

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2010

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2010

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

YEAR ENDED SEPTEMBER 30, 2010

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae (the State) as of and for the year ended September 30, 2010, which collectively comprise the State's basic financial statements as set forth in Section II of the foregoing table of contents. These financial statements are the responsibility of the management of the State. Our responsibility is to express opinions on these financial statements based on our audit.

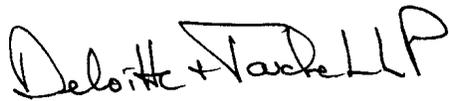
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae as of September 30, 2010, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis, on pages 3 through 9, as well as the Schedule of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund and notes thereto, as set forth in Section III of the foregoing table of contents, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the management of the State. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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 IV of the foregoing table of contents, which are also the responsibility of the management of the State, are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such additional information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 21, 2011 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

June 21, 2011

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Management's Discussion and Analysis
September 30, 2010

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, 2010. We encourage readers to consider this information in conjunction with Kosrae State's financial statements, which follow. Fiscal year 2009 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

- For fiscal year ended September 30, 2010, Kosrae State's total net assets increased by \$3.81 million (or 23.2%) from \$16.39 million in the prior year to \$20.19 million. This increase is primarily attributable to the donated capital assets from the FSM National Government of \$4,217,873. The donation consisted of the High School building donated and constructed by the China Government. It also included road improvements of \$500,000 funded by the FSM National Government although the net book value of such infrastructure was reduced to zero.
- A General Fund budgetary deficit resulted in fiscal year 2010 due to the deficiency of revenues under expenditures by \$.137 million. The ending fund deficit amounted to \$.43 million which is an increase in the deficit of \$.119 million compared to prior year. Although the total revenues increased by 10% compared to fiscal year 2009; likewise total expenditures also increased by 19% compared to prior year; which included loan payments to FSM Development Bank and FSM National Government of \$156,528 and \$150,000 respectively; a subsidy of \$30,000 to an agency and another \$30,000 was spent for the Micronesia games. More than \$36,000 was also reserved as continuing appropriations for election related expenses.
- During fiscal year 2010, Kosrae State's General Fund balance reduced by \$.081 million and resulted in an ending fund balance of \$.575 million. The reduction was due to the deficiency in revenues generated under expenditures of \$.123 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) governmental-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 and component units.

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

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

The statement of activities on the other hand, account for the State's current year's 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, 2010

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 Corporation and Kosrae Port Authority in its report. Although separate, these "component units" are important because Kosrae State is financially accountable for them. Micronesia Petroleum Corporation (MPC), a former component unit of the State was dissolved in March 2009 by Kosrae State Law no. 9-91. Due to its dissolution, all its assets and liabilities were transferred to the State.

Fund Financial Statements

The fund financial statements provide more detailed information about Kosrae State's significant funds. Funds are accounting devices that Kosrae State uses to keep track of specific sources of funding and spending for particular services. The State uses fund accounting to comply with financial and related legal requirements. The fund financial statements present a balance sheet and a statement of revenues, expenditures, and changes in fund balances for its major and aggregated non-major funds.

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

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

FINANCIAL ANALYSIS OF KOSRAE STATE AS A WHOLE

Kosrae State's net assets at the end of fiscal year 2010, exceeded liabilities by \$20.19 million. As earlier stated, the bulk of the increase in the net assets was due to donated capital assets received in fiscal year 2010; although \$7.47 million is restricted. Kosrae State uses these capital assets to provide services to its citizen; consequently, these assets are not available for future spending. Although Kosrae State's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debts must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The following summary of Kosrae State's net assets as of September 30, 2010, with comparable balances for the fiscal year 2009, discloses this relationship:

	<u>2010</u>	<u>2009</u>
ASSETS		
Current and other non-capital assets	\$ 9,214,286	\$ 9,221,088
Capital assets	<u>18,302,263</u>	<u>14,757,241</u>
Total Assets	<u>27,516,549</u>	<u>23,978,329</u>

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September 30, 2010

LIABILITIES		
Long-term liabilities	\$ 5,860,625	\$ 5,630,102
Other liabilities	<u>1,461,101</u>	<u>1,959,597</u>
Total Liabilities	<u>7,321,726</u>	<u>7,589,699</u>
NET ASSETS		
Invested in capital assets, net of related debt	18,302,263	14,757,241
Restricted	7,469,627	7,126,979
Unrestricted	<u>(5,577,067)</u>	<u>(5,495,590)</u>
Total Net Assets	<u>\$ 20,194,823</u>	<u>\$ 16,388,630</u>

At the end of fiscal year 2010, Kosrae State's unrestricted net assets showed a deficit of \$5.57 million, an increase of \$.081 million (or 1.5%) as compared to the prior year. Increases in the deficit currently are due to the decline in State taxes by more than \$.14 million as well as the reduction in operating grants and contributions by almost \$.30 million. The 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.

Net assets increased by \$3.80 million (or 155.2%) from the prior year. Key elements of the differences from the prior year are shown in the following schedule.

	<u>2010</u>	<u>2009</u>
Revenues:		
Operating grants and contributions	\$ 8,571,283	\$ 8,865,031
Capital grants and contributions	4,277,664	2,017,245
Charges for services	489,967	427,596
Revenue sharing	1,048,631	1,039,493
Unrestricted investment earnings	52,016	123,151
Taxes	372,025	518,783
Other	<u>719,358</u>	<u>383,853</u>
Total revenues	<u>15,530,944</u>	<u>13,375,152</u>
Expenses:		
General government	1,942,827	2,423,383
Education	3,809,853	4,147,301
Health services	2,284,819	2,504,432
Economic development	1,152,362	1,326,337
Boards, commissions and other	1,747,285	1,364,191
Environment protection and sanitation	127,370	109,350
Public order and safety	325,247	317,319
Future operations	<u>334,988</u>	<u>-</u>
Total expenses	<u>11,724,751</u>	<u>12,192,313</u>
Special items	<u>-</u>	<u>308,608</u>
Change in net assets	3,806,193	1,491,447
Net assets at the beginning of the year	<u>16,388,630</u>	<u>14,897,183</u>
Net assets at the end of the year	<u>\$ 20,194,823</u>	<u>\$ 16,388,630</u>

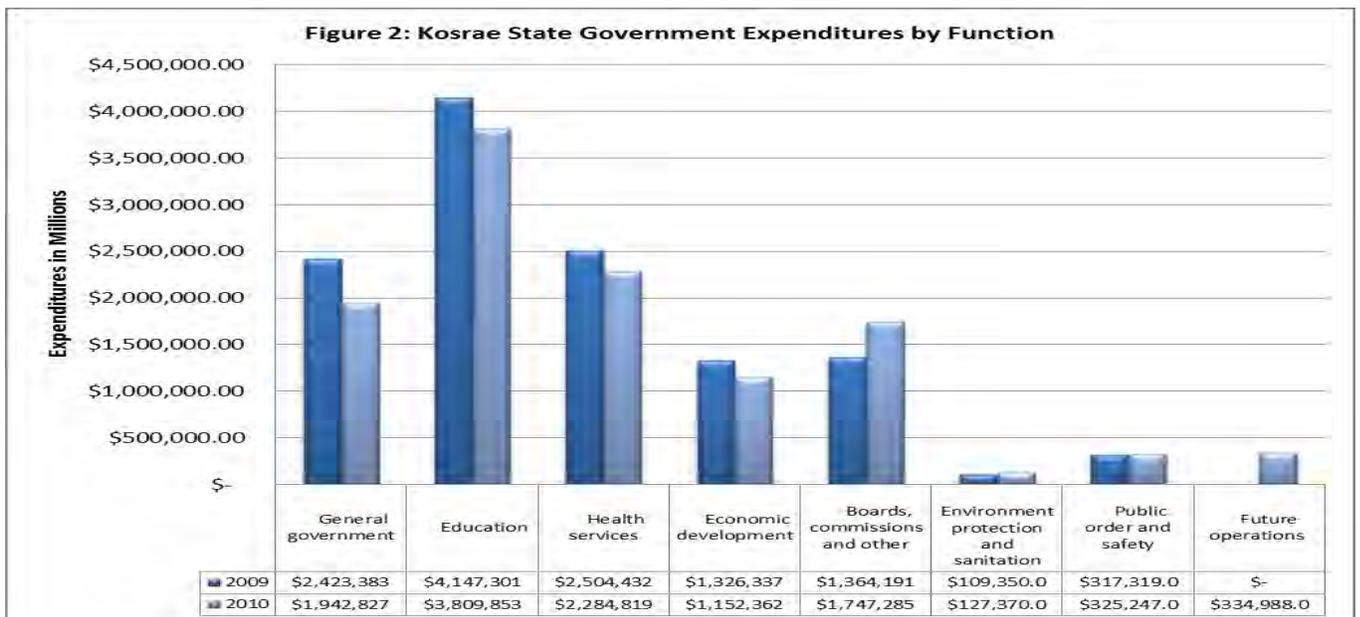
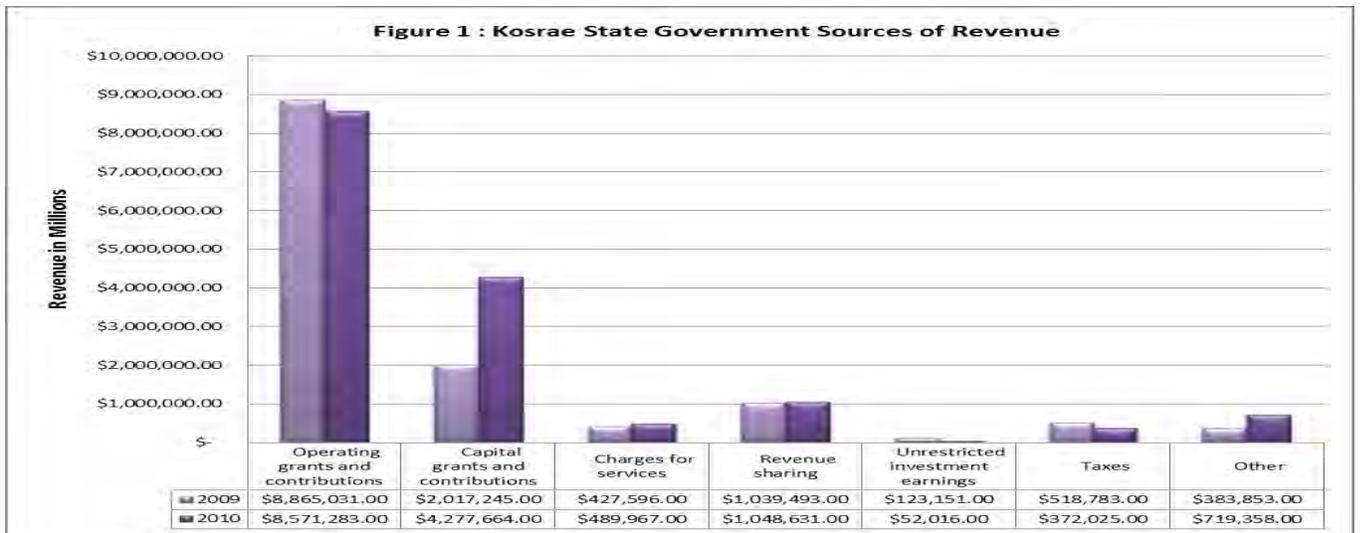
**STATE OF KOSRAE
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Management's Discussion and Analysis
September 30, 2010

Figure 1 below showed that the total revenues in fiscal year 2010 of \$15.53 million increased by \$2.155 million from the prior year's \$13.37 million (up by 16.1%). The increase was primarily due to the increase in the current year's capital grants and contributions of \$2.26 million and other revenues of \$.33 million. In fiscal year 2010, Grants Assistance Fund comprised 52.31% of all Kosrae State funding sources whereas the General Fund comprised only 15.29%.

Figure 2 presented that total expenses of \$11.72 million reflected a 3.8% decrease from prior year expenses without special items.

The following graphs show the major components of revenues and expenditures for the year ended September 30, 2010.



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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 2010, Kosrae State governmental funds reported a combined fund balance of \$8.126 million which represents \$.298million increase or (3.8%) from the \$7.83 million recorded at the end of fiscal 2009. These increases are attributable mainly to the net increase in the fair value of investments (\$.46 million), other grants (\$.105 million) and other revenues (\$.335 million). Of this total combined fund balance, \$8.30 million is reserved to indicate that it is not available for new spending because it has already been committed: 1) to generate income for future operations or to reflect long-term loan or investment activities (\$7.028 million); 2) to liquidate contracts and purchase orders of the prior period (\$1.011million); or 3) to fund specific general fund and grants assistance related activities (\$.261 million). These reserved fund balances are off-set by a combined unreserved deficit of \$.175 million a decrease of \$.091 million (or 34%) from fiscal year 2009. The overall decrease in the unreserved fund deficit is attributed to the Special Revenue Funds and Capital Project funds.

The General Fund is the main operating fund of the State. At the end of the current fiscal year, the unreserved fund deficit of the General Fund was \$.43 million as compared with the prior year ending unreserved fund deficit of \$.311 million, an increase of \$.119 million (or 38%) while total fund balance was \$.575 million compared with a total fund balance of \$.656 million at the end of prior fiscal year, a decline of \$.081 million. The decrease in the overall fund balance of the General Fund was primarily due to the deficiency of revenues under expenditures.

The Grants Assistance Fund has a total fund balance of \$1.87 million, which primarily represents Compact Sector grant revenues received not yet expended at year end. The net increase in fund balance during the current year in the Grants Assistance Fund was \$.091 million or (5%), which primarily was the result of the utilization of the Compact Sector Grant received in the previous year.

The Early Retirement Fund, has a total fund balance of \$1.49 million as compared with the prior year ending fund balance of \$1.55 million ; a deterioration of \$.056 million. The downward revision was due to the repayment ADB loan principal of \$.16 million which offset the net increase in the fair value of investments \$.108 million.

The Compact Trust Fund has a total fund balance of \$2.84 million, all of which is reserved for funding future operations of the primary government commencing in fiscal year 2023. The increase in fund balance during the current year in the Compact Trust Fund was \$.34 million (or 13.53%), which reflected a significant increase in the fair value of investments as compared to the prior year.

GENERAL FUND BUDGETARY HIGHLIGHTS

During the course of the fiscal year, management and elected officials of Kosrae State Government found it necessary to revise the General Fund budget to reign in expenditures, when revenue collections did not match inflated revenue projections. For the year ended September 30, 2010, general fund revenues excluding other financing sources were deficient compared to expenditures by \$.137 million. Other financing sources of \$.042 million offset the deficiency with a resultant change of \$.094 million in unreserved deficit. The ending unreserved fund deficit increased in fiscal year 2010; from \$.311 million in the prior year to \$.43 million in the current year.

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Management's Discussion and Analysis
September 30, 2010

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Kosrae State's investment in capital assets for the primary government as of September 30, 2010, amounted to \$56.84 million, net of accumulated depreciation of \$38.54 million, leaving a net book value of \$18.30 million. This represents a net increase of \$3.545 million (or 24%) from fiscal year 2009. The increase for the year was due to the capital assets donations by FSM National Government of \$4.717 million which offset the depreciation charges of \$ 1.49 million.

The table below summarizes Kosrae State's capital assets, net:

	<u>2010</u>	<u>2009</u>
Buildings	\$ 7,798,295	\$ 3,906,929
Infrastructure	9,749,609	10,197,338
Machinery, equipment and others	<u>754,359</u>	<u>652,974</u>
	\$ <u>18,302,263</u>	\$ <u>14,757,241</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 2010, which is greater than fiscal year 2009 balances primarily due to the addition of the ADB Loans of \$.456 million less the repayments made of \$.418 million:

	<u>2010</u>	<u>2009</u>
FSM National Government Loan	\$ 1,350,000	\$ 1,500,000
ADB Loans	4,370,080	4,035,056
FSM DB Loan	150,602	289,578
Malem Water	127,781	136,173
Other Claims	<u>235,000</u>	<u>235,000</u>
	\$ <u>6,233,463</u>	\$ <u>6,195,807</u>

Interest and principal payment on ADB loans commenced in fiscal year 2008. Additional information on Kosrae State's long-term debt obligations can be found in note 6 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

General Fund

For the local revenues; it is anticipated that beginning of fiscal year 2012 and until fiscal year 2013; the U. S. Federal Aviation Administration (FAA) funded project (95% funding) currently being undertaken by a foreign company, will bring added revenues to the State in terms of import tax, business gross revenue and tax on wages. In addition, the Department of Administration and Finance will launch a tax audit of businesses in Kosrae which is expected to help the State improve its sales taxes collections in the ensuing years.

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Management's Discussion and Analysis
September 30, 2010

Having projected the above scenarios however will not totally eliminate the local revenues deficit. In fact, it is estimated that by the end of fiscal year 2011 if no added revenues are realized; the unreserved fund deficit will increase.

The Kosrae State leaders are cognizant of the above problem and as a result held a Leadership Conference in April 2011 to address and find solutions to the problem that government currently faces. Short-term and long-term solutions to the noted financial problem are presently being worked out by the committees designated by the Governor of Kosrae State.

Grant Assistance Funds

Grants Assistance Funds (specifically compact funding) will continue to be the major funding sources for the Kosrae State in fiscal year 2011 with the total approved funding of \$6,151,184 as follows:

Education Sector	\$2,468,964
Health Sector	\$2,158,786
Environment Sector	\$ 212,131
Private Sector	\$ 827,107
Capacity Building Sector	\$ 484,196

In addition, the Supplemental Education Grant for fiscal year 2010 with the total grant award of \$1.38 million is available in fiscal year 2011.

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 Assets
September 30, 2010

	Primary Government	Component Units
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 1,048,935	\$ 216,252
Investments	-	483,595
Receivables, net	1,238,670	173,179
Inventories	-	402,774
Prepayments	80,219	2,981
Advances	284,207	-
Restricted assets:		
Time certificates of deposit	-	287,042
Total current assets	2,652,031	1,565,823
Noncurrent assets:		
Capital assets, net of accumulated depreciation	18,302,263	22,787,305
Investments	1,200,000	-
Restricted assets:		
Cash and cash equivalents	476,971	-
Time certificates of deposit	554,383	-
Investments	4,330,901	-
Total noncurrent assets	24,864,518	22,787,305
Total assets	\$ 27,516,549	\$ 24,353,128
<u>LIABILITIES</u>		
Current liabilities:		
Current portion of long-term obligations	\$ 372,838	\$ 98,339
Accounts payable	432,364	115,853
Other liabilities and accruals	365,554	390,975
Deferred revenues	290,345	21,200
Due to primary government	-	72,174
Total current liabilities	1,461,101	698,541
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	5,625,625	69,580
Other noncurrent liabilities	235,000	-
Total noncurrent liabilities	5,860,625	69,580
Total liabilities	7,321,726	768,121
Commitments and contingencies		
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	18,302,263	22,619,386
Restricted for:		
Nonexpendable:		
Future operations	2,837,836	-
Expendable:		
Debt service	1,493,065	-
Compact related	1,670,835	-
Other purposes	1,467,891	90,000
Unrestricted	(5,577,067)	875,621
Total net assets	20,194,823	23,585,007
Total liabilities and net assets	\$ 27,516,549	\$ 24,353,128

See accompanying notes to basic financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Statement of Activities
Year Ended September 30, 2010

Functions/Programs	Expenses	Program Revenues			Net (Expenses) Revenues and Changes in Net Assets	
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government	Component Units
Primary government:						
Governmental activities:						
General government	\$ 1,942,827	\$ 264,979	\$ 772,866	\$ 59,791	\$ (845,191)	\$ -
Economic development	1,152,362	1,493	977,454	-	(173,415)	-
Education	3,809,853	851	4,161,710	3,717,873	4,070,581	-
Health services	2,284,819	139,349	2,273,615	-	128,145	-
Public order and safety	325,247	-	-	-	(325,247)	-
Environment protection and sanitation	127,370	80,426	29,604	-	(17,340)	-
Boards, commissions and other	1,747,285	2,869	17,804	500,000	(1,226,612)	-
Future operations	334,988	-	338,230	-	3,242	-
Total primary government	<u>\$ 11,724,751</u>	<u>\$ 489,967</u>	<u>\$ 8,571,283</u>	<u>\$ 4,277,664</u>	<u>1,614,163</u>	<u>-</u>
Component units:						
Kosrae Port Authority	\$ 1,045,520	\$ 161,804	\$ -	\$ 7,725,577	-	6,841,861
Kosrae Utilities Authority	2,730,066	2,095,856	-	-	-	(634,210)
Total component units	<u>\$ 3,775,586</u>	<u>\$ 2,257,660</u>	<u>\$ -</u>	<u>\$ 7,725,577</u>	<u>-</u>	<u>6,207,651</u>
General revenues:						
Taxes:						
Revenue sharing					1,048,631	-
State taxes					372,025	-
Unrestricted investment earnings					52,016	4,986
Other					719,358	-
Total general revenues					<u>2,192,030</u>	<u>4,986</u>
Change in net assets					3,806,193	6,212,637
Net assets at the beginning of the year					<u>16,388,630</u>	<u>17,372,370</u>
Net assets at the end of the year					<u>\$ 20,194,823</u>	<u>\$ 23,585,007</u>

See accompanying notes to basic financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Balance Sheet

Governmental Funds
September 30, 2010

		Special Revenue		Permanent		
	General	Grants Assistance	Early Retirement Program	Compact Trust	Other Governmental Funds	Total
ASSETS						
Cash and cash equivalents	\$ 1,048,935	\$ -	\$ -	\$ -	\$ -	\$ 1,048,935
Investments	262,000	900,000	-	-	38,000	1,200,000
Receivables, net:						
General	217,141	-	-	-	8,496	225,637
Loans	-	-	-	-	466,017	466,017
Federal agencies	-	547,016	-	-	-	547,016
Due from other funds	395,022	1,159,435	-	-	531,036	2,085,493
Prepaid items	59,365	20,854	-	-	-	80,219
Advances	18,112	263,921	-	-	2,174	284,207
Restricted assets:						
Cash and cash equivalents	455,609	-	-	-	21,362	476,971
Time certificates of deposit	200,000	-	-	-	354,383	554,383
Investments	-	-	1,493,065	2,837,836	-	4,330,901
Total assets	\$ 2,656,184	\$ 2,891,226	\$ 1,493,065	\$ 2,837,836	\$ 1,421,468	\$ 11,299,779
LIABILITIES AND FUND BALANCES						
Liabilities:						
Accounts payable	\$ 207,900	\$ 148,147	\$ -	\$ -	\$ 76,317	\$ 432,364
Other liabilities and accruals	182,342	183,212	-	-	-	365,554
Due to other funds	1,690,471	392,045	-	-	2,977	2,085,493
Deferred revenues	-	290,312	-	-	33	290,345
Total liabilities	2,080,713	1,013,716	-	-	79,327	3,173,756
Fund balances:						
Reserved for:						
Related assets	917,609	900,000	1,493,065	2,837,836	879,762	7,028,272
Encumbrances	52,133	713,667	-	-	245,919	1,011,719
Continuing appropriations	36,519	225,045	-	-	-	261,564
Unreserved:						
General fund	(430,790)	-	-	-	-	(430,790)
Special revenue funds	-	38,798	-	-	177,257	216,055
Capital projects funds	-	-	-	-	39,203	39,203
Total fund balances	575,471	1,877,510	1,493,065	2,837,836	1,342,141	8,126,023
Total liabilities and fund balances	\$ 2,656,184	\$ 2,891,226	\$ 1,493,065	\$ 2,837,836	\$ 1,421,468	
Amounts reported for governmental activities in the statement of net assets are different because:						
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds						18,302,263
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					(5,998,463)	
Claims payable					(235,000)	
						(6,233,463)
Net assets of governmental activities						\$ 20,194,823

See accompanying notes to basic financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds
Year Ended September 30, 2010

	Special Revenue			Permanent	Other Governmental Funds	Total
	General	Grants Assistance	Early Retirement Program	Compact Trust		
Revenues:						
Compact funding	\$ -	\$ 7,927,182	\$ -	\$ -	\$ -	\$ 7,927,182
Net change in the fair value of investments	-	-	108,757	338,230	-	446,987
Federal contributions	-	35,722	-	-	-	35,722
FSM revenue sharing	1,048,631	-	-	-	-	1,048,631
State taxes	372,025	-	-	-	-	372,025
CFSM grants	-	-	-	-	59,791	59,791
Fees and charges	200,701	-	-	-	289,266	489,967
Other grants	-	161,392	-	-	-	161,392
Interest income	35,440	61	-	-	16,515	52,016
Other	719,358	-	-	-	-	719,358
Total revenues	<u>2,376,155</u>	<u>8,124,357</u>	<u>108,757</u>	<u>338,230</u>	<u>365,572</u>	<u>11,313,071</u>
Expenditures:						
Current:						
General government	1,162,263	573,060	143,080	-	-	1,878,403
Economic development	150,756	977,454	15,617	-	-	1,143,827
Education	-	4,161,710	-	-	34,035	4,195,745
Health services	-	2,273,615	-	-	114,189	2,387,804
Public order and safety	301,703	-	-	-	22,575	324,278
Environment protection and sanitation	-	29,604	-	-	97,766	127,370
Boards, commissions and other	885,335	17,804	6,664	-	47,050	956,853
Debt service	-	-	165,325	-	-	165,325
Total expenditures	<u>2,500,057</u>	<u>8,033,247</u>	<u>330,686</u>	<u>-</u>	<u>315,615</u>	<u>11,179,605</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(123,902)</u>	<u>91,110</u>	<u>(221,929)</u>	<u>338,230</u>	<u>49,957</u>	<u>133,466</u>
Other financing sources (uses):						
Proceeds from issuance of long-term debt	-	-	165,361	-	-	165,361
Operating transfers in	42,865	-	-	-	-	42,865
Operating transfers out	-	-	-	-	(42,865)	(42,865)
Total other financing sources (uses), net	<u>42,865</u>	<u>-</u>	<u>165,361</u>	<u>-</u>	<u>(42,865)</u>	<u>165,361</u>
Net change in fund balances	<u>(81,037)</u>	<u>91,110</u>	<u>(56,568)</u>	<u>338,230</u>	<u>7,092</u>	<u>298,827</u>
Fund balances at the beginning of the year	656,508	1,786,400	1,549,633	2,499,606	1,335,049	7,827,196
Fund balances at the end of the year	<u>\$ 575,471</u>	<u>\$ 1,877,510</u>	<u>\$ 1,493,065</u>	<u>\$ 2,837,836</u>	<u>\$ 1,342,141</u>	<u>\$ 8,126,023</u>

See accompanying notes to basic 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, 2010

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	\$ 298,827
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Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.

This is the amount by which depreciation exceeded capital outlays in the current period	(672,851)
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The net effect of various miscellaneous transactions involving capital assets (ie., sales, trade-ins, and donations) is to increase net assets: For the current year, this amount consists of:

Donated capital assets from the FSM National Government.	4,217,873
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The incurrence of long-term debt (e.g. bonds, leases) provides current financial resources to governmental funds, while the repayment of principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction has any effect on net assets. For the current year, these amounts consist of:

Long-term debt proceeds	(165,361)
Repayment of ADB Loans	121,404
Repayment of FSMDB Loan	138,976
Repayment of FSM National Government Loan	150,000
Repayment of RUS Loan	<u>8,392</u>
	<u>253,411</u>

Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds. For the current year, these activities consist of:

Foreign exchange adjustment in SDR amount for ADB Loans	<u>(291,067)</u>
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Change in net assets of governmental activities	\$ <u><u>3,806,193</u></u>
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See accompanying notes to basic financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Combining Statement of Net Assets

Component Units
September 30, 2010

<u>ASSETS</u>	<u>Kosrae Port Authority</u>	<u>Kosrae Utilities Authority</u>	<u>Total</u>
Current assets:			
Cash and cash equivalents	\$ 50,405	\$ 165,847	\$ 216,252
Investments	-	483,595	483,595
Time certificates of deposit - restricted	-	287,042	287,042
Receivables, net:			
General	4,735	168,444	173,179
Inventories	-	402,774	402,774
Prepayments	-	2,981	2,981
Total current assets	55,140	1,510,683	1,565,823
Noncurrent assets:			
Capital assets, net of accumulated depreciation	18,668,442	4,118,863	22,787,305
Total assets	\$ 18,723,582	\$ 5,629,546	\$ 24,353,128
<u>LIABILITIES AND NET ASSETS</u>			
Current liabilities:			
Current portion of long-term debt	\$ -	\$ 98,339	\$ 98,339
Accounts payable	13,174	102,679	115,853
Accrued liabilities	29,616	361,359	390,975
Deferred revenues	-	21,200	21,200
Due to primary government	72,174	-	72,174
Total current liabilities	114,964	583,577	698,541
Noncurrent liabilities:			
Noncurrent portion of long-term debt	-	69,580	69,580
Total noncurrent liabilities	-	69,580	69,580
Total liabilities	114,964	653,157	768,121
Net assets:			
Invested in capital assets, net of related debt	18,668,442	3,950,944	22,619,386
Restricted	-	90,000	90,000
Unrestricted	(59,824)	935,445	875,621
Total net assets	18,608,618	4,976,389	23,585,007
Total liabilities and net assets	\$ 18,723,582	\$ 5,629,546	\$ 24,353,128

See accompanying notes to basic financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Component Units
Year Ended September 30, 2010

	Kosrae Port Authority	Kosrae Utilities Authority	Total
Operating revenues:			
Charge for services	\$ 161,804	\$ 2,095,856	\$ 2,257,660
Operating expenses:			
Cost of services	-	1,645,181	1,645,181
Depreciation and amortization	861,995	508,097	1,370,092
Administration and general	183,525	568,124	751,649
Total operating expenses	1,045,520	2,721,402	3,766,922
Operating loss	(883,716)	(625,546)	(1,509,262)
Nonoperating revenues (expenses):			
Interest income	-	3,911	3,911
Net change in fair value of investments	-	1,075	1,075
Interest expense	-	(8,664)	(8,664)
Total nonoperating revenues (expenses), net	-	(3,678)	(3,678)
Capital contributions	7,725,577	-	7,725,577
Change in net assets	6,841,861	(629,224)	6,212,637
Net assets at beginning of year	11,766,757	5,605,613	17,372,370
Net assets at end of year	\$ 18,608,618	\$ 4,976,389	\$ 23,585,007

See accompanying notes to basic financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(1) Summary of Significant Accounting Policies

The accompanying financial statements of the State of Kosrae (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, 2010

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

i. 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.

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

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

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

The government-wide Statement of Net Assets reports \$7,469,627 of restricted net assets, of which \$1,467,891 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, 2010

(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

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.

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.

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

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.

The State reports the following Governmental Fund types:

i. 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.

ii. Special Revenue Funds

These funds account for specific revenue sources that have been aggregated according to enabling legislation to support specific governmental activities.

iii. Capital Projects Funds

These funds account for the acquisition or construction of major State capital facilities financed primarily from loans and federal reimbursements.

iv. Permanent Funds

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

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:

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Grants Assistance Fund, a Governmental Fund Type - Special Revenue Fund. This fund 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.

Early Retirement Program Fund – a Governmental Fund Type – Special Revenue Fund. This fund accounts for loan proceeds or funds from the General Fund invested with investment gains accrued within the fund to provide lower long-term costs of the State operations.

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

E. Reporting Standards

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

F. Cash and Cash Equivalents and Time Certificates of Deposit

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

G. Investments

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(1) Summary of Significant Accounting Policies, Continued

H Receivables

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

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

I. Prepaid Items

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

J. Interfund Receivables/Payables

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

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

K. Inventories

Inventories of materials and supplies 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.

L. Restricted Assets

As of September 30, 2010, cash and cash equivalents and time certificates of deposit of the primary government were restricted for the following uses:

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 \$1,493,065 for the Kosrae State Early Retirement Scheme. Furthermore, investments recorded in the Compact Trust Fund of \$2,837,836 are restricted in that they are not available to be used in current operations. As of September 30, 2010, cash and cash equivalents and time certificates of deposit of the primary government were restricted for the following uses:

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(1) Summary of Significant Accounting Policies, Continued

L. Restricted Assets, Continued

Deposit account established for the purpose of receiving payments pursuant to the Compact of Free Association, as amended.	\$ 340,310
Deposit account established for the Housing Renovation program.	115,299
Deposit account established for the Gifford scholarship fund.	21,362
Time certificate of deposit with a local bank restricted for scholarships for post-secondary students.	354,383
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>
	<u>\$ 1,031,354</u>

Component Units:

Time certificate of deposit with a local bank pledged supporting Kosrae Utility Authority debt.	\$ <u>287,042</u>
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M. Capital Assets

Capital assets, which include property, plant, equipment and infrastructure (e.g. roads, bridges, ramps and other similar items), are reported in the governmental activity column of the government-wide financial statements.

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.

All land and non-depreciable land improvements are capitalized, regardless of cost. 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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(1) Summary of Significant Accounting Policies, Continued

N. 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.

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 statement of net assets.

P. Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. The unreserved fund balances for the governmental funds represent the amount available for budgeting future operations. The reserve for related assets as of September 30, 2010, is represented by the following assets:

	<u>General</u>	<u>Grants Assistance</u>	<u>Early Retirement Program</u>	<u>Section 215 Compact Trust</u>	<u>Other Governmental Funds</u>	<u>Totals</u>
Investments	\$ 262,000	\$ 900,000	\$ -	\$ -	\$ 38,000	\$ 1,200,000
Receivables:						
Loans	-	-	-	-	466,017	466,017
Restricted assets:						
Cash and cash equivalents	455,609	-	-	-	21,362	476,971
Time certificates of deposit	200,000	-	-	-	354,383	554,383
Investments	-	-	1,493,065	2,837,836	-	4,330,901
	<u>\$ 917,609</u>	<u>\$ 900,000</u>	<u>\$ 1,493,065</u>	<u>\$ 2,837,836</u>	<u>\$ 879,762</u>	<u>\$ 7,028,272</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(1) Summary of Significant Accounting Policies, Continued

Q. 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.

R. New Accounting Standards

During fiscal year 2010, the State implemented the following pronouncements:

- GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which addresses whether and when intangible assets should be considered capital assets for financial reporting purposes.
- GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements.
- GASB Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*, which clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, for calculating the annual required contribution (ARC) adjustment.
- GASB Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*, which provides guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code, and establishes requirements for recognizing and measuring the effects of the bankruptcy process on assets and liabilities, and for classifying changes in those items and related costs.

The implementation of these pronouncements did not have a material effect on the accompanying financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(1) Summary of Significant Accounting Policies, Continued

R. New Accounting Standards, Continued

In March 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The provisions of this statement are effective for periods beginning after June 15, 2010. Management has not evaluated the effect that the implementation of this statement will have on the financial statements of the State.

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

In June 2010, GASB issued Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. The provisions of this statement are effective for periods beginning after June 15, 2010. Management has not evaluated the effect that the implementation of this statement will have on the financial statements of the State.

S. Estimates

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

T. Deferred Revenues

In the government-wide financial statements, deferred revenue is recognized when cash, receivables or other assets are recorded prior to their being earned. In the governmental fund financial statements, deferred revenue represents monies received or revenues accrued which have not been earned or do not meet the “available” criterion for revenue recognition under the modified accrual basis of accounting. The deferred revenue in the governmental fund financial statements has primarily resulted as federal funds are received in advance of eligible expenditures.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(1) Summary of Significant Accounting Policies, Continued

U. Total Columns

Total columns are presented primarily to facilitate financial analysis. The Management's Discussion and Analysis includes certain prior year summarized comparative information in total. Such information does not include sufficient detail to constitute a full comparative presentation. Accordingly, such information should be read in conjunction with the State's financial statements for the year ended September 30, 2009 from which summarized information was derived.

(2) Deposits and Investments

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

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

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

- 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.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2010

(2) Deposits and Investments, Continued

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.

A. Deposits

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

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

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

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

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the 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, 2010, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit was \$2,080,289 and the corresponding bank balance was \$2,426,229, which is maintained in financial institutions subject to FDIC insurance. As of September 30, 2010, bank deposits in the amount of \$500,000 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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(2) Deposits and Investments, Continued

A. Deposits, Continued

As of September 30, 2010, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit was \$503,567, and the corresponding bank balance was \$555,710 which were maintained in financial institutions subject to FDIC insurance. As of September 30, 2010, bank deposits in the amount of \$351,139 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

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

- Category 1 Investments that are insured or registered, or securities held by the State or its agent in the State's name;
- Category 2 Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the State's name; or
- Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the State's name.

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

As of September 30, 2010, the State's investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ <u>495,008</u>
Other investments:	
Money market funds	3,802,618
Cash management account	<u>33,275</u>
	<u>3,835,893</u>
	\$ <u>4,330,901</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(2) Deposits and Investments, Continued

B. Investments, Continued

As of September 30, 2010, the State's fixed income securities, including their Moody's investors service credit ratings, had the following maturities:

Investment Type	Investment Maturities (In Years)					Credit Ratings
	Fair Value	Current	1-5	6-10	Over 10	
U.S. Treasury Notes and Bonds	\$ 118,539	\$ -	\$ 66,709	\$ 26,978	\$ 24,852	Aaa/AAA
U.S Government agency obligations:						
Federal Home Loan Mortgage Corporation	105,789	-	3,133	12,302	90,354	AAA
Government National Mortgage Association	11,719	-	-	-	11,719	AAA
Federal National Mortgage Association	63,009	-	-	6,131	56,878	AAA
Tennessee Valley Authority	4,874	-	-	-	4,874	AAA
Housing Urban Development	8,525	-	8,525	-	-	No rating
Municipal Obligations	2,943	-	-	-	2,943	Aa1
Municipal Obligations	1,747	-	-	-	1,747	Aa2
Corporate Bonds	14,607	-	5,790	-	8,817	Aaa/AAA
Corporate Bonds	6,245	-	-	6,245	-	Aa1/AA+
Corporate Bonds	25,446	8,441	-	10,079	6,926	Aa2/AA
Corporate Bonds	4,424	-	-	4,424	-	Aa3/AA-
Corporate Bonds	19,457	-	-	-	19,457	A1/A+
Corporate Bonds	19,224	-	8,977	10,247	-	A2/A
Corporate Bonds	15,344	-	6,598	-	8,746	A3/A-
Corporate Bonds	45,831	-	31,894	11,064	2,873	Baa1/BBB+
Corporate Bonds	6,256	-	6,256	-	-	Baa2/BBB
Corporate Bonds	<u>21,029</u>	<u>-</u>	<u>16,815</u>	<u>4,214</u>	<u>-</u>	No rating
Grand Total	<u>\$ 495,008</u>	<u>\$ 8,441</u>	<u>\$ 154,697</u>	<u>\$ 91,684</u>	<u>\$ 240,186</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, 2010.

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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(2) Deposits and Investments, Continued

B. Investments, Continued

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

As of September 30, 2010, the General Fund holds 3.7% of the shares of the Pacific Islands Development Bank in the amount of \$262,000. As the fair market value of this investment is not readily available, such has been recorded at cost.

As of September 30, 2010, the Grants Assistance Fund holds 5.4% of the shares of the Bank of the Federated States of Micronesia in the amount of \$500,000 and 7.3% of the shares of the Pacific Islands Development Bank in the amount of \$400,000. As the fair market value of these investments is not readily available, such have been recorded at cost.

In addition, as of September 30, 2010, the Grants Assistance Fund holds 100% of the shares of Pacific Tuna Ventures, Inc. and 50% of the shares in a joint venture with the National Fisheries Corporation of Kosrae Sea Ventures, Inc. These investments are accounted for using the equity method and, accordingly, the carrying values have been reduced to \$0.

As of September 30, 2010, the other governmental funds holds 0.7% of the shares of the Pacific Islands Development Bank in the amount of \$38,000. As the fair market value of this investment is not readily available, such has been recorded at cost.

Discretely Presented Component Units

As of September 30, 2010, investments at fair value comprise the following:

Money market funds	\$ 226,877
Common stock	<u>256,718</u>
	\$ <u>483,595</u>

(3) Receivables

Receivables as of September 30, 2010, 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>Other Governmental Funds</u>	<u>Total</u>
Receivables:				
General	\$ 671,511	\$ -	\$ -	\$ 671,511
Federal agencies	-	53,446	612,853	666,299
Taxes	320,721	-	-	320,721
Loans	-	762,630	1,799,654	2,562,284
FSM National Government	-	2,502,774	-	2,502,774
Other	-	<u>367,129</u>	<u>19,803</u>	<u>386,932</u>
	992,232	3,685,979	2,432,310	7,110,521
Less: Allowance for uncollectible accounts	<u>(775,091)</u>	<u>(3,138,963)</u>	<u>(1,957,797)</u>	<u>(5,871,851)</u>
Net receivables	\$ <u>217,141</u>	\$ <u>547,016</u>	\$ <u>474,513</u>	\$ <u>1,238,670</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(3) Receivables, Continued

Loans receivable of the primary government as of September 30, 2010 are as follows:

Grants Assistance Fund

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

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

\$ 762,630

Nonmajor Governmental Funds

Low-income housing loans, details and terms of those loans have not been compiled and such have been provided for in the allowance for uncollectible accounts in the amount of \$1,298,513. \$ 1,764,530

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. 35,124

\$ 1,799,654

Receivables as of September 30, 2010, for the component units, including applicable allowance for uncollectible accounts, are as follows:

	<u>Kosrae Port Authority</u>	<u>Kosrae Utilities Authority</u>	<u>Total</u>
Receivables:			
General	\$ 55,538	\$ 366,990	\$ 422,528
Less: Allowance for uncollectible accounts	<u>(50,803)</u>	<u>(198,546)</u>	<u>(249,349)</u>
Net receivables	\$ <u>4,735</u>	\$ <u>168,444</u>	\$ <u>173,179</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(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, 2010, are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Grants Assistance	General	\$ 1,159,435
Nonmajor governmental funds	General	531,036
General	Nonmajor governmental funds	2,977
General	Grants Assistance	<u>392,045</u>
		<u>\$ 2,085,493</u>

(5) Capital Assets

Capital asset activities for the year ended September 30, 2010, are as follows:

Primary Government

	Balance October <u>1, 2009</u>	<u>Increases</u>	<u>Decreases</u>	Balance September <u>30, 2010</u>
Governmental activities:				
Buildings	\$ 15,166,460	\$ 4,274,907	\$ -	\$ 19,441,367
Infrastructure	32,425,368	500,000	-	32,925,368
Machinery, equipment, others	<u>4,208,686</u>	<u>264,900</u>	-	<u>4,473,586</u>
	<u>51,800,514</u>	<u>5,039,807</u>	-	<u>56,840,321</u>
Less accumulated depreciation:				
Buildings	(11,259,531)	(383,541)	-	(11,643,072)
Infrastructure	(22,228,030)	(947,729)	-	(23,175,759)
Machinery, equipment, others	<u>(3,555,712)</u>	<u>(163,515)</u>	-	<u>(3,719,227)</u>
	<u>(37,043,273)</u>	<u>(1,494,785)</u>	-	<u>(38,538,058)</u>
	<u>\$ 14,757,241</u>	<u>\$ 3,545,022</u>	<u>\$ -</u>	<u>\$ 18,302,263</u>

During the year ended September 30, 2010, depreciation expense was charged as follows:

General government	\$ 64,424
Economic development	8,535
Education	192,145
Health services	134,515
Public safety	7,369
Other appropriations	<u>1,087,797</u>
	<u>\$ 1,494,785</u>

During the year ended September 30, 2010, the State received donated capital assets from the FSM National Government. These capital assets were transferred to the State upon completion of construction at a cost of \$4,217,873.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2010

(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, 2010, the balance payable on this mortgage loan amounted to \$127,781.

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 Early Retirement Program Fund.

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

Funds for the repayment of the ADB loan are expected to be derived from the annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The Financing Agreement requires the State to continue to appropriate salaries for the abolished positions and deposit the 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, \$1,493,065 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, 2010, the balance payable on this loan amounted to \$2,163,958.

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Programs Loan 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, 2010, the balances payable on these loans amounted to \$882,089 and \$898,337, 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 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, 2010, the balance payable on this loan amounted to \$282,616.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(6) Long-Term Obligations, Continued

Primary Government, Continued

Asian Development Bank (ADB) Loans, Continued:

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Program 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, 2010, the balance payable on this loan amounted to \$143,080.

The State also entered into an agreement with the FSM National Government to borrow \$1,500,000 for the purpose of repayment of Compact Sector Grant advances and to partially pay a \$500,000 bank borrowing. Principal payments shall be made in equal quarterly installments of \$37,500, non-interest bearing, commencing on October 1, 2009 and ending on July 1, 2019. As of September 30, 2010, the balance payable on this loan amounted to \$1,350,000.

Additionally, the State has assumed a loan payable to the FSM Development Bank, maturing on July 18, 2010, interest at 5%, with monthly principal and interest payments of \$7,958. As of September 30, 2010, the balance payable on this loan amounted to \$150,602. This loan originated with a discontinued component unit and was assumed by the State through its dissolution.

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

Year ending <u>September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 372,838	\$ 59,087	\$ 431,925
2012	377,258	56,938	434,196
2013	309,969	55,494	365,463
2014	310,055	53,249	363,304
2015	910,145	71,782	981,927
2016 – 2020	936,493	220,602	1,157,095
2021 – 2025	1,028,946	155,034	1,183,980
2026 – 2030	777,547	93,306	870,853
2031 – 2035	658,656	45,561	704,217
2036 – 2039	<u>316,556</u>	<u>16,865</u>	<u>333,421</u>
	<u>\$ 5,998,463</u>	<u>\$ 827,918</u>	<u>\$ 6,826,381</u>

Discretely Presented Component Units

Kosrae Utilities Authority (KUA):

Term loan payable to bank, original amount of \$450,000, interest at 2.50% greater than TCD rate pledged as collateral, monthly repayment of \$8,523, collateralized by a first security interest in a time certificate of deposit. Interest rate effective as of September 30, 2010 ranges from 5.10% to 5.85%. Loan proceeds were used to fund the acquisition of a 1.2MW generator.

\$ 167,919

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(6) Long-Term Obligations, Continued

Discretely Presented Component Units, Continued

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

Year ending September 30,	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 98,339	\$ 3,939	\$ 102,278
2012	<u>69,580</u>	<u>868</u>	<u>70,448</u>
	<u>\$ 167,919</u>	<u>\$ 4,807</u>	<u>\$ 172,726</u>

(7) Change in Long-Term Obligations

Primary Government

Long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2010, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net assets:

	<u>Balance October 1, 2009</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance September 30, 2010</u>	<u>Due Within One Year</u>
Loans payable:					
ADB loans:					
Loan 1520	\$ 1,915,102	\$291,067	\$ 42,211	\$2,163,958	\$ 44,756
Loan 1816	300,973	6,664	25,021	282,616	12,697
Loan 1873	910,573	-	28,484	882,089	56,680
Loan 1874	908,408	15,617	25,688	898,337	38,018
Loan 2099	-	143,080	-	143,080	-
FSMDB loan	289,578	-	138,976	150,602	68,318
MWSP loan	136,173	-	8,392	127,781	2,369
FSMNG loan	<u>1,500,000</u>	<u>-</u>	<u>150,000</u>	<u>1,350,000</u>	<u>150,000</u>
	<u>5,960,807</u>	<u>456,428</u>	<u>418,772</u>	<u>5,998,463</u>	<u>372,838</u>
Other:					
Claims	<u>235,000</u>	<u>-</u>	<u>-</u>	<u>235,000</u>	<u>-</u>
	<u>\$ 6,195,807</u>	<u>\$456,428</u>	<u>\$418,772</u>	<u>\$6,233,463</u>	<u>\$372,838</u>

Included in the net additions is a foreign exchange adjustment due to a change in the SDR calculation of \$291,067 for ADB Loan Number 1520, which was passed through by the FSM National Government, and resulted in an increase in the outstanding loan payable to the FSM National Government.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(7) Change in Long-Term Obligations, Continued

Discretely Presented Component Units

During the year ended September 30, 2010, the following changes occurred in liabilities reported as part of the component unit's long-term liabilities in the statement of net assets:

	Balance October <u>1, 2009</u>	<u>Additions</u>	<u>Reductions</u>	Balance September <u>30, 2010</u>	Due Within <u>One Year</u>
KUA loan payable	\$ 263,185	\$ _____ -	\$ 95,266	\$ 167,919	\$ 98,339

(8) Commitments and Contingencies

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, 2010 is \$352,609.

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.

Loan Guarantee Escrow

As set forth in note 1L, the State has pledged an escrow account in support of certain housing loans. In the event of default, the State could be exposed to an amount in excess of the escrow account balance, an amount that is presently indeterminable.

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, 2010, is not predictable but could have a material impact on the accompanying financial statements. Such impact has currently been estimated to approximate \$235,000, which has been recorded as a liability in the accompanying statement of net assets.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2010

(8) Commitments and Contingencies, Continued

Other

The State issued certain reduction-in-force checks to State employees without withholdings. This matter is being discussed between the State and 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**

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

YEAR ENDED SEPTEMBER 30, 2010

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Revenues, Expenditures, and Changes in Deficit - Budget and Actual
General Fund
Year Ended September 30, 2010

	Budgeted Amounts		Actual - Budgetary	Variance with Final Budget -
	Original	Final	Basis (see Note 1)	
Revenues:				
FSM revenue sharing	\$ 914,560	\$ 914,560	\$ 1,048,631	\$ 134,071
State taxes	426,794	426,794	372,025	(54,769)
Licenses and fees	199,634	199,634	200,701	1,067
Interest and dividends	-	-	35,440	35,440
Other	15,449	15,449	719,358	703,909
Total revenues	1,556,437	1,556,437	2,376,155	819,718
Expenditures:				
Current:				
General government	1,232,111	1,232,111	1,187,904	44,207
Economic development	87,905	87,905	131,168	(43,263)
Education	-	-	(303)	303
Public order and safety	269,267	269,267	302,157	(32,890)
Boards, commissions and other	910,472	910,472	892,390	18,082
Total expenditures	2,499,755	2,499,755	2,513,316	(13,561)
Excess (deficiency) of revenues over (under) expenditures	(943,318)	(943,318)	(137,161)	806,157
Other financing sources:				
Operating transfers in	-	-	42,865	42,865
Total other financing sources	-	-	42,865	42,865
Net change in unreserved deficit	(943,318)	(943,318)	(94,296)	849,022
Other changes in unreserved deficit:				
Increase in reserve for continuing appropriations	-	-	(36,519)	(36,519)
Decrease in reserve for related assets	-	-	8,592	8,592
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary purposes but in the year the supplies are received for financial reporting purposes	-	-	3,206	3,206
Unreserved deficit at the beginning of the year	(311,773)	(311,773)	(311,773)	-
Unreserved deficit at the end of the year	\$ (1,255,091)	\$ (1,255,091)	\$ (430,790)	\$ 824,301

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, 2010

(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.

Accounting principles used in developing data on a budgetary basis differ from those used in preparing the basic financial statements in conformity with GAAP. Amounts included on the Statement of Revenues, Expenditures, and Changes in Fund Deficit - Budget and Actual - General Fund (which are presented on a non-GAAP budgetary basis) are reconciled to unreserved deficit of the Governmental Fund Balance Sheet within the other changes in unreserved deficit section of that statement.

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**

Notes to Required Supplementary Information – Budgetary Reporting, Continued
September 30, 2010

(2) Reconciliation - GAAP and Budgetary Bases of Accounting

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.

Accounting principles used in developing data on a budgetary basis differ from those used in preparing the financial statements in conformity with GAAP. Amounts included on the Statement of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund (which are presented on a non-GAAP budgetary basis) are reconciled to unreserved deficit of the Governmental Fund Balance Sheet within the other changes in unreserved deficit section of that statement. Furthermore, the net change in fund balance (deficit) to the net change in unreserved fund deficit for the General Fund is as follows:

Net change in fund balance (deficit)	\$ (81,037)
Change in fund balance reservations:	
Increase in continuing appropriations	(36,519)
Increase in encumbrances	(10,053)
Decrease in related assets	<u>8,592</u>
Net change in unreserved fund deficit	\$ <u>(119,017)</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2010

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Combining Schedule of Expenditures by Account
Governmental Funds
Year Ended September 30, 2010

	<u>Special Revenue</u>			<u>Permanent</u>	Other Governmental Funds	<u>Total</u>
	<u>General</u>	<u>Grants Assistance</u>	<u>Early Retirement Program</u>	<u>Compact Trust</u>		
Expenditures:						
Salaries and wages:						
Regular	\$ 1,366,060	\$ 2,894,598	\$ -	\$ -	\$ -	\$ 4,260,658
Overtime	41,991	138,263	-	-	-	180,254
Fringe benefits	154,984	330,989	-	-	-	485,973
Other personnel costs	400	353	-	-	-	753
Travel and transportation	155,550	259,252	-	-	-	414,802
Communications	44,265	73,116	-	-	3,587	120,968
Dues, membership, and subscriptions	11,750	2,150	-	-	-	13,900
Food stuffs	7,611	60,848	-	-	1,025	69,484
Port charges	-	8,655	-	-	190	8,845
Office supplies and materials	53,788	646,491	-	-	130,463	830,742
POL	8,849	71,811	-	-	2,141	82,801
Printing and reproduction	3,530	7,915	-	-	-	11,445
Rental services	868	4,950	-	-	-	5,818
Repairs and maintenance	3,250	40,475	-	-	-	43,725
Utilities	90,128	264,242	-	-	12,944	367,314
Subsidies and contributions	35,000	179,000	-	-	-	214,000
Medical referral	-	164,323	-	-	-	164,323
Medical supplies	-	377,190	-	-	114,189	491,379
Contractual services	84,101	949,639	-	-	50,437	1,084,177
Professional services	-	101,271	-	-	-	101,271
Non-payroll compensation	52,123	-	-	-	-	52,123
Scholarships and allowances	1,820	468,447	-	-	-	470,267
Training	-	326,364	-	-	-	326,364
Leased housing, buildings and land	42,691	159,297	-	-	-	201,988
Equipment	14,185	468,952	-	-	-	483,137
Principal repayment	297,368	-	121,404	-	-	418,772
Interest payments	17,103	-	43,921	-	-	61,024
Miscellaneous	12,642	34,656	165,361	-	639	213,298
	<u>\$ 2,500,057</u>	<u>\$ 8,033,247</u>	<u>\$ 330,686</u>	<u>\$ -</u>	<u>\$ 315,615</u>	<u>\$ 11,179,605</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures by Function,
and Changes in Fund Balance (Deficit)
General Fund
Year Ended September 30, 2010
(with comparative totals for the year ended September 30, 2009)

	2010	2009
Revenues:		
FSM revenue sharing	1,048,631	1,039,493
State taxes:		
Sales tax	372,025	518,783
Fees and charges:		
Licenses and fees	200,701	180,996
Interest and dividend income	35,440	31,188
Other:		
Sales of petroleum products		32,229
Other	719,358	351,624
	719,358	383,853
Total revenues	2,376,155	2,154,313
Expenditures:		
Current:		
General government:		
Office of the Governor	186,061	141,359
Department of Administration and Finance	264,979	251,082
Judiciary Branch	161,978	147,483
Legislative Branch	537,764	510,903
Election	11,481	2,000
	1,162,263	1,052,827
Economic Development:		
Department of Resources and Economic Affairs	24,025	54,825
Farmer Extension	(250)	-
Land Management and Preservation	-	(74)
Housing	80,115	99,382
Survey and Mapping	-	60
Mangrove Crab Project	40,375	23,719
Plant Protection	4,741	-
Fisheries Development	1,850	-
Community affairs	(100)	-
	150,756	177,912
Education:		
Scholarship Loan Collection	-	(102)
Public Order and Safety:		
Office of the Attorney General	301,103	274,681
Parole board	600	280
	301,703	274,961
Boards, Commissions and Other:		
Department of Transportation and Infrastructure	269,612	317,263
Community Affairs	-	13,261
Broadcast Authority	41,688	39,307
Sports Council	15,214	15,559
Retirement Pension Program	52,123	80,732
RM Small Business Development Center	3,459	1,825
Land Court	81,047	85,659
Historic Preservation	38,414	5,347
SDA School	-	6,000
Stabilization loan repayment	150,000	-
Micronesia Petroleum Corporation debt service	156,528	-
Micronesia Legal Services	30,000	-
Micro Games	30,000	-
Municipal governments	5,000	16,000
Other	12,250	(19,386)
	885,335	561,567
Total expenditures	2,500,057	2,067,165
Excess (deficiency) of revenues over (under) expenditures	(123,902)	87,148

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures by Function,
and Changes in Fund Balance (Deficit), Continued
General Fund
Year Ended September 30, 2010
(with comparative totals for the year ended September 30, 2009)

	2010	2009
Other financing sources:		
Proceeds from sale of capital assets	-	97,828
Operating transfers in	42,865	51,158
Total other financing sources	42,865	148,986
Special items:		
Discontinued operations of MPC	-	603,906
Write-off of receivables, net of recovery	-	(103,548)
	-	500,358
Net change in fund balance (deficit)	(81,037)	736,492
Fund balance (deficit) at the beginning of the year	656,508	(79,984)
Fund balance at the end of the year	\$ 575,471	\$ 656,508

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**Statement of Revenues, Expenditures by Function,
and Changes in Deficit - Budget and Actual
General Fund
Year Ended September 30, 2010**

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final	Budgetary Basis	
Revenues:				
FSM revenue sharing:	\$ 914,560	\$ 914,560	\$ 1,048,631	\$ 134,071
State taxes:				
Sales tax	426,794	426,794	372,025	(54,769)
Fees and charges:				
Licences and fees	199,634	199,634	200,701	1,067
Interest and dividend income	26,900	26,900	35,440	8,540
Other:				
Other	15,449	15,449	719,358	703,909
	15,449	15,449	719,358	703,909
Total revenues	1,583,337	1,583,337	2,376,155	792,818
Expenditures:				
Current:				
General government:				
Office of the Governor	151,886	151,886	184,509	(32,623)
Department of Administration and Finance	267,690	267,690	275,632	(7,942)
Judiciary Branch	183,301	183,301	175,588	7,713
Legislative Branch	581,234	581,234	540,694	40,540
Election	48,000	48,000	11,481	36,519
	1,232,111	1,232,111	1,187,904	44,207
Economic development:				
Department of Resources and Economic Affairs	6,000	6,000	5,750	250
Farmer's Extension	-	-	(250)	250
Housing	37,500	37,500	79,327	(41,827)
Mangrove Crab Project	39,605	39,605	39,846	(241)
Plant protection	4,800	4,800	4,800	-
Community affairs	-	-	(155)	155
Fisheries development	-	-	1,850	(1,850)
	87,905	87,905	131,168	(43,263)
Education:				
Scholarship Loan Collection	-	-	(303)	303
Public order and safety:				
Office of the Attorney General	268,517	268,517	301,557	(33,040)
Parole board	750	750	600	150
	269,267	269,267	302,157	(32,890)

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**Statement of Revenues, Expenditures by Function,
and Changes in Deficit - Budget and Actual, Continued
General Fund**

	<u>Budgeted Amounts</u>		Amounts	Variance
	<u>Original</u>	<u>Final</u>	<u>Budgetary Basis</u>	
Boards, commissions and other:				
Department of Transportation and Infrastructure	290,955	290,955	274,888	16,067
Broadcast Authority	42,007	42,007	41,950	57
Sports Council	19,835	19,835	15,455	4,380
Retirement Pension Program	57,200	57,200	52,123	5,077
Small Business Development Center	-	-	2,686	(2,686)
Land Court	85,804	85,804	83,026	2,778
KIRMA	42,479	42,479	38,484	3,995
Stabilization Loan Repayment	150,000	150,000	150,000	-
Micronesia Petroleum Corporation Debt Service	157,192	157,192	156,528	664
Micronesia Legal Services	30,000	30,000	30,000	-
Micronesia Games	30,000	30,000	30,000	-
Municipal governments	5,000	5,000	5,000	-
Other	-	-	12,250	(12,250)
	<u>910,472</u>	<u>910,472</u>	<u>892,390</u>	<u>18,082</u>
Total expenditures	<u>2,499,755</u>	<u>2,499,755</u>	<u>2,513,316</u>	<u>(13,561)</u>
Deficiency of revenues under expenditures	<u>(916,418)</u>	<u>(916,418)</u>	<u>(137,161)</u>	<u>779,257</u>
Other financing sources:				
Operating transfers in	-	-	42,865	42,865
Total other financing sources	<u>-</u>	<u>-</u>	<u>42,865</u>	<u>42,865</u>
Net change in unreserved deficit	(916,418)	(916,418)	(94,296)	822,122
Other changes in unreserved deficit:				
Increase in reserve for continuing appropriations	-	-	(36,519)	(36,519)
Decrease in reserve for related assets	-	-	8,592	8,592
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary purposes but in the year the supplies are received for financial reporting purposes	-	-	3,206	3,206
Unreserved deficit at the beginning of the year	<u>(311,773)</u>	<u>(311,773)</u>	<u>(311,773)</u>	<u>-</u>
Unreserved deficit at the end of the year	<u>\$ (1,228,191)</u>	<u>\$ (1,228,191)</u>	<u>\$ (430,790)</u>	<u>\$ 797,401</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Combined Balance Sheet
Nonmajor Governmental Funds
September 30, 2010

	Other Special Revenue	Other Capital Projects	Total
<u>ASSETS</u>			
Investment	\$ -	\$ 38,000	\$ 38,000
Receivables:			
General	-	8,496	8,496
Loans	466,017	-	466,017
Due from other funds	495,934	35,102	531,036
Advances	1,278	896	2,174
Restricted assets:			
Cash and cash equivalents	21,362	-	21,362
Time certificates of deposit	354,383	-	354,383
Total assets	<u>\$ 1,338,974</u>	<u>\$ 82,494</u>	<u>\$ 1,421,468</u>
<u>LIABILITIES AND FUND BALANCES</u>			
Liabilities:			
Accounts payable	\$ 74,781	\$ 1,536	\$ 76,317
Due to other funds	2,977	-	2,977
Deferred revenue	-	33	33
Total liabilities	<u>77,758</u>	<u>1,569</u>	<u>79,327</u>
Fund balances:			
Reserved for:			
Related assets	841,762	38,000	879,762
Encumbrances	242,197	3,722	245,919
Unreserved:			
Special revenue funds	177,257	-	177,257
Capital projects funds	-	39,203	39,203
Total fund balances	<u>1,261,216</u>	<u>80,925</u>	<u>1,342,141</u>
Total liabilities and fund balances	<u>\$ 1,338,974</u>	<u>\$ 82,494</u>	<u>\$ 1,421,468</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Combined Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances
Nonmajor Governmental Funds
Year Ended September 30, 2010

	<u>Other Special Revenue</u>	<u>Other Capital Projects</u>	<u>Total</u>
Revenues:			
Fees and charges	\$ 289,266	\$ -	\$ 289,266
CFSM grants	-	59,791	59,791
Interest income	16,515	-	16,515
	<u>305,781</u>	<u>59,791</u>	<u>365,572</u>
Total revenues			
Expenditures by function:			
Current:			
Education	34,035	-	34,035
Health services	114,189	-	114,189
Public order and safety	-	22,575	22,575
Environment protection and sanitation	97,766	-	97,766
Boards, commissions and other	47,050	-	47,050
	<u>293,040</u>	<u>22,575</u>	<u>315,615</u>
Total expenditures			
Excess of revenues over expenditures	12,741	37,216	49,957
Other financing uses:			
Operating transfers out	(42,865)	-	(42,865)
Net change in fund balances	(30,124)	37,216	7,092
Fund balances at the beginning of the year	<u>1,291,340</u>	<u>43,709</u>	<u>1,335,049</u>
Fund balances at the end of the year	<u>\$ 1,261,216</u>	<u>\$ 80,925</u>	<u>\$ 1,342,141</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Combined Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances
Nonmajor Governmental Funds
Year Ended September 30, 2010

	<u>Other Special Revenue</u>	<u>Other Capital Projects</u>	<u>Total</u>
Revenues:			
Fees and charges	\$ 289,266	\$ -	\$ 289,266
CFSM grants	-	59,791	59,791
Interest income	16,515	-	16,515
	<u>305,781</u>	<u>59,791</u>	<u>365,572</u>
Total revenues			
Expenditures by account:			
Communications	-	3,587	3,587
Food stuffs	-	1,025	1,025
Office supplies and materials	124,640	5,823	130,463
POL	145	1,996	2,141
Contractual services	50,437	-	50,437
Utilities	2,800	10,144	12,944
Medical supplies	114,189	-	114,189
Import charges	190	-	190
Miscellaneous	639	-	639
	<u>293,040</u>	<u>22,575</u>	<u>315,615</u>
Total expenditures			
Excess of revenues over expenditures	12,741	37,216	49,957
Other financing uses:			
Operating transfers out	(42,865)	-	(42,865)
	<u>(42,865)</u>	<u>-</u>	<u>(42,865)</u>
Net change in fund balances	(30,124)	37,216	7,092
Fund balances at the beginning of the year	1,291,340	43,709	1,335,049
	<u>1,291,340</u>	<u>43,709</u>	<u>1,335,049</u>
Fund balances at the end of the year	<u>\$ 1,261,216</u>	<u>\$ 80,925</u>	<u>\$ 1,342,141</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS**

Combining Balance Sheet
September 30, 2010

	Airport Revolving	Production Loan	Scholarship Revolving Loan	Home Improvement Program Revolving	Aluminum Recycling	Health Care	Sports Council	Broadcast Authority	Gifford Scholarship	Transportation Infrastructure Revolving	Total
ASSETS											
Receivables:											
Loans	\$ -	\$ -	\$ -	\$ 466,017	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 466,017
Due from other funds	-	22,995	7,435	36,376	125,160	284,496	1,075	3,187	-	15,210	495,934
Advances	-	1,278	-	-	-	-	-	-	-	-	1,278
Restricted:											
Cash and equivalents	-	-	-	-	-	-	-	-	21,362	-	21,362
Time certificates of deposit	-	-	-	-	-	-	-	-	354,383	-	354,383
Total assets	<u>\$ -</u>	<u>\$ 24,273</u>	<u>\$ 7,435</u>	<u>\$ 502,393</u>	<u>\$ 125,160</u>	<u>\$ 284,496</u>	<u>\$ 1,075</u>	<u>\$ 3,187</u>	<u>\$ 375,745</u>	<u>\$ 15,210</u>	<u>\$ 1,338,974</u>
LIABILITIES AND FUND											
BALANCES											
Liabilities:											
Accounts payable	\$ -	\$ 1,924	\$ -	\$ 21,504	\$ 171	\$ 51,182	\$ -	\$ -	\$ -	\$ -	\$ 74,781
Due to other funds	-	-	-	-	-	-	-	-	2,977	-	2,977
Total liabilities	<u>-</u>	<u>1,924</u>	<u>-</u>	<u>21,504</u>	<u>171</u>	<u>51,182</u>	<u>-</u>	<u>-</u>	<u>2,977</u>	<u>-</u>	<u>77,758</u>
Fund balances:											
Reserved for:											
Related assets	-	-	-	466,017	-	-	-	-	375,745	-	841,762
Encumbrances	-	9,891	-	97,781	-	134,461	64	-	-	-	242,197
Unreserved (deficit)	-	12,458	7,435	(82,909)	124,989	98,853	1,011	3,187	(2,977)	15,210	177,257
Total fund balances	<u>-</u>	<u>22,349</u>	<u>7,435</u>	<u>480,889</u>	<u>124,989</u>	<u>233,314</u>	<u>1,075</u>	<u>3,187</u>	<u>372,768</u>	<u>15,210</u>	<u>1,261,216</u>
Total liabilities and fund balances	<u>\$ -</u>	<u>\$ 24,273</u>	<u>\$ 7,435</u>	<u>\$ 502,393</u>	<u>\$ 125,160</u>	<u>\$ 284,496</u>	<u>\$ 1,075</u>	<u>\$ 3,187</u>	<u>\$ 375,745</u>	<u>\$ 15,210</u>	<u>\$ 1,338,974</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
Year Ended September 30, 2010

	Airport Revolving	Production Loan	Scholarship Revolving Loan	Home Improvement Program Revolving	Aluminum Recycling	Health Care	Sports Council	Broadcast Authority	Gifford Scholarship	Transportation Infrastructure Revolving	Total
Revenues:											
Fees and charges	\$ 15	\$ 64,278	\$ 851	\$ 1,493	\$ 80,426	\$ 139,349	\$ 1,270	\$ 1,584	\$ -	\$ -	\$ 289,266
Interest income	-	-	-	12,513	152	394	-	-	3,456	-	16,515
Total revenues	<u>15</u>	<u>64,278</u>	<u>851</u>	<u>14,006</u>	<u>80,578</u>	<u>139,743</u>	<u>1,270</u>	<u>1,584</u>	<u>3,456</u>	<u>-</u>	<u>305,781</u>
Expenditures by function:											
Current:											
Education	-	-	-	-	-	-	-	-	34,035	-	34,035
Health services	-	-	-	-	-	114,189	-	-	-	-	114,189
Environment protection and sanitation	-	-	-	-	97,766	-	-	-	-	-	97,766
Boards, commissions and other	15	43,424	-	-	-	-	911	2,700	-	-	47,050
Total expenditures	<u>15</u>	<u>43,424</u>	<u>-</u>	<u>-</u>	<u>97,766</u>	<u>114,189</u>	<u>911</u>	<u>2,700</u>	<u>34,035</u>	<u>-</u>	<u>293,040</u>
Excess (deficiency) of revenues over (under) expenditures	-	20,854	851	14,006	(17,188)	25,554	359	(1,116)	(30,579)	-	12,741
Other financing uses:											
Operating transfers out	-	-	-	(42,865)	-	-	-	-	-	-	(42,865)
Net change in fund balances	-	20,854	851	(28,859)	(17,188)	25,554	359	(1,116)	(30,579)	-	(30,124)
Fund balances at the beginning of the year	-	1,495	6,584	509,748	142,177	207,760	716	4,303	403,347	15,210	1,291,340
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ 22,349</u>	<u>\$ 7,435</u>	<u>\$ 480,889</u>	<u>\$ 124,989</u>	<u>\$ 233,314</u>	<u>\$ 1,075</u>	<u>\$ 3,187</u>	<u>\$ 372,768</u>	<u>\$ 15,210</u>	<u>\$ 1,261,216</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
Year Ended September 30, 2010

	Airport Revolving	Production Loan	Scholarship Revolving Loan	Home Improvement Program Revolving	Aluminum Recycling	Health Care	Sports Council	Broadcast Authority	Gifford Scholarship	Transportation Infrastructure Revolving	Total
Revenues:											
Fees and charges	\$ 15	\$ 64,278	\$ 851	\$ 1,493	\$ 80,426	\$ 139,349	\$ 1,270	\$ 1,584	\$ -	\$ -	\$ 289,266
Interest income	-	-	-	12,513	152	394	-	-	3,456	-	16,515
Total revenues	<u>15</u>	<u>64,278</u>	<u>851</u>	<u>14,006</u>	<u>80,578</u>	<u>139,743</u>	<u>1,270</u>	<u>1,584</u>	<u>3,456</u>	<u>-</u>	<u>305,781</u>
Expenditures by account:											
Medical supplies	-	-	-	-	-	114,189	-	-	-	-	114,189
Office supplies and materials	-	26,289	-	-	97,766	-	385	200	-	-	124,640
Utilities	-	-	-	-	-	-	300	2,500	-	-	2,800
Contractual services	-	16,452	-	-	-	-	-	-	33,985	-	50,437
POL	-	-	-	-	-	-	145	-	-	-	145
Import charges	-	190	-	-	-	-	-	-	-	-	190
Others	<u>15</u>	<u>493</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>81</u>	<u>-</u>	<u>50</u>	<u>-</u>	<u>639</u>
Total expenditures	<u>15</u>	<u>43,424</u>	<u>-</u>	<u>-</u>	<u>97,766</u>	<u>114,189</u>	<u>911</u>	<u>2,700</u>	<u>34,035</u>	<u>-</u>	<u>293,040</u>
Excess (deficiency) of revenues over (under) expenditures	-	20,854	851	14,006	(17,188)	25,554	359	(1,116)	(30,579)	-	12,741
Other financing uses:											
Operating transfers out	-	-	-	(42,865)	-	-	-	-	-	-	(42,865)
Net change in fund balances	-	20,854	851	(28,859)	(17,188)	25,554	359	(1,116)	(30,579)	-	(30,124)
Fund balances at the beginning of the year	-	1,495	6,584	509,748	142,177	207,760	716	4,303	403,347	15,210	1,291,340
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ 22,349</u>	<u>\$ 7,435</u>	<u>\$ 480,889</u>	<u>\$ 124,989</u>	<u>\$ 233,314</u>	<u>\$ 1,075</u>	<u>\$ 3,187</u>	<u>\$ 372,768</u>	<u>\$ 15,210</u>	<u>\$ 1,261,216</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet
September 30, 2010

	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
<u>ASSETS</u>					
Investments	\$ -	\$ -	\$ -	\$ -	\$ -
Receivables:					
Federal agencies	66,517	55,963	329,091	29,410	74,135
Advances	-	2,095	5,647	10,544	-
Prepayments	8,537	39,447	-	8,672	1,878
Due from other funds	<u>138,047</u>	<u>366,720</u>	<u>-</u>	<u>12,216</u>	<u>-</u>
	<u>\$ 213,101</u>	<u>\$ 464,225</u>	<u>\$ 334,738</u>	<u>\$ 60,842</u>	<u>\$ 76,013</u>
<u>LIABILITIES AND FUND BALANCES</u>					
Liabilities:					
Accounts payable	\$ 2,662	\$ 105,944	\$ 9,508	\$ 1,351	\$ 2,628
Other liabilities and accruals	85,953	51,576	19,175	7,262	6,603
Due to other funds	-	-	293,805	-	66,782
Deferred revenues	<u>124,486</u>	<u>-</u>	<u>12,250</u>	<u>-</u>	<u>-</u>
Total liabilities	<u>213,101</u>	<u>157,520</u>	<u>334,738</u>	<u>8,613</u>	<u>76,013</u>
Fund balances:					
Reserved for:					
Related assets	-	-	-	-	-
Continuing appropriations	-	-	-	-	-
Encumbrances	15,202	358,812	31,038	51,136	30,941
Unreserved (deficits)	<u>(15,202)</u>	<u>(52,107)</u>	<u>(31,038)</u>	<u>1,093</u>	<u>(30,941)</u>
Total fund balances	<u>-</u>	<u>306,705</u>	<u>-</u>	<u>52,229</u>	<u>-</u>
Total liabilities and fund balances	<u>\$ 213,101</u>	<u>\$ 464,225</u>	<u>\$ 334,738</u>	<u>\$ 60,842</u>	<u>\$ 76,013</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet, Continued
September 30, 2010

	Section 211(a)(6) <u>Infrastructure</u>	Section 211(a)(7) Supplemental <u>Education</u>	U.S. Federal <u>Grants</u>	Compact Capital <u>Projects</u>	Foreign <u>Assistance</u>
<u>ASSETS</u>					
Investments	\$ -	\$ -	\$ -	\$ 800,000	\$ 100,000
Receivables:					
Federal agencies	-	15,256	(23,356)	-	-
Advances	-	2,568	-	-	-
Prepayments	-	175,200	23,356	-	6,831
Due from other funds	<u>200,082</u>	<u>40,464</u>	<u>59,186</u>	<u>-</u>	<u>170,091</u>
	<u>\$ 200,082</u>	<u>\$ 233,488</u>	<u>\$ 59,186</u>	<u>\$ 800,000</u>	<u>\$ 276,922</u>
 <u>LIABILITIES AND FUND BALANCES</u>					
Liabilities:					
Accounts payable	\$ -	\$ 5,255	\$ 15,497	\$ -	\$ 5,302
Other liabilities and accruals	-	8,992	2,199	-	1,452
Due to other funds	-	-	-	31,458	-
Deferred revenues	<u>-</u>	<u>48,593</u>	<u>41,490</u>	<u>-</u>	<u>63,493</u>
Total liabilities	<u>-</u>	<u>62,840</u>	<u>59,186</u>	<u>31,458</u>	<u>70,247</u>
Fund balances:					
Reserved for:					
Related assets	-	-	-	800,000	100,000
Continuing appropriations	-	-	-	-	225,045
Encumbrances	-	211,450	5,924	-	9,164
Unreserved (deficits)	<u>200,082</u>	<u>(40,802)</u>	<u>(5,924)</u>	<u>(31,458)</u>	<u>(127,534)</u>
Total fund balances	<u>200,082</u>	<u>170,648</u>	<u>-</u>	<u>768,542</u>	<u>206,675</u>
Total liabilities and fund balances	<u>\$ 200,082</u>	<u>\$ 233,488</u>	<u>\$ 59,186</u>	<u>\$ 800,000</u>	<u>\$ 276,922</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet, Continued
September 30, 2010

	Compact Special Block 211(b)	Compact Health & Medical 216(a)(2)	Compact Scholarship 216(a)(3)	Compact Energy Block Grant 214	Compact Special Development 212(b)	Total
<u>ASSETS</u>						
Investments	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 900,000
Receivables:						
Federal agencies	-	-	-	-	-	547,016
Advances	-	-	-	-	-	20,854
Prepayments	-	-	-	-	-	263,921
Due from other funds	19,867	143,729	-	153	8,880	1,159,435
	\$ 19,867	\$ 143,729	\$ -	\$ 153	\$ 8,880	\$ 2,891,226
 <u>LIABILITIES AND FUND BALANCES</u>						
Liabilities:						
Accounts payable	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 148,147
Other liabilities and accruals	-	-	-	-	-	183,212
Due to other funds	-	-	-	-	-	392,045
Deferred revenues	-	-	-	-	-	290,312
Total liabilities	-	-	-	-	-	1,013,716
Fund balances:						
Reserved for:						
Related assets	-	-	-	-	-	900,000
Continuing appropriations	-	-	-	-	-	225,045
Encumbrances	-	-	-	-	-	713,667
Unreserved (deficits)	19,867	143,729	-	153	8,880	38,798
Total fund balances	19,867	143,729	-	153	8,880	1,877,510
Total liabilities and fund balances	\$ 19,867	\$ 143,729	\$ -	\$ 153	\$ 8,880	\$ 2,891,226

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, 2010

	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
Revenues:					
Compact funding	\$ 2,384,531	\$ 2,220,463	\$ 750,203	\$ 411,410	\$ 225,737
Federal contributions	-	-	-	-	-
Other grants	-	-	-	-	-
Interest income	-	-	-	-	-
	<u>2,384,531</u>	<u>2,220,463</u>	<u>750,203</u>	<u>411,410</u>	<u>225,737</u>
Expenditures by function:					
Current:					
General government	-	-	-	456,407	-
Economic development	-	-	750,203	-	225,737
Education	2,572,299	-	-	-	-
Health services	-	2,254,916	-	-	-
Environment protection and sanitation	-	-	-	-	-
Boards, commissions, and other	-	-	-	-	-
	<u>2,572,299</u>	<u>2,254,916</u>	<u>750,203</u>	<u>456,407</u>	<u>225,737</u>
Total expenditures	<u>2,572,299</u>	<u>2,254,916</u>	<u>750,203</u>	<u>456,407</u>	<u>225,737</u>
Net change in fund balances	(187,768)	(34,453)	-	(44,997)	-
Fund balances at the beginning of the year	<u>187,768</u>	<u>341,158</u>	<u>-</u>	<u>97,226</u>	<u>-</u>
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ 306,705</u>	<u>\$ -</u>	<u>\$ 52,229</u>	<u>\$ -</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, 2010

	Section 211(a)(6) Infrastructure	Section 211(a)(7) Supplemental Education	U.S. Federal Grants	Compact Capital Projects	Foreign Assistance
Revenues:					
Compact funding	\$ 200,000	\$ 1,734,838	\$ -	\$ -	\$ -
Federal contributions	-	-	35,722	-	-
Other grants	-	-	-	-	161,392
Interest income	-	-	-	-	61
	<u>200,000</u>	<u>1,734,838</u>	<u>35,722</u>	<u>-</u>	<u>161,453</u>
Expenditures by function:					
Current:					
General government	66,786	-	5,771	-	44,096
Economic development	-	-	-	-	1,514
Education	-	1,564,190	-	-	25,221
Health services	-	-	12,147	-	6,552
Environment protection and sanitation	-	-	-	-	29,604
Boards, commissions, and other	-	-	17,804	-	-
	<u>66,786</u>	<u>1,564,190</u>	<u>35,722</u>	<u>-</u>	<u>106,987</u>
Total expenditures	<u>66,786</u>	<u>1,564,190</u>	<u>35,722</u>	<u>-</u>	<u>106,987</u>
Net change in fund balances	133,214	170,648	-	-	54,466
Fund balances at the beginning of the year	<u>66,868</u>	<u>-</u>	<u>-</u>	<u>768,542</u>	<u>152,209</u>
Fund balances at the end of the year	<u>\$ 200,082</u>	<u>\$ 170,648</u>	<u>\$ -</u>	<u>\$ 768,542</u>	<u>\$ 206,675</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, 2010

	Compact Special Block 211(b)	Compact Health & Medical 216(a)(2)	Compact Scholarship 216(a)(3)	Compact Energy Block Grant 214	Compact Special Development 212(b)	Total
Revenues:						
Compact funding	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 7,927,182
Federal contributions	-	-	-	-	-	35,722
Other grants	-	-	-	-	-	161,392
Interest income	-	-	-	-	-	61
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,124,357</u>
Expenditures by function:						
Current:						
General government	-	-	-	-	-	573,060
Economic development	-	-	-	-	-	977,454
Education	-	-	-	-	-	4,161,710
Health services	-	-	-	-	-	2,273,615
Environment protection and sanitation	-	-	-	-	-	29,604
Boards, commissions, and other	-	-	-	-	-	17,804
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,033,247</u>
Total expenditures	-	-	-	-	-	91,110
Net change in fund balances	-	-	-	-	-	91,110
Fund balances at the beginning of the year	<u>19,867</u>	<u>143,729</u>	<u>-</u>	<u>153</u>	<u>8,880</u>	<u>1,786,400</u>
Fund balances at the end of the year	<u>\$ 19,867</u>	<u>\$ 143,729</u>	<u>\$ -</u>	<u>\$ 153</u>	<u>\$ 8,880</u>	<u>\$ 1,877,510</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, 2010**

	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
Revenues:					
Compact funding	\$ 2,384,531	\$ 2,220,463	\$ 750,203	\$ 411,410	\$ 225,737
Federal contributions	-	-	-	-	-
Other grants	-	-	-	-	-
Interest income	-	-	-	-	-
	<u>2,384,531</u>	<u>2,220,463</u>	<u>750,203</u>	<u>411,410</u>	<u>225,737</u>
Expenditures by account:					
Salaries and wages:					
Regular	1,366,616	777,978	301,056	128,241	98,337
Overtime		114,219	11,389	9,304	1,909
Fringe benefits	162,473	92,381	39,199	-	12,432
Other personnel costs	-	-	4,478	-	-
Travel and transportation	21,983	79,487	41,690	68,647	9,400
Communications	41,274	2,219	12,504	7,208	3,081
Dues, membership, and subscriptions	-	500	1,050	600	-
Food stuffs	5,823	39,280	172	-	1,670
Port charges	348	371	21	-	55
Office supplies and materials	263,348	64,220	56,569	30,264	43,665
POL	27,872	10,234	8,278	554	11,368
Printing and reproduction	1,518	5,346	210	303	538
Rental services	867		340		-
Repairs and maintenance	19,813	10,430	167	150	1,173
Utilities	88,959	138,393	18,462	2,200	4,009
Subsidies and contributions	65,000		100,000		-
Medical referral	-	164,323	-	-	-
Medical supplies	-	377,190	-	-	-
Contractual services	149,889	46,654	119,289	27,123	35,439
Professional services	-	-		20,458	-
Scholarships and allowances	209,840	4,280	199	11,000	1,280
Training	24,038	28,075	24,708	123,918	-
Leased housing, buildings and land	58,996	18,855	6,134	18,697	1,265
Equipment	54,797	270,059	2,795	7,740	-
Miscellaneous	8,845	10,422	1,493	-	116
Total expenditures	<u>2,572,299</u>	<u>2,254,916</u>	<u>750,203</u>	<u>456,407</u>	<u>225,737</u>
Net change in fund balances	(187,768)	(34,453)	-	(44,997)	-
Fund balances at the beginning of the year	<u>187,768</u>	<u>341,158</u>	<u>-</u>	<u>97,226</u>	<u>-</u>
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ 306,705</u>	<u>\$ -</u>	<u>\$ 52,229</u>	<u>\$ -</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, 2010

	Section 211(a)(6) Infrastructure	Section 211(a)(7) Supplemental Education	U.S. Federal Grants	Compact Capital Projects	Foreign Assistance
Revenues:					
Compact funding	\$ 200,000	\$ 1,734,838	\$ -	\$ -	\$ -
Federal contributions	-	-	35,722	-	-
Other grants	-	-	-	-	161,392
Interest income	-	-	-	-	61
	<u>200,000</u>	<u>1,734,838</u>	<u>35,722</u>	<u>-</u>	<u>161,453</u>
Expenditures by account:					
Salaries and wages:					
Regular	-	190,834	19,483	-	12,053
Overtime	-	-	1,442	-	-
Fringe benefits	-	21,642	1,845	-	1,017
Other personnel costs	-	-	-	-	(4,125)
Travel and transportation	-	29,573	4,354	-	4,118
Communications	-	5,722	246	-	862
Dues, membership, and subscriptions	-	-	-	-	-
Food stuffs	-	9,275	-	-	4,628
Port charges	-	5,501	-	-	2,359
Office supplies and materials	-	144,732	6,313	-	37,380
POL	-	7,456	721	-	5,328
Printing and reproduction	-	-	-	-	-
Rental services	-	1,245	-	-	2,498
Repairs and maintenance	-	8,742	-	-	-
Utilities	-	12,219	-	-	-
Subsidies and contributions	-	14,000	-	-	-
Medical referral	-	-	-	-	-
Medical supplies	-	-	-	-	-
Contractual services	66,786	504,459	-	-	-
Professional services	-	80,813	-	-	-
Scholarships and allowances	-	241,848	-	-	-
Training	-	125,625	-	-	-
Leased housing, buildings and land	-	54,032	1,318	-	-
Equipment	-	92,732	-	-	40,829
Miscellaneous	-	13,740	-	-	40
	<u>66,786</u>	<u>1,564,190</u>	<u>35,722</u>	<u>-</u>	<u>106,987</u>
Net change in fund balances	133,214	170,648	-	-	54,466
Fund balances at the beginning of the year	66,868	-	-	768,542	152,209
Fund balances at the end of the year	<u>\$ 200,082</u>	<u>\$ 170,648</u>	<u>\$ -</u>	<u>\$ 768,542</u>	<u>\$ 206,675</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, 2010

	Compact Special Block 211(b)	Compact Health & Medical 216(a)(2)	Compact Scholarship 216(a)(3)	Compact Energy Block Grant 214	Compact Special Development 212(b)	Total
Revenues:						
Compact funding	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 7,927,182
Federal contributions	-	-	-	-	-	35,722
Other grants	-	-	-	-	-	161,392
Interest income	-	-	-	-	-	61
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,124,357</u>
Expenditures by account:						
Salaries and wages:						
Regular	-	-	-	-	-	2,894,598
Overtime	-	-	-	-	-	138,263
Fringe benefits	-	-	-	-	-	330,989
Other personnel costs	-	-	-	-	-	353
Travel and transportation	-	-	-	-	-	259,252
Communications	-	-	-	-	-	73,116
Dues, membership, and subscriptions	-	-	-	-	-	2,150
Food stuffs	-	-	-	-	-	60,848
Port charges	-	-	-	-	-	8,655
Office supplies and materials	-	-	-	-	-	646,491
POL	-	-	-	-	-	71,811
Printing and reproduction	-	-	-	-	-	7,915
Rental services	-	-	-	-	-	4,950
Repairs and maintenance	-	-	-	-	-	40,475
Utilities	-	-	-	-	-	264,242
Subsidies and contributions	-	-	-	-	-	179,000
Medical referral	-	-	-	-	-	164,323
Medical supplies	-	-	-	-	-	377,190
Contractual services	-	-	-	-	-	949,639
Professional services	-	-	-	-	-	101,271
Scholarships and allowances	-	-	-	-	-	468,447
Training	-	-	-	-	-	326,364
Leased housing, buildings and land	-	-	-	-	-	159,297
Equipment	-	-	-	-	-	468,952
Miscellaneous	-	-	-	-	-	34,656
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,033,247</u>
Total expenditures	-	-	-	-	-	8,033,247
Net change in fund balances	-	-	-	-	-	91,110
Fund balances at the beginning of the year	19,867	143,729	-	153	8,880	1,786,400
Fund balances at the end of the year	<u>\$ 19,867</u>	<u>\$ 143,729</u>	<u>\$ -</u>	<u>\$ 153</u>	<u>\$ 8,880</u>	<u>\$ 1,877,510</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 the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae as of and for the year ended September 30, 2010, which collectively comprise the State of Kosrae's basic financial statements and have issued our report thereon dated June 21, 2011. 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.

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 discretely presented component units, 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, we considered the State of Kosrae's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of Kosrae's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Kosrae's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying Schedule of Findings and Questioned Costs (pages 73 and 74) as item 2010-1 that we consider to be significant deficiencies in internal control over financial reporting.

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

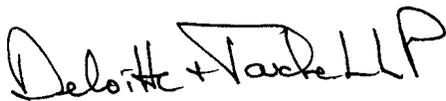
Compliance and Other Matters

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

We also noted certain matters that we reported to management of the State of Kosrae in a separate letter dated June 21, 2011.

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

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

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

June 21, 2011

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

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

Compliance

We have audited the State of Kosrae's compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on the State of Kosrae's major federal program for the year ended September 30, 2010. The State of Kosrae's major federal program is identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (pages 73 and 74). Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the State of Kosrae's management. Our responsibility is to express an opinion on the State of Kosrae's compliance based on our audit.

As discussed in Note 2B to the Schedule of Expenditures of Federal Awards, the State of Kosrae's basic financial statements include the operations of certain entities whose federal awards are not included in the Schedule of Expenditures of Federal Awards for the year ended September 30, 2010. Our audit, described below, did not include the operations of the entities identified in Note 2B as these entities conducted separate audits in accordance with OMB Circular A-133, if required.

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

In our opinion, the State of Kosrae complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended September 30, 2010.

Internal Control Over Compliance

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

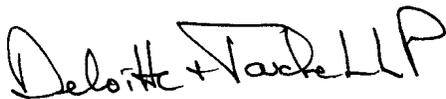
A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae as of and for the year ended September 30, 2010, and have issued our report thereon dated June 21, 2011. Our audit was performed for the purpose of forming our opinions on the financial statements that collectively comprise the State of Kosrae's basic financial statements. The accompanying schedule of expenditures of federal awards (pages 69 and 70) is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the State of Kosrae. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects when considered in relation to the basic financial statements taken as a whole.

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



June 21, 2011

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Summary Schedule of Expenditures of Federal Awards, by Grantor
Year Ended September 30, 2010

Agency/Program	Expenditures
U.S. Department of Agriculture	\$ 17,803
U.S. Department of the Interior	7,897,962
U.S. Department of Transportation	(1,653)
U.S. Department of Health and Human Services	<u>12,148</u>
GRAND TOTAL	<u>\$ 7,926,260</u>

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

U.S. Department of Agriculture:	
Rural Self-Help TA	10.420

Reconciliation to the basic financial statements:	
Grants Assistance Fund expenditures	\$ 8,033,247
Less:	
Foreign Assistance Fund expenditures	<u>(106,987)</u>
	<u>\$ 7,926,260</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, 2010

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF AGRICULTURE		
Rural Self-Help Housing Technical Assistance	10.420	\$ <u>17,803</u>
Total U.S. Department of Agriculture		\$ <u><u>17,803</u></u>
U.S. DEPARTMENT OF THE INTERIOR		
Economic, Social and Political Development of the Territories:	15.875	
Compact Health and Medical 216(a)(2)		\$ -
Compact Special Block Grant		-
Compact Capital Projects 211(b)		-
Compact II Capacity Building		456,407
Compact II Education Sector		2,572,299
Compact II Environment		225,737
Compact II Health Sector		2,254,916
Compact II Private Sector Development		750,203
Compact II Infrastructure Sector		66,786
Supplemental Education Grant		<u>1,564,190</u>
		<u>7,890,538</u>
Technical Assistance:		
Road Maintenance Equipment		7,424
Total U.S. Department of the Interior		\$ <u><u>7,897,962</u></u>
U.S. DEPARTMENT OF TRANSPORTATION		
Airport Improvement Program	20.106	\$ <u>(1,653)</u>
Total U.S. Department of Transportation		\$ <u><u>(1,653)</u></u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES		
Cancer Prevention and Control Program (See Note)	93.U55/CCU923887.02	\$ 12,148
Breast and Cervical Cancer	93 Unknown	<u>-</u>
Total U.S. Department of Health and Human Services		\$ <u><u>12,148</u></u>
GRAND TOTAL		\$ <u><u>7,926,260</u></u>

Note: The grant is received through the University of Hawaii and the grant number is U55/CCU923887.02.

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, 2010

(1) Scope of Review

The Government of the State of Kosrae is a governmental entity governed by its own Constitution. All significant operations of the State are included in the scope of the OMB Circular A-133 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as the State's cognizant agency for the Single Audit.

A. Programs Subject to Single Audit

- U.S. Department of Agriculture
- U.S. Department of Health and Human Services
- U.S. Department of the Interior
- U.S. Department of Transportation

(2) Summary of Significant Accounting Policies

A. Basis of Accounting

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

B. Single Audit Reporting Entity

For purposes of complying with The Single Audit Act of 1984, as amended in 1996, the State's reporting entity is defined in Note 1A to its September 30, 2010 basic financial statements; except that all of the discretely presented component units are excluded. Accordingly, the accompanying Schedule of Expenditures of Federal Awards presents the federal award programs administered by the State, as defined above, for the year ended September 30, 2010.

C. CFDA #15.875

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

(3) Component Units

The Kosrae Utilities Authority (KUA), a discretely presented component unit of the State of Kosrae, separately satisfies the requirements of OMB Circular A-133.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Programs Selected For
Audit in Accordance with OMB Circular A-133
Year Ended September 30, 2010

<u>Program Title</u>	<u>CFDA No.</u>	<u>2010 Fiscal Year Expenditures</u>
<u>U.S. Department of the Interior</u>		
Compact of Free Association:		
Compact Sector Grants	15.875	\$ <u>7,890,538</u>
Total U.S. Federal program expenditures		\$ <u>7,926,260</u>
% of total U.S. Federal expenditures covered by major programs		<u>99%</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

Part I - Summary of Auditors' Results

Financial Statements

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

Federal Awards

Internal control over major programs:

- | | | |
|----|--|---------------|
| 5. | Material weakness(es) identified? | No |
| 6. | Significant deficiency(ies) identified? | None reported |
| 7. | Type of auditors' report issued on compliance for major programs: | Unqualified |
| 8. | Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? | No |
| 9. | Identification of major programs: | |

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

- | | | |
|-----|--|------------|
| 10. | Dollar threshold used to distinguish between Type A and Type B Programs: | \$ 300,000 |
| 11. | Auditee qualified as a low-risk auditee? | Yes |

Part II - Financial Statement Findings Section

<u>Finding Number</u>	<u>Findings</u>
2010-1	Equity Investments

Part III - Federal Award Findings and Questioned Cost Section

No matters are reportable.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2010

Financial Statements Findings Section

Finding No.: 2010-1
Area: Equity Investments

Criteria:

If an equity investment has been written to a nil value, and if it appears that the investor has ceased all operations, the State should engage in a legal review to establish that the corporation has been wound-up and there are no further matters open that would prevent the State from removing any form of investment in the investee from its books.

Condition:

No such documentation has been provided for investments in Kosrae Sea Venture Inc. or for SEMO. While management has represented that these entities have ceased all operations, no legal support has been provided to document this representation.

Cause:

The cause of this condition is the lack of a legal review to document the State's representation.

Effect:

Since the equity investments have been written down to a nil value, there is no impact of this matter on the financial statements.

Recommendation:

A legal review should be obtained to support management's representation.

Auditee Response and Corrective Action Plan:

We have sought the opinion of Acting Attorney General and we are waiting for his legal determination.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Unresolved Prior Years' Findings and Questioned Costs
Year Ended September 30, 2010

There are no unresolved questioned costs or prior year findings of the State of Kosrae as of September 30, 2010.