

**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, 2012

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2012

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

YEAR ENDED SEPTEMBER 30, 2012

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, 2012, which collectively comprise the State's basic financial statements as set forth in Section II of the foregoing table of contents. These financial statements are the responsibility of the management of the State. Our responsibility is to express opinions on these financial statements based on our audit.

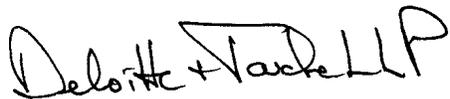
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and 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 previously present fairly, in all material respects, the respective financial position of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae as of September 30, 2012, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 12, 2013 on our consideration of the State's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 9 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

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

June 12, 2013

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2012

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, 2012. We encourage readers to consider this information in conjunction with Kosrae State's financial statements, which follow. Fiscal year 2011 comparative information has been included, where appropriate. This analysis is required by the Governmental Accounting Standards Board (GASB) which provides guidelines on what must be included and excluded from this analysis.

FINANCIAL HIGHLIGHTS

- Kosrae State's total net assets for fiscal year ended September 30, 2012 increased by \$.56 million (or 2.9%) from \$19.38 million in the prior year to \$19.94 million in the current year. The increase is due mainly to positive result in the total amount of revenues for the year which registered \$0.77 million increase as compared to the prior year particularly the Compact Trust.
- For fiscal year ended September 30, 2012, the State's General Fund unassigned fund deficit was reduced to \$0.15 million from \$0.24 million in the prior year. GASB defines unassigned fund balance as a residual fund balance that is not restricted, committed and assigned.
- For the year ended September 30, 2012, the General Fund total fund balance increased by \$0.13 million from \$1.78 million in fiscal year 2011 to \$1.91 million in fiscal year 2012.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

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

Government-Wide Financial Statements

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

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 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, 2012

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.

Governmental Fund Financial Statements

The governmental 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 governmental fund financial statements present a balance sheet and a statement of revenues, expenditures, and changes in fund balances for its major and aggregated non-major funds.

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

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

FINANCIAL ANALYSIS OF KOSRAE STATE AS A WHOLE

Kosrae State's assets at the end of fiscal year 2012 exceeded liabilities by \$19.94 million. The bulk of the net assets amount is from investment in capital assets which comprised 85% of the total, and \$6.75 million are restricted. Kosrae State uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although Kosrae State's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The following summary of Kosrae State's net assets as of September 30, 2012, with comparable balances for the fiscal year 2011, discloses this relationship:

	<u>2012</u>	<u>2011</u>	<u>Change</u>	<u>%</u>
ASSETS				
Current and other non-capital assets	\$ 9,406,856	\$ 8,575,724	\$ 831,132	9.69
Capital assets	<u>16,992,248</u>	<u>17,537,338</u>	<u>(545,090)</u>	(3.11)
Total assets	\$ <u>26,399,104</u>	\$ <u>26,113,062</u>	\$ <u>286,042</u>	1.10

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Management's Discussion and Analysis
September 30, 2012

	<u>2012</u>	<u>2011</u>	<u>Change</u>	<u>%</u>
LIABILITIES				
Long-term liabilities	\$ 5,292,119	\$ 5,454,246	\$ (162,127)	(2.97)
Other liabilities	<u>1,166,713</u>	<u>1,278,146</u>	<u>(111,433)</u>	(8.72)
Total liabilities	<u>6,458,832</u>	<u>6,732,392</u>	<u>(273,560)</u>	(4.06)
NET ASSETS				
Invested in capital assets, net of related debt	16,992,248	17,537,338	(545,090)	(3.11)
Restricted	6,757,643	6,047,181	710,462	11.75
Unrestricted	<u>(3,809,619)</u>	<u>(4,203,849)</u>	<u>394,230</u>	(9.38)
Total net assets	<u>\$ 19,940,272</u>	<u>\$ 19,380,670</u>	<u>\$ 559,602</u>	2.89

At the end of fiscal year 2012, Kosrae State's unrestricted net assets showed a deficit of \$3.80 million, a decrease of \$0.39 million (or 9.4%) as compared with the prior year. The decrease in the deficit is due to the positive variance in total revenues for the year. 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 also increased by \$0.56 million (or 2.9%) from the prior year. Key elements of the differences from the prior year are shown in the following schedule.

	<u>2012</u>	<u>2011</u>	<u>Change</u>	<u>%</u>
Revenues:				
Operating grants and contributions	\$ 8,313,506	\$ 7,807,856	\$ 505,650	6.48
Charges for services	441,897	455,934	(14,037)	(3.08)
Revenue sharing	1,461,391	1,325,147	136,244	10.28
Unrestricted investment earnings	391,604	142,342	249,262	175.11
Taxes	418,091	305,790	112,301	36.72
Other	<u>74,348</u>	<u>296,000</u>	<u>(221,652)</u>	(74.88)
Total revenues	<u>11,100,837</u>	<u>10,333,069</u>	<u>767,768</u>	7.43
Expenses:				
General government	1,891,579	1,903,321	(11,742)	(0.62)
Education	3,845,157	3,987,771	(142,614)	(3.58)
Health services	2,361,942	2,287,091	74,851	3.27
Economic development	923,540	981,085	(57,545)	(5.87)
Boards, commissions and other	1,017,129	996,600	20,529	2.06
Environment protection and sanitation	558,049	604,965	(46,916)	(7.76)
Public order and safety	361,384	336,857	24,527	7.28
Unallotted interest on long-term debt	<u>110,218</u>	<u>49,532</u>	<u>60,686</u>	122.52
Total expenses	<u>11,068,998</u>	<u>11,147,222</u>	<u>(78,224)</u>	0.70
Contributions to permanent funds	<u>527,763</u>	<u>-</u>	<u>527,763</u>	-
Change in net assets	559,602	(814,153)	1,373,755	(168.73)
Net assets at the beginning of the year	<u>19,380,670</u>	<u>20,194,823</u>	<u>(814,153)</u>	(4.03)
Net assets at the end of the year	<u>\$ 19,940,272</u>	<u>\$ 19,380,670</u>	<u>\$ 559,602</u>	2.89

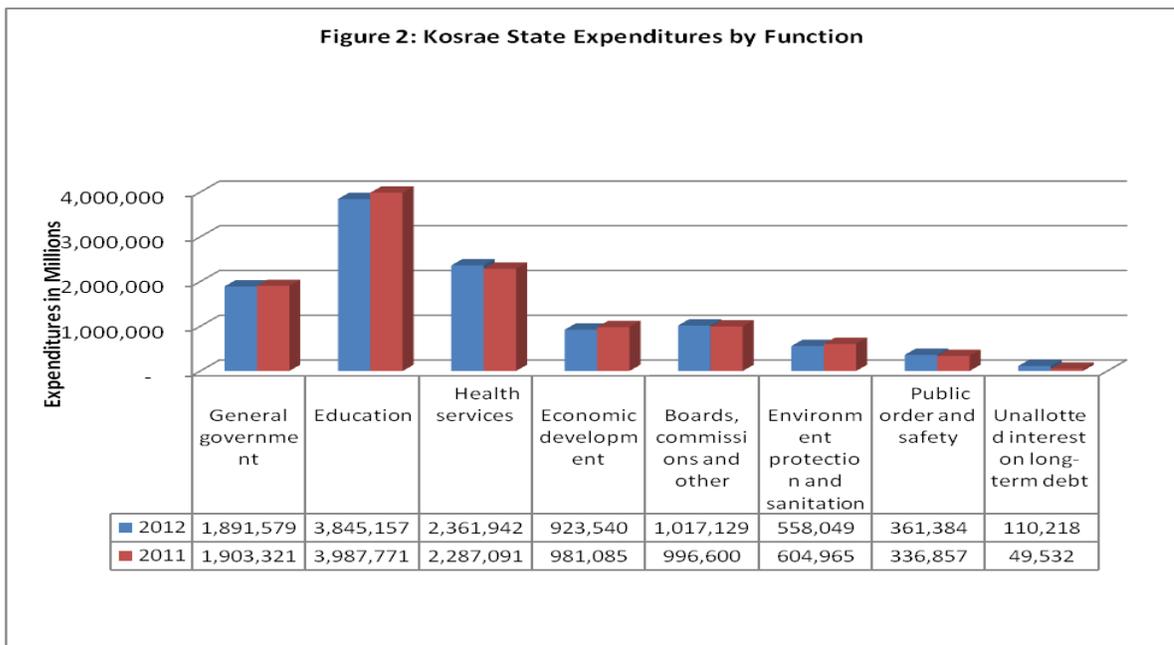
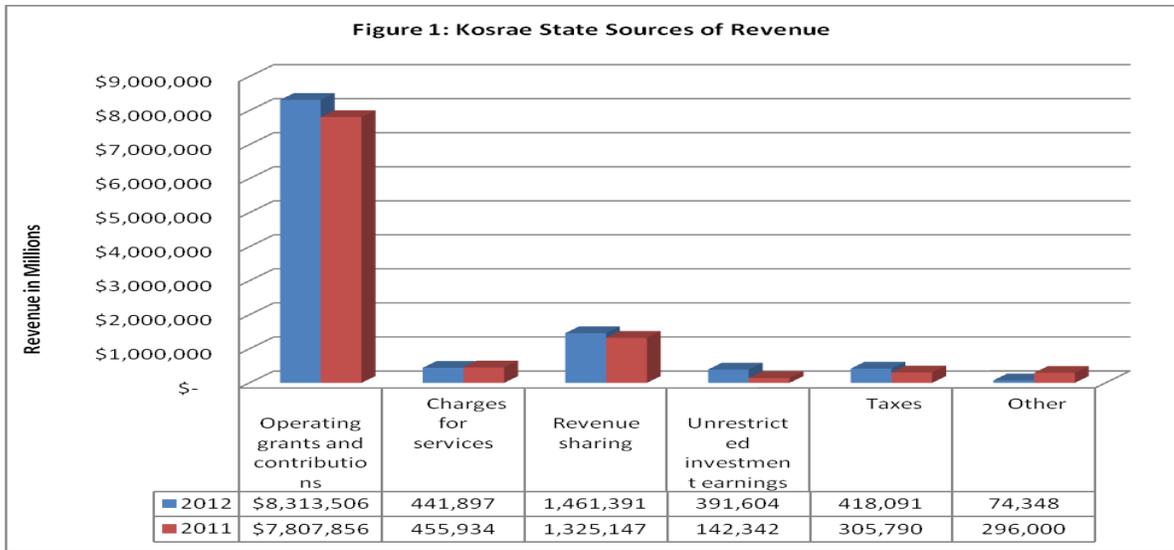
**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2012

Figure 1 below showed that the total revenues in fiscal year 2012 of \$11.10 million increased by \$0.77 million (or 7.4%) from the prior year's \$10.33 million. The increase was primarily due to the increase in the current year's operating grants and contributions by \$0.50 million, revenue sharing of \$0.14 million, unrestricted investment earnings of \$0.25 million and taxes of \$0.11 million. In fiscal year 2012, Grants Assistance Fund revenues comprised 75% of all Kosrae State funding sources whereas the General Fund revenues comprised only 22%.

Figure 2 presents that total expenses of \$11.07 million reflected a .7% decrease from the prior year expenses of \$11.15 million.

The following graphs show the major components of revenues and expenditures for the year ended September 30, 2012.



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Management's Discussion and Analysis
September 30, 2012

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 2012, Kosrae State governmental funds reported a combined fund balance of \$8.59 million, which represents \$.92 million increase or (12%) from the \$7.67 million recorded at the end of fiscal 2011. These increases are attributable mainly to the increase in Compact funding of \$0.476 million, net change in fair value of investments of \$0.786 million, State taxes of \$0.112 million, and FSM revenue sharing of \$0.136 million. Of the total combined fund balance of \$8.59 million, \$5.41 million is designated as non-spendable fund balance; \$2.89 million is restricted fund balance; \$0.50 million is for committed fund balance and (\$0.21) for unassigned fund deficit. Encumbrances are classified as restricted and committed fund balances depending on the revenue constraints of the particular programs.

The General Fund is the main operating fund of the State. At the end of the current fiscal year, the unassigned fund deficit was \$0.15 million, which decreased by \$0.09 million from \$0.24 million from prior year. The total fund balance for the General Fund also increased by \$0.13 million from of \$1.78 million in fiscal year 2011 to \$1.91 million in current year. The excess of revenues under expenditures for the year was \$0.051 million.

The Grants Assistance Fund has a total fund balance of \$1.88 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 \$0.23 million or (14%), which primarily was the result of the increase of the total revenues in fiscal year 2012 by \$0.50 million.

The Compact Trust Fund has a total fund balance of \$3.33 million, all of which is restricted for the funding of future operations of the primary government commencing in fiscal year 2023. The increase in fund balance during the current year in the Compact Trust Fund was \$0.53 million (or 18.83%), which reflected an increase in the fair value of investments for the year of \$0.53 million as compared to the negative \$0.03 million from 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, 2012, General Fund revenues of \$2.18 million, excluding other financing sources, were in excess of expenditures of \$2.11 million by \$0.07 million. Such increase and the changes in the encumbrance and debt service of \$0.03 million and \$0.04 million, respectively, resulted in the total fund balance of \$1.91 million for the year.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Kosrae State's investment in capital assets for the primary government as of September 30, 2012, amounted to \$57.58 million, net of accumulated depreciation of \$40.59 million, resulting to a net book value of \$16.99 million. The increase in capital assets of \$0.48 million was due to the acquisitions of machinery and equipment and major renovation of the Kosrae State Gymnasium. The total depreciation for the year is \$1.03 million.

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September 30, 2012

The table below summarizes Kosrae State's capital assets:

	<u>2012</u>	<u>2011</u>	<u>Change</u>	<u>%</u>
Buildings	\$ 7,096,749	\$ 7,377,229	\$ (280,480)	(3.80)
Infrastructure	8,857,981	9,301,880	(443,899)	(4.77)
Machinery, equipment and others	<u>1,037,518</u>	<u>858,229</u>	<u>179,289</u>	20.89
	<u>\$ 16,992,248</u>	<u>\$ 17,537,338</u>	<u>\$ (545,090)</u>	(3.11)

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 2012 with comparative balances from fiscal year 2011.

	<u>2012</u>	<u>2011</u>	<u>Change</u>	<u>%</u>
FSM National Government Loan	\$ 1,310,000	\$ 1,310,000	\$ -	-
ADB Loans	4,138,474	4,263,383	(124,909)	(2.93)
FSM DB Loan	33,707	88,272	(54,565)	(61.81)
Malem Water	122,938	125,413	(2,745)	(2.19)
Other Claims	<u>35,000</u>	<u>35,000</u>	<u>-</u>	-
	<u>\$ 5,640,119</u>	<u>\$ 5,822,068</u>	<u>\$ (181,949)</u>	(3.13)

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 notes 6 and 7 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

General Fund

Revenues for the six months ending March 31, 2013, showed a slight increase of 5% as compared to the same period in FY 2012. Such increase is generated mainly from infrastructure projects being undertaken by a foreign contractor. A reduction in revenues; however, is expected to occur due to the completion of these infrastructures.

The leaders of Kosrae State are aware of the current situation of the government and have taken steps for the implementation of the Long-term fiscal framework (LTFF) through a task force created in the 2012 Kosrae Leadership Conference. The LTFF identified steps for reforms to remedy the financial burden of the State in the ensuing years.

The LTFF report has been drafted and it is expected to be implemented in FY 2014.

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Grant Assistance Funds

Grants Assistance Funds (specifically compact funding) will continue to be the major funding source for Kosrae State in fiscal year 2013 with total approved funding of \$7,509,887 as follows:

Education Sector	\$2,439,446
Health Sector	\$2,111,506
Environment Sector	\$ 215,903
Private Sector	\$ 782,462
Capacity Building Sector	\$ 502,060
SEG	\$1,280,928
ERA	\$ 177,582

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.

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Statement of Net Assets
September 30, 2012

	Primary Government	Component Units
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 1,077,865	\$ 130,491
Investments	-	546,800
Receivables, net	1,170,489	131,687
Inventories	-	305,005
Prepayments	260,158	4,834
Advances	114,253	-
Restricted assets:		
Time certificates of deposit	-	164,052
Total current assets	2,622,765	1,282,869
Noncurrent assets:		
Capital assets:		
Nondepreciable capital assets	-	73,750
Capital assets, net of accumulated depreciation	16,992,248	20,307,526
Investments	1,230,000	-
Other noncurrent assets	-	252,800
Restricted assets:		
Cash and cash equivalents	311,108	-
Time certificates of deposit	554,383	-
Investments	4,688,600	-
Total noncurrent assets	23,776,339	20,634,076
Total assets	\$ 26,399,104	\$ 21,916,945
<u>LIABILITIES</u>		
Current liabilities:		
Current portion of long-term obligations	\$ 348,000	\$ 216,611
Accounts payable	113,441	322,268
Federal grants payable	-	175,000
Other liabilities and accruals	441,808	122,690
Deferred revenues	263,464	10,268
Total current liabilities	1,166,713	846,837
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	5,257,119	-
Other noncurrent liabilities	35,000	-
Total noncurrent liabilities	5,292,119	-
Total liabilities	6,458,832	846,837
Commitments and contingencies		
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	16,992,248	20,381,276
Restricted for:		
Nonexpendable:		
Future operations	3,330,816	-
Expendable:		
Debt service	1,357,784	-
Compact related	1,581,740	-
Other purposes	487,303	90,000
Unrestricted	(3,809,619)	598,832
Total net assets	19,940,272	21,070,108
Total liabilities and net assets	\$ 26,399,104	\$ 21,916,945

See accompanying notes to financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Statement of Activities
Year Ended September 30, 2012

<u>Functions/Programs</u>	<u>Expenses</u>	Program Revenues		Net (Expenses) Revenues and Changes in Net Assets	
		Charges for Services	Operating Grants and Contributions	Primary Government	Component Units
Primary government:					
Governmental activities:					
General government	\$ 1,891,579	\$ 68,125	\$ 966,352	\$ (857,102)	\$ -
Economic development	923,540	132,232	915,955	124,647	-
Education	3,845,157	1,072	3,742,366	(101,719)	-
Health services	2,361,942	158,742	2,198,484	(4,716)	-
Public order and safety	361,384	17,422	-	(343,962)	-
Environment protection and sanitation	558,049	61,886	490,349	(5,814)	-
Boards, commissions and other	1,017,129	2,418	-	(1,014,711)	-
Unallocated interest on long-term debt	110,218	-	-	(110,218)	-
Total primary government	<u>\$ 11,068,998</u>	<u>\$ 441,897</u>	<u>\$ 8,313,506</u>	<u>(2,313,595)</u>	<u>-</u>
Component units:					
Kosrae Port Authority	\$ 1,053,427	\$ 176,425	\$ -	-	(877,002)
Kosrae Utilities Authority	3,148,523	2,768,974	-	-	(379,549)
Total component units	<u>\$ 4,201,950</u>	<u>\$ 2,945,399</u>	<u>\$ -</u>	<u>-</u>	<u>(1,256,551)</u>
General revenues:					
Taxes:					
FSM revenue sharing:					
Gross revenue taxes				672,674	-
Import taxes				378,193	-
Income taxes				356,894	-
Other taxes				53,630	-
State taxes				418,091	-
Unrestricted investment earnings				391,604	62,225
Other				74,348	36,934
Total general revenues				<u>2,345,434</u>	<u>99,159</u>
Contributions to permanent fund				527,763	82,615
Change in net assets				<u>559,602</u>	<u>(1,074,777)</u>
Net assets at the beginning of the year				<u>19,380,670</u>	<u>22,144,885</u>
Net assets at the end of the year				<u>\$ 19,940,272</u>	<u>\$ 21,070,108</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Balance Sheet

Governmental Funds
September 30, 2012

		Special Revenue	Permanent	Other Governmental Funds	
	General	Grants Assistance	Compact Trust		Total
ASSETS					
Cash and cash equivalents	\$ 1,077,865	\$ -	\$ -	\$ -	\$ 1,077,865
Investments	292,000	900,000	-	38,000	1,230,000
Receivables, net:					
General	244,750	5,966	-	300	251,016
Loans	30,000	-	-	443,603	473,603
Federal agencies	-	445,870	-	-	445,870
Due from other funds	200,635	1,002,259	-	631,182	1,834,076
Prepaid items	21,870	238,288	-	-	260,158
Advances	70,136	43,337	-	780	114,253
Restricted assets:					
Cash and cash equivalents	285,813	-	-	25,295	311,108
Time certificates of deposit	200,000	-	-	354,383	554,383
Investments	1,357,784	-	3,330,816	-	4,688,600
Total assets	<u>\$ 3,780,853</u>	<u>\$ 2,635,720</u>	<u>\$ 3,330,816</u>	<u>\$ 1,493,543</u>	<u>\$ 11,240,932</u>
LIABILITIES AND FUND BALANCES					
Liabilities:					
Accounts payable	\$ 18,199	\$ 72,451	\$ -	\$ 22,791	\$ 113,441
Other liabilities and accruals	216,041	223,086	-	2,681	441,808
Due to other funds	1,633,441	197,658	-	2,977	1,834,076
Deferred revenues	-	263,431	-	33	263,464
Total liabilities	<u>1,867,681</u>	<u>756,626</u>	<u>-</u>	<u>28,482</u>	<u>2,652,789</u>
Fund balances:					
Non-spendable	414,005	1,181,625	3,330,816	481,603	5,408,049
Restricted	1,645,253	760,866	-	487,303	2,893,422
Committed	-	-	-	496,155	496,155
Unassigned:					
General fund	(146,086)	-	-	-	(146,086)
Special revenue funds	-	(63,397)	-	-	(63,397)
Total fund balances	<u>1,913,172</u>	<u>1,879,094</u>	<u>3,330,816</u>	<u>1,465,061</u>	<u>8,588,143</u>
Total liabilities and fund balances	<u>\$ 3,780,853</u>	<u>\$ 2,635,720</u>	<u>\$ 3,330,816</u>	<u>\$ 1,493,543</u>	

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

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

16,992,248

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 (5,605,119)
Claims payable (35,000)

(5,640,119)

Net assets of governmental activities

\$ 19,940,272

See accompanying notes to financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

	General	Special Revenue Grants Assistance	Permanent Compact Trust	Other Governmental Funds	Total
Revenues:					
Compact funding	\$ -	\$ 7,870,252	\$ -	\$ -	\$ 7,870,252
Net change in the fair value of investments	274,325	-	527,763	-	802,088
Federal contributions	-	116,820	-	-	116,820
FSM revenue sharing	1,461,391	-	-	-	1,461,391
State taxes	418,091	-	-	-	418,091
CFSM grants	-	-	-	37,000	37,000
Fees and charges	181,566	-	-	260,331	441,897
Other grants	-	289,434	-	-	289,434
Interest income	43,626	2,748	-	70,905	117,279
Other	74,348	-	-	-	74,348
Total revenues	2,453,347	8,279,254	527,763	368,236	11,628,600
Expenditures:					
Current:					
General government	1,142,817	700,061	-	-	1,842,878
Economic development	-	915,955	-	-	915,955
Education	-	3,742,366	-	-	3,742,366
Health services	-	2,198,484	-	118,930	2,317,414
Public order and safety	331,207	-	-	25,000	356,207
Environment protection and sanitation	-	490,349	-	70,175	560,524
Boards, commissions and other	613,165	-	-	122,221	735,386
Debt service	315,097	-	-	-	315,097
Total expenditures	2,402,286	8,047,215	-	336,326	10,785,827
Excess of revenues over expenditures	51,061	232,039	527,763	31,910	842,773
Other financing sources:					
Proceeds from issuance of long-term debt	79,970	-	-	-	79,970
Total other financing sources	79,970	-	-	-	79,970
Net change in fund balances	131,031	232,039	527,763	31,910	922,743
Fund balances at the beginning of the year	1,782,141	1,647,055	2,803,053	1,433,151	7,665,400
Fund balances at the end of the year	\$ 1,913,172	\$ 1,879,094	\$ 3,330,816	\$ 1,465,061	\$ 8,588,143

See accompanying notes to financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

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

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	\$ 922,743
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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	(545,090)
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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	(79,970)	
Repayment of ADB Loans	204,879	
Repayment of FSMDB Loan	54,565	
Repayment of RUS Loan	<u>2,475</u>	
		<u>181,949</u>
Change in net assets of governmental activities		\$ <u>559,602</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Combining Statement of Net Assets

Component Units
September 30, 2012

<u>ASSETS</u>	<u>Kosrae Port Authority</u>	<u>Kosrae Utilities Authority</u>	<u>Total</u>
Current assets:			
Cash and cash equivalents	\$ 6,809	\$ 123,682	\$ 130,491
Investments	-	546,800	546,800
Time certificate of deposit - restricted	-	164,052	164,052
Receivables:			
General	68,401	315,045	383,446
Allowance for doubtful debts	(50,804)	(200,955)	(251,759)
Net receivables	17,597	114,090	131,687
Inventories	-	305,005	305,005
Prepayments	3,150	1,684	4,834
Total current assets	27,556	1,255,313	1,282,869
Noncurrent assets:			
Deposit for fuel purchase contract	-	252,800	252,800
Capital assets:			
Nondepreciable capital assets	-	73,750	73,750
Capital assets, net of accumulated depreciation	16,944,452	3,363,074	20,307,526
Total assets	\$ 16,972,008	\$ 4,944,937	\$ 21,916,945
<u>LIABILITIES AND NET ASSETS</u>			
Current liabilities:			
Short-term note payable	\$ -	\$ 216,611	\$ 216,611
Accounts payable	7,248	315,020	322,268
Federal grants payable	-	175,000	175,000
Accrued liabilities	88,863	33,827	122,690
Deferred revenues	-	10,268	10,268
Total liabilities	96,111	750,726	846,837
Net assets:			
Invested in capital assets, net of related debt	16,944,452	3,436,824	20,381,276
Restricted	-	90,000	90,000
Unrestricted	(68,555)	667,387	598,832
Total net assets	16,875,897	4,194,211	21,070,108
Total liabilities and net assets	\$ 16,972,008	\$ 4,944,937	\$ 21,916,945

See accompanying notes to 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, 2012

	<u>Kosrae Port Authority</u>	<u>Kosrae Utilities Authority</u>	<u>Total</u>
Operating revenues:			
Charge for services	\$ 176,425	\$ 2,516,176	\$ 2,692,601
Operating expenses:			
Cost of services	-	2,094,155	2,094,155
Depreciation and amortization	861,995	424,113	1,286,108
Administration and general	191,432	618,906	810,338
Total operating expenses	<u>1,053,427</u>	<u>3,137,174</u>	<u>4,190,601</u>
Operating loss	<u>(877,002)</u>	<u>(620,998)</u>	<u>(1,498,000)</u>
Nonoperating revenues (expenses):			
Interest income	-	716	716
Net change in fair value of investments	-	61,509	61,509
Interest expense	-	(11,349)	(11,349)
Federal grants	-	36,934	36,934
Other	-	252,798	252,798
Total nonoperating revenues (expenses), net	<u>-</u>	<u>340,608</u>	<u>340,608</u>
Capital Contributions:			
U.S. Government	<u>-</u>	<u>82,615</u>	<u>82,615</u>
Change in net assets	(877,002)	(197,775)	(1,074,777)
Net assets at beginning of year	<u>17,752,899</u>	<u>4,391,986</u>	<u>22,144,885</u>
Net assets at end of year	\$ <u>16,875,897</u>	\$ <u>4,194,211</u>	\$ <u>21,070,108</u>

See accompanying notes to financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies

The State of Kosrae (the State) was constituted on January 11, 1984, under the provisions of the Kosrae State Constitution (the Constitution) as approved by the people of Kosrae. The Constitution provides for the separation of powers of the executive, legislative, and judicial branches of the government.

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

A. Reporting Entity

The State is one of the four states that make up the Federated States of Micronesia (FSM), along with the states of Chuuk, Pohnpei and Yap. The State is a constitutional government comprised of three branches: the Legislative Branch, consisting of 14 members elected for a term of four years by qualified voters of their respective election districts; the Executive Branch, headed by the Governor and Lt. Governor who are primarily responsible for executing the laws and administering state government services; and the Judiciary Branch made up of the State Supreme Court, which consists of a Chief Justice and up to four Associate Justices, and other courts that may be created by law.

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

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

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

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

Discretely Presented Component Units:

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

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

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

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.

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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

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 \$6,757,643 of restricted net assets, of which \$487,303 is restricted by enabling legislation.

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

C. Fund Financial Statements

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

C. Fund Financial Statements, Continued

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

D. Measurement Focus and Basis of Accounting

Government-wide Financial Statements:

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

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

Governmental Fund Financial Statements:

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

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Component Unit Financial Statements:

Discretely presented component units distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a discretely presented component unit's principal ongoing operations. All other revenues are reported as nonoperating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, sets forth minimum criteria (percentage of the assets, liabilities, revenues or expenditures/expenses for either fund category or the governmental and enterprise combined) for the determination of major funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The nonmajor funds are combined in a column in the fund financial statements and detailed in the combining statements. The State reports the following major funds:

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

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

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

E. Reporting Standards

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

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

F. Cash and Cash Equivalents and Time Certificates of Deposit

Cash and cash equivalents of the primary government and the discretely presented component units include cash held in demand accounts as well as short-term investments with 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 of the primary government and the discretely presented component units are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Investments in the equity of companies are carried at cost if less than twenty percent of the companies' total equity, on the equity method if greater than twenty percent and less than fifty percent and on a consolidated basis if greater than fifty percent.

H. Receivables

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

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

I. Prepaid Items

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

J. Interfund Receivables/Payables

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

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

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

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

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 \$1,357,784 for the Early Retirement Scheme. Furthermore, investments recorded in the Compact Trust Fund of \$3,330,816 are restricted in that they are not available to be used in current operations.

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

Primary Government:

Deposit account established for the purpose of receiving payments pursuant to the Compact of Free Association, as amended.	\$ 198,344
Deposit account established for the Housing Renovation program.	87,469
Deposit account established for the Gifford scholarship fund.	25,295
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>\$ 865,491</u>

Discretely Presented Component Units:

Time certificate of deposit with a local bank pledged supporting Kosrae Utility Authority debt.	<u>\$ 164,052</u>
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**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

M. Capital Assets

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

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

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

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

N. 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 financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

P. 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.

Q. Fund Balance

Fund balance classifications are based on the extent to which the State is bound to honor constraints on the specific purposes for which amounts in those funds can be spent and are reported under the following fund balance classifications:

- Non-spendable - includes fund balance amounts that cannot be spent either because it is not in spendable form or because of legal or contractual constraints.
- Restricted - includes fund balance amounts that are constrained for specific purposes which are externally imposed by providers, such as creditors or amounts constrained due to constitutional provisions or enabling legislation.
- Committed - includes fund balance amounts that are constrained for specific purposes that are internally imposed by the government through formal action of the highest level of decision making authority and does not lapse at year-end.
- Assigned - includes fund balance amounts that are intended to be used for specific purposes that are neither considered restricted or committed.
- Unassigned includes negative fund balances in other governmental funds.

The State has a general policy to first use restricted resources for expenditures incurred for which both restricted and unrestricted (committed, assigned, and unassigned) resources are available. When expenditures are incurred for which only unrestricted resources are available, the general policy of the State is to use committed resources first, followed by assigned, and then unassigned. The use of restricted/committed resources may be deferred based on a review of the specific transaction.

A formal minimum fund balance policy has not been adopted.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

R. New Accounting Standards

During fiscal year 2012, the State implemented the following pronouncements:

- GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to the frequency and timing of measurements for actuarial valuations first used to report funded status information in OPEB plan financial statements. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions* (an amendment of GASB Statement No. 53), which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

In December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*, which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain FASB and American Institute of Certified Public Accountants (AICPA) pronouncements. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

R. New Accounting Standards, Continued

In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management has not yet determined the effect of implementation of this statement on the financial statements of the State.

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

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

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

S. 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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

T. Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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.

U. Total Columns

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

(2) Deposits and Investments

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

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

- 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.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2012

(2) Deposits and Investments, Continued

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

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

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

A. Deposits

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

As of September 30, 2012, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit was \$1,943,356 and the corresponding bank balance was \$2,068,454, which is maintained in financial institutions subject to FDIC insurance. As of September 30, 2012, 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.

As of September 30, 2012, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit was \$130,491, and the corresponding bank balance was \$143,209, which were maintained in financial institutions subject to FDIC insurance. As of September 30, 2012, these bank deposits were fully FDIC insured.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2012

(2) Deposits and Investments, Continued

B. Investments

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

Fixed income securities:	
Domestic fixed income	\$ 282,072
Other investments:	
Money market funds	4,383,491
Cash management account	<u>23,037</u>
	<u>\$ 4,688,600</u>

As of September 30, 2012, 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	\$ 15,695	\$ 8,730	\$ 1,692	\$ 5,273	\$ -	Aaa/AAA
U.S. Government Agencies Obligations:						
Federal Home Loan Mortgage Corporation	48,667	-	399	11,558	36,711	AAA
Government National Mortgage Association	6,038	4,974	-	-	1,064	AAA
Federal National Mortgage Association	37,416	-	5,086	-	32,329	AAA
Tennessee Valley Authority Fed Book Notes	10,543	-	-	5,546	4,997	AAA
Housing Urban Development	7,818	-	7,818	-	-	No rating
AID-Tunisia	11,462	-	5,401	6,061	-	AAA
Municipal Obligations	3,339	-	-	-	3,339	A2
Municipal Obligations	14,026	-	2,257	7,139	4,630	Aa1
Municipal Obligations	3,973	-	-	-	3,973	Aa2
Municipal Obligations	5,660	5,660	-	-	-	No rating
Municipal Obligations	2,717	2,717	-	-	-	WR
Corporate Bonds	6,864	-	-	-	6,864	A1
Corporate Bonds	9,987	-	9,987	-	-	A2
Corporate Bonds	17,706	4,211	13,495	-	-	A3
Corporate Bonds	8,381	6,832	-	1,550	-	Aa1
Corporate Bonds	17,577	-	8,978	2,788	5,811	Aa2
Corporate Bonds	24,287	2,469	8,364	5,176	8,277	Aaa
Corporate Bonds	12,196	5,168	7,028	-	-	Baa1
Corporate Bonds	5,770	-	2,835	-	2,934	Baa2
Corporate Bonds	<u>11,950</u>	<u>5,272</u>	<u>-</u>	<u>6,679</u>	<u>-</u>	No rating
	<u>\$282,072</u>	<u>\$46,033</u>	<u>\$73,340</u>	<u>\$51,770</u>	<u>\$110,929</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, 2012.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2012

(2) Deposits and Investments, Continued

B. Investments, Continued

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the State.

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

As of September 30, 2012, the General Fund holds 7.3% of the shares of the Pacific Islands Development Bank in the amount of \$292,000. As the fair market value of this investment is not readily available, such has been recorded at cost.

As of September 30, 2012, 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.

As of September 30, 2012, 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, 2012, 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, 2012, investments at fair value comprise the following:

Money market funds	\$ 13,613
Common stock	299,949
Fixed income securities	<u>208,238</u>
	521,800
Investment in Ocean Energy Kosrae	<u>25,000</u>
	\$ <u>546,800</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2012

(3) Receivables

Receivables as of September 30, 2012, 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	\$ 604,797	\$ -	\$ -	\$ 604,797
Federal agencies	-	88,064	604,657	692,721
Taxes	415,044	-	-	415,044
Loans	30,000	762,630	1,978,854	2,771,484
FSM National Government	-	2,367,010	-	2,367,010
Other	<u>-</u>	<u>29,200</u>	<u>363,709</u>	<u>392,909</u>
	1,049,841	3,246,904	2,947,220	7,243,965
Less: Allowance for uncollectible accounts	<u>(775,091)</u>	<u>(2,795,068)</u>	<u>(2,503,317)</u>	<u>(6,073,476)</u>
Net receivables	<u>\$ 274,750</u>	<u>\$ 451,836</u>	<u>\$ 443,903</u>	<u>\$ 1,170,489</u>

Loans receivable of the primary government as of September 30, 2012 are as follows:

General Fund

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

Grants Assistance Fund

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

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

\$ 762,630

Nonmajor Governmental Funds

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 \$1,501,198. \$ 1,944,801

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. 34,053

\$ 1,978,854

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2012

(4) Interfund Receivables and Payables

Receivables and payables between funds reflected as due to/from other funds in the combined balance sheet at September 30, 2012, are summarized as follows:

Receivable Fund	Payable Fund	Amount
Grants Assistance	General	\$ 1,002,259
Nonmajor governmental funds	General	631,182
General	Nonmajor governmental funds	2,977
General	Grants Assistance	<u>197,658</u>
		<u>\$ 1,834,076</u>

(5) Capital Assets

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

Primary Government

	Balance October 1, 2011	Increases	Decreases	Balance September 30, 2012
Governmental activities:				
Buildings	\$ 19,441,367	\$ 149,736	-	\$ 19,591,103
Infrastructure	32,925,368	-		32,925,368
Machinery, equipment, others	<u>4,734,116</u>	<u>334,565</u>	-	<u>5,068,681</u>
	<u>57,100,851</u>	<u>484,301</u>	-	<u>57,585,152</u>
Less accumulated depreciation:				
Buildings	(12,064,138)	(430,216)	-	(12,494,354)
Infrastructure	(23,623,488)	(443,899)	-	(24,067,387)
Machinery, equipment, others	<u>(3,875,887)</u>	<u>(155,276)</u>	-	<u>(4,031,163)</u>
	<u>(39,563,513)</u>	<u>(1,029,391)</u>	-	<u>(40,592,904)</u>
	<u>\$ 17,537,338</u>	<u>\$ (545,090)</u>	<u>\$ -</u>	<u>\$ 16,992,248</u>

During the year ended September 30, 2012, depreciation expense was charged as follows:

General government	\$ 57,901
Economic development	7,585
Education	239,405
Health services	118,103
Public safety	5,177
Boards, commissions and others	<u>601,220</u>
	<u>\$ 1,029,391</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2012

5) Capital Assets, Continued

Discretely Presented Component Units

	Balance October <u>1, 2011</u>	<u>Increases</u>	<u>Decreases</u>	Balance September <u>30, 2012</u>
Depreciable assets:				
Buildings	\$ 8,618,737	\$ -	\$ -	\$ 8,618,737
Utility plant	11,720,314	137,436	-	11,857,750
Infrastructure	37,972,012	-	-	37,972,012
Machinery, equipment, others	<u>924,968</u>	<u>-</u>	<u>-</u>	<u>924,968</u>
	59,236,031	137,436	-	59,373,467
Less accumulated depreciation	<u>(37,779,833)</u>	<u>(1,286,108)</u>	<u>-</u>	<u>(39,065,941)</u>
	21,456,198	(1,148,672)	-	20,307,526
Nondepreciable assets:				
Construction work-in-progress	<u>78,556</u>	<u>1,655</u>	<u>(6,461)</u>	<u>73,750</u>
	<u>\$ 21,534,754</u>	<u>\$ (1,147,017)</u>	<u>\$ (6,461)</u>	<u>\$ 20,381,276</u>

(6) Long-Term Obligations

Primary Government

Malem Wastewater System Project (MWSP) Loan:

The State borrowed \$145,000 from the U.S. Department of Agriculture Rural Utilities Services for the Malem Wastewater System Project, payable in annual installments of \$8,119 commencing September 28, 2001, interest at 4.5% per annum, due September 28, 2040. As of September 30, 2012, the balance payable on this mortgage loan amounted to \$122,938.

Asian Development Bank (ADB) Loans:

The State implemented an Early Retirement Scheme (ERS) in which employees holding certain nonessential positions as identified by the State were retired early with a payout of the equivalent of two-years' wages. This ERS program is funded by a \$2,000,000 loan from the ADB (Loan Number 1520 (SF)) through the FSM National Government, non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The activities of the ERS Program are recorded in the General Fund.

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.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2012

(6) Long-Term Obligations, Continued

Primary Government, Continued

Asian Development Bank (ADB) Loans, Continued:

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, \$1,357,784 is deposited in an investment account held jointly with the FSM National Government. That investment account is restricted for the repayment of this debt. As of September 30, 2012, the balance payable on this loan amounted to \$2,079,814.

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, 2012, the balance payable on this loan amounted to \$236,434.

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Program Loans with ADB (Loan Number 1873 (SF) and Loan Number 1874 FSM (SF)) for the purpose of promoting private sector development in Kosrae, with interest at 1% to 1.5% per annum. Principal payments shall be made in 32 equal semi-annual payments with the first payment due on May 15, 2010 and the last payment on November 15, 2025. As of September 30, 2012, the balances payable on these loans amounted to \$736,947 and \$795,585, respectively.

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Program Loan with ADB (Loan Number 2099 FSM (SF)) for the purpose of funding the Omnibus Infrastructure Development Project, with interest at 1% to 1.5% per annum. Principal payments shall be made semiannually commencing 2013, with a maturity date of 2037. As of September 30, 2012, the balance payable on this loan amounted to \$289,694.

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, 2012, the balance payable on this loan amounted to \$1,310,000.

Additionally, the State has assumed a loan payable to the FSM Development Bank, maturing on July 18, 2010, interest at 9% per annum, with monthly principal and interest payments of \$5,071. As of September 30, 2012, the balance payable on this loan amounted to \$33,707. This loan originated with a discontinued component unit and was assumed by the State through its dissolution.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2012

(6) Long-Term Obligations, Continued

Primary Government, Continued

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

Year ending September 30,	Principal	Interest	Total
2013	\$ 348,000	\$ 60,243	\$ 408,243
2014	314,409	54,899	369,308
2015	314,531	52,583	367,114
2016	314,658	50,262	364,920
2017	314,791	47,934	362,725
2018 – 2022	1,617,270	198,996	1,816,266
2023 – 2027	979,728	129,571	1,109,299
2028 – 2032	794,077	71,663	865,740
2033 – 2037	600,082	23,246	623,328
2038	<u>7,573</u>	<u>344</u>	<u>7,917</u>
	<u>\$ 5,605,119</u>	<u>\$ 689,741</u>	<u>\$ 6,294,860</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, 2012, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net assets:

	Balance October 1, 2011	Additions	Reductions	Balance September 30, 2012	Due Within One Year
Loans payable:					
ADB loans:					
Loan 1520	\$ 2,122,211	\$ -	\$ (42,397)	\$ 2,079,814	\$ 46,221
Loan 1816	259,367	-	(22,933)	236,434	11,822
Loan 1873	825,120	-	(88,173)	736,947	54,589
Loan 1874	846,961	-	(51,376)	795,585	37,004
Loan 2099	209,724	79,970	-	289,694	12,071
FSMDB loan	88,272	-	(54,565)	33,707	33,707
MWSP loan	125,413	-	(2,475)	122,938	2,586
FSMNG loan	<u>1,310,000</u>	<u>-</u>	<u>-</u>	<u>1,310,000</u>	<u>150,000</u>
	5,787,068	79,970	(261,919)	5,605,119	348,000
Other:					
Claims	<u>35,000</u>	<u>-</u>	<u>-</u>	<u>35,000</u>	<u>-</u>
	<u>\$ 5,822,068</u>	<u>\$ 79,970</u>	<u>\$ (269,919)</u>	<u>\$ 5,640,119</u>	<u>\$ 348,000</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2012

(7) Change in Long-Term Obligations, Continued

Discretely Presented Component Units

During the year ended September 30, 2012, 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 1, 2011	Additions	Reductions	Balance September 30, 2012	Due Within One Year
KUA loan payable	\$ 69,312	\$ -	\$ 69,312	\$ -	\$ -

(8) Fund Balances

Classifications of fund balances comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. The following table enumerates the fund balance classifications:

	General Fund	Grants Assistance Fund	Compact Trust Fund	Nonmajor Funds	Total Governmental Funds
Non-spendable:					
General government	\$ 92,005	\$ 13,754	\$ -	\$ -	\$ 105,759
Economic development	30,000	74,806	-	-	104,806
Education	-	58,171	-	-	58,171
Health services	-	14,404	-	-	14,404
Home improvement program	-	120,490	-	443,603	564,093
Pacific Islands Development Bank	292,000	400,000	-	38,000	730,000
Bank of the FSM	-	500,000	-	-	500,000
Permanent fund principal	-	-	3,330,816	-	3,330,816
Restricted for:					
General government	-	18,552	-	-	18,552
Education	-	255,695	-	-	255,695
Health services	-	241,151	-	-	241,151
Economic development	-	71,157	-	-	71,157
Debt service	1,357,784	-	-	-	1,357,784
Housing renovation program	87,469	-	-	-	87,469
USDA development loans	200,000	-	-	-	200,000
Capital projects	-	97,447	-	41,368	138,815
Housing improvement program	-	-	-	69,234	69,234
Scholarships	-	-	-	376,701	376,701
Other foreign assistance	-	76,864	-	-	76,864
Committed for:					
Education	-	-	-	8,507	8,507
Health services	-	-	-	373,449	373,449
Environment protection	-	-	-	86,986	86,986
Board, commissioners, others	-	-	-	27,213	27,213
Unassigned	(146,086)	(63,397)	-	-	(209,483)
	<u>\$ 1,913,172</u>	<u>\$ 1,879,094</u>	<u>\$ 3,330,816</u>	<u>\$ 1,465,061</u>	<u>\$ 8,588,143</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2012

(9) Commitments and Contingencies

Encumbrances

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

	<u>General</u>	<u>Grants Assistance</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Encumbrances	\$ <u>71,636</u>	\$ <u>640,328</u>	\$ <u>99,374</u>	\$ <u>811,338</u>

Sick Leave

It is the policy of the State to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave as of September 30, 2012 is \$87,219.

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, 2012, is not predictable but could have a material impact on the accompanying financial statements. Such impact has currently been estimated to approximate \$35,000, which has been recorded as a liability in the accompanying statement of net assets.

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, 2012

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

	<u>Budgeted Amounts</u>		Actual - Budgetary	Variance with <u>Final Budget -</u>
	<u>Original</u>	<u>Final</u>	Basis (see Note 1)	
Revenues:				
FSM revenue sharing	\$ 917,688	\$ 917,688	\$ 1,461,391	\$ 543,703
State taxes	807,793	807,793	418,091	(389,702)
Licenses and fees	40,510	40,510	181,566	141,056
Interest and dividends	31,188	31,188	43,626	12,438
Other	<u>188,920</u>	<u>188,920</u>	<u>74,348</u>	<u>(114,572)</u>
Total revenues	<u>1,986,099</u>	<u>1,986,099</u>	<u>2,179,022</u>	<u>192,923</u>
Expenditures:				
Current:				
General government	1,090,559	1,128,110	1,157,055	(28,945)
Public order and safety	316,148	336,148	341,992	(5,844)
Boards, commissions and other	<u>654,793</u>	<u>658,675</u>	<u>615,094</u>	<u>43,581</u>
Total expenditures	<u>2,061,500</u>	<u>2,122,933</u>	<u>2,114,141</u>	<u>8,792</u>
Net change in fund balance	(75,401)	(136,834)	64,881	184,131
Encumbrance	-	-	26,954	(26,954)
Debt service	-	-	39,196	(39,196)
Fund balance at the beginning of the year	<u>1,782,141</u>	<u>1,782,141</u>	<u>1,782,141</u>	<u>-</u>
Fund balance at the end of the year	<u>\$ 1,706,740</u>	<u>\$ 1,645,307</u>	<u>\$ 1,913,172</u>	<u>\$ 250,281</u>

See accompanying notes to required supplementary information - budgetary reporting.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

(1) Budgetary Information

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

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

Encumbrance accounting is employed in governmental funds. For budgetary purposes, the encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be reappropriated and honored during the subsequent fiscal year.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 201

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

	General	Special Revenue Grants Assistance	Permanent Compact Trust	Other Governmental Funds	Total
Expenditures:					
Salaries and wages:					
Regular	\$ 1,141,823	\$ 3,219,731	\$ -	\$ 53,287	\$ 4,414,841
Overtime	31,058	100,778	-	-	131,836
Fringe benefits	139,393	403,193	-	1,734	544,320
Other personnel costs	14,238	(495)	-	-	13,743
Travel and transportation	139,241	240,442	-	19,704	399,387
Communications	43,964	72,169	-	3,343	119,476
Customs and tax expenses	-	16	-	333	349
Dues, membership, and subscriptions	24,950	2,100	-	-	27,050
Food stuffs	26,985	30,814	-	881	58,680
Port charges	426	9,315	-	7,968	17,709
Office supplies and materials	94,000	435,511	-	104,360	633,871
POL	32,813	106,316	-	6,196	145,325
Printing and reproduction	1,371	13,798	-	124	15,293
Rental services	6,818	3,310	-	33	10,161
Repairs and maintenance	2,299	5,415	-	178	7,892
Utilities	105,664	279,674	-	5,041	390,379
Subsidies and contributions	30,510	3,800	-	-	34,310
Medical referral	-	193,360	-	-	193,360
Medical supplies	-	485,787	-	118,930	604,717
Contractual services	35,739	709,237	-	4,055	749,031
Professional services	-	34,793	-	-	34,793
Non-payroll compensation	11,193	29,900	-	-	41,093
Scholarships and allowances	3,770	416,490	-	-	420,260
Training	29,707	309,309	-	7,964	346,980
Leased housing, buildings and land	28,037	106,366	-	-	134,403
Equipment	41,503	695,306	-	2,200	739,009
Non-Capital outlay	16,293	98,217	-	-	114,510
Principal repayment	261,919	-	-	-	261,919
Interest payments	114,034	-	-	-	114,034
Miscellaneous	24,538	42,563	-	(5)	67,096
	<u>\$ 2,402,286</u>	<u>\$ 8,047,215</u>	<u>\$ -</u>	<u>\$ 336,326</u>	<u>\$ 10,785,827</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

	2012	2011
Revenues:		
FSM revenue sharing:		
Gross revenue taxes	672,674	530,737
Import taxes	378,193	411,998
Income taxes	356,894	331,672
Other taxes	53,630	50,740
	1,461,391	1,325,147
State taxes:		
Sales tax	418,091	305,790
Fees and charges:		
Licenses and fees	181,566	217,667
Net change in fair value of investments	274,325	50,762
Interest and dividend income	43,626	57,021
Other:		
Other	74,348	96,000
Total revenues	2,453,347	2,052,387
Expenditures:		
Current:		
General government:		
Office of the Governor	187,828	149,308
Department of Administration and Finance	116,406	338,580
Judiciary Branch	227,495	190,951
Legislative Branch	609,238	548,135
Election	1,850	35,900
	1,142,817	1,262,874
Economic Development:		
Department of Resources and Economic Affairs	-	315
Farmer Extension	-	4,118
Land Management and Preservation	-	(618)
Private Sector Development Project	-	60,113
Fisheries Development	-	2,520
Marine Surveillance	-	71
	-	66,519
Public Order and Safety:		
Office of the Attorney General	330,507	296,164
Parole board	700	995
	331,207	297,159
Boards, Commissions and Other:		
Department of Transportation and Infrastructure	287,050	279,044
Broadcast Authority	43,548	42,293
Sports Council	16,838	8,266
Retirement Pension Program	7,958	16,676
RM Small Business Development Center	12,871	421
Land Court	115,733	104,406
USDA Rural Development	25,958	31,172
Stabilization loan repayment	-	40,000
Micronesia Petroleum Corporation debt service	60,856	68,935
Micronesia Legal Services	15,000	-
Municipal governments	10,000	7,503
Other	17,353	30
	613,165	598,746

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

	2012	2011
Expenditures, continued:		
Debt Service:		
Principal payments	261,919	173,341
Interest charges	53,178	51,900
	315,097	225,241
Total expenditures	2,402,286	2,450,539
Excess (deficiency) of revenues over (under) expenditures	51,061	(398,152)
Other financing sources:		
Proceeds from issuance of long-term debt	79,970	66,644
Operating transfers in	-	45,113
	79,970	111,757
Net change in fund balance	131,031	(286,395)
Fund balance at the beginning of the year	1,782,141	2,068,536
Fund balance at the end of the year	\$ 1,913,172	\$ 1,782,141

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final	Budgetary Basis	
Revenues:				
FSM revenue sharing:	\$ 917,688	\$ 917,688	\$ 1,461,391	\$ 543,703
State taxes:				
Sales tax	807,793	807,793	418,091	(389,702)
Fees and charges:				
Licences and fees	40,510	40,510	181,566	141,056
Interest and dividend income	31,188	31,188	43,626	12,438
Other:				
Other	188,920	188,920	74,348	(114,572)
Total revenues	1,986,099	1,986,099	2,179,022	192,923
Expenditures:				
Current:				
General government:				
Office of the Governor	170,623	185,373	191,426	(6,053)
Department of Administration and Finance	83,275	96,026	119,830	(23,804)
Judiciary Branch	227,907	227,907	227,817	90
Legislative Branch	606,254	616,304	616,132	172
Election	2,500	2,500	1,850	650
	1,090,559	1,128,110	1,157,055	(28,945)
Public order and safety:				
Office of the Attorney General	315,398	335,398	341,292	(5,894)
Parole board	750	750	700	50
	316,148	336,148	341,992	(5,844)
Boards, commissions and other:				
Department of Transportation and Infrastructure	292,677	296,629	292,348	4,281
USDA Rural Development	23,190	23,190	25,958	(2,768)
Broadcast Authority	43,118	43,118	43,548	(430)
Sports Council	17,563	17,493	17,060	433
Retirement Pension Program	12,122	12,122	7,958	4,164
Small Business Development Center	-	-	9,842	(9,842)
Land Court	118,946	118,946	116,222	2,724
Stabilization Loan Repayment	40,000	40,000	-	40,000
Micronesia Petroleum Corporation Debt Service	60,856	60,856	60,856	-
Micronesia Legal Services	15,000	15,000	15,000	-
Municipal governments	12,000	12,000	10,000	2,000
Other	19,321	19,321	16,302	3,019
	654,793	658,675	615,094	43,581
Total expenditures	2,061,500	2,122,933	2,114,141	8,792
Net change in fund balance	(75,401)	(136,834)	64,881	184,131
Encumbrance	-	-	26,954	26,954
Debt service	-	-	39,196	39,196
Fund balance at the beginning of the year	1,782,141	1,782,141	1,782,141	-
Fund balance at the end of the year	\$ 1,706,740	\$ 1,645,307	\$ 1,913,172	\$ 250,281

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS**

**Combining Balance Sheet
September 30, 2012**

	Scholarship Revolving Loan	Production and Development Loan	Health Care	Sports Council	Broadcasting Authority	Transportation Infrastructure Revolving	Home Improvement Program Revolving	Aluminum Recycling	CFSM Grants	Gifford Scholarship	Total
ASSETS											
Investments	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 38,000	\$ -	\$ 38,000
Receivables:											
General	-	-	-	-	-	-	-	-	300	-	300
Loans	-	-	-	-	-	-	443,603	-	-	-	443,603
Due from other funds	8,507	19,057	388,221	1,140	4,340	2,715	78,815	86,986	41,401	-	631,182
Advances	-	780	-	-	-	-	-	-	-	-	780
Restricted:											
Cash and equivalents	-	-	-	-	-	-	-	-	-	25,295	25,295
Time certificates of deposit	-	-	-	-	-	-	-	-	-	354,383	354,383
Total assets	\$ 8,507	\$ 19,837	\$ 388,221	\$ 1,140	\$ 4,340	\$ 2,715	\$ 522,418	\$ 86,986	\$ 79,701	\$ 379,678	\$ 1,493,543
LIABILITIES AND FUND BALANCES											
LIABILITIES:											
Accounts payable	\$ -	\$ 819	\$ 14,772	\$ -	\$ -	\$ -	\$ 9,581	\$ -	\$ 300	\$ -	\$ 25,472
Due to other funds	-	-	-	-	-	-	-	-	-	2,977	2,977
Deferred revenue	-	-	-	-	-	-	-	-	33	-	33
Total liabilities	-	819	14,772	-	-	-	9,581	-	333	2,977	28,482
FUND BALANCES:											
Non-spendable	-	-	-	-	-	-	443,603	-	38,000	-	481,603
Restricted	-	-	-	-	-	-	69,234	-	41,368	376,701	487,303
Committed	8,507	19,018	373,449	1,140	4,340	2,715	-	86,986	-	-	496,155
Total fund balances	8,507	19,018	373,449	1,140	4,340	2,715	512,837	86,986	79,368	376,701	1,465,061
Total liabilities and fund balances	\$ 8,507	\$ 19,837	\$ 388,221	\$ 1,140	\$ 4,340	\$ 2,715	\$ 522,418	\$ 86,986	\$ 79,701	\$ 379,678	\$ 1,493,543

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, 2012**

	Scholarship Revolving Loan	Production and Development Loan	Health Care	Sports Council	Broadcasting Authority	Transportation Infrastructure Revolving	Home Improvement Program Revolving	Aluminum Recycling	CFSM Grants	Gifford Scholarship	Total
Revenues:											
Fees and charges	\$ 1,072	\$ 36,287	\$ 158,668	\$ 50	\$ 2,368	\$ -	\$ -	\$ 61,886	\$ -	\$ -	\$ 260,331
CFSM grants	-	-	-	-	-	-	-	-	37,000	-	37,000
Interest income	-	-	330	-	-	-	69,248	82	-	1,245	70,905
Total revenues	<u>1,072</u>	<u>36,287</u>	<u>158,998</u>	<u>50</u>	<u>2,368</u>	<u>-</u>	<u>69,248</u>	<u>61,968</u>	<u>37,000</u>	<u>1,245</u>	<u>368,236</u>
Expenditures by function:											
Current:											
Health services	-	-	118,930	-	-	-	-	-	-	-	118,930
Public order and safety	-	-	-	-	-	-	-	-	25,000	-	25,000
Environment, protection and sanitation	-	-	-	-	-	-	-	70,175	-	-	70,175
Boards, commissions and other	-	41,879	-	-	1,483	4,823	74,036	-	-	-	122,221
Total expenditures	<u>-</u>	<u>41,879</u>	<u>118,930</u>	<u>-</u>	<u>1,483</u>	<u>4,823</u>	<u>74,036</u>	<u>70,175</u>	<u>25,000</u>	<u>-</u>	<u>336,326</u>
Net change in fund balances	1,072	(5,592)	40,068	50	885	(4,823)	(4,788)	(8,207)	12,000	1,245	31,910
Fund balances at the beginning of the year	7,435	24,610	333,381	1,090	3,455	7,538	517,625	95,193	67,368	375,456	1,433,151
Fund balances at the end of the year	<u>\$ 8,507</u>	<u>\$ 19,018</u>	<u>\$ 373,449</u>	<u>\$ 1,140</u>	<u>\$ 4,340</u>	<u>\$ 2,715</u>	<u>\$ 512,837</u>	<u>\$ 86,986</u>	<u>\$ 79,368</u>	<u>\$ 376,701</u>	<u>\$ 1,465,061</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, 2012

	Scholarship Revolving Loan	Production and Development Loan	Health Care	Sports Council	Broadcasting Authority	Transportation Infrastructure Revolving	Home Improvement Program Revolving	Aluminum Recycling	CFSM Grants	Gifford Scholarship	Total
Revenues:											
Fees and charges	\$ 1,072	\$ 36,287	\$ 158,668	\$ 50	\$ 2,368	\$ -	\$ -	\$ 61,886	\$ -	\$ -	\$ 260,331
CFSM Grants	-	-	-	-	-	-	-	-	37,000	-	37,000
Interest income	-	-	330	-	-	-	69,248	82	-	1,245	70,905
Total revenues	<u>1,072</u>	<u>36,287</u>	<u>158,998</u>	<u>50</u>	<u>2,368</u>	<u>-</u>	<u>69,248</u>	<u>61,968</u>	<u>37,000</u>	<u>1,245</u>	<u>368,236</u>
Expenditures by account:											
Salaries and wages:											
Regular	-	-	-	-	-	-	44,649	-	10,372	-	55,021
Travel and transportation	-	13,198	-	-	-	-	6,506	-	-	-	19,704
Communications	-	-	-	-	772	68	1,695	-	808	-	3,343
Food stuffs	-	-	-	-	-	-	-	-	881	-	881
Port charges	-	7,968	-	-	-	-	-	-	-	-	7,968
Office supplies and materials	-	18,402	-	-	191	3,129	6,537	70,165	5,936	-	104,360
POL	-	-	-	-	-	-	1,201	-	4,995	-	6,196
Contractual services	-	1,993	-	-	-	-	2,062	-	-	-	4,055
Utilities	-	-	-	-	500	1,526	1,007	-	2,008	-	5,041
Medical supplies	-	-	118,930	-	-	-	-	-	-	-	118,930
Rental	-	-	-	-	20	-	13	-	-	-	33
Import charges	-	333	-	-	-	-	-	-	-	-	333
Equipment	-	-	-	-	-	-	2,200	-	-	-	2,200
Repairs and maintenance	-	-	-	-	-	100	78	-	-	-	178
Training	-	-	-	-	-	-	7,964	-	-	-	7,964
Printing and reproduction	-	-	-	-	-	-	124	-	-	-	124
Miscellaneous	-	(15)	-	-	-	-	-	10	-	-	(5)
Total expenditures	<u>-</u>	<u>41,879</u>	<u>118,930</u>	<u>-</u>	<u>1,483</u>	<u>4,823</u>	<u>74,036</u>	<u>70,175</u>	<u>25,000</u>	<u>-</u>	<u>336,326</u>
Net change in fund balances	1,072	(5,592)	40,068	50	885	(4,823)	(4,788)	(8,207)	12,000	1,245	31,910
Fund balances at the beginning of the year	<u>7,435</u>	<u>24,610</u>	<u>333,381</u>	<u>1,090</u>	<u>3,455</u>	<u>7,538</u>	<u>517,625</u>	<u>95,193</u>	<u>67,368</u>	<u>375,456</u>	<u>1,433,151</u>
Fund balances at the end of the year	<u>\$ 8,507</u>	<u>\$ 19,018</u>	<u>\$ 373,449</u>	<u>\$ 1,140</u>	<u>\$ 4,340</u>	<u>\$ 2,715</u>	<u>\$ 512,837</u>	<u>\$ 86,986</u>	<u>\$ 79,368</u>	<u>\$ 376,701</u>	<u>\$ 1,465,061</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet
September 30, 2012

	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	71,499	11,292	175,764	63,164	35,332
Other				5,966	
Advances	496	13,977	10,559	13,754	-
Prepayments	16,005	427	64,247	-	-
Due from other funds	<u>132,740</u>	<u>153,109</u>	<u>-</u>	<u>-</u>	<u>19,240</u>
	<u>\$ 220,740</u>	<u>\$ 178,805</u>	<u>\$ 250,570</u>	<u>\$ 82,884</u>	<u>\$ 54,572</u>
<u>LIABILITIES AND FUND BALANCES</u>					
Liabilities:					
Accounts payable	\$ 7,849	\$ 11,656	\$ 17,074	\$ 3,055	\$ 2,921
Other liabilities and accruals	103,579	53,096	25,203	10,114	6,968
Due to other funds	-	-	113,027	24,931	-
Deferred revenues	<u>11,355</u>	<u>2,227</u>	<u>24,155</u>	<u>12,478</u>	<u>2,426</u>
Total liabilities	<u>122,783</u>	<u>66,979</u>	<u>179,459</u>	<u>50,578</u>	<u>12,315</u>
Fund balances:					
Non-spendable	16,501	14,404	74,806	13,754	-
Restricted	81,456	97,422	-	18,552	42,257
Unassigned	<u>-</u>	<u>-</u>	<u>(3,695)</u>	<u>-</u>	<u>-</u>
Total fund balances	<u>97,957</u>	<u>111,826</u>	<u>71,111</u>	<u>32,306</u>	<u>42,257</u>
Total liabilities and fund balances	<u>\$ 220,740</u>	<u>\$ 178,805</u>	<u>\$ 250,570</u>	<u>\$ 82,884</u>	<u>\$ 54,572</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet, Continued
September 30, 2012

	Section 211(a)(6) Infrastructure	Section 211(a)(7) Supplemental Education	ERA	U.S. Federal Grants	Compact Capital Projects	Foreign Assistance
<u>ASSETS</u>						
Investments	\$ -	\$ -	\$ -	\$ -	\$ 800,000	\$ 100,000
Receivables:						
Federal agencies	-	48,775	4,615	35,429	-	-
Other						
Advances	-	4,551	-	-	-	-
Prepayments	-	37,119	-	-	-	120,490
Due from other funds	<u>97,447</u>	<u>195,511</u>	<u>4,628</u>	<u>71,010</u>	<u>-</u>	<u>155,945</u>
	<u>\$ 97,447</u>	<u>\$ 285,956</u>	<u>\$ 9,243</u>	<u>\$ 106,439</u>	<u>\$ 800,000</u>	<u>\$ 376,435</u>
 <u>LIABILITIES AND FUND BALANCES</u>						
Liabilities:						
Accounts payable	\$ -	\$ 11,710	\$ -	\$ 15,828	\$ -	\$ 2,358
Other liabilities and accruals	-	9,744	9,243	3,286	-	1,851
Due to other funds	-	-	-	-	59,702	-
Deferred revenues	<u>-</u>	<u>48,593</u>	<u>-</u>	<u>87,325</u>	<u>-</u>	<u>74,872</u>
Total liabilities	<u>-</u>	<u>70,047</u>	<u>9,243</u>	<u>106,439</u>	<u>59,702</u>	<u>79,081</u>
Fund balances:						
Non-spendable	-	41,670	-	-	800,000	220,490
Restricted	97,447	174,239	-	-	-	76,864
Unassigned	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(59,702)</u>	<u>-</u>
Total fund balances	<u>97,447</u>	<u>215,909</u>	<u>-</u>	<u>-</u>	<u>740,298</u>	<u>297,354</u>
Total liabilities and fund balances	<u>\$ 97,447</u>	<u>\$ 285,956</u>	<u>\$ 9,243</u>	<u>\$ 106,439</u>	<u>\$ 800,000</u>	<u>\$ 376,435</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet, Continued
September 30, 2012

	Compact Special Block 211(b)	Compact Special Development 212(b)	Compact Energy Block Grant 214	Compact Health & Medical 216(a)(2)	Compact Scholarship 216(a)(3)	Total
<u>ASSETS</u>						
Investments	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 900,000
Receivables:						
Federal agencies	-	-	-	-	-	445,870
Other						5,966
Advances	-	-	-	-	-	43,337
Prepayments	-	-	-	-	-	238,288
Due from other funds	<u>19,867</u>	<u>8,880</u>	<u>153</u>	<u>143,729</u>	<u>-</u>	<u>1,002,259</u>
	<u>\$ 19,867</u>	<u>\$ 8,880</u>	<u>\$ 153</u>	<u>\$ 143,729</u>	<u>\$ -</u>	<u>\$ 2,635,720</u>
<u>LIABILITIES AND FUND BALANCES</u>						
Liabilities:						
Accounts payable	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 72,451
Other liabilities and accruals	-	-	-	-	-	223,084
Due to other funds	-	-	-	-	-	197,660
Deferred revenues	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>263,431</u>
Total liabilities	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>756,626</u>
Fund balances:						
Non-spendable	-	-	-	-	-	1,181,625
Restricted	19,867	8,880	153	143,729	-	760,866
Unassigned	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(63,397)</u>
Total fund balances	<u>19,867</u>	<u>8,880</u>	<u>153</u>	<u>143,729</u>	<u>-</u>	<u>1,879,094</u>
Total liabilities and fund balances	<u>\$ 19,867</u>	<u>\$ 8,880</u>	<u>\$ 153</u>	<u>\$ 143,729</u>	<u>\$ -</u>	<u>\$ 2,635,720</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, 2012

	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	\$ 2,583,295	\$ 2,170,292	\$ 841,777	\$ 478,694	\$ 350,945
Federal contributions	-	-	-	-	-
Other grants	-	-	-	-	-
Interest income	-	-	-	-	-
	<u>2,583,295</u>	<u>2,170,292</u>	<u>841,777</u>	<u>478,694</u>	<u>350,945</u>
Expenditures by function:					
Current:					
General government	-	-	-	446,388	-
Economic development	-	-	808,763	-	-
Education	2,491,612	-	-	-	-
Health services	-	2,189,108	-	-	-
Environment protection and sanitation	-	-	-	-	308,688
	<u>2,491,612</u>	<u>2,189,108</u>	<u>808,763</u>	<u>446,388</u>	<u>308,688</u>
Total expenditures	<u>2,491,612</u>	<u>2,189,108</u>	<u>808,763</u>	<u>446,388</u>	<u>308,688</u>
Net change in fund balances	91,683	(18,816)	33,014	32,306	42,257
Fund balances at the beginning of the year	<u>6,274</u>	<u>130,642</u>	<u>38,097</u>	<u>-</u>	<u>-</u>
Fund balances at the end of the year	<u>\$ 97,957</u>	<u>\$ 111,826</u>	<u>\$ 71,111</u>	<u>\$ 32,306</u>	<u>\$ 42,257</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, 2012

	Section 211(a)(6) Infrastructure	Section 211(a)(7) Supplemental Education	ERA	U.S. Federal Grants	Compact Capital Projects	Foreign Assistance
Revenues:						
Compact funding	\$ -	\$ 1,269,234	\$ 176,015	\$ -	\$ -	\$ -
Federal contributions	-	-	-	116,820	-	-
Other grants	-	-	-	-	-	289,434
Interest income	-	-	-	-	2,748	-
	<u>-</u>	<u>1,269,234</u>	<u>176,015</u>	<u>116,820</u>	<u>2,748</u>	<u>289,434</u>
Expenditures by function:						
Current:						
General government	48,691	-	176,015	-	30,992	(2,025)
Economic development	-	-	-	102,495	-	4,697
Education	-	1,238,044	-	-	-	12,710
Health services	-	-	-	9,376	-	-
Environment protection and sanitation	-	-	-	4,949	-	176,712
	<u>48,691</u>	<u>1,238,044</u>	<u>176,015</u>	<u>116,820</u>	<u>30,992</u>	<u>192,094</u>
Net change in fund balances	(48,691)	31,190	-	-	(28,244)	97,340
Fund balances at the beginning of the year	<u>146,138</u>	<u>184,719</u>	<u>-</u>	<u>-</u>	<u>768,542</u>	<u>200,014</u>
Fund balances at the end of the year	<u>\$ 97,447</u>	<u>\$ 215,909</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 740,298</u>	<u>\$ 297,354</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, 2012

	Compact Special Block 211(b)	Compact Special Development 212(b)	Compact Energy Block Grant 214	Compact Health & Medical 216(a)(2)	Compact Scholarship 216(a)(3)	Total
Revenues:						
Compact funding	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 7,870,252
Federal contributions	-	-	-	-	-	116,820
Other grants	-	-	-	-	-	289,434
Interest income	-	-	-	-	-	2,748
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,279,254</u>
Expenditures by function:						
Current:						
General government	-	-	-	-	-	700,061
Economic development	-	-	-	-	-	915,955
Education	-	-	-	-	-	3,742,366
Health services	-	-	-	-	-	2,198,484
Environment protection and sanitation	-	-	-	-	-	490,349
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,047,215</u>
Total expenditures	-	-	-	-	-	8,047,215
Net change in fund balances	-	-	-	-	-	232,039
Fund balances at the beginning of the year	<u>19,867</u>	<u>8,880</u>	<u>153</u>	<u>143,729</u>	<u>-</u>	<u>1,647,055</u>
Fund balances at the end of the year	<u>\$ 19,867</u>	<u>\$ 8,880</u>	<u>\$ 153</u>	<u>\$ 143,729</u>	<u>\$ -</u>	<u>\$ 1,879,094</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, 2012

	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	\$ 2,583,295	\$ 2,170,292	\$ 841,777	\$ 478,694	\$ 350,945
Federal contributions	-	-	-	-	-
Other grants	-	-	-	-	-
Interest income	-	-	-	-	-
	<u>2,583,295</u>	<u>2,170,292</u>	<u>841,777</u>	<u>478,694</u>	<u>350,945</u>
Expenditures by account:					
Salaries and wages:					
Regular	1,444,471	778,121	369,072	156,011	105,887
Overtime	-	79,403	15,555	-	812
Fringe benefits	183,782	97,148	51,588	14,630	14,058
Other personnel costs	-	830	-	-	-
Travel and transportation	14,119	32,091	47,663	77,237	14,751
Communications	18,521	17,059	14,221	7,166	2,065
Customs and tax expenses	-	-	-	-	16
Dues, membership, and subscriptions	185	2,100	-	-	-
Food stuffs	1,454	27,340	-	-	250
Port charges	900	154	1,469	-	-
Office supplies and materials	104,433	49,096	55,019	7,956	13,204
POL	38,472	24,988	15,642	2,272	12,918
Printing and reproduction	2,960	5,520	184	62	1,694
Rental services	34	-	515	515	230
Repairs and maintenance	1,288	1,539	1,664	-	270
Utilities	52,595	155,023	21,922	2,575	6,736
Subsidies and contributions	-	-	-	3,800	-
Medical referral	2,288	193,360	-	-	-
Medical supplies	-	485,787	-	-	-
Contractual services	108,595	68,030	96,023	20,167	16,608
Professional services	-	898	3,500	30,395	-
Scholarships and allowances	209,764	-	-	7,406	1,320
Training	49,964	32,005	27,312	89,464	-
Leased housing, buildings and land	23,238	23,424	11,430	22,022	1,710
Nonpayroll compensation	27,700	-	-	1,000	-
Equipment	158,515	102,812	64,752	2,050	115,779
Non-Capital outlay	43,948	12,380	6,650	1,540	380
Miscellaneous	4,386	-	4,582	120	-
Total expenditures	<u>2,491,612</u>	<u>2,189,108</u>	<u>808,763</u>	<u>446,388</u>	<u>308,688</u>
Net change in fund balances	91,683	(18,816)	33,014	32,306	42,257
Fund balances at the beginning of the year	6,274	130,642	38,097	-	-
Fund balances at the end of the year	<u>\$ 97,957</u>	<u>\$ 111,826</u>	<u>\$ 71,111</u>	<u>\$ 32,306</u>	<u>\$ 42,257</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, 2012

	Section 211(a)(6) Infrastructure	Section 211(a)(7) Supplemental Education	ERA	U.S. Federal Grants	Compact Capital Projects	Foreign Assistance
Revenues:						
Compact funding	\$ -	\$ 1,269,234	\$ 176,015	\$ -	\$ -	\$ -
Federal contributions	-	-	-	116,820	-	-
Other grants	-	-	-	-	-	289,434
Interest income	-	-	-	-	2,748	-
	<u>-</u>	<u>1,269,234</u>	<u>176,015</u>	<u>116,820</u>	<u>2,748</u>	<u>289,434</u>
Expenditures by account:						
Salaries and wages:						
Regular	-	141,341	156,006	41,418	-	27,404
Overtime	-	-	3,034	1,907	-	67
Fringe benefits	-	17,275	16,975	4,898	-	2,839
Other personnel costs	-	700	-	-	-	(2,025)
Travel and transportation	-	34,494	-	8,115	-	11,972
Communications	-	11,425	-	839	-	873
Customs and tax expenses	-	-	-	-	-	-
Dues, membership, and subscriptions	-	-	-	-	-	-
Food stuffs	-	24	-	-	-	1,746
Port charges	-	6,750	-	-	-	42
Office supplies and materials	24,409	90,099	-	424	-	90,871
POL	-	9,681	-	1,101	-	1,242
Printing and reproduction	-	3,018	-	-	-	359
Rental services	-	1,800	-	-	-	217
Repairs and maintenance	-	594	-	60	-	-
Utilities	-	40,823	-	-	-	-
Subsidies and contributions	-	-	-	-	-	-
Medical referral	-	-	-	-	-	-
Medical supplies	-	-	-	-	-	-
Contractual services	24,282	307,901	-	58,058	-	9,573
Professional services	-	-	-	-	-	-
Scholarships and allowances	-	198,000	-	-	-	-
Training	-	106,210	-	-	-	4,354
Leased housing, buildings and land	-	24,542	-	-	-	-
Nonpayroll compensation	-	1,200	-	-	-	-
Equipment	-	208,847	-	-	-	42,550
Non-Capital outlay	-	33,320	-	-	-	-
Miscellaneous	-	-	-	-	30,992	10
Total expenditures	<u>48,691</u>	<u>1,238,044</u>	<u>176,015</u>	<u>116,820</u>	<u>30,992</u>	<u>192,094</u>
Net change in fund balances	(48,691)	31,190	-	-	(28,244)	97,340
Fund balances at the beginning of the year	146,138	184,719	-	-	768,542	200,014
Fund balances at the end of the year	<u>\$ 97,447</u>	<u>\$ 215,909</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 740,298</u>	<u>\$ 297,354</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, 2012

	Compact Special Block 211(b)	Compact Special Development 212(b)	Compact Energy Block Grant 214	Compact Health & Medical 216(a)(2)	Compact Scholarship 216(a)(3)	Total
Revenues:						
Compact funding	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 7,870,252
Federal contributions	-	-	-	-	-	116,820
Other grants	-	-	-	-	-	289,434
Interest income	-	-	-	-	-	2,748
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,279,254</u>
Expenditures by account:						
Salaries and wages:						
Regular	-	-	-	-	-	3,219,731
Overtime	-	-	-	-	-	100,778
Fringe benefits	-	-	-	-	-	403,193
Other personnel costs	-	-	-	-	-	(495)
Travel and transportation	-	-	-	-	-	240,442
Communications	-	-	-	-	-	72,169
Customs and tax expenses	-	-	-	-	-	16
Dues, membership, and subscriptions	-	-	-	-	-	2,285
Food stuffs	-	-	-	-	-	30,814
Port charges	-	-	-	-	-	9,315
Office supplies and materials	-	-	-	-	-	435,511
POL	-	-	-	-	-	106,316
Printing and reproduction	-	-	-	-	-	13,797
Rental services	-	-	-	-	-	3,311
Repairs and maintenance	-	-	-	-	-	5,415
Utilities	-	-	-	-	-	279,674
Subsidies and contributions	-	-	-	-	-	3,800
Medical referral	-	-	-	-	-	195,648
Medical supplies	-	-	-	-	-	485,787
Contractual services	-	-	-	-	-	709,237
Professional services	-	-	-	-	-	34,793
Scholarships and allowances	-	-	-	-	-	416,490
Training	-	-	-	-	-	309,309
Leased housing, buildings and land	-	-	-	-	-	106,366
Nonpayroll compensation	-	-	-	-	-	29,900
Equipment	-	-	-	-	-	695,305
Non-Capital outlay	-	-	-	-	-	98,218
Miscellaneous	-	-	-	-	-	40,090
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,047,215</u>
Total expenditures	-	-	-	-	-	8,047,215
Net change in fund balances	-	-	-	-	-	232,039
Fund balances at the beginning of the year	19,867	8,880	153	143,729	-	1,647,055
Fund balances at the end of the year	<u>\$ 19,867</u>	<u>\$ 8,880</u>	<u>\$ 153</u>	<u>\$ 143,729</u>	<u>\$ -</u>	<u>\$ 1,879,094</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, 2012, which collectively comprise the State of Kosrae's basic financial statements and have issued our report thereon dated June 12, 2013. 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

Management of the State of Kosrae is responsible for establishing and maintaining effective 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.

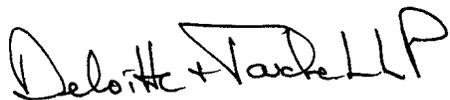
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined previously. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying Schedule of Findings and Questioned Costs (pages 67 through 69) as item 2012-2, 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*.

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 12, 2013

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

Honorable 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 each of the State of Kosrae's major federal programs for the year ended September 30, 2012. The State of Kosrae's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (pages 67 through 69). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the State of 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, 2012. Our audit, described below, did not include the operations of the entities identified in Note 2B as these entities conducted separate audits in accordance with OMB Circular A-133, if required.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; 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 each of its major federal programs for the year ended September 30, 2012. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which described in the accompanying Schedule of Findings and Questioned Costs as item 2012-1.

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.

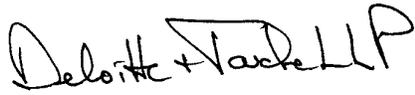
Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did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

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae as of and for the year ended September 30, 2012, and have issued our report thereon dated June 12, 2013, which contained an unqualified opinion on those financial statements. Our audit was conducted 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 64 and 65) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of Federal Awards is fairly stated in all material respects in relation to the financial statements as a whole.

The State of 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 the response.

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.

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

June 12, 2013

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

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

Agency/Program	Expenditures
U.S. Department of Agriculture	\$ 107,444
U.S. Department of the Interior	7,738,301
U.S. Department of Health and Human Services	<u>9,376</u>
GRAND TOTAL	<u>\$ 7,855,121</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 Housing Technical Assistance	10.420	\$ <u>44,437</u>

Reconciliation to the basic financial statements:		
Grants Assistance Fund expenditures		\$ 8,047,215
Less:		
Foreign Assistance Fund expenditures		<u>(192,094)</u>
		<u>\$ 7,855,121</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, 2012

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF AGRICULTURE		
Rural Self-Help Housing Technical Assistance	10.420	\$ 44,437
Forestry Legacy Program	10.664	4,949
Community Facilities Loans and Grants	10.766	<u>58,058</u>
Total U.S. Department of Agriculture		<u>\$ 107,444</u>
U.S. DEPARTMENT OF THE INTERIOR		
Economic, Social and Political Development of the Territories:	15.875	
Compact Capital Project		\$ 30,992
Compact of Free Association Sector Grants:		
Compact II Education Sector		2,491,612
Compact II Health Sector		2,189,108
Compact II Private Sector Development		808,763
Compact II Capacity Building		446,388
Compact II Environment		308,688
Compact II Infrastructure Sector		48,691
Supplemental Education Grant		1,238,044
Compact II ERA		<u>176,015</u>
Total U.S. Department of the Interior		<u>\$ 7,738,301</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES		
Cancer Prevention and Control Program (See Note)	93.U55/CCU923887.02	\$ 2,066
Breast and Cervical Cancer	93 Unknown	<u>7,310</u>
Total U.S. Department of Health and Human Services		<u>\$ 9,376</u>
TOTAL FEDERAL AWARDS		<u>\$ 7,855,121</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, 2012

(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.

- Programs Subject to Single Audit

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

(2) Summary of Significant Accounting Policies

A. Basis of Accounting

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

B. 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, 2012 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, 2012.

C. CFDA #15.875

CFDA #15.875 represents funding from 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 Findings and Questioned Costs
Year Ended September 30, 2012

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? | Yes |
| 7. Type of auditors' report issued on compliance for major programs: | Unqualified |
| 8. Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? | Yes |
| 9. Identification of major programs: | |

<u>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 low-risk auditee? | Yes |

Part II - Financial Statement Findings Section

<u>Finding Number</u>	<u>Findings</u>
2012-2	Equity Investment

Part III - Federal Award Findings and Questioned Cost Section

<u>Finding Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
2012-1	Equipment and Real Property Management	\$ -

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

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

Criteria:

Fixed asset records should be periodically reconciled and timely recorded. Property records must be maintained that include a description, an identification number and condition of the property.

Condition:

A physical count of fixed assets was performed as of September 30, 2012. However, the State continues to reconcile the physical count with the fixed assets register and this process is ongoing.

Cause:

The cause of this condition is that only one person has been tasked to perform the required reconciliation.

Effect:

The effect of this condition is that the required reconciliation has yet to be completed.

Recommendation:

We recommend that the State of Kosrae complete the subject reconciliation.

Auditee Response and Corrective Action Plan:

We agree with the finding and we will complete the reconciliation by conducting another inventory count beginning in July 2013. A copy of the memorandum to this effect is attached. Under the direct supervision of the Administrator Finance Division; the process is expected to be completed by the end of September 30, 2013; and the result will be maintained for the inspection of the auditors.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Finding No.: 2012-2
Area: Equity Investment

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 an investment in SEMO. While management has represented that this entity has 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.

Prior Year Status:

This matter was reported in the State of Kosrae's prior Single Audits as Finding No. 2010-1 and Finding No. 2011-1.

Recommendation:

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

Auditee Response and Corrective Action Plan:

Contrary to the earlier representation; SEMO is still in existence under a different name; KIDCO. KIDCO uses Quick books as the entity's accounting system. The unaudited reports have been submitted and the Department of Administration and Finance is currently assisting the entity to properly classify its financial transactions. The process is on-going and the goal is to also recommend measures to strengthen any internal control weaknesses.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Prior Audit Findings
Year Ended September 30, 2012

The status of unresolved prior audit findings is disclosed within the Schedule of Findings and Questioned Costs section of this report (pages 67 through 69).