

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2017

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2017

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**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2017

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 and each major fund of the State of Kosrae (the State) as of and for the year ended September 30, 2017, 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 and each major fund of the State of Kosrae as of September 30, 2017, 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

Receivables from the FSM National Government

As discussed in Note 3 to the financial statements, the State is in discussion with the FSM National Government to determine the ultimate collectability of certain receivables due from the FSM National Government in consultation with the grantor agency and Asian Development Bank arising from Utwe water project transactions.

Other Matters

Required Supplementary Information

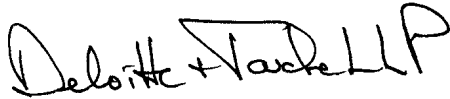
Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 10 as well as the Schedule of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual - General Fund and notes thereto, on pages 46 and 47, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board (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 May 30, 2018, 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.

May 30, 2018

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2017

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, 2017. We encourage readers to consider this information in conjunction with Kosrae State's financial statements, which follow. Fiscal year 2016 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 fiscal year ended September 30, 2017 decreased by \$0.95 million (or 2%) from \$39.71 million in the prior year to \$38.76 million in the current year. The decrease is mainly due to the depreciation expense exceeding the capital acquisition costs.
- For fiscal year ended September 30, 2017, Kosrae State's General Fund unassigned fund deficit has increased to \$1.25 million from \$1.04 million in the prior year or an increase of \$0.21 million. GASB defines unassigned fund balance as a residual fund balance that is not restricted, committed and assigned.
- For the year ended September 30, 2017, the General Fund total fund balance decreased by \$0.35 million from \$1.92 million in fiscal year 2016 to \$1.57 million in fiscal year 2017. The decrease was due to the reduction of other financing sources of \$0.82 million for the year as compared to the prior year; although the total expenditures for the year were reduced by \$0.55 million in the current year and negative change in revenues of \$0.59 million.

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 Kosrae State's financial status.

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 Kosrae State's net position serve as indicator to measure Kosrae State's financial position.

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2017

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. Kosrae 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.

Kosrae 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 2017 exceeded liabilities by \$38.76 million. The bulk of the amount is from net investment in capital assets, although \$7.43 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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2017

The following summary of Kosrae State's net position as of September 30, 2017, with comparable balances for the fiscal year 2016, discloses this relationship:

	Government Activities			
	2017	2016	Change	%
ASSETS				
Current and other assets	\$ 10,625,034	\$ 10,203,861	\$ 421,173	4%
Capital assets	<u>35,613,650</u>	<u>36,417,194</u>	<u>(803,544)</u>	<u>-2%</u>
Total assets	<u>\$ 46,238,684</u>	<u>\$ 46,621,055</u>	<u>\$ (382,371)</u>	<u>-1%</u>
LIABILITIES				
Long-term debt	\$ 4,393,947	\$ 4,454,355	\$ (60,408)	-1%
Current and other liabilities	<u>3,081,975</u>	<u>2,452,065</u>	<u>629,910</u>	<u>26%</u>
Total liabilities	<u>7,475,922</u>	<u>6,906,420</u>	<u>569,502</u>	<u>8%</u>
NET POSITION				
Net investment in capital assets	33,741,566	34,605,315	(863,749)	-2%
Restricted	7,427,614	6,921,766	505,848	7%
Unrestricted	<u>(2,406,418)</u>	<u>(1,812,446)</u>	<u>(593,972)</u>	<u>33%</u>
Total Net Position	<u>\$ 38,762,762</u>	<u>\$ 39,714,635</u>	<u>\$ (951,873)</u>	<u>-2%</u>

At the end of fiscal year 2017, Kosrae State's unrestricted net position showed a deficit of \$2.41 million, a decrease of \$0.59 million as compared with the prior year. The decrease in overall net position of \$0.95 million was due primarily to a decrease in net investment in capital assets of \$0.80 million offset by the increase in restricted assets of \$0.50 million. 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 and unused employee leave balances. Kosrae State will include these amounts in future year's budgets as funding permits.

The net position decreased by \$0.95 million (or 2%) compared with prior year and the key elements of the differences from the prior year are shown in the following schedule.

	Governmental Activities			
	2017	2016	Change	%
Revenues:				
Operating grants and contributions	\$ 9,366,320	\$ 10,156,647	\$ (790,327)	-8%
Capital grants and contributions	614,718	12,913,260	(12,298,542)	-95%
Charges for services	637,837	501,941	135,896	27%
Revenue sharing	1,143,172	1,096,733	46,439	4%
Unrestricted investment earnings	197,333	187,313	10,020	5%
Taxes	447,431	435,377	12,054	3%
Other	<u>86,742</u>	<u>791,536</u>	<u>(704,794)</u>	<u>-89%</u>
Total revenues	<u>12,493,553</u>	<u>26,082,807</u>	<u>(13,589,254)</u>	<u>-52%</u>

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FEDERATED STATES OF MICRONESIA**

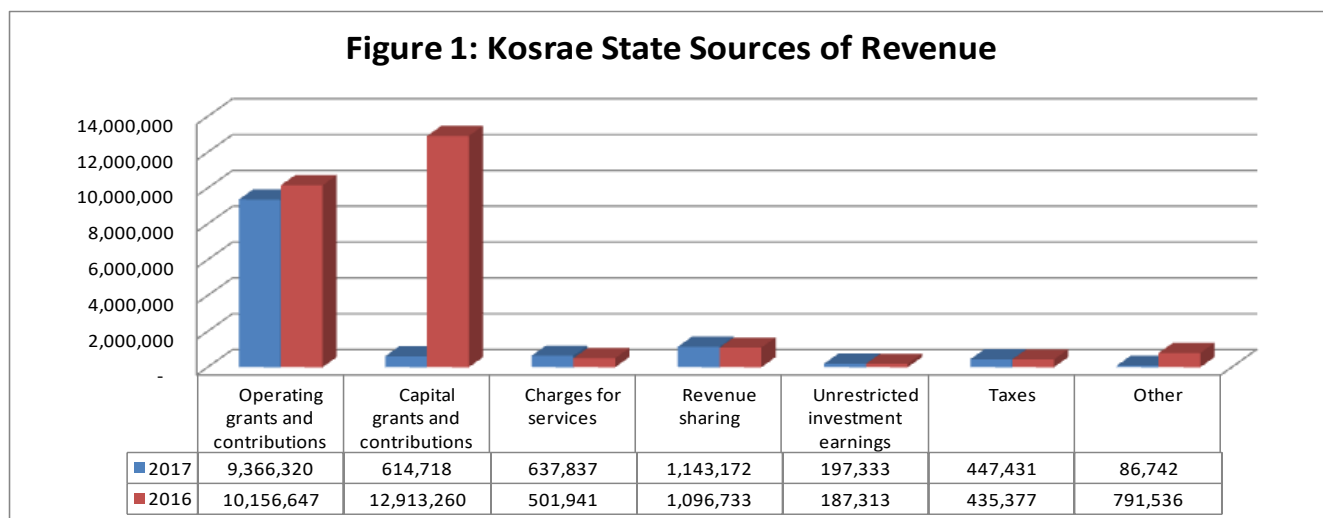
Management's Discussion and Analysis
September 30, 2017

	Governmental Activities			
	2017	2016	Change	%
Expenses:				
General government	2,084,103	1,933,644	150,459	8%
Education	4,407,210	4,878,720	(471,510)	-10%
Health services	3,402,433	3,490,378	(87,945)	-3%
Economic development	487,887	337,404	150,483	45%
Boards, commissions and other	2,186,207	3,177,422	(991,215)	-31%
Environment protection and sanitation	449,899	409,185	40,714	10%
Public order and safety	399,158	338,457	60,701	18%
Unallocated interest	76,850	39,048	37,802	97%
Total expenses	13,493,747	14,604,258	(1,110,511)	-8%
Excess (deficiency) of revenues over (under) expenditures	(1,000,194)	11,478,549	(12,478,743)	-109%
Special item - SDR foreign exchange	(5,333)	(36,896)	31,563	-86%
Special item - impairment loss on capital assets	(583,293)	-	(583,293)	
Contributions to permanent fund	636,947	390,479	246,468	63%
Change in net position	(951,873)	11,832,132	(12,784,005)	-108%
Net position at the beginning of the year	39,714,635	27,882,503	11,832,132	42%
Net position at the end of the year	\$ 38,762,762	\$ 39,714,635	\$ (951,873)	-2%

Figure 1 below shows that the total revenues in fiscal year 2017 of \$12.49 million were decreased by \$13.59 million (or -52%) from the prior year's \$26.08 million. The decrease of \$13.59 million was primarily due to the combined reduction of \$13.79 million in capital grants and contributions, operating grants and other revenues and an offset combined increase in other revenue categories of \$0.20 million. In fiscal year 2017, Grants Assistance Fund revenues are comprised of 70% of all Kosrae State funding sources whereas the General Fund revenues are comprised of only 20%.

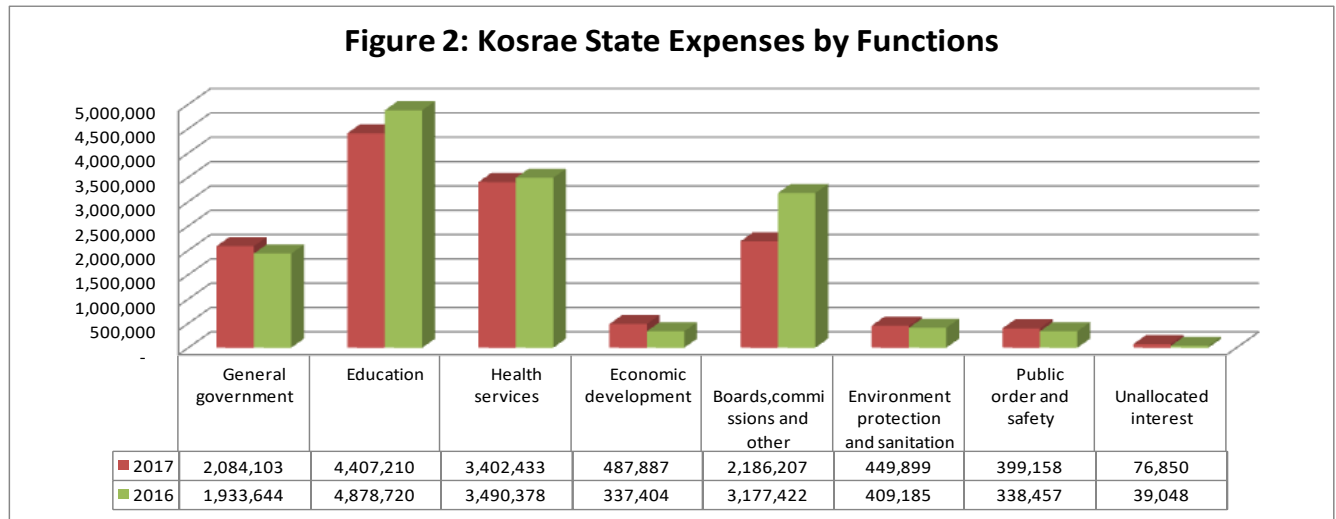
Figure 2 presents that total expenses of \$13.49 million for fiscal year 2017 reflected an 8% decrease from the prior year expenses of \$14.60 million.

The following graphs show the major components of revenues and expenses for the year ended September 30, 2017.



**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2017



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 2017, Kosrae State governmental funds reported a combined fund balance of \$8.10 million, which represents \$0.24 million increase from the \$7.86 million recorded at the end of fiscal 2016. The increase was attributable mainly to the following: positive change in fund balances for Compact Trust of \$0.64 million and for Other Governmental funds of \$0.09 million or total of \$0.73 million against the combined negative fund balances of General Fund and Grants Assistance Funds of \$0.49 million, resulting in positive \$0.24 million. Of the total combined fund balance of \$8.10 million, \$7.09 million is designated as non-spendable fund balance; \$1.76 million is designated as restricted; \$0.49 million is designated as committed, and \$(1.24) million is designated as unassigned fund deficit.

The General Fund is the main operating fund of Kosrae State. At the end of the current fiscal year, the unassigned fund deficit was \$(1.25) million, which increased by \$(0.21) million from \$(1.04) million from prior year. Consequently, the total fund balance for the General Fund decreased by \$0.35 million from \$1.92 million in fiscal year 2016 to \$1.57 million in current year.

The Grants Assistance Fund has a total fund balance of \$0.52 million. The net decrease in fund balance during the current year was \$0.15 million or (22%), which primarily was the result of the deficiency of revenues under expenditures.

Compact Trust Fund has a total fund balance of \$4.98 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 \$0.64 million or 15% which corresponds to the net increase in the fair value of investments for the year.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2017

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, 2017, General Fund revenues of \$2.14 million, excluding other financing sources, were deficient against expenditures of \$3.24 million by \$1.10 million on the budgetary basis. The deficiency of revenues under expenditures was offset against other financing sources of \$0.68 million. These financing sources were: operating transfers-in from Transportation Fund of \$0.02 million and the proceeds of issuance of long-term debt of \$0.21 million and the advance lease of \$0.45 million. The net change in fund balance was negative \$0.41 million on the budgetary basis.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Kosrae State's investment in capital assets for the primary government as of September 30, 2017 amounted to \$79.54 million, net of accumulated depreciation of \$43.93 million, resulted in a net book value of \$35.61 million. The decrease in capital assets of \$0.80 million was due to depreciation expense of \$1.76 million, which exceeded capital outlays of \$1.54 million, and an impairment loss in the amount of \$0.58 million.

The table below summarizes Kosrae State's capital assets:

	Governmental Activities			
	2017	2016	Change	%
Buildings	\$ 12,034,972	\$ 12,020,345	\$ 14,627	0%
Infrastructure	21,413,326	22,642,811	(1,229,485)	-5%
Machinery, equipment and others	<u>2,165,352</u>	<u>1,754,038</u>	<u>411,314</u>	<u>23%</u>
	<u>\$ 35,613,650</u>	<u>\$ 36,417,194</u>	<u>\$ (803,544)</u>	<u>-2%</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 obligations for fiscal year 2017 with comparative balances from fiscal year 2016.

	Governmental Activities			
	2017	2016	Change	%
ABD Loans	\$ 4,290,193	\$ 4,347,164	\$ (56,971)	-1%
Malem Waters	103,754	107,191	(3,437)	-3%
Claims	<u>110,000</u>	<u>110,000</u>	<u>-</u>	<u>0%</u>
	<u>\$ 4,503,947</u>	<u>\$ 4,564,355</u>	<u>\$ (60,408)</u>	<u>-1%</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2017

Kosrae State's long-term debt decreased by \$0.06 million or 1% due primarily to the additional loan from Asian Development Bank in the amount of \$0.21 million and the repayments of various loans in the amount of \$0.27 million. 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, 2018 showed a slight increase of \$0.01 million or 2% as compared to the same period in fiscal year 2017. The expenditures however for the six months ending March 31, 2018 showed increase of \$0.07 million or 8% compared to the same period in fiscal year 2017. This could result in deficiency of revenues under expenditures at the end of fiscal year 2018.

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 Kosrae State in the ensuing years. The LTFF was 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 2018 with total approved funding of \$7,551,458 as follows:

Education Sector	\$2,646,791
Health Sector	\$2,386,076
Environment Sector	\$ 336,337
Private Sector	\$ 480,055
Capacity Building Sector	\$ 351,693
SEG	\$1,151,635
ERA	\$ 198,871

In addition, the combined US Federal pass-through and direct grants for FY 2018 amounted to more than \$.95 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, 2017

	Primary Government	Component Units
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 287,676	\$ 538,910
Time certificate of deposit	-	166,702
Investments	-	671,823
Receivables, net	1,156,785	710,835
Inventories	-	231,633
Prepayments	36,352	14,377
Advances	74,922	-
Due from component units	46,296	-
Restricted assets:		
Cash and cash equivalents	799,344	-
Time certificate of deposit	-	200,000
Total current assets	<u>2,401,375</u>	<u>2,534,280</u>
Noncurrent assets:		
Capital assets:		
Nondepreciable capital assets	-	29,281
Capital assets, net of accumulated depreciation	35,613,650	18,153,866
Investments	1,173,951	-
Other noncurrent assets	820,000	252,800
Restricted assets:		
Time certificates of deposit	354,779	-
Investments	<u>5,874,929</u>	<u>-</u>
Total noncurrent assets	<u>43,837,309</u>	<u>18,435,947</u>
Total assets	<u>\$ 46,238,684</u>	<u>\$ 20,970,227</u>
LIABILITIES		
Current liabilities:		
Current portion of long-term obligations	\$ 243,105	\$ -
Accounts payable	446,968	224,376
Contracts payable	708,988	-
Other liabilities and accruals	329,760	66,101
Due to primary government	-	118,470
Loans payable	-	120,912
Unearned revenues	<u>1,086,259</u>	<u>29,744</u>
Total current liabilities	<u>2,815,080</u>	<u>559,603</u>
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	4,150,842	-
Unearned revenues	400,000	-
Other noncurrent liabilities	<u>110,000</u>	<u>-</u>
Total noncurrent liabilities	<u>4,660,842</u>	<u>-</u>
Total liabilities	<u>7,475,922</u>	<u>559,603</u>
Commitments and contingencies		
NET POSITION		
Net investment in capital assets	33,741,566	18,183,147
Restricted for:		
Nonexpendable:		
Future operations	4,976,741	-
Expendable:		
Debt service	898,188	-
Compact related	48,979	-
Other purposes	1,503,706	696,599
Unrestricted	<u>(2,406,418)</u>	<u>1,530,878</u>
Total net position	<u>38,762,762</u>	<u>20,410,624</u>
Total liabilities and net position	<u>\$ 46,238,684</u>	<u>\$ 20,970,227</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Statement of Activities
Year Ended September 30, 2017

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	\$ 2,084,103	\$ 637,837	\$ 1,466,762	\$ 298,462	\$ 318,958	\$ -		
Economic development	487,887	-	416,809	-	(71,078)	-		
Education	4,407,210	-	3,925,214	149,979	(332,017)	-		
Health services	3,402,433	-	3,185,867	166,277	(50,289)	-		
Public order and safety	399,158	-	-	-	(399,158)	-		
Environment protection and sanitation	449,899	-	371,668	-	(78,231)	-		
Boards, commissions and other	2,186,207	-	-	-	(2,186,207)	-		
Unallocated interest on long-term debt	76,850	-	-	-	(76,850)	-		
Total primary government	<u>\$ 13,493,747</u>	<u>\$ 637,837</u>	<u>\$ 9,366,320</u>	<u>\$ 614,718</u>	<u>(2,874,872)</u>	<u>-</u>		
Component units:								
Kosrae Port Authority	\$ 1,218,023	\$ 376,513	\$ -	\$ -	-	(841,510)		
Kosrae Utilities Authority	2,616,462	2,551,484	-	-	-	(64,978)		
Kosrae Housing Authority	240,621	132,928	-	-	-	(107,693)		
Total component units	<u>\$ 4,075,106</u>	<u>\$ 3,060,925</u>	<u>\$ -</u>	<u>\$ -</u>	<u>-</u>	<u>(1,014,181)</u>		
General revenues:								
Taxes:								
FSM revenue sharing:								
Gross revenue taxes							354,156	-
Import taxes							356,775	-
Income taxes							352,805	-
Other taxes							79,436	-
State taxes							447,431	-
Unrestricted investment earnings							197,333	53,873
Other							86,742	30,296
Total general revenues							1,874,678	84,169
Special item - loss on SDR foreign exchange							(5,333)	-
Special item - impairment loss on capital assets							(583,293)	-
Contributions to permanent fund							636,947	-
Total general revenues, special item and contributions							1,922,999	84,169
Change in net position							(951,873)	(930,012)
Net position at the beginning of the year							39,714,635	21,340,636
Net position at the end of the year							\$ 38,762,762	\$ 20,410,624

See accompanying notes to financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Balance Sheet

Governmental Funds
September 30, 2017

		Special Revenue	Permanent	Other Governmental Funds	Total
	General	Grants Assistance	Compact Trust		
ASSETS					
Cash and cash equivalents	\$ 287,676	\$ -	\$ -	\$ -	\$ 287,676
Investments	1,173,951	-	-	-	1,173,951
Receivables, net:					
General	4,402	-	-	36,992	41,394
Federal agencies	-	177,086	-	-	177,086
Due from FSM National Government	708,988	-	-	-	708,988
Taxes	199,317	-	-	-	199,317
Loans	30,000	-	-	-	30,000
Due from component units	46,296	-	-	-	46,296
Due from other funds	110,347	1,632,375	-	565,094	2,307,816
Prepaid items	-	1,213	-	35,139	36,352
Advances	46,397	28,525	-	-	74,922
Other assets	627,000	100,000	-	93,000	820,000
Restricted assets:					
Cash and cash equivalents	757,975	-	-	41,369	799,344
Time certificates of deposit	-	-	-	354,779	354,779
Investments	898,188	-	4,976,741	-	5,874,929
Total assets	\$ 4,890,537	\$ 1,939,199	\$ 4,976,741	\$ 1,126,373	\$ 12,932,850
LIABILITIES AND FUND BALANCES					
Liabilities:					
Accounts payable	\$ 257,083	\$ 104,762	\$ -	\$ 85,123	\$ 446,968
Contracts payable	708,988	-	-	-	708,988
Other liabilities and accruals	153,364	174,102	-	2,294	329,760
Due to other funds	2,197,469	107,371	-	2,976	2,307,816
Unearned revenues	-	1,036,226	-	33	1,036,259
Total liabilities	3,316,904	1,422,461	-	90,426	4,829,791
Fund balances:					
Non-spendable	1,923,644	100,000	4,976,741	93,000	7,093,385
Restricted	898,188	416,738	-	440,453	1,755,379
Committed	-	-	-	494,216	494,216
Unassigned:					
General fund	(1,248,199)	-	-	-	(1,248,199)
Special revenue funds	-	-	-	8,278	8,278
Total fund balances	1,573,633	516,738	4,976,741	1,035,947	8,103,059
Total liabilities and fund balances	\$ 4,890,537	\$ 1,939,199	\$ 4,976,741	\$ 1,126,373	

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

35,613,650

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 (4,393,947)
Advance lease payment (450,000)
Claims payable (110,000)

(4,953,947)

Net position of governmental activities

\$ 38,762,762

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, 2017

		Special Revenue	Permanent	Other Governmental Funds	Total
	General	Grants Assistance	Compact Trust		
Revenues:					
Compact funding	\$ -	\$ 6,871,317	\$ -	\$ -	\$ 6,871,317
Net change in the fair value of investments	144,362	-	636,947	-	781,309
Federal contributions	-	1,885,554	-	-	1,885,554
FSM revenue sharing	1,143,172	-	-	-	1,143,172
State taxes	447,431	-	-	-	447,431
CFSM grants	-	-	-	609,449	609,449
Fees and charges	268,855	-	-	368,982	637,837
Interest income	50,509	-	-	2,462	52,971
Other	86,742	-	-	-	86,742
Total revenues	<u>2,141,071</u>	<u>8,756,871</u>	<u>636,947</u>	<u>980,893</u>	<u>12,515,782</u>
Expenditures:					
Current:					
General government	1,019,637	1,004,742	-	13,995	2,038,374
Economic development	64,289	416,809	-	-	481,098
Education	26,776	3,925,214	-	-	3,951,990
Health services	-	3,185,867	-	157,404	3,343,271
Public order and safety	389,891	-	-	-	389,891
Environment protection and sanitation	-	371,669	-	78,230	449,899
Boards, commissions and other	1,314,042	-	-	613,363	1,927,405
Debt service	356,081	-	-	-	356,081
Total expenditures	<u>3,170,716</u>	<u>8,904,301</u>	<u>-</u>	<u>862,992</u>	<u>12,938,009</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(1,029,645)</u>	<u>(147,430)</u>	<u>636,947</u>	<u>117,901</u>	<u>(422,227)</u>
Other financing sources (uses):					
Operating transfers in	22,042	-	-	-	22,042
Operating transfers out	-	-	-	(22,042)	(22,042)
Advance lease payment	450,000	-	-	-	450,000
Proceeds from issuance of long-term debt	213,490	-	-	-	213,490
Total other financing sources (uses), net	<u>685,532</u>	<u>-</u>	<u>-</u>	<u>(22,042)</u>	<u>663,490</u>
Net change in fund balances	<u>(344,113)</u>	<u>(147,430)</u>	<u>636,947</u>	<u>95,859</u>	<u>241,263</u>
Fund balances at the beginning of the year	<u>1,917,746</u>	<u>664,168</u>	<u>4,339,794</u>	<u>940,088</u>	<u>7,861,796</u>
Fund balances at the end of the year	<u>\$ 1,573,633</u>	<u>\$ 516,738</u>	<u>\$ 4,976,741</u>	<u>\$ 1,035,947</u>	<u>\$ 8,103,059</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, 2017

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	\$ 241,263
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 the sum of depreciation (\$1,764,053) exceeded capital outlays (\$929,084) in the current period.	(834,969)
Some capital assets were donated by the U.S. Government.	316,256
Some capital assets were donated by the Japan Government.	298,462
Governmental funds report advance lease payment as revenues. However, in the statement of net position, such is reported as unearned revenues.	(450,000)
Special item associated with impairment loss on infrastructure assets	(583,293)
Special item associated with loss on SDR foreign exchange adjustment.	(5,333)
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	(213,490)
Repayment of ADB loans	275,794
Repayment of RUS loan	<u>3,437</u>
	<u>65,741</u>
Change in net position of governmental activities	\$ <u>(951,873)</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Combining Statement of Net Position

Component Units
September 30, 2017

<u>ASSETS</u>	Kosrae Port Authority	Kosrae Utilities Authority	Kosrae Housing Authority	Total
Current assets:				
Cash and cash equivalents	\$ -	\$ 474,760	\$ 64,150	\$ 538,910
Time certificate of deposit	-	166,702	-	166,702
Investments	-	671,823	-	671,823
Time certificate of deposit - restricted	-	-	200,000	200,000
Receivables:				
General	104,807	237,227	-	342,034
Loan	-	-	505,617	505,617
	104,807	237,227	505,617	847,651
Allowance for doubtful debts	(83,760)	(53,056)	-	(136,816)
Net receivables	21,047	184,171	505,617	710,835
Inventories	-	231,633	-	231,633
Prepayments	-	2,335	12,042	14,377
Total current assets	21,047	1,731,424	781,809	2,534,280
Noncurrent assets:				
Deposit for fuel purchase contract	-	252,800	-	252,800
Capital assets:				
Nondepreciable capital assets	-	29,281	-	29,281
Capital assets, net of accumulated depreciation	15,934,657	2,212,225	6,984	18,153,866
Total assets	\$ 15,955,704	\$ 4,225,730	\$ 788,793	\$ 20,970,227
<u>LIABILITIES AND NET POSITION</u>				
Current liabilities:				
Accounts payable	\$ 47,178	\$ 177,198	\$ -	\$ 224,376
Accrued liabilities	11,021	47,078	8,002	66,101
Due to primary government	72,174	-	46,296	118,470
Loans payable	-	-	120,912	120,912
Unearned revenues	-	29,744	-	29,744
Total current liabilities	130,373	254,020	175,210	559,603
Total liabilities	130,373	254,020	175,210	559,603
Net position:				
Net investment in capital assets	15,934,657	2,241,506	6,984	18,183,147
Restricted	-	90,000	606,599	696,599
Unrestricted	(109,326)	1,640,204	-	1,530,878
Total net position	15,825,331	3,971,710	613,583	20,410,624
Total liabilities and net position	\$ 15,955,704	\$ 4,225,730	\$ 788,793	\$ 20,970,227

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, 2017

	Kosrae Port Authority	Kosrae Utilities Authority	Kosrae Housing Authority	Total
Operating revenues:				
Charge for services	\$ 376,513	\$ 2,551,484	\$ 132,928	\$ 3,060,925
Operating expenses:				
Cost of services	-	1,403,785	-	1,403,785
Depreciation and amortization	741,740	371,550	911	1,114,201
Administration and general	476,283	841,127	239,710	1,557,120
Total operating expenses	<u>1,218,023</u>	<u>2,616,462</u>	<u>240,621</u>	<u>4,075,106</u>
Operating income (loss)	<u>(841,510)</u>	<u>(64,978)</u>	<u>(107,693)</u>	<u>(1,014,181)</u>
Nonoperating revenues (expenses):				
Interest income	-	1,336	-	1,336
Net change in fair value of investments	-	52,537	-	52,537
Interest expense	-	(5,975)	(7,883)	(13,858)
Gain on disposal of capital assets	-	71	-	71
Subsidy from FSM National Government	-	-	44,083	44,083
Total nonoperating revenues (expenses), net	<u>-</u>	<u>47,969</u>	<u>36,200</u>	<u>84,169</u>
Change in net position	(841,510)	(17,009)	(71,493)	(930,012)
Net position at beginning of year	<u>16,666,841</u>	<u>3,988,719</u>	<u>685,076</u>	<u>21,340,636</u>
Net position at end of year	\$ <u>15,825,331</u>	\$ <u>3,971,710</u>	\$ <u>613,583</u>	\$ <u>20,410,624</u>

See accompanying notes to financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2017

(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, 2017

(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.

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, 2017

(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 \$7,427,614 of restricted net position, of which \$1,503,706 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, 2017

(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, 2017

(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, 2017

(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 (i.e., 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, 2017

(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 \$898,188 for the Early Retirement Scheme. Furthermore, investments recorded in the Compact Trust Fund of \$4,976,741 are restricted in that they are not available to be used in current operations.

As of September 30, 2017, 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.	\$ 757,975
Deposit account established for the Gifford scholarship fund.	41,369
Time certificate of deposit with a local bank restricted for scholarships for post-secondary students.	<u>354,779</u>
	\$ <u>1,154,123</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 8.9% 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 assets are 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, 2017

(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, 2017

(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, 2017

(1) Summary of Significant Accounting Policies, Continued

T. New Accounting Standards

During the year ended September 30, 2017, the State implemented the following pronouncements:

- GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements 67 and 68 with the reporting requirements in Statement 68.
- GASB 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).
- GASB Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements.
- GASB 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*.
- GASB 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.
- GASB 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 implementation of these statements did not have a material effect on the accompanying 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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(1) Summary of Significant Accounting Policies, Continued

T. New Accounting Standards, Continued

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.

In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) associated with the retirement of a tangible capital asset. The provisions in Statement No. 83 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments. The provisions in Statement No. 84 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2017, GASB issued Statement No. 85, *Omnibus 2017*, which address practice issues that have been identified during implementation and application of certain GASB Statements including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits). The provisions in Statement No. 85 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 May 2017, GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt. The provisions in Statement No. 86 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 June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether 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, 2017

(1) Summary of Significant Accounting Policies, Continued

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, 2016 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, 2017

(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 January 9, 2017 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, 2017

(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, 2017

(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, 2017, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit was \$1,441,799 and the corresponding bank balance was \$1,827,278, which is maintained in financial institutions subject to FDIC insurance. As of September 30, 2017, bank deposits in the amount of \$466,989 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, 2017, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit was \$905,612 and the corresponding bank balance was \$906,430, which were maintained in financial institutions subject to FDIC insurance. As of September 30, 2017, bank deposits in the amount of \$547,319 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, 2017, the State's investments are as follows:

General Fund:	
Fixed income	\$ 251,900
Domestic equities	1,173,951
Common equities	605,195
Cash management account	<u>41,093</u>
	<u>2,072,139</u>
Compact Trust Fund:	
Common trust funds:	
Domestic Equity	734,280
International Equity	998,534
Fixed Income	1,977,126
Global Equity	466,869
Private Equity	224,266
Hedge Fund	216,698
Real Estate	356,671
Money market funds	<u>2,297</u>
	<u>4,976,741</u>
	\$ <u>7,048,880</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

As of September 30, 2017, 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	\$ 87,400	\$ 7,382	\$ 25,120	\$ 48,817	\$ 6,081	Aaa
U.S. Government Agencies Obligations:						
Federal Home Loan Mortgage Corp.	3,308	129	134	-	3,045	Aaa
Government National Mortgage Assoc.	193	-	-	-	193	Aaa
Federal National Mortgage Association	22,495	16,489	2,355	-	3,651	Aaa
Federal Home Loan Bank	5,222	-	-	5,222	-	Aaa
Tennessee Valley Authority	3,682	-	-	3,682	-	Aaa
Freddie Mac	6,378	-	3,365	3,013	-	Aaa
Overseas Private Inv Corp	17,949	-	-	17,949	-	Aaa
Private Export Funding	6,970	-	-	6,970	-	Aaa
Municipal Obligations	13,821	-	6,956	4,134	2,731	Aa1
Corporate Bonds	21,603	6,731	7,757	5,119	1,996	Aaa
Corporate Bonds	10,479	-	8,464	2,015	-	Aa1
Corporate Bonds	3,723	-	2,035	1,688	-	Aa2
Corporate Bonds	9,660	2,020	2,030	5,610	-	Aa3
Corporate Bonds	6,980	-	-	5,275	1,705	A1
Corporate Bonds	6,850	2,698	-	4,152	-	A2
Corporate Bonds	7,097	-	4,045	2,051	1,001	A3
Corporate Bonds	3,123	-	-	1,411	1,712	Baa1
Corporate Bonds	3,083	-	1,358	1,725	-	Baa2
Corporate Bonds	3,148	-	-	-	3,148	Baa3
Corporate Bonds	1,649	-	-	-	1,649	Ba1
Corporate Bonds	<u>7,087</u>	<u>-</u>	<u>-</u>	<u>1,105</u>	<u>5,982</u>	No Rating
	<u>\$ 251,900</u>	<u>\$ 35,449</u>	<u>\$ 63,619</u>	<u>\$ 119,938</u>	<u>\$ 32,894</u>	

The State has the following recurring fair value measurements as of September 30, 2017:

General Fund:

	Total	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Investments by fair value level:				
Fixed income:				
U.S. Treasury obligations	\$ 87,400	\$ -	\$ 87,400	\$ -
U.S. Government Agencies	66,197	-	66,197	-
Municipal obligations	13,821	-	13,821	-
Corporate notes	<u>84,482</u>	<u>-</u>	<u>84,482</u>	<u>-</u>
	251,900	-	251,900	-
Equity securities:				
U.S. equities	<u>605,195</u>	<u>605,195</u>	<u>-</u>	<u>-</u>
Total investments at fair value	857,095	\$ <u>605,195</u>	\$ <u>254,460</u>	\$ <u>-</u>
Investments measured at NAV:				
Equity investment in Bank of the FSM	1,173,951			
Investments measured at amortized cost:				
Cash management account	<u>41,093</u>			
	<u>\$ 2,072,139</u>			

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

Compact Trust Fund:

	Total	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Investments by fair value level:				
Common trust funds:				
Domestic Equity	\$ 734,280	\$ 734,280	\$ -	\$ -
International Equity	998,534	998,534	-	-
Global Equity	466,869	466,869	-	-
Fixed Income	1,977,126	1,977,126	-	-
Private Equity	<u>224,266</u>	<u>-</u>	<u>-</u>	<u>224,266</u>
Total investments at fair value	<u>4,401,075</u>	<u>\$ 4,176,809</u>	<u>\$ -</u>	<u>\$ 224,266</u>
Investments measured at NAV:				
Hedge Fund	216,698			
Real Estate	356,671			
Investments measured at amortized cost:				
Money market funds	<u>2,297</u>			
	<u>\$ 4,976,741</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, 2017.

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, 2017. High yield debt receiving a credit rating below "A" comprises approximately 32.7% of the MIM CFI fixed income portfolio as rated by Moody's at September 30, 2017. At September 30, 2017, the weighted average maturity of the bonds comprising MIM CFI is 9.96 years.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(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, 2017. High yield debt receiving a credit rating below "A" comprises approximately 79.9% of the MIM OFI fixed income portfolio as rated by Moody's at September 30, 2017. At September 30, 2017, the weighted average maturity of the bonds comprising MIM OFI is 8.56 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, 2017, the Trust Fund held approximately \$198,312,000 in securities of foreign issuers held in common trust funds. Of this amount, approximately \$37,201,000 was held in securities whose functional currency is the Euro, \$16,282,000 whose functional currency is the British pound, \$24,087,000 whose functional currency is the Japanese yen, and \$120,742,000 in functional currencies of 36 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 12.8% of invested assets at September 30, 2017.

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.

Discretely Presented Component Units

Kosrae Utilities Authority (KUA):

As of September 30, 2017, investments comprise the following:

Money market funds	\$ 23,603
Common equities	399,290
Fixed income	<u>248,930</u>
	\$ <u>671,823</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units, Continued

Kosrae Utilities Authority (KUA), Continued:

As of September 30, 2017, 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. Treasury obligations	Aaa	\$ 115,885	\$ -	\$ 83,925	\$ 31,960
U.S. Government agencies	Aaa	17,680	-	17,680	-
Corporate notes	A1	7,334	-	-	7,334
Corporate notes	A2	7,518	-	7,518	-
Corporate notes	A3	38,225	-	14,683	23,542
Corporate notes	Baa1	16,218	-	8,085	8,133
Corporate notes	Baa2	15,063	-	-	15,063
Corporate notes	Baa3	5,156	-	-	5,156
Corporate notes	Not rated	<u>25,851</u>	<u>-</u>	<u>25,851</u>	<u>-</u>
		\$ 248,930	\$ -	\$ 157,742	\$ 91,188

KUA has the following recurring fair value measurements as of September 30, 2017:

	Total	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Investments by fair value level:				
Fixed income:				
U.S. Treasury obligations	\$ 115,885	\$ -	\$ 115,885	\$ -
U.S. Government agencies	43,531	-	43,531	-
Corporate notes	89,514	-	89,514	-
Total fixed income	<u>248,930</u>	<u>-</u>	<u>248,930</u>	<u>-</u>
Equity securities:				
U.S. equities	383,746	383,746	-	-
Non U.S. equities	15,544	15,544	-	-
	<u>399,290</u>	<u>399,290</u>	<u>-</u>	<u>-</u>
Total investments at fair value	<u>648,220</u>	<u>\$ 399,290</u>	<u>\$ 248,930</u>	<u>\$ -</u>
Investments measured at amortized cost:				
Money market funds	<u>23,603</u>			
	<u>\$ 671,823</u>			

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(3) Receivables

Primary Government

Receivables as of September 30, 2017, 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	\$ 105,354	\$ -	\$ -	\$ 1,003,987	\$ 1,109,341
Federal agencies	-	177,086	-	-	177,086
Due from FSM National Government	708,988	-	-	-	708,988
Taxes	199,317	-	-	-	199,317
Loans	<u>397,500</u>	<u>395,130</u>	<u>-</u>	<u>32,282</u>	<u>824,912</u>
	1,411,159	572,216	-	1,036,269	3,019,644
Less: Allowance for uncollectible accounts	<u>(468,452)</u>	<u>(395,130)</u>	<u>-</u>	<u>(999,277)</u>	<u>(1,862,859)</u>
Net receivables	\$ <u>942,707</u>	\$ <u>177,086</u>	\$ <u>-</u>	\$ <u>36,992</u>	\$ <u>1,156,785</u>

The final settlement of receivables due from the FSM National Government arising from Utwe water project transactions can be determined only by final action of the FSM National Government in consultation with the grantor agency and Asian Development Bank. 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, 2017 are as follows:

General 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

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

\$ 397,500

Grants Assistance Fund

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

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. \$ 32,282

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(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, 2017, are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Grants Assistance	General	\$ 1,632,375
Nonmajor governmental funds	General	565,094
General	Nonmajor governmental funds	2,976
General	Grants Assistance	<u>107,371</u>
		<u>\$ 2,307,816</u>

(5) Capital Assets

Capital asset activities for the year ended September 30, 2017, are as follows:

Primary Government

	<u>Balance October 1, 2016</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance September 30, 2017</u>
Depreciable assets:				
Buildings	\$ 26,835,654	\$ 598,256	\$ -	\$ 27,433,910
Infrastructure	48,735,705	213,491	(4,551,812)	44,397,384
Machinery, equipment, others	<u>6,975,825</u>	<u>732,055</u>	<u>-</u>	<u>7,707,880</u>
	<u>82,547,184</u>	<u>1,543,802</u>	<u>(4,551,812)</u>	<u>79,539,174</u>
Less accumulated depreciation:				
Buildings	(14,815,309)	(583,629)	-	(15,398,938)
Infrastructure	(26,092,894)	(859,683)	3,968,519	(22,984,058)
Machinery, equipment, others	<u>(5,221,787)</u>	<u>(320,741)</u>	<u>-</u>	<u>(5,542,528)</u>
	<u>(46,129,990)</u>	<u>(1,764,053)</u>	<u>3,968,519</u>	<u>(43,925,524)</u>
	<u>\$ 36,417,194</u>	<u>\$ (220,251)</u>	<u>\$ (583,293)</u>	<u>\$ 35,613,650</u>

During the year ended September 30, 2017, depreciation expense was charged as follows:

General government	\$ 55,309
Economic development	12,953
Education	466,545
Health services	92,684
Public safety	14,267
Boards, commissions and others	<u>1,122,295</u>
	<u>\$ 1,764,053</u>

During the year ended September 30, 2017, the State received a \$450,000 advance lease payment from a party that operates a Kosrae shipyard. The advance payment was used to purchase \$650,000 of capital assets from Kosrae Industrial Corporation (KIDCO), which is a related party joint venture company and recorded a related party payable of \$200,000 to the joint venture. The State received an additional \$200,000 prepayment in November 2017 for the same purpose from the same company and paid the remaining balance for the capital asset purchase and then liquidated the joint venture company.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(5) Capital Assets, Continued

Primary Government, Continued

Annual amortization of the lease prepayments received as of September 30, 2017, is as follows:

<u>Year ending September 30</u>	
2018	\$ 50,000
2019	50,000
2020	50,000
2021	50,000
2022	50,000
2023 - 2026	<u>200,000</u>
	\$ <u>450,000</u>

During the year ended September 30, 2017, the State recognized an impairment loss of \$583,293 in connection with certain infrastructure assets. These infrastructure assets were either not working or were abandoned due to a lack of repair and maintenance funds. The impairment loss was charged to the boards, commissions and other functional classification.

Discretely Presented Component Units

	Balance October <u>1, 2016</u>	<u>Increases</u>	<u>Decreases</u>	Balance September <u>30, 2017</u>
Depreciable assets:				
Buildings	\$ 11,945,365	\$ 3,598	\$ -	\$ 11,948,963
Utility plant	10,625,223	254,015	(707)	10,878,531
Infrastructure	37,972,012	-	-	37,972,012
Machinery, equipment, others	<u>942,150</u>	<u>1,100</u>	<u>-</u>	<u>943,250</u>
	61,484,750	258,713	(707)	61,742,756
Less accumulated depreciation	<u>(42,475,396)</u>	<u>(1,114,201)</u>	<u>707</u>	<u>(43,588,890)</u>
	19,009,354	(855,488)	-	18,153,866
Nondepreciable assets:				
Construction work-in-progress	<u>69,305</u>	<u>62,964</u>	<u>(102,988)</u>	<u>29,281</u>
	\$ <u>19,078,659</u>	\$ <u>(792,524)</u>	\$ <u>(102,988)</u>	\$ <u>18,183,147</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, 2017, the balance payable on this loan amounted to \$103,754.

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, 2017

(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, \$898,188 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, 2017, the balance payable on this loan amounted to \$1,612,148.

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, 2017, the balance payable on this loan amounted to \$79,946.

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, 2017, the balances payable on these loans amounted to \$390,421 and \$439,348, 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, 2017, the balance payable on this loan amounted to \$1,768,330.

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>
2018	\$ 243,105	\$ 60,967	\$ 304,072
2019	256,692	57,621	314,313
2020	256,854	54,065	310,919
2021	257,023	50,503	307,526
2022	257,200	46,933	304,133
2023 – 2027	1,233,474	180,962	1,414,436
2028 – 2032	1,065,073	101,256	1,166,329
2033 – 2037	<u>824,526</u>	<u>29,475</u>	<u>854,001</u>
	\$ <u>4,393,947</u>	\$ <u>581,782</u>	\$ <u>4,975,729</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(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, 2017, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net position:

	Balance October <u>1, 2016</u>	<u>Additions</u>	<u>Reductions</u>	Balance September <u>30, 2017</u>	Due Within <u>One Year</u>
Loans payable:					
ADB loans:					
Loan 1520	\$ 1,634,723	\$ -	\$ (22,575)	\$ 1,612,148	\$ 80,613
Loan 1816	96,348	-	(16,402)	79,946	5,329
Loan 1873	435,133	-	(44,712)	390,421	32,500
Loan 1874	476,272	-	(36,924)	439,348	26,627
Loan 2099	<u>1,704,688</u>	<u>213,490</u>	<u>(149,848)</u>	<u>1,768,330</u>	<u>94,592</u>
	4,347,164	213,490	(270,461)	4,290,193	239,661
MWSP loan	<u>107,191</u>	<u>-</u>	<u>(3,437)</u>	<u>103,754</u>	<u>3,444</u>
	4,454,355	213,490	(273,898)	4,393,947	243,105
Other:					
Claims	<u>110,000</u>	<u>-</u>	<u>-</u>	<u>110,000</u>	<u>-</u>
	<u>\$ 4,564,355</u>	<u>\$ 213,490</u>	<u>\$ (273,898)</u>	<u>\$ 4,503,947</u>	<u>\$ 243,105</u>

When the ADB extends credit to a particular country, the loan is issued 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, 2017, the State recognized a foreign exchange loss of \$5,333 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, 2017

(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 <u>Fund</u>	Grants Assistance <u>Fund</u>	Compact Trust <u>Fund</u>	Nonmajor <u>Funds</u>	Total Governmental <u>Funds</u>
Non-spendable:					
General government	\$ 46,397	\$ -	\$ -	\$ -	\$ 46,397
Economic development	30,000	-	-	-	30,000
Pacific Islands Development Bank	627,000	100,000	-	93,000	820,000
Due from component units	46,296				46,296
Bank of the FSM	1,173,951	-	-	-	1,173,951
Permanent fund principal	-	-	4,976,741	-	4,976,741
Restricted for:					
General government	-	367,759	-	-	367,759
Debt service	898,188	-	-	-	898,188
Capital projects	-	48,979	-	47,281	96,260
Scholarships	-	-	-	393,172	393,172
Committed for:					
Education	-	-	-	1,605	1,605
Health services	-	-	-	357,940	357,940
Environment protection	-	-	-	103,265	103,265
Board, commissioners, others	-	-	-	31,406	31,406
Unassigned	(1,248,199)	-	-	8,278	(1,239,921)
	<u>\$ 1,573,633</u>	<u>\$ 516,738</u>	<u>\$ 4,976,741</u>	<u>\$ 1,035,947</u>	<u>\$ 8,103,059</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, 2017, are as follows:

<u>Source</u>	<u>Recipient</u>	<u>Transfers Out</u>	<u>Transfers In</u>
Nonmajor Funds	General Fund	\$ <u>22,042</u>	\$ <u>22,042</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 \$22,042 from the nonmajor funds to the General Fund representing the residual fund balance of the Transportation and Infrastructure Revolving Fund.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(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, 2017, 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>68,978</u>	\$ <u>1,086,838</u>	\$ <u>666,929</u>	\$ <u>1,822,745</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, 2017 is \$536,244.

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, 2017, 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, 2017

(11) Budgetary Compliance

For the year ended September 30, 2017, significant over-expenditures exceeded appropriations within the General Fund for the following:

Debt service	\$	356,081
Department of Transportation and Infrastructure	\$	204,161
Office of the Attorney General	\$	49,079
Legislative branch	\$	21,621
Land court	\$	15,583
Office of the Governor	\$	12,236

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2017

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, 2017

	<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	\$ 1,143,172	\$ (51,450)
State taxes	362,130	362,130	447,431	85,301
Licenses and fees	205,103	205,103	268,855	63,752
Interest and dividends	-	-	194,871	194,871
Other	<u>86,355</u>	<u>86,355</u>	<u>86,742</u>	<u>387</u>
Total revenues	<u>1,848,210</u>	<u>1,848,210</u>	<u>2,141,071</u>	<u>292,861</u>
Expenditures:				
Current:				
General government	1,059,134	1,033,215	1,052,941	(19,726)
Education	26,589	24,456	27,236	(2,780)
Public order and safety	358,660	344,666	393,315	(48,649)
Economic development	-	-	64,989	(64,989)
Boards, commissions and other	<u>462,698</u>	<u>1,141,415</u>	<u>1,701,213</u>	<u>(559,798)</u>
Total expenditures	<u>1,907,081</u>	<u>2,543,752</u>	<u>3,239,694</u>	<u>(695,942)</u>
Deficiency of revenues under expenditures	<u>(58,871)</u>	<u>(695,542)</u>	<u>(1,098,623)</u>	<u>(403,081)</u>
Other financing sources:				
Operating transfers in	-	-	22,042	22,042
Advance lease payment	-	-	450,000	450,000
Proceeds from issuance of long-term debt	<u>-</u>	<u>-</u>	<u>213,490</u>	<u>213,490</u>
	<u>-</u>	<u>-</u>	<u>685,532</u>	<u>685,532</u>
Net change in fund balance	(58,871)	(695,542)	(413,091)	282,451
Encumbrances	48,628	48,628	68,978	20,350
Fund balance at the beginning of the year	<u>1,917,746</u>	<u>1,917,746</u>	<u>1,917,746</u>	<u>-</u>
Fund balance at the end of the year	<u>\$ 1,907,503</u>	<u>\$ 1,270,832</u>	<u>\$ 1,573,633</u>	<u>\$ 302,801</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, 2017

(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**

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2017

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Combining Schedule of Expenditures by Account
Governmental Funds
Year Ended September 30, 2017

		Special Revenue	Permanent		
	General	Grants Assistance	Compact Trust	Other Governmental Funds	Total
Expenditures:					
Salaries and wages:					
Regular	\$ 1,221,947	\$ 3,880,592	\$ -	\$ 46,828	\$ 5,149,367
Overtime	39,957	169,507	-	-	209,464
Fringe benefits	149,197	501,888	-	6,604	657,689
Other personnel costs	2,036	12,530	-	-	14,566
Travel and transportation	129,200	362,764	-	64,225	556,189
Communications	40,894	86,019	-	-	126,913
Dues, membership, and subscriptions	11,800	7,945	-	-	19,745
Food stuffs	15,456	25,714	-	1,779	42,949
Port charges	-	1,283	-	-	1,283
Office supplies and materials	91,529	760,787	-	107,327	959,643
POL	20,535	97,651	-	29,998	148,184
Printing and reproduction	2,686	22,873	-	-	25,559
Rental services	(320)	3,997	-	-	3,677
Repairs and maintenance	1,466	13,115	-	-	14,581
Utilities	94,575	336,234	-	-	430,809
Subsidies and contributions	7,720	-	-	-	7,720
Medical referral	-	2,873	-	-	2,873
Medical supplies	-	444,527	-	87,783	532,310
Contractual services	254,209	1,122,332	-	466,907	1,843,448
Professional services	-	129,321	-	-	129,321
Scholarships and allowances	5,290	202,217	-	-	207,507
Training	18,435	235,639	-	-	254,074
Leased housing, buildings and land	6,925	99,789	-	-	106,714
Nonpayroll compensation	925	-	-	-	925
Equipment	665,849	344,744	-	44,203	1,054,796
Principal repayment	279,231	-	-	-	279,231
Interest payments	76,850	-	-	-	76,850
Miscellaneous	34,324	39,960	-	7,338	81,622
	<u>\$ 3,170,716</u>	<u>\$ 8,904,301</u>	<u>\$ -</u>	<u>\$ 862,992</u>	<u>\$ 12,938,009</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, 2017
(with comparative totals for the year ended September 30, 2016)

	<u>2017</u>	<u>2016</u>
Revenues:		
FSM revenue sharing:		
Gross revenue taxes	\$ 354,156	\$ 323,975
Import taxes	356,775	327,993
Income taxes	352,805	346,932
Other taxes	79,436	97,833
	<u>1,143,172</u>	<u>1,096,733</u>
State taxes:		
Sales tax	<u>447,431</u>	<u>435,377</u>
Fees and charges:		
Licenses and fees	<u>268,855</u>	<u>223,371</u>
Net change in fair value of investments	<u>144,362</u>	<u>149,235</u>
Interest and dividend income	<u>50,509</u>	<u>35,573</u>
Other:		
Other	<u>86,742</u>	<u>791,536</u>
Total revenues	<u>2,141,071</u>	<u>2,731,825</u>
Expenditures:		
Current:		
General government:		
Office of the Governor	170,151	177,048
Department of Administration and Finance	89,669	391,109
Judiciary Branch	180,729	190,334
Legislative Branch	574,559	501,471
Election	4,529	1,620
	<u>1,019,637</u>	<u>1,261,582</u>
Economic development:		
Land management and preservation	52,854	-
Agriculture development program	11,435	-
	<u>64,289</u>	<u>-</u>
Education:		
Scholarship board	<u>26,776</u>	<u>83,963</u>
Public order and safety:		
Office of the Attorney General	389,571	331,402
Parole board	320	340
	<u>389,891</u>	<u>331,742</u>
Boards, Commissions and Other:		
Department of Transportation and Infrastructure	1,103,790	1,500,860
Broadcast Authority	45,813	44,522
Sports Council	15,502	9,346
RM Small Business Development Center	2,960	6,810
Land Court	134,831	122,271
Municipal governments	8,000	14,790
Other	3,146	15,500
	<u>1,314,042</u>	<u>1,714,099</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, 2017
(with comparative totals for the year ended September 30, 2016)

	<u>2017</u>	<u>2016</u>
Expenditures, continued:		
Debt service:		
Principal payments	279,231	287,610
Interest charges	<u>76,850</u>	<u>39,047</u>
	<u>356,081</u>	<u>326,657</u>
Total expenditures	<u>3,170,716</u>	<u>3,718,043</u>
Deficiency of revenues under expenditures	<u>(1,029,645)</u>	<u>(986,218)</u>
Other financing sources:		
Operating transfers in	22,042	740,298
Advance lease payment	450,000	-
Proceeds from issuance of long-term debt	<u>213,490</u>	<u>760,702</u>
	<u>685,532</u>	<u>1,501,000</u>
Net change in fund balance	(344,113)	514,782
Fund balance at the beginning of the year	<u>1,917,746</u>	<u>1,402,964</u>
Fund balance at the end of the year	<u>\$ 1,573,633</u>	<u>\$ 1,917,746</u>

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, 2017

	Budgeted Amounts		Actual Amounts - Budgetary Basis	Variance
	Original	Final		
Revenues:				
FSM revenue sharing:	\$ 1,194,622	\$ 1,194,622	1,143,172	\$ (51,450)
State taxes:				
Sales tax	\$ 362,130	362,130	447,431	85,301
Fees and charges:				
Licences and fees	\$ 205,103	205,103	268,855	63,752
Interest and dividend income	\$ -	-	194,871	194,871
Other:				
Other	\$ 86,355	86,355	86,742	387
Total revenues	\$ 1,848,210	1,848,210	2,141,071	292,861
Expenditures:				
Current:				
General government:				
Office of the Governor	168,889	165,193	177,429	(12,236)
Department of Administration and Finance	94,820	94,093	94,788	(695)
Judiciary Branch	235,933	213,950	196,215	17,735
Legislative Branch	559,492	558,359	579,980	(21,621)
Election	-	1,620	4,529	(2,909)
	1,059,134	1,033,215	1,052,941	(19,726)
Education:				
Scholarship board	26,589	24,456	27,236	(2,780)
Public order and safety:				
Office of the Attorney General	357,910	343,916	392,995	(49,079)
Parole board	750	750	320	430
	358,660	344,666	393,315	(48,649)
Economic development:				
Land management and preservation	-	-	53,554	(53,554)
Agriculture development program	-	-	11,435	(11,435)
	-	-	64,989	(64,989)
Boards, commissions and other:				
Department of Transportation and Infrastructure	250,834	900,834	1,110,235	(209,401)
Broadcast Authority	51,624	51,624	45,963	5,661
Sports Council	18,211	16,128	20,135	(4,007)
Small Business Development Center	-	-	2,960	(2,960)
Land Court	133,410	133,410	148,993	(15,583)
Municipal governments	-	14,300	8,000	6,300
Other	500	17,000	8,846	8,154
Debt Service:				
Principal payments	3,437	3,437	279,231	(275,794)
Interest charges	4,682	4,682	76,850	(72,168)
	462,698	1,141,415	1,701,213	(559,798)
Total expenditures	1,907,081	2,543,752	3,239,694	(695,942)
Deficiency of revenues under expenditures	(58,871)	(695,542)	(1,098,623)	(403,081)
Other financing sources:				
Operating transfer in	-	-	22,042	22,042
Advance lease payment	-	-	450,000	450,000
Proceeds from issuance of long-term debt	-	-	213,490	213,490
	-	-	685,532	685,532
Net change in fund balance	(58,871)	(695,542)	(413,091)	282,451
Encumbrances	48,628	48,628	68,978	20,350
Fund balances at the beginning of the year	1,917,746	1,917,746	1,917,746	-
Fund balance at the end of the year	\$ 1,907,503	\$ 1,270,832	\$ 1,573,633	\$ 302,801

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

Combining Balance Sheet
September 30, 2017

	38	37/39	36	33	35	34	32	25	88	40	
	Scholarship Revolving Loan	Production and Development Loan	Health Care	Sports Council	Broadcasting Authority	Transportation Infrastructure Revolving	Aluminum Recycling	CFSM Grants	Gifford Scholarship	Land Administration	Total
ASSETS											
Receivables:											
General	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 36,992	\$ -	\$ -	\$ 36,992
Due from other funds	1,605	17,268	407,446	484	7,971	-	107,332	14,710	-	8,278	565,094
Prepaid items	-	7,315	27,824	-	-	-	-	-	-	-	35,139
Other assets	-	-	-	-	-	-	-	93,000	-	-	93,000
Restricted:											
Cash and equivalents	-	-	-	-	-	-	-	-	41,369	-	41,369
Time certificates of deposit	-	-	-	-	-	-	-	-	354,779	-	354,779
Total assets	<u>\$ 1,605</u>	<u>\$ 24,583</u>	<u>\$ 435,270</u>	<u>\$ 484</u>	<u>\$ 7,971</u>	<u>\$ -</u>	<u>\$ 107,332</u>	<u>\$ 144,702</u>	<u>\$ 396,148</u>	<u>\$ 8,278</u>	<u>\$ 1,126,373</u>
LIABILITIES AND FUND											
<u>BALANCES (DEFICIT)</u>											
Liabilities:											
Accounts payable	\$ -	\$ 1,632	\$ 77,330	\$ -	\$ -	\$ -	\$ 4,067	\$ 2,094	\$ -	\$ -	\$ 85,123
Other liabilities and accruals	-	-	-	-	-	-	-	2,294	-	-	2,294
Due to other funds	-	-	-	-	-	-	-	-	2,976	-	2,976
Unearned revenue	-	-	-	-	-	-	-	33	-	-	33
Total liabilities	<u>-</u>	<u>1,632</u>	<u>77,330</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>4,067</u>	<u>4,421</u>	<u>2,976</u>	<u>-</u>	<u>90,426</u>
Fund balances (deficit):											
Non-spendable	-	-	-	-	-	-	-	93,000	-	-	93,000
Restricted	-	-	-	-	-	-	-	47,281	393,172	-	440,453
Committed	1,605	22,951	357,940	484	7,971	-	103,265	-	-	-	494,216
Unassigned	-	-	-	-	-	-	-	-	-	8,278	8,278
Total fund balances (deficit)	<u>1,605</u>	<u>22,951</u>	<u>357,940</u>	<u>484</u>	<u>7,971</u>	<u>-</u>	<u>103,265</u>	<u>140,281</u>	<u>393,172</u>	<u>8,278</u>	<u>1,035,947</u>
Total liabilities and fund balances	<u>\$ 1,605</u>	<u>\$ 24,583</u>	<u>\$ 435,270</u>	<u>\$ 484</u>	<u>\$ 7,971</u>	<u>\$ -</u>	<u>\$ 107,332</u>	<u>\$ 144,702</u>	<u>\$ 396,148</u>	<u>\$ 8,278</u>	<u>\$ 1,126,373</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, 2017

	38	37/39	36	33	35	34	32	25	88	40	
	Scholarship Revolving Loan	Production and Development Loan	Health Care	Sports Council	Broadcasting Authority	Transportation Infrastructure Revolving	Aluminum Recycling	CFSM Grants	Gifford Scholarship	Land Administration	Total
Revenues:											
Fees and charges	\$ 2,246	\$ 13,629	\$ 252,321	\$ 252	\$ 808	\$ -	\$ 83,726	\$ -	\$ -	\$ 16,000	\$ 368,982
CFSM grants	-	-	-	-	-	-	-	609,449	-	-	609,449
Interest income	-	14	123	-	-	-	70	-	2,255	-	2,462
Total revenues	<u>2,246</u>	<u>13,643</u>	<u>252,444</u>	<u>252</u>	<u>808</u>	<u>-</u>	<u>83,796</u>	<u>609,449</u>	<u>2,255</u>	<u>16,000</u>	<u>980,893</u>
Expenditures by function:											
Current:											
General Government	-	-	-	-	-	-	-	13,995	-	-	13,995
Health services	-	-	157,404	-	-	-	-	-	-	-	157,404
Environment, protection and sanitation	-	-	-	-	-	-	78,230	-	-	-	78,230
Boards, commissions and other	<u>7,000</u>	<u>10,909</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>595,454</u>	<u>-</u>	<u>-</u>	<u>613,363</u>
Total expenditures	<u>7,000</u>	<u>10,909</u>	<u>157,404</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>78,230</u>	<u>609,449</u>	<u>-</u>	<u>-</u>	<u>862,992</u>
Excess of revenues over expenditures	(4,754)	2,734	95,040	252	808	-	5,566	-	2,255	16,000	117,901
Other financing uses:											
Operating transfer out	-	-	-	-	-	(22,042)	-	-	-	-	(22,042)
Net change in fund balances (deficit)	<u>(4,754)</u>	<u>2,734</u>	<u>95,040</u>	<u>252</u>	<u>808</u>	<u>(22,042)</u>	<u>5,566</u>	<u>-</u>	<u>2,255</u>	<u>16,000</u>	<u>95,859</u>
Fund balances (deficit) at the beginning of the year	<u>6,359</u>	<u>20,217</u>	<u>262,900</u>	<u>232</u>	<u>7,163</u>	<u>22,042</u>	<u>97,699</u>	<u>140,281</u>	<u>390,917</u>	<u>(7,722)</u>	<u>940,088</u>
Fund balances (deficit) at the end of the year	<u>\$ 1,605</u>	<u>\$ 22,951</u>	<u>\$ 357,940</u>	<u>\$ 484</u>	<u>\$ 7,971</u>	<u>\$ -</u>	<u>\$ 103,265</u>	<u>\$ 140,281</u>	<u>\$ 393,172</u>	<u>\$ 8,278</u>	<u>\$ 1,035,947</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 Account,
and Changes in Fund Balances (Deficit)
Year Ended September 30, 2017

	38	37/39	36	33	35	34	32	25	88	40	
	Scholarship Revolving Loan	Production and Development Loan	Health Care	Sports Council	Broadcasting Authority	Transportation Infrastructure Revolving	Aluminum Recycling	CFSM Grants	Gifford Scholarship	Land Administration	Total
Revenues:											
Fees and charges	\$ 2,246	\$ 13,629	\$ 252,321	\$ 252	\$ 808	\$ -	\$ 83,726	\$ -	\$ -	\$ 16,000	\$ 368,982
CFSM Grants	-	-	-	-	-	-	-	609,449	-	-	609,449
Interest income	-	14	123	-	-	-	70	-	2,255	-	2,462
Total revenues	2,246	13,643	252,444	252	808	-	83,796	609,449	2,255	16,000	980,893
Expenditures by account:											
Salaries and wages:											
Regular	-	-	4,800	-	-	-	-	42,028	-	-	46,828
Fringe benefits	-	-	596	-	-	-	-	6,008	-	-	6,604
Travel and transportation	-	-	64,225	-	-	-	-	-	-	-	64,225
Food stuffs	-	-	-	-	-	-	-	1,779	-	-	1,779
Office supplies and materials	-	10,571	-	-	-	-	78,230	18,526	-	-	107,327
POL	-	-	-	-	-	-	-	29,998	-	-	29,998
Contractual services	-	-	-	-	-	-	-	466,907	-	-	466,907
Medical supplies	-	-	87,783	-	-	-	-	-	-	-	87,783
Equipment	-	-	-	-	-	-	-	44,203	-	-	44,203
Miscellaneous	7,000	338	-	-	-	-	-	-	-	-	7,338
Total expenditures	7,000	10,909	157,404	-	-	-	78,230	609,449	-	-	862,992
Excess of revenues over expenditures	(4,754)	2,734	95,040	252	808	-	5,566	-	2,255	16,000	117,901
Other financing uses:											
Operating transfer out	-	-	-	-	-	(22,042)	-	-	-	-	(22,042)
Net change in fund balances (deficit)	(4,754)	2,734	95,040	252	808	(22,042)	5,566	-	2,255	16,000	95,859
Fund balances (deficit) at the beginning of the year	6,359	20,217	262,900	232	7,163	22,042	97,699	140,281	390,917	(7,722)	940,088
Fund balances (deficit) at the end of the year	\$ 1,605	\$ 22,951	\$ 357,940	\$ 484	\$ 7,971	\$ -	\$ 103,265	\$ 140,281	\$ 393,172	\$ 8,278	\$ 1,035,947

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet
September 30, 2017

	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
<u>ASSETS</u>						
Receivables:						
Federal agencies	\$ 11,074	\$ -	\$ 6,000	\$ -	\$ -	\$ 2,451
Advances	-	9,244	-	2,866	2,601	-
Prepayments	30	225	999	-	-	-
Due from other funds	205,941	413,560	113,117	79,241	57,406	138,397
Other assets	-	-	-	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total assets	<u>\$ 217,045</u>	<u>\$ 423,029</u>	<u>\$ 120,116</u>	<u>\$ 82,107</u>	<u>\$ 60,007</u>	<u>\$ 140,848</u>
<u>LIABILITIES AND FUND BALANCES</u>						
Liabilities:						
Accounts payable	\$ 6,821	\$ 54,254	\$ 1,079	\$ 3,880	\$ 692	\$ 49
Other liabilities and accruals	61,408	36,780	10,378	6,368	5,116	1,795
Due to other funds	-	-	-	-	-	525
Unearned revenues	<u>148,816</u>	<u>331,995</u>	<u>108,659</u>	<u>71,859</u>	<u>54,199</u>	<u>89,500</u>
Total liabilities	<u>217,045</u>	<u>423,029</u>	<u>120,116</u>	<u>82,107</u>	<u>60,007</u>	<u>91,869</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>\$ 217,045</u>	<u>\$ 423,029</u>	<u>\$ 120,116</u>	<u>\$ 82,107</u>	<u>\$ 60,007</u>	<u>\$ 140,848</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet, Continued
September 30, 2017

	Section 211(a)(7) Supplemental Education	Enhanced Reporting Accountability	U.S. Federal Grants	Foreign Assistance	Total
<u>ASSETS</u>					
Receivables:					
Federal agencies	\$ -	\$ 1,968	\$ 155,593	\$ -	\$ 177,086
Advances	639	-	13,175	-	28,525
Prepayments	(41)	-	-	-	1,213
Due from other funds	245,908	11,046	-	367,759	1,632,375
Other assets	-	-	-	100,000	100,000
	<u>-</u>	<u>-</u>	<u>-</u>	<u>100,000</u>	<u>100,000</u>
Total assets	<u>\$ 246,506</u>	<u>\$ 13,014</u>	<u>\$ 168,768</u>	<u>\$ 467,759</u>	<u>\$ 1,939,199</u>
<u>LIABILITIES AND FUND BALANCES</u>					
Liabilities:					
Accounts payable	\$ 12,682	\$ -	\$ 25,305	\$ -	\$ 104,762
Other liabilities and accruals	7,097	8,543	36,617	-	174,102
Due to other funds	-	-	106,846	-	107,371
Unearned revenues	<u>226,727</u>	<u>4,471</u>	<u>-</u>	<u>-</u>	<u>1,036,226</u>
Total liabilities	<u>246,506</u>	<u>13,014</u>	<u>168,768</u>	<u>-</u>	<u>1,422,461</u>
Fund balances:					
Non-spendable	-	-	-	100,000	100,000
Restricted	<u>-</u>	<u>-</u>	<u>-</u>	<u>367,759</u>	<u>416,738</u>
Total fund balances	<u>-</u>	<u>-</u>	<u>-</u>	<u>467,759</u>	<u>516,738</u>
Total liabilities and fund balances	<u>\$ 246,506</u>	<u>\$ 13,014</u>	<u>\$ 168,768</u>	<u>\$ 467,759</u>	<u>\$ 1,939,199</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, 2017

	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	\$ 2,309,554	\$ 1,924,495	\$ 416,809	\$ 295,608	\$ 279,267	\$ 373,175
Federal contributions	-	-	-	-	-	-
Total revenues	<u>2,309,554</u>	<u>1,924,495</u>	<u>416,809</u>	<u>295,608</u>	<u>279,267</u>	<u>373,175</u>
Expenditures by function:						
Current:						
General government	-	-	-	295,608	-	373,175
Economic development	-	-	416,809	-	-	-
Education	2,309,554	-	-	-	-	-
Health services	-	1,924,495	-	-	-	-
Environment protection and sanitation	-	-	-	-	279,267	-
Total expenditures	<u>2,309,554</u>	<u>1,924,495</u>	<u>416,809</u>	<u>295,608</u>	<u>279,267</u>	<u>373,175</u>
Excess of revenues over expenditures	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
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, 2017

	Section 211(a)(7) Supplemental Education	Enhanced Reporting Accountability	U.S. Federal Grants	Foreign Assistance	Total
Revenues:					
Compact funding	\$ 1,083,880	\$ 188,529	\$ -	\$ -	\$ 6,871,317
Federal contributions	-	-	1,885,554	-	1,885,554
Total revenues	<u>1,083,880</u>	<u>188,529</u>	<u>1,885,554</u>	<u>-</u>	<u>8,756,871</u>
Expenditures by function:					
Current:					
General government	-	188,529	-	147,430	1,004,742
Economic development	-	-	-	-	416,809
Education	1,083,880	-	531,780	-	3,925,214
Health services	-	-	1,261,372	-	3,185,867
Environment protection and sanitation	-	-	92,402	-	371,669
Total expenditures	<u>1,083,880</u>	<u>188,529</u>	<u>1,885,554</u>	<u>147,430</u>	<u>8,904,301</u>
Excess of revenues over expenditures	<u>-</u>	<u>-</u>	<u>-</u>	<u>(147,430)</u>	<u>(147,430)</u>
Net change in fund balances	-	-	-	(147,430)	(147,430)
Fund balances at the beginning of the year	<u>-</u>	<u>-</u>	<u>-</u>	<u>615,189</u>	<u>664,168</u>
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 467,759</u>	<u>\$ 516,738</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, 2017

	10	11	13	14	12	18/19
	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	\$ 2,309,554	\$ 1,924,495	\$ 416,809	\$ 295,608	\$ 279,267	\$ 373,175
Federal contributions	-	-	-	-	-	-
Total revenues	<u>2,309,554</u>	<u>1,924,495</u>	<u>416,809</u>	<u>295,608</u>	<u>279,267</u>	<u>373,175</u>
Expenditures by account:						
Salaries and wages:						
Regular	1,458,361	708,899	192,095	150,435	144,147	-
Overtime	-	154,067	10,741	-	156	-
Fringe benefits	193,391	95,995	27,399	13,161	20,164	-
Other personnel costs	-	-	-	-	-	-
Travel and transportation	-	23,747	25,771	34,194	9,910	3,350
Communications	17,488	3,027	14,396	9,561	5,407	389
Dues, membership, and subscriptions	-	4,000	150	1,925	-	-
Food stuffs	66	25,248	-	-	-	-
Port charges	-	778	298	-	-	-
Office supplies and materials	191,917	49,935	51,180	5,534	26,722	8,360
POL	39,864	10,958	7,548	850	15,802	188
Printing and reproduction	2,160	6,797	-	608	2,860	2,052
Rental services	329	90	280	-	904	-
Repairs and maintenance	5,648	349	1,069	235	338	-
Utilities	76,509	174,897	20,916	2,900	5,074	2,150
Medical referral	-	2,873	-	-	-	-
Medical supplies	-	412,869	-	-	-	-
Contractual services	105,863	116,998	47,660	7,851	25,705	307,923
Professional services	-	56,564	-	-	-	48,763
Scholarships and allowances	192,547	540	1,080	-	1,240	-
Training	-	34,430	-	46,292	6,260	-
Leased housing, buildings and land	23,710	22,944	-	14,415	2,930	-
Equipment	-	18,400	-	7,647	11,603	-
Miscellaneous	1,701	90	16,226	-	45	-
Total expenditures	<u>2,309,554</u>	<u>1,924,495</u>	<u>416,809</u>	<u>295,608</u>	<u>279,267</u>	<u>373,175</u>
Excess of revenues over expenditures	-	-	-	-	-	-
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, 2017

	15	16	20/21	23	
	Section 211(a)(7) Supplemental Education	Enhanced Reporting Accountability	U.S. Federal Grants	Foreign Assistance	Total
Compact funding	\$ 1,083,880	\$ 188,529	\$ -	\$ -	\$ 6,871,317
Federal contributions	-	-	1,885,554	-	1,885,554
Total revenues	<u>1,083,880</u>	<u>188,529</u>	<u>1,885,554</u>	<u>-</u>	<u>8,756,871</u>
Expenditures by account:					
Salaries and wages:					
Regular	160,851	164,460	901,344	-	3,880,592
Overtime	-	4,543	-	-	169,507
Fringe benefits	18,581	19,526	113,671	-	501,888
Other personnel costs	-	-	12,530	-	12,530
Travel and transportation	45,378	-	220,414	-	362,764
Communications	21,485	-	14,266	-	86,019
Dues, membership, and subscriptions	1,870	-	-	-	7,945
Food stuffs	-	-	400	-	25,714
Port charges	125	-	82	-	1,283
Office supplies and materials	250,161	-	176,103	875	760,787
POL	1,803	-	20,638	-	97,651
Printing and reproduction	200	-	8,196	-	22,873
Rental services	1,060	-	1,334	-	3,997
Repairs and maintenance	2,131	-	3,345	-	13,115
Utilities	28,750	-	25,038	-	336,234
Medical referral	-	-	-	-	2,873
Medical supplies	-	-	31,658	-	444,527
Contractual services	357,857	-	102,860	49,615	1,122,332
Professional services	-	-	23,994	-	129,321
Scholarships and allowances	-	-	6,810	-	202,217
Training	121,607	-	27,050	-	235,639
Leased housing, buildings and land	32,094	-	3,696	-	99,789
Equipment	38,677	-	171,477	96,940	344,744
Miscellaneous	1,250	-	20,648	-	39,960
Total expenditures	<u>1,083,880</u>	<u>188,529</u>	<u>1,885,554</u>	<u>147,430</u>	<u>8,904,301</u>
Excess of revenues over expenditures	<u>-</u>	<u>-</u>	<u>-</u>	<u>(147,430)</u>	<u>(147,430)</u>
Net change in fund balances	<u>-</u>	<u>-</u>	<u>-</u>	<u>(147,430)</u>	<u>(147,430)</u>
Fund balances at the beginning of the year	<u>-</u>	<u>-</u>	<u>-</u>	<u>615,189</u>	<u>664,168</u>
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 467,759</u>	<u>\$ 516,738</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, 2017, 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 May 30, 2018.

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.

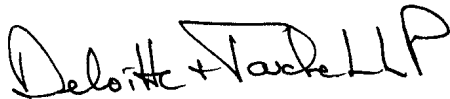
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not 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 + Nauck LLP". The signature is stylized, with the "D" being large and the "LLP" being written in a cursive-like font.

May 30, 2018

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, 2017. 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, 2017. 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* (Uniform Guidance), if required.

Management's Responsibility

Management is responsible for compliance with 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, 2017.

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.

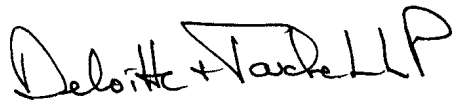
A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement 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, 2017, and the related notes to the financial statements, which collectively comprise State of Kosrae's basic financial statements. We issued our report thereon dated May 30, 2018, which contained unmodified opinions on those financial statements. 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.

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

May 30, 2018

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Summary Schedule of Expenditures of Federal Awards, by Grantor
Year Ended September 30, 2017

Agency	Expenditures
U.S. Department of Agriculture	\$ 48,836
U.S. Department of the Interior	6,914,882
U.S. Department of Education	531,780
U.S. Department of Health and Human Services	<u>1,261,373</u>
GRAND TOTAL	<u>\$ 8,756,871</u>

Reconciliation to the basic financial statements:

Grants Assistance Fund expenditures	\$ 8,904,301
Less:	
Foreign Assistance Fund expenditures	<u>(147,430)</u>
	<u>\$ 8,756,871</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, 2017

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Entity Identifying Number	Federal Expenditures
U.S. DEPARTMENT OF AGRICULTURE:			
Direct Programs:			
Cooperative Forestry Assistance	10.664		4,402
Urban and Community Forestry Program	10.675		23,758
Forest Legacy Program	10.676		11,118
Forest Stewardship Program	10.678		9,558
Total U.S. Department of Agriculture			<u>\$ 48,836</u>
U.S. DEPARTMENT OF THE INTERIOR:			
Pass-Through From the FSM National Government:		A3	
Economic, Social and Political Development of the Territories:			
Compact of Free Association Sector Grants:	15.875		
Compact II Education Sector			\$ 2,309,554
Compact II Health Sector			1,924,495
Compact II Private Sector Development			416,809
Compact II Capacity Building			295,608
Compact II Environment			279,267
Compact II Infrastructure Sector			373,175
Supplemental Education Grant			1,083,880
Compact II Enhanced Reporting Accountability			188,529
Historic Preservation Fund Grants-In Aid	15.904		43,565
Total U.S. Department of the Interior			<u>\$ 6,914,882</u>
U.S. DEPARTMENT OF EDUCATION:			
Pass-Through From the FSM National Government:		A3	
Special Education Cluster (IDEA):			
Special Education - Grants to States	84.027A		\$ 531,780
Total Special Education Cluster (IDEA) and			
Total U.S. Department of Education			<u>\$ 531,780</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES:			
Pass-Through From the FSM National Government:		A3	
Affordable Care Act (ACA) Personal Responsibility Education Program	93.092		\$ 28,276
Maternal and Child Health Federal Consolidated Programs	93.110		7,246
Project Grants and Cooperative Agreements for Tuberculosis			
Control Programs	93.116		31,289
Family Planning - Services	93.217		21,573
Health Center Program Cluster:			
Health Center Program (Community Health Centers, MHC, HCH and PHPC)	93.224		789,083
Subtotal Health Center Program Cluster			789,083
Grants to States to Support Oral health Workforce Activities	93.236		7,956
Substance Abuse and Mental Health Services - Projects of Regional and National Significance	93.243		113,230
Universal Newborn Hearing Screening	93.251		2,719
Immunization Cooperative Agreements	93.268		42,273
Centers for Disease Control and Prevention_Investigations and Technical Assistance	93.283		62,792
EHID-IS Surveillance Program	93.314		3,256
PPHF: Racial and Ethnic Approaches to Community Health Program Financed Solely By Public Prevention And Health Funds	93.738		4,315
Preventive Health & Health Services Block Grant funded solely with PPHF	93.758		3,494
Cancer Prevention and Control Programs for State, Territorial and Tribal Org	93.898		12,354
Assistance Programs for Chronic Disease Prevention & Control	93.945		40,028
Block Grants for Community Mental Health Service	93.958		1,260
Block Grants for Prevention and Treatment of Substance Abuse	93.959		62,502
Maternal and Child Health Services Block Grant to the States	93.994		27,727
Total U.S. Department of Health and Human Services			<u>\$ 1,261,373</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 8,756,871</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, 2017

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 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, 2017. 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* (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, 2017 basic financial statements; and all of the discretely presented component units are excluded and did not expend federal awards during the year ended September 30, 2017. Accordingly, the accompanying Schedule presents the federal award programs administered by the State of Kosrae, as defined above, for the year ended September 30, 2017.

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, 2017

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: | |

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
15.875	Economic, Social and Political Development of the Territories – Compact of Free Association Compact Sector Grants
93.224	Health Center Program Cluster

- | | |
|--|-----------|
| 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, 2017

There are no unresolved prior audit findings and questioned costs.