferred Inflows of Resources

In addition to liabilities, the statements of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. The State has no items that qualify for reporting in this category.

R. 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.

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.

S. Interfund/Intrafund Transactions

As a general rule, the effect of interfund activity has been eliminated in the government-wide 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 KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

T. New Accounting Standards

During fiscal year 2016, the State implemented the following pronouncements:

- GASB Statement No. 72, *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements and requires entities to expand their fair value disclosures by determining major categories of debt and equity securities within the fair value hierarchy on the basis of the nature and risk of the investment. The implementation of this statement required additional disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques. Additionally, the implementation resulted in the re-measurement of equity investment from cost-basis to the net asset value (NAV), as cost-basis measurement is no longer an allowable measurable method for equity investment. Such implementation had a material effect on the accompanying financial statements resulting in the restatement of the State's beginning net position/fund balance. Net position for governmental activities and fund balance for the General Fund as of October 1, 2015 increased by \$566,202 as a result of the implementation of GASB Statement No. 72. Refer to Note 2B for more information regarding the State's investments.
- GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which eliminates two of the four categories of authoritative GAAP that exist under the existing hierarchy prescribed by Statement No. 55. The two categories that will remain under the new standard are (1) GASB Statements and (2) GASB technical bulletins and implementation guides in addition to AICPA guidance that the GASB clears. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, addresses for certain external investment pools and their participants the accounting and financial reporting implications that result from changes in the regulatory provisions referenced by previous accounting and financial reporting standards. Those provisions were based on the Investment Company Act of 1940, Rule 2a7. Rule 2a7 contains the Securities and Exchange Commission's regulations that apply to money market funds and were significantly amended in 2014. The implementation of this statement did not have a material effect on the accompanying financial statements.

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements No. 67 and No. 68 with the reporting requirements in Statement No. 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

T. New Accounting Standards, Continued

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, as amended*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB). The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, as amended*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements. The provisions in Statement No. 77 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In December 2015, GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, which addresses a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The provisions in Statement No. 78 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units. The provisions in Statement No. 80 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The provisions in Statement No. 81 are effective for fiscal years beginning after December 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

T. New Accounting Standards, Continued

In March 2016, GASB issued Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The provisions in Statement No. 82 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

U. 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. However, no material losses have been sustained from this practice in the last three years.

V. Estimates

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

W. 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, 2015 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.

**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(2) Deposits and Investments, Continued

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:

- 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.

The Secretary of Administration and Finance shall be responsible for investment of all public funds collected or appropriated for use by the State. Funds under this arrangement shall include all appropriations from the State, whether funds are appropriated from the State Treasury or funds from other sources. Any funds in excess of the amount necessary for the operation of the State shall be deposited or invested to earn the safest optimum interest. The Secretary shall determine the amount to be invested with the consideration that such amount should not cause disruption of any government service due to low or lack of funds in the operational budget. The Secretary shall cause all investments to be made into financially secure institutions in Kosrae or abroad as determined by the financial institution paying the highest rate of interest on savings when the investment is made.

The investment policy for the Compact Trust Fund (the Trust Fund), which was adopted by the Trust Fund Committee on September 15, 2010 and amended through December 17, 2013 requires the Trust Fund to allocate its managed investment portfolios among domestic and foreign equity and fixed income securities. All or a portion of the Trust Fund may be invested in exchange traded funds ("ETFs"), mutual funds, real estate investment trusts ("REITs"), separate accounts and common trust funds (commingled vehicles), hedge funds, private equity funds, and other pooled investment vehicles ("pooled vehicles"). A common trust fund is similar to an open-ended investment company or mutual fund, but participation is limited to investors with trust accounts. Commingled and pooled vehicles that invest exclusively in marketable fixed income securities are considered to be fixed income securities for the purpose of compliance with the Trust Fund's investment policy.

**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(2) Deposits and Investments, Continued

The fair values of ETFs, mutual funds, and common trust funds are generally determined by the fair value of the underlying marketable equity and debt securities owned, which are principally common stocks and bonds, respectively. Publicly traded ETFs, mutual funds, and similar vehicles may trade at prices above or below the fair values of the underlying investments held; therefore the fair value of such investments may differ from the sum of the fair values of the underlying investments owned. The core fixed income portfolios may be invested in debt securities issued by the U.S. government and government agencies, foreign governments, domestic and international corporate securities, including asset-backed and mortgage-backed obligations. The fixed income portfolio may invest in convertible and high yield debt securities; however the average quality of the fixed income portfolio must be rated "investment grade" by at least one nationally recognized rating agency at the time of purchase. The Trust Fund's fixed income investment objective is for each portfolio to achieve total return similar to a relevant index, such as Barclays Capital Aggregate Index and the Bank of America Merrill Lynch Global High Yield Index.

The Trust Fund's equity investment objective is for its various portfolios to achieve total returns similar to their benchmark equity indices. Benchmark indices include the Russell 3000, the S&P 500 and the MSCI EAFE.

Private equity funds are a form of pooled investment vehicle, typically limited partnerships controlled by a private equity firm that acts as general partner. The general partner seeks to obtain specific dollar commitments from qualified institutional and accredited investors to invest capital in the fund as limited partners. The passive limited partners fund pro rata portions of their commitments when the general partner has identified an appropriate opportunity, which may be venture capital in the form of equity securities, convertible debt securities, or real estate for which no active markets exist. Venture capital is often used to finance new products and technologies, expand working capital, make acquisitions, or finance leveraged buyouts. A typical private equity fund could make between 15 and 25 separate investments over a ten-year life, with no single investment exceeding 10% of the total capital commitment. The fair values of the underlying investments held by each private equity fund are generally determined by management of the equity investee or as determined by the general partner or manager of the private equity fund and is based upon the Trust Fund's percentage ownership of the underlying investments. Investments in private equity funds generally tend to be illiquid for significant periods of time.

Hedge funds are a form of pooled investment vehicle, generally a limited partnership or a foreign (off-shore) investment corporation, that seeks to maximize absolute returns whose offering memorandum allows for the fund to take both long and short positions, use leverage and derivatives, and invest in many markets. Hedge funds often take large risks using a broad range of speculative strategies, including investing in unconventional and illiquid investments. The fair value of the Trust Fund's investment in a hedge fund is determined by the hedge fund manager and is based upon the Trust Fund's percentage ownership of the underlying investments.

Commingled separate accounts invested in real estate and related assets are carried at fair value of the underlying investments. The fair value of separate account investments in real property real estate partnerships are generally determined based on independent appraisals obtained no less frequently than annually. The fair value of separate account investments in real estate partnerships are generally determined based upon the equity method of accounting, and the fair value of underlying investments in real estate loans and mortgages are generally determined through the use of cash flow forecasting or other models by management of the insurance company that manages the separate account.

**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(2) Deposits and Investments, Continued

Derivatives, options and future contracts are permitted investments for the purpose of reducing risk and efficient portfolio management. Derivatives, options and futures may not be used for speculative purposes.

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, 2016, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit was \$1,354,853 and the corresponding bank balance was \$1,611,428, which is maintained in financial institutions subject to FDIC insurance. As of September 30, 2016, bank deposits in the amount of \$382,741 were FDIC insured. The State does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Therefore, these deposits are exposed to custodial credit risk.

As of September 30, 2016, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit was \$1,197,321 and the corresponding bank balance was \$1,247,675, which were maintained in financial institutions subject to FDIC insurance. As of September 30, 2016, bank deposits in the amount of \$615,745 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.

B. Investments

Primary Government

As of September 30, 2016, the State's investments are as follows:

General Fund:	
Fixed income	\$ 295,535
Domestic equities	1,139,176
Common equities	656,676
Cash management account	<u>25,505</u>
	<u>2,116,892</u>
Compact Trust Fund:	
Common trust funds:	
Domestic Equity	1,185,027
International Equity	1,118,422
Fixed Income	827,529
Private Equity	321,229
Hedge Fund	378,951
Real Estate	491,960
Money market funds	<u>16,676</u>
	<u>4,339,794</u>
	\$ <u>6,456,686</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

As of September 30, 2016, the State's fixed income securities, including their Moody's investors service credit ratings, had the following maturities:

Investment Type	Fair Value	Investment Maturities (In Years)				Credit Ratings
		Current	1-5	6-10	Over 10	
U.S. Treasury Notes and Bonds	\$ 97,856	\$ 24,528	\$ 42,903	\$ 27,825	\$ 2,600	AAA
U.S. Government Agencies Obligations:						
Federal Home Loan Mortgage Corp.	17,987	12,996	616	-	4,375	AAA
Government National Mortgage Assoc.	235	-	-	-	235	AAA
Federal National Mortgage Association	19,592	-	12,656	-	6,936	AAA
Federal Home Loan Bank	15,716	15,716	-	-	-	AAA
Tennessee Valley Authority	3,928	-	-	3,928	-	AAA
AID-Tunisia	7,075	-	7,075	-	-	AAA
NCUA	3,541	3,541	-	-	-	AAA
Overseas Private Inv Corp	21,000	-	-	21,000	-	AAA
Private Export Funding	7,439	-	-	7,439	-	AAA
Municipal Obligations	5,520	-	4,231	-	1,289	AAA
Municipal Obligations	8,389	-	4,613	1,819	1,957	Aa
Corporate Bonds	15,932	5,952	5,894	4,086	-	AAA
Corporate Bonds	37,332	10,501	26,831	-	-	Aa
Corporate Bonds	25,502	-	6,683	3,927	14,892	A
Corporate Bonds	5,877	-	2,854	3,023	-	Baa
Corporate Bonds	<u>2,614</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,614</u>	No Rating
	<u>\$ 295,535</u>	<u>\$ 73,234</u>	<u>\$ 114,356</u>	<u>\$ 73,047</u>	<u>\$ 34,898</u>	

The State has the following recurring fair value measurements as of September 30, 2016:

General Fund:

	Total	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Investments by fair value level:				
Fixed income:				
U.S. Treasury obligations	\$ 97,856	\$ -	\$ 97,856	\$ -
U.S. Government Agencies	96,513	-	96,513	-
Municipal obligations	13,909	-	13,909	-
Corporate notes	<u>87,257</u>	<u>-</u>	<u>87,257</u>	<u>-</u>
	295,535	-	295,535	-
Equity securities:				
U.S. equities	<u>656,676</u>	<u>656,676</u>	<u>-</u>	<u>-</u>
Total investments at fair value	952,211	\$ <u>656,676</u>	\$ <u>295,535</u>	\$ <u>-</u>
Investments measured at NAV:				
Equity investment in Bank of the FSM	1,139,176			
Investments measured at amortized cost:				
Cash management account	<u>25,505</u>			
	<u>\$ 2,116,892</u>			

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

Compact Trust Fund:

	<u>Total</u>	<u>Fair Value Measurements Using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments by fair value level:				
Common trust funds:				
Domestic Equity	\$ 1,185,027	\$ 1,185,027	\$ -	\$ -
International Equity	1,118,422	1,118,422	-	-
Fixed Income	827,529	827,529	-	-
Private Equity	<u>321,229</u>	<u>-</u>	<u>-</u>	<u>321,229</u>
Total investments at fair value	3,452,207	\$ <u>3,130,978</u>	\$ <u>-</u>	\$ <u>321,229</u>
Investments measured at NAV:				
Hedge Fund	378,951			
Real Estate	491,960			
Investments measured at amortized cost:				
Money market funds	<u>16,676</u>			
	<u>\$ 4,339,794</u>			

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, 2016.

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.

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.

The Trust Fund's fixed income allocation consists of a Mercer Investment Management Opportunistic Fixed Income mutual fund ("MIM OFI") and a Mercer Investment Management Core Fixed Income Fund ("MIM CFI"); the performance of these funds is expected to closely replicate the performance of 50% of the JP Morgan Government Bond Index Emerging Market Global Diversified Index and 50% Bank of America/Merrill Lynch Global High Yield and the Barclays Capital U.S. Aggregate Bond Index, respectively. The bonds held by MIM CFI vary in credit quality with an average overall rating of "Aa3" as rated by Moody's as of September 30, 2016. High yield debt receiving a credit rating below "A" comprises approximately 32.2% of the MIM CFI fixed income portfolio as rated by Moody's at September 30, 2016. At September 30, 2016, the weighted average maturity of the bonds comprising MIM CFI is 8.23 years.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

The bonds held by MIM OFI vary in credit quality with an average overall rating of "BB" as rated by Moody's as of September 30, 2016. High yield debt receiving a credit rating below "A" comprises approximately 83.6% of the MIM OFI fixed income portfolio as rated by Moody's at September 30, 2016. At September 30, 2016, the weighted average maturity of the bonds comprising MIM OFI is 3.70 years.

The Trust Fund's investment policy does not require direct investment in fixed maturity securities ("Bonds") as a means of managing its exposure to loss of principal due to increasing interest rates. The Trust Fund's investment policy requires the performance of each investment class to be periodically compared with an associated benchmark. Bonds and bond funds generally decrease in value in response to rising interest rates. Bonds, however, have a fixed date of maturity and do not have exposure to loss of principal from rising interest rates, whereas shares of a common trust fund, ETF, or similar investment vehicle have no maturity date.

The Trust Fund's exposure to foreign currency risk is derived from its investment in common trust funds, ETFs and REITs that hold investments in securities of foreign issuers and sovereigns. Foreign currency risk is the risk that changes in foreign exchange rates will adversely affect the fair values of an investment or deposit. At September 30, 2016, the Trust Fund held approximately \$1,407,000 in securities of foreign issuers held in common trust funds. Of this amount, approximately \$303,000 was held in securities whose functional currency is the Euro, \$168,000 whose functional currency is the British pound, \$155,000 whose functional currency is the Japanese yen, and \$781,000 in functional currencies of 35 other countries. Foreign currency exposure data is not available for the Trust Fund's investment in the Hedge Funds and its investments in Global Private Equity Funds, which comprise 16.4% of invested assets at September 30, 2016.

The Trust Fund's investment in hedge funds includes ownership of the Mercer Hedge Fund Series A ("Mercer Hedge Fund") and the Blackstone Partners Offshore Fund Ltd. Mercer Hedge Funds Investors SPC, who incorporated the Mercer Hedge Fund, and the Blackstone Partners Offshore Fund Ltd. are registered under the Mutual Funds Law of the Cayman Islands. The fair value of the Trust Fund's position in the hedge fund pools are equivalent to the value of the pool shares.

The State owns 50,000 shares of the outstanding common stock of the Bank of the Federated States of Micronesia, which engages in commercial banking services in the FSM. An equity investment in the common stock of the Bank of the Federated States of Micronesia (investee) is stated at the net asset value (NAV). The NAV is used as a practical expedient to estimate fair value. The NAV is determined based on the total shareholders' equities reported by the investee.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units

Kosrae Utilities Authority (KUA):

As of September 30, 2016, investments comprise the following:

Money market funds	\$ 6,001
Common equities	201,920
Fixed income	<u>111,365</u>
	<u>\$ 319,286</u>

As of September 30, 2016, the fixed income securities consist of the following:

		Investment maturities (In Years)			
		Fair Value	Less Than 1 Year	1 to 5 Years	6 to 10 Years
U.S. Government agencies	AAA	\$ 71,478	\$ 6,004	\$ 57,120	\$ 8,354
Corporate notes	A1	3,255	-	-	3,255
Corporate notes	A2	3,312	-	3,312	-
Corporate notes	A3	16,924	-	3,269	13,655
Corporate notes	BAA1	6,309	-	-	6,309
Corporate notes	BAA2	4,025	-	-	4,025
Corporate notes	BAA3	3,182	-	3,182	-
Corporate notes	BA3	<u>2,880</u>	<u>-</u>	<u>-</u>	<u>2,880</u>
		<u>\$ 111,365</u>	<u>\$ 6,004</u>	<u>\$ 66,883</u>	<u>\$ 38,478</u>

KUA has the following recurring fair value measurements as of September 30, 2016:

	Total	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Investments by fair value level:				
Fixed income:				
U.S. Government Agencies	\$ 71,478	\$ -	\$ 71,478	\$ -
Corporate notes	<u>39,887</u>	<u>-</u>	<u>39,887</u>	<u>-</u>
Total fixed income	111,365	-	111,365	-
Equity securities:				
U.S. equities	<u>201,920</u>	<u>201,920</u>	<u>-</u>	<u>-</u>
Total investments at fair value	313,285	<u>\$ 201,920</u>	<u>\$ 111,365</u>	<u>\$ -</u>
Investments measured at amortized cost:				
Money market funds	<u>6,001</u>			
	<u>\$ 319,286</u>			

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(3) Receivables

Primary Government

Receivables as of September 30, 2016, for the primary government's individual major funds and nonmajor 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:					
General	\$ 104,415	\$ -	\$ -	\$ 997,341	\$ 1,101,756
Federal agencies	-	351,539	-	-	351,539
Due from FSM National Government	695,073	-	-	-	695,073
Taxes	189,855	-	-	-	189,855
Loans	<u>30,000</u>	<u>762,630</u>	-	<u>32,593</u>	<u>825,223</u>
	1,019,343	1,114,169	-	1,029,934	3,163,446
Less: Allowance for uncollectible accounts	<u>(100,953)</u>	<u>(762,630)</u>	-	<u>(999,588)</u>	<u>(1,863,171)</u>
Net receivables	\$ <u>918,390</u>	\$ <u>351,539</u>	\$ <u>-</u>	\$ <u>30,346</u>	\$ <u>1,300,275</u>

The final settlement of receivables due from the FSM National Government arising from Compact sector grant transactions can be determined only by final action of the FSM National Government in consultation with the grantor agency. Management is of the opinion that collection efforts will be favorable and thus no allowance for uncollectible accounts is considered necessary.

Loans receivable of the primary government as of September 30, 2016 are as follows:

General Fund

Loan receivable due from Tropical Waters, Inc., uncollateralized and interest free. \$ 30,000

Grants Assistance Fund

Note receivable due from Pacific Tuna Ventures, Inc., payable in monthly installments of \$11,875, uncollateralized, due May 1996, interest at 3% per annum. This note has been fully provided for in the allowance for uncollectible accounts. \$ 367,500

Loans receivable from post-secondary students issued under a student financial assistance program to qualified Kosraean students, uncollateralized with interest at up to 6% per annum. These loans have been fully provided for in the allowance for uncollectible accounts. 395,130

\$ 762,630

Nonmajor Governmental Funds

Loans receivable from post-secondary students issued under a student financial assistance program to qualified Kosraean students, uncollateralized with interest at up to 6% per annum. These loans have been fully provided for in the allowance for uncollectible accounts. \$ 32,593

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(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, 2016, are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Grants Assistance	General	\$ 1,611,013
Nonmajor governmental funds	General	456,484
General	Nonmajor governmental funds	10,699
General	Grants Assistance	<u>53,914</u>
		\$ <u>2,132,110</u>
<u>Due from Component Unit</u>		

As described in Note 1, the State's Home Improvement Program Revolving Fund transferred \$513,387 of fund balance existing at September 30, 2015 and designated for the operations of the Kosrae Housing Authority (KHA) to the newly created KHA during the current year. Additionally, cash of \$96,296 resulted from the transfer, which the State has recorded as due from component unit. This receivable will be repaid over a period of 15 months.

During the current year, the State and KHA entered into agreement that \$50,000 is to be repaid in 2017 and \$46,296 in 2018.

(5) Capital Assets

Capital asset activities for the year ended September 30, 2016, are as follows:

Primary Government

	Balance October <u>1, 2015</u>	<u>Increases</u>	<u>Decreases</u>	Balance September <u>30, 2016</u>
Depreciable assets:				
Buildings	\$ 26,835,654	\$ -	\$ -	\$ 26,835,654
Infrastructure	32,925,368	15,810,337	-	48,735,705
Machinery, equipment, others	<u>6,786,298</u>	<u>189,527</u>	-	<u>6,975,825</u>
	<u>66,547,320</u>	<u>15,999,864</u>	-	<u>82,547,184</u>
Less accumulated depreciation:				
Buildings	(14,229,437)	(585,872)	-	(14,815,309)
Infrastructure	(25,376,110)	(716,784)	-	(26,092,894)
Machinery, equipment, others	<u>(4,902,734)</u>	<u>(319,053)</u>	-	<u>(5,221,787)</u>
	<u>(44,508,281)</u>	<u>(1,621,709)</u>	-	<u>(46,129,990)</u>
	22,039,039	14,378,155	-	36,417,194
Nondepreciable assets:				
Construction work-in progress	<u>1,636,301</u>	<u>1,260,776</u>	<u>(2,897,077)</u>	<u>-</u>
	<u>\$ 23,675,340</u>	<u>\$ 15,638,931</u>	<u>\$ (2,897,077)</u>	<u>\$ 36,417,194</u>

During the year ended September 30, 2016, the State recognized certain infrastructure capital assets of \$12,913,260 that were donated by the People's Republic of China.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(5) Capital Assets, Continued

During the year ended September 30, 2016, depreciation expense was charged as follows:

General government	\$ 53,499
Economic development	8,893
Education	460,224
Health services	107,137
Public safety	6,715
Boards, commissions and others	<u>985,241</u>
	<u>\$ 1,621,709</u>

Discretely Presented Component Units

	Balance October <u>1, 2015</u>	<u>Increases</u>	<u>Decreases</u>	Balance September <u>30, 2016</u>
Depreciable assets:				
Buildings	\$ 11,941,369	\$ -	\$ -	\$ 11,941,369
Utility plant	10,837,861	84,642	(297,280)	10,625,223
Infrastructure	37,972,012	-	-	37,972,012
Machinery, equipment, others	<u>924,968</u>	<u>21,178</u>	<u>-</u>	<u>946,146</u>
	61,676,210	105,820	(297,280)	61,484,750
Less accumulated depreciation	<u>(41,621,953)</u>	<u>(1,128,458)</u>	<u>275,015</u>	<u>(42,475,396)</u>
	20,054,257	(1,022,638)	(22,265)	19,009,354
Nondepreciable assets:				
Construction work-in-progress	<u>66,972</u>	<u>18,474</u>	<u>(16,141)</u>	<u>69,305</u>
	<u>\$ 20,121,229</u>	<u>\$ (1,004,164)</u>	<u>\$ (38,406)</u>	<u>\$ 19,078,659</u>

(6) Long-Term Obligations

Primary Government

Malem Wastewater System Project (MWSP) Loan:

The State borrowed \$145,000 from the U.S. Department of Agriculture Rural Utilities Services for the Malem Wastewater System Project, payable in annual installments of \$8,119 commencing September 28, 2001, interest at 4.5% per annum, due September 28, 2040. As of September 30, 2016, the balance payable on this loan amounted to \$107,191.

Asian Development Bank (ADB) Loans:

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 \$2,000,000 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.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(6) Long-Term Obligations, Continued

Primary Government, Continued

Asian Development Bank (ADB) Loans, Continued:

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

Funds for the repayment of the ADB loan are expected to be derived from the annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The Financing Agreement requires the State to continue to appropriate salaries for the abolished positions and deposit the appropriated funds into the ERS Trust Account. These funds had not been deposited to the Trust Account as of September 30, 2002. Of the required \$2,000,000 identified for future debt service payments, \$977,716 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, 2016, the balance payable on this loan amounted to \$1,634,723.

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 Loan with ADB (Loan Number 1816 FSM (SF)) for the purpose of funding the Basic Social Services Project, with interest at 1% to 1.5% per annum. Principal payments shall be made semiannually commencing February 1, 2009, with a maturity date of August 1, 2032. As of September 30, 2016, the balance payable on this loan amounted to \$96,348.

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 Kosrae, 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, 2016, the balances payable on these loans amounted to \$435,133 and \$476,272, respectively.

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 Loan with ADB (Loan Number 2099 FSM (SF)) for the purpose of funding the Omnibus Infrastructure Development Project, with interest at 1% to 1.5% per annum. Principal payments shall be made semiannually commencing 2013, with a maturity date of 2037. As of September 30, 2016, the balance payable on this loan amounted to \$1,704,688.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(6) Long-Term Obligations, Continued

Primary Government, 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>
2017	\$ 209,223	\$ 61,788	\$ 271,011
2018	249,357	57,951	307,308
2019	249,512	55,307	304,819
2020	249,674	51,856	301,530
2021	249,843	48,398	298,241
2022 – 2026	1,227,592	189,842	1,417,434
2027 – 2031	1,027,818	110,816	1,138,634
2032 – 2036	908,246	40,361	948,607
2037	<u>83,090</u>	<u>915</u>	<u>84,005</u>
	\$ <u>4,454,355</u>	\$ <u>617,234</u>	\$ <u>5,071,589</u>

(7) 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, 2016, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net position:

	<u>Balance October 1, 2015</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance September 30, 2016</u>	<u>Due Within One Year</u>
Loans payable:					
ADB loans:					
Loan 1520	\$ 1,681,923	\$ -	\$ (47,200)	\$ 1,634,723	\$ 39,986
Loan 1816	117,429	-	(21,081)	96,348	6,034
Loan 1873	486,711	-	(51,578)	435,133	45,949
Loan 1874	524,972	-	(48,700)	476,272	27,282
Loan 2099	<u>1,018,606</u>	<u>760,702</u>	<u>(74,620)</u>	<u>1,704,688</u>	<u>86,677</u>
	3,829,641	760,702	(243,179)	4,347,164	205,928
MWSP loan	<u>114,726</u>	-	<u>(7,535)</u>	<u>107,191</u>	<u>3,295</u>
	3,944,367	760,702	(250,714)	4,454,355	209,223
Other:					
Claims	<u>120,000</u>	-	<u>(10,000)</u>	<u>110,000</u>	-
	\$ <u>4,064,367</u>	\$ <u>760,702</u>	\$ <u>(260,714)</u>	\$ <u>4,564,355</u>	\$ <u>209,223</u>

When the ADB extends credit to a particular country, the loan is booked in Special Drawing Rights (SDRs) but the actual loan is delivered in the currency of the borrower, at the current exchange rate between the currency and the SDR. The value of the SDR is subject to periodic review by the International Monetary Fund, which may result in the recognition of a foreign exchange gain or loss. During the year ended September 30, 2016, the State recognized a foreign exchange loss of \$36,896 associated with valuation of the SDR, which is presented as a special item in the accompanying financial statements, and which results in an increase in ADB loans payable.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

**(8) Fund Balances**

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	\$ 138,553	\$ -	\$ -	\$ -	\$ 138,553
Economic development	30,000	-	-	-	30,000
Pacific Islands Development Bank	627,000	100,000	-	93,000	820,000
Bank of the FSM	1,139,176	-	-	-	1,139,176
Due from component unit	46,296	-	-	-	46,296
Permanent fund principal	-	-	4,339,794	-	4,339,794
Restricted for:					
General government	-	515,189	-	-	515,189
Debt service	977,716	-	-	-	977,716
Capital projects	-	48,979	-	47,281	96,260
Scholarships	-	-	-	390,917	390,917
Committed for:					
Education	-	-	-	6,359	6,359
Health services	-	-	-	262,900	262,900
Environment protection	-	-	-	97,699	97,699
Board, commissioners, others	-	-	-	49,654	49,654
Unassigned	<u>(1,040,995)</u>	<u>-</u>	<u>-</u>	<u>(7,722)</u>	<u>(1,048,717)</u>
	<u>\$ 1,917,746</u>	<u>\$ 664,168</u>	<u>\$ 4,339,794</u>	<u>\$ 940,088</u>	<u>\$ 7,861,796</u>

**(9) Operating Transfers In/Out**

**Primary Government**

Operating transfers in/out for each major governmental fund and nonmajor governmental funds in the aggregate, for the year ended September 30, 2016, are as follows:

<u>Source</u>	<u>Recipient</u>	<u>Transfers Out</u>	<u>Transfers In</u>
Grants Assistance Fund	General Fund	\$ <u>740,298</u>	\$ <u>740,298</u>

Transfers are used to 1) move revenues from the fund that enabling legislation or budget requires to collect them to the fund that enabling legislation or budget requires to expend them, 2) use unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations, and 3) record reductions in interfund loans for amounts that are not expected to be repaid. Specifically, the State transferred \$740,298 from the Grants Assistance Fund to the General Fund representing the residual fund balance of the Compact Capital Projects Fund.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
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(10) Commitments and Contingencies

Encumbrances

The State utilizes encumbrance accounting to identify fund obligations. Encumbrances represent commitments related to unperformed contracts for goods. At September 30, 2016, 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>48,628</u>	\$ <u>852,692</u>	\$ <u>98,089</u>	\$ <u>999,409</u>

Sick Leave

It is the policy of the State to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave as of September 30, 2016 is \$475,194.

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.

Federal Grants

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.

Litigation

The State is party to numerous legal proceedings, many of which are normal recurrences in governmental operations. The State's Attorney General is of the opinion that the probable outcome of suits existing at September 30, 2016, is not predictable but could have a material impact on the accompanying financial statements. Such impact has currently been estimated to approximate \$110,000, which has been recorded as a liability in the accompanying government-wide financial statements.

Other

The State issued certain reduction-in-force checks to State employees without withholdings. This matter is being discussed between the State and the FSM National Government and State management believes that no adverse impact on the accompanying financial statements will result.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2016

(11) Budgetary Compliance

For the year ended September 30, 2016, significant over-expenditures exceeded appropriations within the General Fund for the following:

Department of Transportation and Infrastructure	\$ 1,247,665
Debt service	\$ 326,657
Department of Administration and Finance	\$ 297,743
Department of Education	\$ 61,640

These over-expenditures of the General Fund have not been funded by legislative authorization. The over-expenditures for the Department of Transportation and Infrastructure was the result of additional ADB loan drawdowns for the Utwe Water Project of \$760,702 and unpaid contracts for \$500,074; the Department of Administration and Finance over-expenditures pertained to the escrow account of \$284,142 transferred to Kosrae Housing Authority; and the over-expenditures for the Department of Education was due to the CAT Team classroom construction in the amount of \$62,557.

(12) Restatement

Subsequent to the issuance of the 2015 financial statements, management of the State determined that capital assets of the governmental activities were understated by \$943,859; and that contracts payable in the General Fund were understated by \$194,999. Accordingly, account balances have been restated from the amounts previously reported as follows:

	Governmental <u>Activities</u>	General <u>Fund</u>
Implementation of GASB Statement No. 72 (Note 1)	\$ 566,202	\$ 566,202
Understatement of contracts payable	(194,999)	(194,999)
Understatement of capital assets	<u>943,859</u>	
Prior period adjustment	\$ <u>1,315,062</u>	\$ <u>371,203</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

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

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**YEAR ENDED SEPTEMBER 30, 2016**

**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

Schedule of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual  
General Fund  
Year Ended September 30, 2016

	<u>Budgeted Amounts</u>		Actual - Bugetary Basis	Variance with
	<u>Original</u>	<u>Final</u>	<u>(see Note 1)</u>	<u>Final Budget -</u>
Revenues:				
FSM revenue sharing	\$ 1,194,622	\$ 1,194,622	\$ 1,096,733	\$ (97,889)
State taxes	362,130	362,130	435,377	73,247
Licenses and fees	205,103	205,103	223,371	18,268
Interest and dividends	-	-	35,573	35,573
Other	<u>86,355</u>	<u>86,355</u>	<u>940,771</u>	<u>854,416</u>
Total revenues	<u>1,848,210</u>	<u>1,848,210</u>	<u>2,731,825</u>	<u>883,615</u>
Expenditures:				
Current:				
General government	1,031,595	1,033,215	1,284,083	(250,868)
Education	24,456	24,456	86,096	(61,640)
Public order and safety	344,666	344,666	345,736	(1,070)
Boards, commissions and other	<u>457,736</u>	<u>488,536</u>	<u>2,050,756</u>	<u>(1,562,220)</u>
Total expenditures	<u>1,858,453</u>	<u>1,890,873</u>	<u>3,766,671</u>	<u>(1,875,798)</u>
Deficiency of revenues under expenditures	<u>(10,243)</u>	<u>(42,663)</u>	<u>(1,034,846)</u>	<u>(992,183)</u>
Other financing sources:				
Operating transfers in	-	-	740,298	740,298
Proceeds from issuance of long-term debt	<u>-</u>	<u>-</u>	<u>760,702</u>	<u>760,702</u>
	<u>-</u>	<u>-</u>	<u>1,501,000</u>	<u>1,501,000</u>
Net change in fund balance	(10,243)	(42,663)	466,154	508,817
Encumbrances	38,024	38,024	48,628	10,604
Fund balance at the beginning of the year	<u>1,402,964</u>	<u>1,402,964</u>	<u>1,402,964</u>	<u>-</u>
Fund balance at the end of the year	<u>\$ 1,430,745</u>	<u>\$ 1,398,325</u>	<u>\$ 1,917,746</u>	<u>\$ 519,421</u>

See accompanying notes to required supplementary information - budgetary reporting.

**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

Notes to Required Supplementary Information – Budgetary Reporting  
September 30, 2016

(1) Budgetary Information

The Governor presents to the Kosrae 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 Kosrae State Legislature reviews and approves these estimates making changes, as it deems appropriate. The Appropriation Committee of the Kosrae State Legislature, during the regular session of the Kosrae State Legislature, holds public hearings at which time Departments and Offices are required to justify their budget estimates. During the regular session of the Kosrae State Legislature, an appropriation bill, as required by the Constitution, is introduced and budget estimates are then legally enacted by the Kosrae State Legislature.

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

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 KOSRAE  
FEDERATED STATES OF MICRONESIA**

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**OTHER SUPPLEMENTARY INFORMATION**

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**YEAR ENDED SEPTEMBER 30, 2016**

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Combining Schedule of Expenditures by Account  
Governmental Funds  
Year Ended September 30, 2016

	General	Special	Permanent	Other	Total
		Revenue	Compact	Governmental	
		Grants	Trust	Funds	
		Assistance			
Expenditures:					
Salaries and wages:					
Regular	\$ 1,123,444	\$ 3,783,849	\$ -	\$ 268,998	\$ 5,176,291
Overtime	30,653	121,958	-	-	152,611
Fringe benefits	147,613	491,922	-	36,458	675,993
Other personnel costs	675	9,046	-	-	9,721
Travel and transportation	78,231	332,586	-	109,206	520,023
Communications	38,737	84,232	-	4,745	127,714
Customs and tax	-	2,271	-	-	2,271
Dues, membership, and subscriptions	11,500	5,091	-	-	16,591
Food stuffs	19,806	27,850	-	1,356	49,012
Port charges	-	4,486	-	-	4,486
Office supplies and materials	86,513	862,025	-	133,726	1,082,264
POL	29,979	95,596	-	11,652	137,227
Printing and reproduction	990	24,474	-	-	25,464
Rental services	3,795	9,858	-	650	14,303
Repairs and maintenance	2,890	27,732	-	-	30,622
Utilities	106,219	313,652	-	6,109	425,980
Subsidies and contributions	75,377	-	-	-	75,377
Medical referral	-	32,810	-	-	32,810
Medical supplies	-	539,513	-	105,796	645,309
Contractual services	1,292,121	1,180,978	-	228,746	2,701,845
Professional services	-	39,215	-	-	39,215
Scholarships and allowances	2,080	198,561	-	-	200,641
Training	2,819	259,427	-	-	262,246
Leased housing, buildings and land	11,072	118,244	-	-	129,316
Nonpayroll compensation	1,940	941	-	-	2,881
Equipment	10,823	209,410	-	7,785	228,018
Payment to component units	284,142	-	-	513,387	797,529
Principal repayment	287,610	-	-	-	287,610
Interest payments	39,047	-	-	-	39,047
Miscellaneous	29,967	45,432	-	1,943	77,342
	<u>\$ 3,718,043</u>	<u>\$ 8,821,159</u>	<u>\$ -</u>	<u>\$ 1,430,557</u>	<u>\$ 13,969,759</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balance  
General Fund  
Year Ended September 30, 2016  
(with comparative totals for the year ended September 30, 2015)

	<u>2016</u>	<u>2015</u>
Revenues:		
FSM revenue sharing:		
Gross revenue taxes	\$ 323,975	\$ 309,398
Import taxes	327,993	301,970
Income taxes	346,932	325,815
Other taxes	97,833	72,619
	<u>1,096,733</u>	<u>1,009,802</u>
State taxes:		
Sales tax	<u>435,377</u>	<u>403,154</u>
Fees and charges:		
Licenses and fees	<u>223,371</u>	<u>199,464</u>
Net change in fair value of investments	<u>149,235</u>	<u>29,495</u>
Interest and dividend income	<u>35,573</u>	<u>35,439</u>
Other:		
Other	<u>791,536</u>	<u>55,606</u>
Total revenues	<u>2,731,825</u>	<u>1,732,960</u>
Expenditures:		
Current:		
General government:		
Office of the Governor	177,048	165,981
Department of Administration and Finance	391,109	101,805
Judiciary Branch	190,334	184,654
Legislative Branch	501,471	541,466
Election	1,620	30,085
	<u>1,261,582</u>	<u>1,023,991</u>
Economic development:		
Land management services	<u>-</u>	<u>25,231</u>
Education:		
Scholarship board	<u>83,963</u>	<u>25,662</u>
Public order and safety:		
Office of the Attorney General	331,402	320,428
Parole board	340	400
	<u>331,742</u>	<u>320,828</u>
Boards, Commissions and Other:		
Department of Transportation and Infrastructure	1,500,860	939,594
Broadcast Authority	44,522	46,081
Sports Council	9,346	15,269
RM Small Business Development Center	6,810	744
Land Court	122,271	97,885
Municipal governments	14,790	3,750
Other	15,500	37,578
	<u>1,714,099</u>	<u>1,140,901</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balance, Continued  
General Fund  
Year Ended September 30, 2016  
(with comparative totals for the year ended September 30, 2015)

	2016	2015
Expenditures, continued:		
Debt service:		
Principal payments	287,610	193,863
Interest charges	39,047	41,962
	326,657	235,825
Total expenditures	3,718,043	2,772,438
Deficiency of revenues under expenditures	(986,218)	(1,039,478)
Other financing sources:		
Operating transfers in	740,298	-
Proceeds from issuance of long-term debt	760,702	692,442
	1,501,000	692,442
Net change in fund balance	514,782	(347,036)
Fund balance at the beginning of the year	1,402,964	1,750,000
Fund balance at the end of the year	\$ 1,917,746	\$ 1,402,964

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balance - Budget and Actual  
General Fund  
Year Ended September 30, 2016

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final	Budgetary Basis	
Revenues:				
FSM revenue sharing:	\$ 1,194,622	\$ 1,194,622	1,096,733	\$ (97,889)
State taxes:				
Sales tax	362,130	362,130	435,377	73,247
Fees and charges:				
Licences and fees	205,103	205,103	223,371	18,268
Interest and dividend income	-	-	35,573	35,573
Other:				
Other	86,355	86,355	940,771	854,416
Total revenues	<u>1,848,210</u>	<u>1,848,210</u>	<u>2,731,825</u>	<u>883,615</u>
Expenditures:				
Current:				
General government:				
Office of the Governor	165,193	165,193	180,744	(15,551)
Department of Administration and Finance	94,093	94,093	391,836	(297,743)
Judiciary Branch	213,950	213,950	207,279	6,671
Legislative Branch	558,359	558,359	502,604	55,755
Election	-	1,620	1,620	-
	<u>1,031,595</u>	<u>1,033,215</u>	<u>1,284,083</u>	<u>(250,868)</u>
Education:				
Scholarship board	24,456	24,456	86,096	(61,640)
Public order and safety:				
Office of the Attorney General	343,916	343,916	345,396	(1,480)
Parole board	750	750	340	410
	<u>344,666</u>	<u>344,666</u>	<u>345,736</u>	<u>(1,070)</u>
Boards, commissions and other:				
Department of Transportation and Infrastructure	256,074	256,074	1,503,739	(1,247,665)
Broadcast Authority	51,624	51,624	44,522	7,102
Sports Council	16,128	16,128	11,429	4,699
Small Business Development Center	-	-	6,810	(6,810)
Land Court	133,410	133,410	127,309	6,101
Municipal governments	-	14,300	14,790	(490)
Other	500	17,000	15,500	1,500
Debt Service:				
Principal payments	-	-	287,609	(287,609)
Interest charges	-	-	39,048	(39,048)
	<u>457,736</u>	<u>488,536</u>	<u>2,050,756</u>	<u>(1,562,220)</u>
Total expenditures	<u>1,858,453</u>	<u>1,890,873</u>	<u>3,766,671</u>	<u>(1,875,798)</u>
Deficiency of revenues under expenditures	<u>(10,243)</u>	<u>(42,663)</u>	<u>(1,034,846)</u>	<u>(992,183)</u>
Other financing sources:				
Operating transfer in	-	-	740,298	740,298
Proceeds from issuance of long-term debt	-	-	760,702	760,702
	<u>-</u>	<u>-</u>	<u>1,501,000</u>	<u>1,501,000</u>
Net change in fund balance	(10,243)	(42,663)	466,154	508,817
Encumbrances	38,024	38,024	48,628	10,604
Fund balances at the beginning of the year	1,402,964	1,402,964	1,402,964	-
Fund balance at the end of the year	<u>\$ 1,430,745</u>	<u>\$ 1,398,325</u>	<u>\$ 1,917,746</u>	<u>\$ 519,421</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS

Combining Balance Sheet  
September 30, 2016

	Scholarship Revolving Loan	Production and Development Loan	Health Care	Sports Council	Broadcasting Authority	Transportation Infrastructure Revolving	Home Improvement Program Revolving	Aluminum Recycling	CFSM Grants	Gifford Scholarship	Land Administration	Total
<b>ASSETS</b>												
Receivables:												
General	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 30,346	\$ -	\$ -	\$ 30,346
Due from other funds	6,359	19,937	264,730	232	7,163	22,042	-	103,985	32,036	-	-	456,484
Prepaid items	-	304	9,497	-	-	-	-	-	460	-	-	10,261
Other assets	-	-	-	-	-	-	-	-	93,000	-	-	93,000
Restricted:												
Cash and equivalents	-	-	-	-	-	-	-	-	-	39,511	-	39,511
Time certificates of deposit	-	-	-	-	-	-	-	-	-	354,383	-	354,383
Total assets	<u>\$ 6,359</u>	<u>\$ 20,241</u>	<u>\$ 274,227</u>	<u>\$ 232</u>	<u>\$ 7,163</u>	<u>\$ 22,042</u>	<u>\$ -</u>	<u>\$ 103,985</u>	<u>\$ 155,842</u>	<u>\$ 393,894</u>	<u>\$ -</u>	<u>\$ 983,985</u>
<b>LIABILITIES AND FUND</b>												
<b>BALANCES (DEFICIT)</b>												
Liabilities:												
Accounts payable	\$ -	\$ 24	\$ 11,327	\$ -	\$ -	\$ -	\$ -	\$ 6,286	\$ 4,834	\$ -	\$ -	\$ 22,471
Other liabilities and accruals	-	-	-	-	-	-	-	-	10,694	-	-	10,694
Due to other funds	-	-	-	-	-	-	-	-	-	2,977	7,722	10,699
Unearned revenue	-	-	-	-	-	-	-	-	33	-	-	33
Total liabilities	<u>-</u>	<u>24</u>	<u>11,327</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>6,286</u>	<u>15,561</u>	<u>2,977</u>	<u>7,722</u>	<u>43,897</u>
Fund balances (deficit):												
Non-spendable	-	-	-	-	-	-	-	-	93,000	-	-	93,000
Restricted	-	-	-	-	-	-	-	-	47,281	390,917	-	438,198
Committed	6,359	20,217	262,900	232	7,163	22,042	-	97,699	-	-	-	416,612
Unassigned	-	-	-	-	-	-	-	-	-	-	(7,722)	(7,722)
Total fund balances (deficit)	<u>6,359</u>	<u>20,217</u>	<u>262,900</u>	<u>232</u>	<u>7,163</u>	<u>22,042</u>	<u>-</u>	<u>97,699</u>	<u>140,281</u>	<u>390,917</u>	<u>(7,722)</u>	<u>940,088</u>
Total liabilities and fund balances	<u>\$ 6,359</u>	<u>\$ 20,241</u>	<u>\$ 274,227</u>	<u>\$ 232</u>	<u>\$ 7,163</u>	<u>\$ 22,042</u>	<u>\$ -</u>	<u>\$ 103,985</u>	<u>\$ 155,842</u>	<u>\$ 393,894</u>	<u>\$ -</u>	<u>\$ 983,985</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
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, 2016

	Scholarship Revolving Loan	Production and Development Loan	Health Care	Sports Council	Broadcasting Authority	Transportation Infrastructure Revolving	Home Improvement Program Revolving	Aluminum Recycling	CFSM Grants	Gifford Scholarship	Land Administration	Total
<b>Revenues:</b>												
Fees and charges	\$ 715	\$ 21,664	\$ 134,435	\$ 50	\$ 913	\$ 20,693	\$ -	\$ 85,083	\$ -	\$ -	\$ 15,017	\$ 278,570
CFSM grants	-	-	-	-	-	-	-	-	558,241	-	-	558,241
Interest income	-	71	127	-	-	-	-	94	-	2,213	-	2,505
<b>Total revenues</b>	<b>715</b>	<b>21,735</b>	<b>134,562</b>	<b>50</b>	<b>913</b>	<b>20,693</b>	<b>-</b>	<b>85,177</b>	<b>558,241</b>	<b>2,213</b>	<b>15,017</b>	<b>839,316</b>
<b>Expenditures by function:</b>												
<b>Current:</b>												
General Government	-	-	-	-	-	-	-	-	46,296	-	-	46,296
Health services	-	-	225,641	-	-	-	-	-	51,000	-	-	276,641
Environment, protection and sanitation	-	-	-	-	-	-	-	80,489	25,788	-	-	106,277
Economic development	-	-	-	-	-	-	-	-	13,187	-	-	13,187
Boards, commissions and other	1,535	12,493	-	-	1,530	-	513,387	-	459,211	-	-	988,156
<b>Total expenditures</b>	<b>1,535</b>	<b>12,493</b>	<b>225,641</b>	<b>-</b>	<b>1,530</b>	<b>-</b>	<b>513,387</b>	<b>80,489</b>	<b>595,482</b>	<b>-</b>	<b>-</b>	<b>1,430,557</b>
<b>Net change in fund balances (deficit)</b>	<b>(820)</b>	<b>9,242</b>	<b>(91,079)</b>	<b>50</b>	<b>(617)</b>	<b>20,693</b>	<b>(513,387)</b>	<b>4,688</b>	<b>(37,241)</b>	<b>2,213</b>	<b>15,017</b>	<b>(591,241)</b>
<b>Fund balances (deficit) at the beginning of the year</b>	<b>7,179</b>	<b>10,975</b>	<b>353,979</b>	<b>182</b>	<b>7,780</b>	<b>1,349</b>	<b>513,387</b>	<b>93,011</b>	<b>177,522</b>	<b>388,704</b>	<b>(22,739)</b>	<b>1,531,329</b>
<b>Fund balances (deficit) at the end of the year</b>	<b>\$ 6,359</b>	<b>\$ 20,217</b>	<b>\$ 262,900</b>	<b>\$ 232</b>	<b>\$ 7,163</b>	<b>\$ 22,042</b>	<b>\$ -</b>	<b>\$ 97,699</b>	<b>\$ 140,281</b>	<b>\$ 390,917</b>	<b>\$ (7,722)</b>	<b>\$ 940,088</b>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
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, 2016

	Scholarship Revolving Loan	Production and Development Loan	Health Care	Sports Council	Broadcasting Authority	Transportation Infrastructure Revolving	Home Improvement Program Revolving	Aluminum Recycling	CFSM Grants	Gifford Scholarship	Land Administration	Total
Revenues:												
Fees and charges	\$ 715	\$ 21,664	\$ 134,435	\$ 50	\$ 913	\$ 20,693	\$ -	\$ 85,083	\$ -	\$ -	\$ 15,017	\$ 278,570
CFSM Grants	-	-	-	-	-	-	-	-	558,241	-	-	558,241
Interest income	-	71	127	-	-	-	-	94	-	2,213	-	2,505
Total revenues	715	21,735	134,562	50	913	20,693	-	85,177	558,241	2,213	15,017	839,316
Expenditures by account:												
Salaries and wages:												
Regular	-	-	-	-	-	-	-	-	268,998	-	-	268,998
Fringe benefits	-	-	-	-	-	-	-	-	36,458	-	-	36,458
Travel and transportation	-	-	107,852	-	-	-	-	-	1,354	-	-	109,206
Communications	-	-	-	-	-	-	-	-	4,745	-	-	4,745
Food stuffs	-	-	-	-	-	-	-	-	1,356	-	-	1,356
Office supplies and materials	-	6,147	4,208	-	-	-	-	80,489	42,882	-	-	133,726
POL	-	-	-	-	-	-	-	-	11,652	-	-	11,652
Contractual services	-	5,938	-	-	-	-	-	-	222,808	-	-	228,746
Utilities	-	-	-	-	1,500	-	-	-	4,609	-	-	6,109
Medical supplies	-	-	105,796	-	-	-	-	-	-	-	-	105,796
Rental	-	-	-	-	30	-	-	-	620	-	-	650
Equipment	-	-	7,785	-	-	-	-	-	-	-	-	7,785
Payment to component unit	-	-	-	-	-	-	513,387	-	-	-	-	513,387
Miscellaneous	1,535	408	-	-	-	-	-	-	-	-	-	1,943
Total expenditures	1,535	12,493	225,641	-	1,530	-	513,387	80,489	595,482	-	-	1,430,557
Net change in fund balances (deficit)	(820)	9,242	(91,079)	50	(617)	20,693	(513,387)	4,688	(37,241)	2,213	15,017	(591,241)
Fund balances (deficit) at the beginning of the year	7,179	10,975	353,979	182	7,780	1,349	513,387	93,011	177,522	388,704	(22,739)	1,531,329
Fund balances (deficit) at the end of the year	\$ 6,359	\$ 20,217	\$ 262,900	\$ 232	\$ 7,163	\$ 22,042	\$ -	\$ 97,699	\$ 140,281	\$ 390,917	\$ (7,722)	\$ 940,088

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet  
September 30, 2016

	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Section 211(a)(5) Environment	Section 211(a)(6) Infrastructure
<b><u>ASSETS</u></b>						
Receivables:						
Federal agencies	\$ 112,821	\$ 24,417	\$ -	\$ -	\$ 684	\$ -
Advances	-	7,479	148	-	-	-
Prepayments	2,688	225	-	1,048	-	-
Due from other funds	148,376	271,103	42,951	108,316	41,755	90,433
Other assets	-	-	-	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total assets	<u>\$ 263,885</u>	<u>\$ 303,224</u>	<u>\$ 43,099</u>	<u>\$ 109,364</u>	<u>\$ 42,439</u>	<u>\$ 90,433</u>
<b><u>LIABILITIES AND FUND BALANCES</u></b>						
Liabilities:						
Accounts payable	\$ 18,491	\$ 43,873	\$ 8,298	\$ 2,977	\$ 1,612	\$ -
Other liabilities and accruals	64,447	36,621	6,018	5,878	4,100	1,670
Due to other funds	-	-	-	-	-	-
Unearned revenues	<u>180,947</u>	<u>222,730</u>	<u>28,783</u>	<u>100,509</u>	<u>36,727</u>	<u>39,784</u>
Total liabilities	<u>263,885</u>	<u>303,224</u>	<u>43,099</u>	<u>109,364</u>	<u>42,439</u>	<u>41,454</u>
Fund balances:						
Non-spendable	-	-	-	-	-	-
Restricted	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>48,979</u>
Total fund balances	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>48,979</u>
Total liabilities and fund balances	<u>\$ 263,885</u>	<u>\$ 303,224</u>	<u>\$ 43,099</u>	<u>\$ 109,364</u>	<u>\$ 42,439</u>	<u>\$ 90,433</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet, Continued  
September 30, 2016

	<u>Section 211(a)(7) Supplemental Education</u>	<u>Enhanced Reporting Accountability</u>	<u>U.S. Federal Grants</u>	<u>Compact Capital Projects</u>	<u>Foreign Assistance</u>	<u>Total</u>
<b><u>ASSETS</u></b>						
Receivables:						
Federal agencies	\$ 92,867	\$ 2,230	\$ 118,520	\$ -	\$ -	\$ 351,539
Advances	1,198	-	7,487	-	-	16,312
Prepayments	5,262	-	1,401	-	-	10,624
Due from other funds	271,864	5,372	115,019	-	515,824	1,611,013
Other assets	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>100,000</u>	<u>100,000</u>
Total assets	<u>\$ 371,191</u>	<u>\$ 7,602</u>	<u>\$ 242,427</u>	<u>\$ -</u>	<u>\$ 615,824</u>	<u>\$ 2,089,488</u>
<b><u>LIABILITIES AND FUND BALANCES</u></b>						
Liabilities:						
Accounts payable	\$ 29,978	\$ -	\$ 50,197	\$ -	\$ 635	\$ 156,061
Other liabilities and accruals	6,691	7,602	37,008	-	-	170,035
Due to other funds	-	-	53,914	-	-	53,914
Unearned revenues	<u>334,522</u>	<u>-</u>	<u>101,308</u>	<u>-</u>	<u>-</u>	<u>1,045,310</u>
Total liabilities	<u>371,191</u>	<u>7,602</u>	<u>242,427</u>	<u>-</u>	<u>635</u>	<u>1,425,320</u>
Fund balances:						
Non-spendable	-	-	-	-	100,000	100,000
Restricted	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>515,189</u>	<u>564,168</u>
Total fund balances	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>615,189</u>	<u>664,168</u>
Total liabilities and fund balances	<u>\$ 371,191</u>	<u>\$ 7,602</u>	<u>\$ 242,427</u>	<u>\$ -</u>	<u>\$ 615,824</u>	<u>\$ 2,089,488</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**GRANTS ASSISTANCE FUND**

Combining Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balances  
Year Ended September 30, 2016

	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Section 211(a)(5) Environment	Section 211(a)(6) Infrastructure
Revenues:						
Compact funding	\$ 2,553,771	\$ 2,108,019	\$ 370,362	\$ 270,258	\$ 177,672	\$ 88,596
Federal contributions	-	-	-	-	-	-
Other grants	-	-	-	-	-	-
Total revenues	<u>2,553,771</u>	<u>2,108,019</u>	<u>370,362</u>	<u>270,258</u>	<u>177,672</u>	<u>88,596</u>
Expenditures by function:						
Current:						
General government	-	-	-	270,258	-	88,596
Economic development	-	-	370,362	-	-	-
Education	2,553,771	-	-	-	-	-
Health services	-	2,108,019	-	-	-	-
Environment protection and sanitation	-	-	-	-	177,672	-
Total expenditures	<u>2,553,771</u>	<u>2,108,019</u>	<u>370,362</u>	<u>270,258</u>	<u>177,672</u>	<u>88,596</u>
Excess of revenues over expenditures	-	-	-	-	-	-
Other financing uses:						
Operating transfers out	-	-	-	-	-	-
Net change in fund balances	-	-	-	-	-	-
Fund balances at the beginning of the year	-	-	-	-	-	48,979
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 48,979</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**GRANTS ASSISTANCE FUND**

Combining Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balances, Continued  
Year Ended September 30, 2016

	Section 211(a)(7) Supplemental Education	Enhanced Reporting Accountability	U.S. Federal Grants	Compact Capital Projects	Foreign Assistance	Total
<b>Revenues:</b>						
Compact funding	\$ 1,102,470	\$ 193,968	\$ -	\$ -	\$ -	\$ 6,865,116
Federal contributions	-	-	1,737,341	-	-	1,737,341
Other grants	-	-	-	-	235,246	235,246
Total revenues	<u>1,102,470</u>	<u>193,968</u>	<u>1,737,341</u>	<u>-</u>	<u>235,246</u>	<u>8,837,703</u>
<b>Expenditures by function:</b>						
<b>Current:</b>						
General government	-	193,968	-	-	19,445	572,267
Economic development	-	-	-	-	-	370,362
Education	1,102,470	-	542,035	-	160,527	4,358,803
Health services	-	-	1,105,851	-	2,949	3,216,819
Environment protection and sanitation	-	-	89,455	-	35,781	302,908
Total expenditures	<u>1,102,470</u>	<u>193,968</u>	<u>1,737,341</u>	<u>-</u>	<u>218,702</u>	<u>8,821,159</u>
Excess of revenues over expenditures	-	-	-	-	16,544	16,544
<b>Other financing uses:</b>						
Operating transfers out	-	-	-	(740,298)	-	(740,298)
Net change in fund balances	-	-	-	(740,298)	16,544	(723,754)
Fund balances at the beginning of the year	-	-	-	740,298	598,645	1,387,922
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 615,189</u>	<u>\$ 664,168</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**GRANTS ASSISTANCE FUND**

Combining Statement of Revenues, Expenditures by Account,  
and Changes in Fund Balances  
Year Ended September 30, 2016

	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Section 211(a)(5) Environment	Section 211(a)(6) Infrastructure
Revenues:						
Compact funding	\$ 2,553,771	\$ 2,108,019	\$ 370,362	\$ 270,258	\$ 177,672	\$ 88,596
Federal contributions	-	-	-	-	-	-
Other grants	-	-	-	-	-	-
Total revenues	<u>2,553,771</u>	<u>2,108,019</u>	<u>370,362</u>	<u>270,258</u>	<u>177,672</u>	<u>88,596</u>
Expenditures by account:						
Salaries and wages:						
Regular	1,483,164	765,309	120,767	141,660	92,544	-
Overtime	-	108,675	9,862	-	58	-
Fringe benefits	202,406	99,494	18,974	11,638	13,264	-
Other personnel costs	-	-	-	-	-	-
Travel and transportation	3,740	37,908	20,431	19,133	13,541	-
Communications	13,285	3,202	11,818	12,433	3,874	-
Customs and tax	-	-	-	-	-	-
Dues, membership, and subscriptions	-	2,500	-	2,441	-	-
Food stuffs	-	25,470	-	-	-	-
Port charges	1,934	1,167	919	-	200	-
Office supplies and materials	264,753	99,594	14,986	9,307	17,323	1,785
POL	37,428	9,603	7,818	795	9,396	-
Printing and reproduction	196	5,497	330	-	312	1,343
Rental services	661	30	629	30	130	-
Repairs and maintenance	12,875	40	241	-	1,707	-
Utilities	75,418	148,833	18,990	2,500	3,854	-
Medical referral	-	32,810	-	-	-	-
Medical supplies	-	493,408	-	-	-	-
Contractual services	191,990	102,859	130,537	1,369	15,224	75,297
Professional services	-	6,944	-	-	-	10,171
Scholarships and allowances	190,141	280	1,020	-	1,160	-
Training	11,226	49,754	-	52,559	-	-
Leased housing, buildings and land	40,736	27,395	-	13,645	5,085	-
Nonpayroll compensation	-	-	-	-	-	-
Equipment	17,861	87,108	-	2,748	-	-
Miscellaneous	5,957	139	13,040	-	-	-
Total expenditures	<u>2,553,771</u>	<u>2,108,019</u>	<u>370,362</u>	<u>270,258</u>	<u>177,672</u>	<u>88,596</u>
Excess of revenues over expenditures	-	-	-	-	-	-
Other financing uses:						
Operating transfers out	-	-	-	-	-	-
Net change in fund balances	-	-	-	-	-	-
Fund balances at the beginning of the year	-	-	-	-	-	48,979
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 48,979</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**GRANTS ASSISTANCE FUND**

Combining Statement of Revenues, Expenditures by Account,  
and Changes in Fund Balances, Continued  
Year Ended September 30, 2016

	Section 211(a)(7) Supplemental Education	Enhanced Reporting Accountability	U.S. Federal Grants	Compact Capital Projects	Foreign Assistance	Total
Compact funding	\$ 1,102,470	\$ 193,968	\$ -	\$ -	\$ -	\$ 6,865,116
Federal contributions	-	-	1,737,341	-	-	1,737,341
Other grants	-	-	-	-	235,246	235,246
Total revenues	<u>1,102,470</u>	<u>193,968</u>	<u>1,737,341</u>	<u>-</u>	<u>235,246</u>	<u>8,837,703</u>
Expenditures by account:						
Salaries and wages:						
Regular	168,397	170,858	841,150	-	-	3,783,849
Overtime	-	3,215	148	-	-	121,958
Fringe benefits	19,895	19,895	106,362	-	(6)	491,922
Other personnel costs	-	-	9,046	-	-	9,046
Travel and transportation	23,799	-	212,576	-	1,458	332,586
Communications	18,288	-	21,332	-	-	84,232
Customs and tax	2,271	-	-	-	-	2,271
Dues, membership, and subscriptions	-	-	150	-	-	5,091
Food stuffs	-	-	441	-	1,939	27,850
Port charges	95	-	40	-	131	4,486
Office supplies and materials	226,440	-	217,913	-	9,924	862,025
POL	11,883	-	18,635	-	38	95,596
Printing and reproduction	8,195	-	8,451	-	150	24,474
Rental services	3,148	-	5,230	-	-	9,858
Repairs and maintenance	6,942	-	5,927	-	-	27,732
Utilities	34,843	-	29,214	-	-	313,652
Medical referral	-	-	-	-	-	32,810
Medical supplies	-	-	46,105	-	-	539,513
Contractual services	371,340	-	95,780	-	196,582	1,180,978
Professional services	2,505	-	19,595	-	-	39,215
Scholarships and allowances	-	-	5,960	-	-	198,561
Training	144,188	-	1,700	-	-	259,427
Leased housing, buildings and land	31,383	-	-	-	-	118,244
Nonpayroll compensation	-	-	941	-	-	941
Equipment	26,585	-	67,207	-	7,901	209,410
Miscellaneous	2,273	-	23,438	-	585	45,432
Total expenditures	<u>1,102,470</u>	<u>193,968</u>	<u>1,737,341</u>	<u>-</u>	<u>218,702</u>	<u>8,821,159</u>
Excess of revenues over expenditures	-	-	-	-	16,544	16,544
Other financing uses:						
Operating transfers out	-	-	-	(740,298)	-	(740,298)
Net change in fund balances	-	-	-	(740,298)	16,544	(723,754)
Fund balances at the beginning of the year	-	-	-	740,298	598,645	1,387,922
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 615,189</u>	<u>\$ 664,168</u>

See Accompanying Independent Auditors' Report.

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

Honorable Lyndon Jackson  
Governor, State of Kosrae  
Federated States of Micronesia:

We have audited, in accordance with the 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, the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of State of Kosrae as of and for the year ended September 30, 2016, and the related notes to the financial statements, which collectively comprise State of Kosrae's basic financial statements, and have issued our report thereon dated June 30, 2017. Our report includes emphasis-of-matter paragraphs for the implementation of new accounting standards and a restatement to correct an error.

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 Kosrae Port Authority, the Kosrae Utilities Authority, and the Kosrae Housing Authority, which were all audited by us. We have issued separate reports on our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters for these entities. The findings, if any, included in those reports are not included herein.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered State of Kosrae's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of State of Kosrae's internal control. Accordingly, we do not express an opinion on the effectiveness of State of Kosrae's internal control.

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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

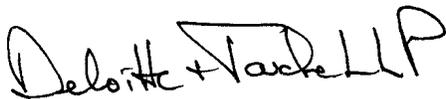
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

## **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether State of Kosrae's financial statements are free from 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*.

## **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

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

June 30, 2017

## **INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS REQUIRED BY THE UNIFORM GUIDANCE**

Honorable Lyndon Jackson  
Governor, State of Kosrae  
Federated States of Micronesia:

### **Report on Compliance for Each Major Federal Program**

We have audited State of Kosrae's compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of State of Kosrae's major federal programs for the year ended September 30, 2016. State of Kosrae's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs.

As discussed in note 3B to the Schedule of Expenditures of Federal Awards, State of Kosrae's basic financial statements include the operations of certain entities whose federal awards are not included in the accompanying Schedule of Expenditures of Federal Awards for the year ended September 30, 2016. Our audit, described below, did not include the operations of the entities identified in note 3B as these entities conducted separate audits in accordance with Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the Uniform Guidance), if required.

### **Management's Responsibility**

Management is responsible for compliance with the federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

### **Auditors' Responsibility**

Our responsibility is to express an opinion on compliance for each of State of Kosrae's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of the Uniform Guidance. Those standards and the Uniform Guidance 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 State of Kosrae'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 on compliance for each major federal program. However, our audit does not provide a legal determination of State of Kosrae's compliance.

## **Opinion on Each Major Federal Program**

In our opinion, State of Kosrae complied, in all material respects, with the types of 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, 2016.

## **Report on Internal Control Over Compliance**

Management of State of Kosrae is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered State of Kosrae's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, 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 State of Kosrae's internal control over compliance.

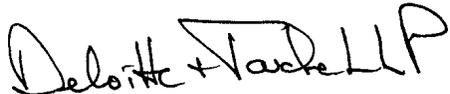
*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or a 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. *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.

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 material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

## Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

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 State of Kosrae as of and for the year ended September 30, 2016, and the related notes to the financial statements, which collectively comprise State of Kosrae's basic financial statements. We issued our report thereon dated June 30, 2017, which contained unmodified opinions on those financial statements and included emphasis-of-matter paragraphs for the implementation of new accounting standards and a restatement to correct an error. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the basic 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 basic 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 basic financial statements or to the basic 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 basic financial statements as a whole.



June 30, 2017

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Summary Schedule of Expenditures of Federal Awards, by Grantor  
Year Ended September 30, 2016

Agency/Program	CFDA#	Expenditures
U.S. Department of Agriculture		\$ 45,551
U.S. Department of the Interior		6,909,020
U.S. Department of Education		542,035
U.S. Department of Health and Human Services		<u>1,105,851</u>
GRAND TOTAL		<u>\$ 8,602,457</u>

Reconciliation to the basic financial statements:		
Grants Assistance Fund expenditures		\$ 8,821,159
Less:		
Foreign Assistance Fund expenditures		<u>(218,702)</u>
		<u>\$ 8,602,457</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2016

Federal Grantor/Pass-Through Grantor/Program	CFDA#	Pass-Through Entity Identifying #	Expenditures
<b>U.S. DEPARTMENT OF AGRICULTURE:</b>			
Direct Programs:			
Cooperative Forestry Assistance	10.664		14,971
Urban and Community Forestry Program	10.675		18,888
Forest Legacy Program	10.676		4,325
Forest Stewardship Program	10.678		<u>7,367</u>
Total U.S. Department of Agriculture			<u>\$ 45,551</u>
<b>U.S. DEPARTMENT OF THE INTERIOR:</b>			
Pass-Through From the FSM National Government: A3			
Economic, Social and Political Development of the Territories:			
Compact of Free Association Sector Grants:			
Compact II Education Sector	15.875		\$ 2,553,771
Compact II Health Sector			2,108,019
Compact II Private Sector Development			370,362
Compact II Capacity Building			270,258
Compact II Environment			177,672
Compact II Infrastructure Sector			88,596
Supplemental Education Grant			1,102,470
Compact II Enhanced Reporting Accountability			193,968
Historic Preservation Fund Grants-In Aid	15.904		<u>43,904</u>
Total U.S. Department of the Interior			<u>\$ 6,909,020</u>
<b>U.S. DEPARTMENT OF EDUCATION:</b>			
Pass-Through From the FSM National Government: A3			
Special Education - Grants to States	84.027A		<u>\$ 542,035</u>
Total U.S. Department of Education			<u>\$ 542,035</u>
<b>U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES:</b>			
Pass-Through From the FSM National Government: A3			
Affordable Care Act (ACA) Personal Responsibility Education Program	93.092		\$ 36,143
Maternal and Child Health Federal Consolidated Programs	93.110		5,534
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116		22,231
Family Planning - Services	93.217		27,617
Consolidated Health Centers (Community Health Centers,MHC, HCH and PHPC)	93.224		647,240
Affordable Care Act (ACA) Abstinence Education Program	93.235		3,980
Grants to States to Support Oral health Workforce Activities	93.236		15,000
Substance Abuse and Mental Health Services - Projects of Regional and National Significance	93.243		69,681
Universal Newborn Hearing Screening	93.251		4,841
Immunization Cooperative Agreements	93.268		54,154
Cancer Prevention and Control Program	93.283		9,106
Centers for Disease Control and Prevention_Investigations and Technical Assistance	93.283		65,709
Tracking Surveillance	93.314		3,009
Affordable Care Act- Coordinated Chronic Disease Prevention & Health Promotion	93.544		-
Community Health Intervention	93.738		2,949
Preventive Health & Health Services Block Grant funded solely with PPHF	93.758		2,789
Assistance Programs for Chronic Disease Prevention & Control	93.945		33,172
Block Grants for Community Mental Health Service	93.958		3,539
Block Grants for Prevention and Treatment of Substance Abuse	93.959		60,876
Maternal and Child Health Services Block Grant to the States	93.994		<u>38,281</u>
Total U.S. Department of Health and Human Services			<u>\$ 1,105,851</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 8,602,457</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2016

1. Scope

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

2. Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards (the Schedule) includes the federal grant activity of State of Kosrae under programs of the federal government for the year ended September 30, 2016. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the Uniform Guidance). Because the Schedule presents only a selected portion of the operations of State of Kosrae, it is not intended to and does not present the financial positions or changes in financial positions of State of Kosrae.

3. Summary of Significant Accounting Policies

A. Basis of Accounting

Expenditures reported on the Schedule are reported on the modified accrual basis of accounting, consistent with the manner in which State of Kosrae maintains its accounting records. All expenditures and capital outlays that represent the federal share are reported as expenditures. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Pass-through entity identifying numbers are presented, where available.

B. Reporting Entity

For purposes of complying with the Single Audit Act of 1984, as amended in 1996, the State of Kosrae's reporting entity is defined in Note 1A to its September 30, 2016 basic financial statements; and all of the discretely presented component units are excluded. Accordingly, the accompanying Schedule presents the federal award programs administered by the State of Kosrae, as defined above, for the year ended September 30, 2016.

C. Matching Costs

Matching costs, i.e., the non-federal share of certain program costs, are not included in the accompanying Schedule.

D. Indirect Cost Allocation

The State of Kosrae did not receive any indirect cost allocation. The State of Kosrae did not elect to use the de minimis indirect cost rate allowed under the Uniform Guidance and did 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 (the Compact), 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 for purposes of major program determinations.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2016

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

*Financial Statements*

- |   |               |
|---|---------------|
| 1. Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP: | Unmodified    |
| Internal control over financial reporting:  |               |
| 2. Material weakness(es) identified?  | No            |
| 3. Significant deficiency(ies) identified?  | None reported |
| 4. Noncompliance material to financial statements noted?  | No            |

*Federal Awards*

Internal control over major federal programs:

- |   |            |
|---|------------|
| 5. Material weakness(es) identified?  | No         |
| 6. Significant deficiency(ies) identified?  | None noted |
| 7. Type of auditors' report issued on compliance for major federal programs:                          | Unmodified |
| 8. Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? | No         |
| 9. Identification of major federal programs:  |            |

CFDA Number

Name of Federal Program

15.875

Economic, Social and Political Development of the Territories – Compact of Free Association Compact Sector Grants

- |  |           |
|--|-----------|
| 10. Dollar threshold used to distinguish between Type A and Type B Programs: | \$750,000 |
| 11. Auditee qualified as low-risk auditee?                                   | Yes       |

**Section II – Financial Statements Findings**

No matters were reported.

**Section III - Federal Award Findings and Questioned Costs**

No matters were reported.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Summary Schedule of Prior Audit Findings and Questioned Costs  
Year Ended September 30, 2016

There are no unresolved prior audit findings and questioned costs.