

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

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

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**YEAR ENDED SEPTEMBER 30, 2011**

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2011

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

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**YEAR ENDED SEPTEMBER 30, 2011**

## 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, 2011, which collectively comprise the State's basic financial statements as set forth in Section II of the foregoing table of contents. These financial statements are the responsibility of the management of the State. Our responsibility is to express opinions on these financial statements based on our audit.

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

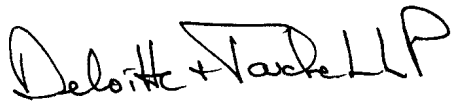
In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae as of September 30, 2011, 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.

As discussed in Note 1 to the financial statements, during the year ended September 30, 2011, the State adopted Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 13, 2012 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.

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

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State's basic financial statements. The combining and individual fund financial statements, as set forth in Section IV of the foregoing table of contents, which are also the responsibility of the management of the State, are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual fund financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

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

June 13, 2012

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis  
September 30, 2011

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, 2011. We encourage readers to consider this information in conjunction with Kosrae State's financial statements, which follow. Fiscal year 2010 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, 2011 decreased by \$0.81 million (or 4%) from \$20.19 million in the prior year to \$19.38 million. The decrease is due mainly to depreciation expense of capital assets which amounted to \$1.03 million and a reduction in revenues for the year, particularly in Compact Trust and Grants Assistance.
- For fiscal year ended September 30, 2011, the State implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which changes the State's fund balance designation and revised the General Fund budgetary deficit into an unassigned fund balance of negative \$0.24 million. GASB defines unassigned fund balance as a residual fund balance that is not restricted, committed and assigned.
- For the year ended September 30, 2011, the General Fund total fund balance was restated by \$1.49 million due to the State's adoption of GASB 54. As a result, previously classified special revenue funds are moved to the General Fund, thereby increasing the total fund balance by \$1.49 million. Please refer to Note 2 of the RSI-Budgetary Reporting for detailed discussion.

### **OVERVIEW OF THE FINANCIAL STATEMENTS**

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

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

#### Government-Wide Financial Statements

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

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.

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



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- Governmental activities- Most of Kosrae State's basic services are included here, such as education, health, special appropriations, finance, judiciary, and general administration. Compact sector and other federal grants finance most of these activities.
- Component Units-Kosrae State includes the operating results of the Kosrae Utilities Corporation and Kosrae Port Authority in its report. Although separate, these "component units" are important because Kosrae State is financially accountable for them. Micronesia Petroleum Corporation (MPC), a former component unit of the State, was dissolved in March 2009 by Kosrae State Law no. 9-91. Due to its dissolution, all of its assets and liabilities were transferred to the State.

Fund Financial Statements

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

Most of Kosrae State's basic services are included in governmental funds, which focus on (1) how cash and other financial assets, 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 2011 exceeded liabilities by \$19.38 million. The bulk of the amount is from investment in capital assets, although \$6.05 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, 2011, with comparable balances for the fiscal year 2010, discloses this relationship:

	<u>2011</u>	<u>2010</u>
<b>ASSETS</b>		
Current and other non-capital assets	\$ 8,575,724	\$ 9,214,286
Capital assets	<u>17,537,338</u>	<u>18,302,263</u>
Total assets	\$ <u>26,113,062</u>	\$ <u>27,516,549</u>

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<b>LIABILITIES</b>		
Long-term liabilities	\$ 5,454,246	\$ 5,860,625
Other liabilities	<u>1,278,146</u>	<u>1,461,101</u>
Total liabilities	<u>6,732,392</u>	<u>7,321,726</u>
<b>NET ASSETS</b>		
Invested in capital assets	17,537,338	18,302,263
Restricted	6,047,181	7,469,627
Unrestricted	<u>(4,203,849)</u>	<u>(5,577,067)</u>
Total net assets	<u>19,380,670</u>	<u>20,194,823</u>
Total liabilities and net assets	\$ <u>26,113,062</u>	\$ <u>27,516,549</u>

At the end of fiscal year 2011, Kosrae State's unrestricted net assets showed a deficit of \$4.20 million, a decrease of \$1.37 million (or 24.62%) as compared with the prior year. The decrease in the deficit is mainly due to use of restricted net assets for governmental activities. 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, however, decreased by \$0.81 million (or 4%) from the prior year. Key elements of the differences from the prior year are shown in the following schedule.

	<u>2011</u>	<u>2010</u>
<b>Revenues:</b>		
Operating grants and contributions	\$ 7,807,856	\$ 8,571,283
Capital grants and contributions	-	4,277,664
Charges for services	455,934	489,967
FSM revenue sharing	1,325,147	1,048,631
Unrestricted investment earnings	142,342	52,016
Taxes	305,790	372,025
Other	<u>296,000</u>	<u>719,358</u>
Total revenues	<u>10,333,069</u>	<u>15,530,944</u>
<b>Expenses:</b>		
General government	1,903,321	1,942,827
Education	3,987,771	3,809,853
Health services	2,287,091	2,284,819
Economic development	981,085	1,152,362
Boards, commissions, and other	996,600	1,747,285
Environment protection and sanitation	604,965	127,370
Public order and safety	336,857	325,247
Foreign exchange adjustment	-	291,067
Unallocated interest on long-term debt	<u>49,532</u>	<u>43,921</u>
Total expenses	<u>11,147,222</u>	<u>11,724,751</u>
Change in net assets	(814,153)	3,806,193
Net assets at the beginning of the year	<u>20,194,823</u>	<u>16,388,630</u>
Net assets at the end of the year	\$ <u>19,380,670</u>	\$ <u>20,194,823</u>

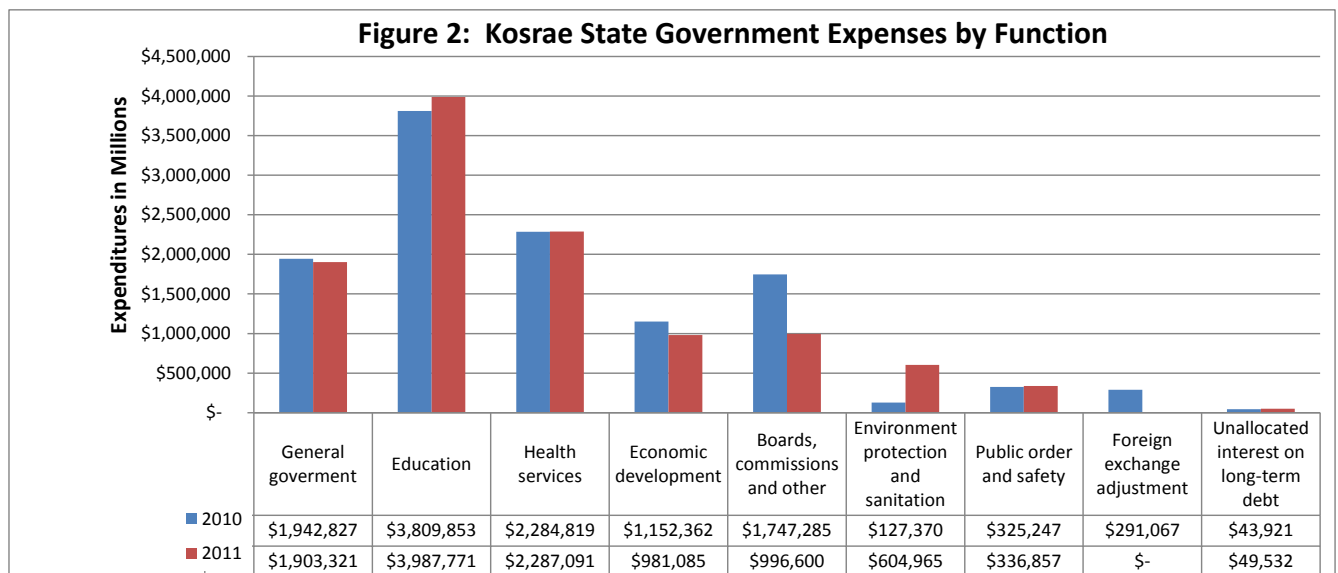
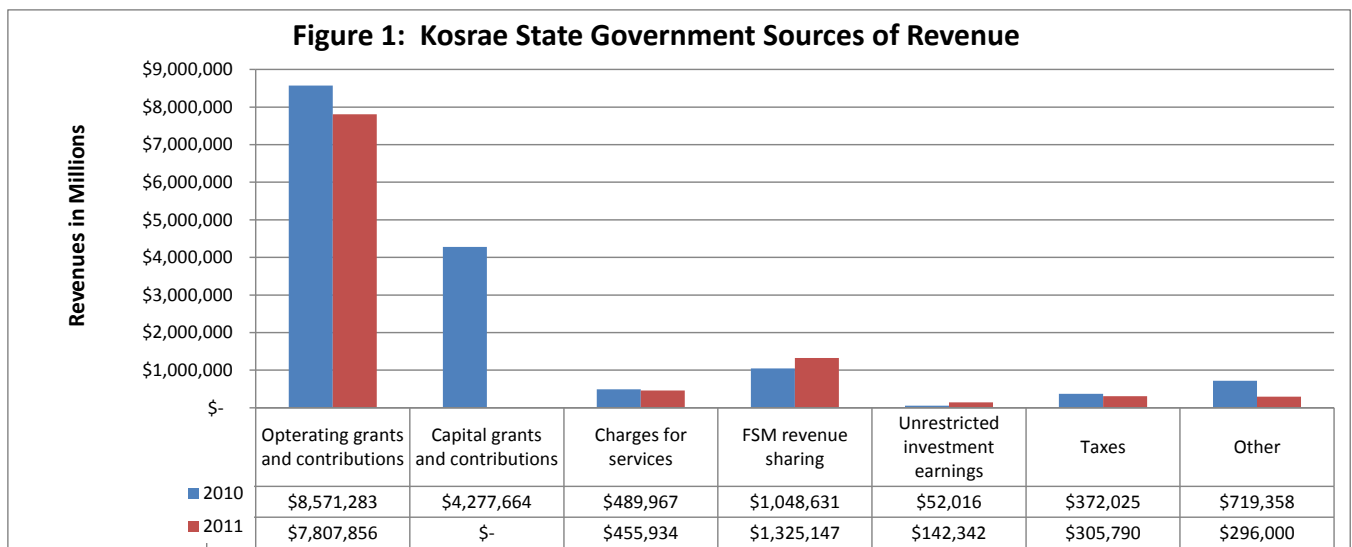
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Figure 1 below showed that the total revenues in fiscal year 2011 of \$10.33 million decreased by \$5.20 million from the prior year's \$15.53 million (or 33.47%). The decrease was primarily due to the decrease in the current year's operating grants and contributions by \$0.76 million, capital grants and contributions of \$4.28 million, and other revenues by \$0.42 million. In fiscal year 2011, Grants Assistance Fund revenues comprised 76.75% of all Kosrae State funding sources whereas the General Fund revenues comprised only 20.25%.

Figure 2 presents that total expenses of \$11.15 million reflected a 4.93% decrease from the prior year expenses of \$11.72 million.

The following graphs show the major components of revenues and expenditures for the year ended September 30, 2011.



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

As earlier stated, the government implemented GASB Statement No. 54. GASB 54 applies only to governmental funds. Under this method, fund balance classifications are determined based on revenue constraints as it relates to the specific purposes for which funds can be spent. The State does not have the formal spending prioritization plan; thus, it follows the default policy where restricted resources would be spent first followed by the unrestricted amount in the following order: committed, assigned and unassigned. For further explanations of GASB 54, please refer to Note 10.

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 2011, Kosrae State governmental funds reported a combined fund balance of \$7.67 million, which represents \$0.460 million decrease or (5.67%) from the \$8.13 million recorded at the end of fiscal 2010. These decreases are attributable mainly to the decrease in the Compact funding of \$0.533 million, net change in fair value of investments of \$0.431 million, State taxes of \$0.06 million, and other revenues of \$0.623 million. Of the total combined fund balance of \$7.67 million, \$4.71 million is designated as non-spendable fund balance; \$2.77 million is restricted fund balance and \$.47 million is for committed fund balance. Encumbrances identified in Note 9 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 residual amount of the fund balance after all fund designations, which is called unassigned fund balance, is negative \$0.24 million. However, total General Fund fund balance of \$1.78 million increased by \$1.21 due to the movement of the Early Retirement Program Fund from Special Revenue Funds into the General Fund. The deficiency of revenues under expenditures for the year was \$0.53 million. Please refer to Note 8 which shows detailed designations per fund types. For further clarity, the changes in amount and account in the General Fund Unassigned Fund Balance is presented below:

Beginning unreserved fund deficit (9/30/2010 audit)	\$ (430,790)
Net change in fund balance for the year	(111,916)
Restatement of Fund balance	1,318,586
Elimination of 9/30/2010 Reserved fund balances:	
Reserved for related assets	917,609
Reserved for Encumbrances	52,133
Reserved for Continuing appropriations	36,519
Increase in non-spendable fund balance	(384,969)
Increase in Restricted fund balance:	
Early Retirement fund	(1,318,586)
Restricted assets	(317,942)
Committed fund balance	<u>(2,716)</u>
Unassigned fund balance	\$ <u>(242,072)</u>

The Grants Assistance Fund has a total fund balance of \$1.65 million, which primarily represents Compact Sector grant revenues received not yet expended at year end. The net decrease in fund balance during the current year in the Grants Assistance Fund was \$0.230 million or (12%), which primarily was the result of the reduction of the total revenues in fiscal year 2011 by \$0.347 million.

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The Compact Trust Fund has a total fund balance of \$2.80 million, all of which is restricted for the funding of future operations of the primary government commencing in fiscal year 2023. The decrease in fund balance during the current year in the Compact Trust Fund was \$0.034 million (or 1.22%), which reflected a slight decrease in the fair value of investments as compared to the prior year.

**GENERAL FUND BUDGETARY HIGHLIGHTS**

During the course of the fiscal year, management and elected officials of Kosrae State Government found it necessary to revise the General Fund budget to reign in expenditures, when revenue collections did not match inflated revenue projections. For the year ended September 30, 2011, General Fund revenues, excluding other financing sources, were deficient compared to expenditures by \$0.157 million. Other financing sources of \$0.045 million offset the deficiency with resultant change of negative \$0.112 million in fund balance before Early Retirement Fund transfers.

**CAPITAL ASSET AND DEBT ADMINISTRATION**

Capital Assets

Kosrae State's investment in capital assets for the primary government as of September 30, 2011, amounted to \$57.10 million, net of accumulated depreciation of \$39.56 million, resulting to a net book value of \$17.54 million. The increase in capital assets of \$260,530 was due to the acquisitions of machinery and equipment. The total depreciation for the year is \$1.03 million.

The table below summarizes Kosrae State's capital assets:

	<u>2011</u>	<u>2010</u>
Buildings	\$ 19,441,367	\$ 19,441,367
Infrastructure	32,925,368	32,925,368
Machinery, equipment, others	<u>4,734,116</u>	<u>4,473,586</u>
	57,100,851	56,840,321
Accumulated depreciation	<u>(39,563,513)</u>	<u>(38,538,058)</u>
	<u>\$ 17,537,338</u>	<u>\$ 18,302,263</u>

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

Long-Term Debt

The following schedule shows Kosrae State's long-term obligations for fiscal year 2011 with comparative balances from fiscal year 2010.

	<u>2011</u>	<u>2010</u>
FSM National Government Loan	\$ 1,310,000	\$ 1,350,000
ADB Loans	4,263,383	4,370,080
FSM DB Loan	88,272	150,602
Malem Water	125,413	127,781
Other Claims	<u>35,000</u>	<u>235,000</u>
	<u>\$ 5,822,068</u>	<u>\$ 6,233,463</u>

Interest and principal payment on ADB loans commenced in fiscal year 2008. Additional information on Kosrae State's long-term debt obligations can be found in notes 6 and 7 to the financial statements.

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

General Fund

The revenues for the seven months ending April 30, 2012 showed an increase in FSM revenue share by more than 39% compared with the same period in fiscal year 2011. The increase is triggered by the FAA funded project being undertaken by a foreign contractor. Such project, however, is close to completion and therefore it is expected that a reduction in the FSM revenue share will occur in the ensuing months. Sales taxes slightly increased and also are not expected to increase tremendously in the coming months.

The leaders of Kosrae State are aware of the current financial situation of the government and are working on solutions to lessen the problem. A task force was created to work on this endeavor and such came up with several recommendations that are expected to increase State future revenue collections. Such recommendations are submitted to the Kosrae State Legislature for legislation.

In addition, consultants coursed by Graduate School, USDA are commissioned to further formalize the steps and ways to prepare the State to tackle a more pressing financial dilemma that is expected to occur; the reduction in Compact Sector funding.

Grant Assistance Funds

Grants Assistance Funds (specifically Compact funding) will continue to be the major funding source for Kosrae State in fiscal year 2012 with total approved funding of \$6,571,081 (inclusive of unallocated grants of \$586,573) as follows:

Education Sector	\$2,578,877
Health Sector	\$2,268,706
Environment Sector	\$ 366,898
Private Sector	\$ 890,725
Capacity Building Sector	\$ 465,875

In addition, the Supplemental Education Grant for fiscal year 2011 with a total grant award of \$1.28 million is available in fiscal year 2012. Moreover, funding for the seventh sector called Enhanced Reporting and Accountability Grant or ERA was approved in fiscal year 2012.

**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, 2011

	Primary Government	Component Units
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 909,237	\$ 180,643
Investments	-	460,291
Receivables, net	1,029,559	171,295
Inventories	-	363,527
Prepayments	106,472	5,970
Advances	128,125	-
Restricted assets:		
Time certificates of deposit	-	238,575
Total current assets	2,173,393	1,420,301
Noncurrent assets:		
Capital assets, net of accumulated depreciation	17,537,338	21,534,754
Investments	1,200,000	-
Restricted assets:		
Cash and cash equivalents	526,309	-
Time certificates of deposit	554,383	-
Investments	4,121,639	-
Total noncurrent assets	23,939,669	21,534,754
Total assets	\$ 26,113,062	\$ 22,955,055
<u>LIABILITIES</u>		
Current liabilities:		
Current portion of long-term obligations	\$ 367,822	\$ 69,312
Accounts payable	304,909	413,135
Other liabilities and accruals	371,243	43,324
Deferred revenues	234,172	53,478
Due to primary government	-	230,921
Total current liabilities	1,278,146	810,170
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	5,419,246	-
Other noncurrent liabilities	35,000	-
Total noncurrent liabilities	5,454,246	-
Total liabilities	6,732,392	810,170
Commitments and contingencies		
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	17,537,338	21,465,442
Restricted for:		
Nonexpendable:		
Future operations	2,803,053	-
Expendable:		
Debt service	1,318,586	-
Compact related	1,447,041	-
Other purposes	478,501	90,000
Unrestricted	(4,203,849)	589,443
Total net assets	19,380,670	22,144,885
Total liabilities and net assets	\$ 26,113,062	\$ 22,955,055

See accompanying notes to basic financial statements.

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Statement of Activities  
Year Ended September 30, 2011

	Program Revenues			Net (Expenses) Revenues and Changes in Net Assets	
Expenses	Charges for Services	Operating Grants and Contributions	Primary Government	Component Units	
<u>Functions/Programs</u>					
Primary government:					
Governmental activities:					
General government	\$ 1,903,321	\$ 109,383	\$ 426,780	\$ (1,367,158)	\$ -
Economic development	981,085	103,038	905,574	27,527	-
Education	3,987,771	-	3,730,792	(256,979)	-
Health services	2,287,091	138,014	2,265,975	116,898	-
Public order and safety	336,857	21,662	-	(315,195)	-
Environment protection and sanitation	604,965	61,482	513,518	(29,965)	-
Boards, commissions and other	996,600	22,355	-	(974,245)	-
Unallocated interest on long-term debt	49,532	-	(34,783)	(84,315)	-
Total primary government	<u>\$ 11,147,222</u>	<u>\$ 455,934</u>	<u>\$ 7,807,856</u>	<u>(2,883,432)</u>	<u>-</u>
Component units:					
Kosrae Port Authority	\$ 1,044,706	\$ 188,987	\$ -	-	(855,719)
Kosrae Utilities Authority	2,928,522	2,347,648	-	-	(580,874)
Total component units	<u>\$ 3,973,228</u>	<u>\$ 2,536,635</u>	<u>\$ -</u>	<u>-</u>	<u>(1,436,593)</u>
General revenues:					
Taxes:					
FSM revenue sharing:					
Gross revenue taxes				530,737	-
Import taxes				411,998	-
Income taxes				331,672	-
Other taxes				50,740	-
State taxes				305,790	-
Unrestricted investment earnings				142,342	(21,595)
Other				296,000	18,066
Total general revenues				<u>2,069,279</u>	<u>(3,529)</u>
Change in net assets				(814,153)	(1,440,122)
Net assets at the beginning of the year				<u>20,194,823</u>	<u>23,585,007</u>
Net assets at the end of the year				<u>\$ 19,380,670</u>	<u>\$ 22,144,885</u>

See accompanying notes to basic financial statements.



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Balance Sheet

Governmental Funds  
September 30, 2011

		Special Revenue	Permanent	Other Governmental Funds	
	General	Grants Assistance	Compact Trust		Total
<b>ASSETS</b>					
Cash and cash equivalents	\$ 909,237	\$ -	\$ -	\$ -	\$ 909,237
Investments	262,000	900,000	-	38,000	1,200,000
Receivables, net:					
General	181,961	-	-	300	182,261
Loans	30,000	-	-	440,782	470,782
Federal agencies	-	376,516	-	-	376,516
Due from other funds	207,504	1,035,254	-	595,068	1,837,826
Prepaid items	-	106,472	-	-	106,472
Advances	92,969	31,990	-	3,166	128,125
Restricted assets:					
Cash and cash equivalents	502,259	-	-	24,050	526,309
Time certificates of deposit	200,000	-	-	354,383	554,383
Investments	1,318,586	-	2,803,053	-	4,121,639
Total assets	<u>\$ 3,704,516</u>	<u>\$ 2,450,232</u>	<u>\$ 2,803,053</u>	<u>\$ 1,455,749</u>	<u>\$ 10,413,550</u>
<b>LIABILITIES AND FUND BALANCES</b>					
Liabilities:					
Accounts payable	\$ 123,784	\$ 161,537	\$ -	\$ 19,588	\$ 304,909
Other liabilities and accruals	168,269	202,974	-	-	371,243
Due to other funds	1,630,322	204,527	-	2,977	1,837,826
Deferred revenues	-	234,139	-	33	234,172
Total liabilities	<u>1,922,375</u>	<u>803,177</u>	<u>-</u>	<u>22,598</u>	<u>2,748,150</u>
Fund balances:					
Non-spendable	384,969	1,035,950	2,803,053	481,948	4,705,920
Restricted	1,636,528	658,164	-	478,501	2,773,193
Committed	2,716	-	-	472,702	475,418
Unassigned:					
General fund	(242,072)	-	-	-	(242,072)
Special revenue funds	-	(47,059)	-	-	(47,059)
Total fund balances	<u>1,782,141</u>	<u>1,647,055</u>	<u>2,803,053</u>	<u>1,433,151</u>	<u>7,665,400</u>
Total liabilities and fund balances	<u>\$ 3,704,516</u>	<u>\$ 2,450,232</u>	<u>\$ 2,803,053</u>	<u>\$ 1,455,749</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

17,537,338

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 (5,787,068)  
Claims payable (35,000)

(5,822,068)

Net assets of governmental activities

\$ 19,380,670

See accompanying notes to basic financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures, and Changes in Fund Balances  
Governmental Funds  
Year Ended September 30, 2011

	General	Special Revenue  Grants Assistance	Permanent  Compact Trust	Other Governmental Funds	Total
Revenues:					
Compact funding	\$ -	\$ 7,394,150	\$ -	\$ -	\$ 7,394,150
Net change in the fair value of investments	50,762	-	(34,783)	-	15,979
Federal contributions	-	96,435	-	-	96,435
FSM revenue sharing	1,325,147	-	-	-	1,325,147
State taxes	305,790	-	-	-	305,790
CFSM grants	-	-	-	15,051	15,051
Fees and charges	217,667	-	-	238,267	455,934
Other grants	-	286,241	-	-	286,241
Interest income	57,021	278	-	85,042	142,341
Other	96,000	-	-	-	96,000
Total revenues	<u>2,052,387</u>	<u>7,777,104</u>	<u>(34,783)</u>	<u>338,360</u>	<u>10,133,068</u>
Expenditures:					
Current:					
General government	1,262,874	591,700	-	-	1,854,574
Economic development	66,519	905,574	-	-	972,093
Education	-	3,730,792	-	-	3,730,792
Health services	-	2,265,975	-	38,449	2,304,424
Public order and safety	297,159	-	-	28,608	325,767
Environment protection and sanitation	-	513,518	-	91,447	604,965
Boards, commissions and other	598,746	-	-	43,733	642,479
Debt service	225,241	-	-	-	225,241
Total expenditures	<u>2,450,539</u>	<u>8,007,559</u>	<u>-</u>	<u>202,237</u>	<u>10,660,335</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(398,152)</u>	<u>(230,455)</u>	<u>(34,783)</u>	<u>136,123</u>	<u>(527,267)</u>
Other financing sources (uses):					
Proceeds from issuance of long-term debt	66,644	-	-	-	66,644
Operating transfers in	45,113	-	-	-	45,113
Operating transfers out	-	-	-	(45,113)	(45,113)
Total other financing sources (uses), net	<u>111,757</u>	<u>-</u>	<u>-</u>	<u>(45,113)</u>	<u>66,644</u>
Net change in fund balances	<u>(286,395)</u>	<u>(230,455)</u>	<u>(34,783)</u>	<u>91,010</u>	<u>(460,623)</u>
Fund balances at the beginning of the year	<u>2,068,536</u>	<u>1,877,510</u>	<u>2,837,836</u>	<u>1,342,141</u>	<u>8,126,023</u>
Fund balances at the end of the year	<u>\$ 1,782,141</u>	<u>\$ 1,647,055</u>	<u>\$ 2,803,053</u>	<u>\$ 1,433,151</u>	<u>\$ 7,665,400</u>

See accompanying notes to basic financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Reconciliation of the Statement of Revenues, Expenditure, and Changes in Fund  
Balances of Governmental Funds to the Statement of Activities  
Year Ended September 30, 2011

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	\$ (460,623)
<p>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.</p> <p>This is the amount by which depreciation exceeded capital outlays in the current period</p>	
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds	200,000
<p>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:</p>	
Long-term debt proceeds	(66,644)
Repayment of ADB Loans	173,341
Repayment of FSMDB Loan	62,330
Repayment of FSM National Government Loan	40,000
Repayment of RUS Loan	<u>2,368</u>
	<u>211,395</u>
Change in net assets of governmental activities	\$ <u>(814,153)</u>

See accompanying notes to basic financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Combining Statement of Net Assets

Component Units  
September 30, 2011

<u>ASSETS</u>	Kosrae Port Authority	Kosrae Utilities Authority	Total
Current assets:			
Cash and cash equivalents	\$ 27,176	\$ 153,467	\$ 180,643
Investments	-	460,291	460,291
Time certificates of deposit - restricted	-	238,575	238,575
Receivables:			
General	63,748	356,745	420,493
Allowance for doubtful debts	(50,804)	(198,394)	(249,198)
Net receivables	12,944	158,351	171,295
Inventories	-	363,527	363,527
Prepayments	3,150	2,820	5,970
Total current assets	43,270	1,377,031	1,420,301
Noncurrent assets:			
Capital assets, net of accumulated depreciation	17,806,447	3,728,307	21,534,754
Total assets	\$ 17,849,717	\$ 5,105,338	\$ 22,955,055
<u>LIABILITIES AND NET ASSETS</u>			
Current liabilities:			
Current portion of long-term debt	\$ -	\$ 69,312	\$ 69,312
Accounts payable	13,895	399,240	413,135
Accrued liabilities	10,749	32,575	43,324
Deferred revenues	-	53,478	53,478
Due to primary government	72,174	158,747	230,921
Total liabilities	96,818	713,352	810,170
Net assets:			
Invested in capital assets, net of related debt	17,806,447	3,658,995	21,465,442
Restricted	-	90,000	90,000
Unrestricted	(53,548)	642,991	589,443
Total net assets	17,752,899	4,391,986	22,144,885
Total liabilities and net assets	\$ 17,849,717	\$ 5,105,338	\$ 22,955,055

See accompanying notes to basic financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

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

Component Units  
Year Ended September 30, 2011

	<u>Kosrae Port Authority</u>	<u>Kosrae Utilities Authority</u>	<u>Total</u>
Operating revenues:			
Charge for services	\$ 188,987	\$ 2,347,648	\$ 2,536,635
Operating expenses:			
Cost of services	-	1,894,071	1,894,071
Depreciation and amortization	861,995	426,617	1,288,612
Administration and general	182,711	597,187	779,898
Total operating expenses	<u>1,044,706</u>	<u>2,917,875</u>	<u>3,962,581</u>
Operating loss	<u>(855,719)</u>	<u>(570,227)</u>	<u>(1,425,946)</u>
Nonoperating revenues (expenses):			
Interest income	-	1,709	1,709
Net change in fair value of investments	-	(23,304)	(23,304)
Interest expense	-	(10,647)	(10,647)
Federal grants	-	18,066	18,066
Total nonoperating revenues (expenses), net	<u>-</u>	<u>(14,176)</u>	<u>(14,176)</u>
Change in net assets	(855,719)	(584,403)	(1,440,122)
Net assets at beginning of year	<u>18,608,618</u>	<u>\$ 4,976,389</u>	<u>\$ 23,585,007</u>
Net assets at end of year	<u>\$ 17,752,899</u>	<u>\$ 4,391,986</u>	<u>\$ 22,144,885</u>

See accompanying notes to basic financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies

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

A. Reporting Entity

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

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

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

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

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

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2011

(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.

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

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

P.O. Box 727  
Tofol, Kosrae, FSM 96944

B. Government-Wide Financial Statements

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

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, 2011

(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 \$6,047,181 of restricted net assets, of which \$478,501 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, 2011

(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, 2011

(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.

The State reports the following Governmental Fund types:

i. General Fund

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

ii. Special Revenue Funds

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

iii. Permanent Funds

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

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

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

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

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

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

E. Reporting Standards

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

F. Cash and Cash Equivalents and Time Certificates of Deposit

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

G. Investments

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

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

Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

H Receivables

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

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

I. Prepaid Items

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

J. Interfund Receivables/Payables

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

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

K. Inventories

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

Inventories of the discretely presented component units are valued at the lower of cost (FIFO) or market.

L. Restricted Assets

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 \$1,318,586 for the Kosrae State Early Retirement Scheme. Furthermore, investments recorded in the Compact Trust Fund of \$2,803,053 are restricted in that they are not available to be used in current operations.

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

Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

L. Restricted Assets, Continued

As of September 30, 2011, 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.	\$ 384,317
Deposit account established for the Housing Renovation program.	117,942
Deposit account established for the Gifford scholarship fund.	24,050
Time certificate of deposit with a local bank restricted for scholarships for post-secondary students.	354,383
Time certificate of deposit for the Loan Guarantee Escrow Account established for the sole purpose of loan collateralization made through the USDA Rural Development. The escrow account may be drawn down in the event of a borrower's default on the obligation under the terms of the promissory note and the deed of trust security instrument supporting such note and for which such note is guaranteed by the State, the trustee of the Loan Guarantee Escrow Account.	<u>200,000</u>
	\$ <u>1,080,692</u>

Discretely Presented Component Units:

Time certificate of deposit with a local bank pledged supporting Kosrae Utility Authority debt.	\$ <u>238,575</u>
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M. Capital Assets

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

Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair market value at the date of donation.

All land and non-depreciable land improvements are capitalized, regardless of cost. Singular pieces of machinery and equipment, other than vehicles, that equal or exceed \$50,000 are capitalized. Buildings and infrastructure projects with a cost that equals or exceeds \$100,000 are capitalized. The costs of normal maintenance and repairs that do not add to the value of assets or materially extend asset lives are not capitalized.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

M. Capital Assets, Continued

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 statement of net assets.

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.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

Q. Fund Balance

GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, was implemented, effective for the fiscal year ending September 30, 2011. It establishes fund balance classifications 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. As a result of implementing this statement, there were significant changes in the State's fund structure. Funds that did not meet the new special revenue fund definition were moved to the General Fund. Amounts previously reported as reserved and unreserved fund balance are now 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.

R. Risk Financing

The State is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. It is the policy of the primary government not to purchase commercial insurance for the risks of loss to which it is exposed. Instead, the State management believes it is more economical to manage its risks internally. In the event of claim settlements and judgments, the State reports all of its risk management activities in its General Fund. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. 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, 2011

(1) Summary of Significant Accounting Policies, Continued

S. New Accounting Standards

During fiscal year 2011, the State implemented the following pronouncements:

- GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which establishes fund balance classifications that 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 the governmental funds. The Statement requires governments to disclose information in the notes about the processes through which constraints are imposed, as well as accounting policies that determine whether restricted, committed, assigned, and unassigned amounts are considered to be spent. This Statement also provides guidance for classifying stabilization amounts on the face of the balance sheet and requires disclosure of certain information about stabilization arrangements in the notes to the financial statements. As a result of implementation, the Statement of Revenues, Expenditures and Changes in Fund Balance for Governmental Funds have been restated due to reclassification of funds. Beginning fund balance for the Early Retirement Program Fund decreased by \$1,493,065 while the General Fund increased by the same amount. Details on the State's fund balance classifications are reflected in note 8.
- GASB Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

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

In 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.



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

S. New Accounting Standards, Continued

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 Financial Accounting Standards Board (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.

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

In July 2011, GASB issued Statement No. 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 provisions of this statement are effective for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

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.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

U. Total Columns

Total columns are presented primarily to facilitate financial analysis. The Management's Discussion and Analysis includes certain prior year summarized comparative information in total. Such information does not include sufficient detail to constitute a full comparative presentation. Accordingly, such information should be read in conjunction with the State's financial statements for the year ended September 30, 2010 from which summarized information was derived.

(2) Deposits and Investments

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

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

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

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

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

Notes to Financial Statements  
September 30, 2011

(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

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

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

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

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

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the State's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. The State does not have a deposit policy for custodial credit risk.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2011

(2) Deposits and Investments, Continued

A. Deposits, Continued

As of September 30, 2011, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit was \$1,989,929 and the corresponding bank balance was \$2,305,020, which is maintained in financial institutions subject to FDIC insurance. As of September 30, 2011, 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, 2011, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit was \$419,218, and the corresponding bank balance was \$431,339, which were maintained in financial institutions subject to FDIC insurance. As of September 30, 2011, these bank deposits were fully FDIC insured.

B. Investments

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

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

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

As of September 30, 2011, the State's investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ <u>337,602</u>
Other investments:	
Money market funds	3,760,249
Cash management account	<u>23,788</u>
	<u>3,784,037</u>
	\$ <u>4,121,639</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2011

(2) Deposits and Investments, Continued

B. Investments, Continued

As of September 30, 2011, 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	\$ 1,857	\$ -	\$ 1,857	\$ -	\$ -	Aaa/AAA
U.S. Government Agencies Obligations:						
Federal Home Loan Mortgage Corporation	68,530	-	815	9,977	57,738	AAA
Government National Mortgage Association	10,923	-	-	-	10,923	AAA
Federal National Mortgage Association	54,733	-	-	6,204	48,529	AAA
Tennessee Valley Authority Fed Book Notes	5,249	-	-	-	5,249	AAA
Housing Urban Development	8,432	-	8,432	-	-	No rating
Municipal Obligations	14,471	-	-	8,546	5,925	Aa1
Municipal Obligations	4,001	-	-	-	4,001	Aa2
Corporate Bonds	20,861	-	5,668	6,310	8,883	Aaa/AAA
Corporate Bonds	6,131	-	-	6,131	-	Aa1/AA+
Corporate Bonds	28,633	-	10,877	11,979	5,777	Aa2/AA
Corporate Bonds	7,194	-	-	-	7,194	A1/A+
Corporate Bonds	14,152	-	9,842	4,310	-	A2/A
Corporate Bonds	32,021	-	17,875	6,662	7,484	A3/A-
Corporate Bonds	19,457	-	15,064	4,393	-	Baa1/BBB+
Corporate Bonds	6,238	-	3,148	-	3,090	Baa2/BBB
Corporate Bonds	<u>34,719</u>	<u>11,800</u>	<u>5,853</u>	<u>4,105</u>	<u>12,961</u>	No rating
	<u>\$ 337,602</u>	<u>\$ 11,800</u>	<u>\$ 79,431</u>	<u>\$ 68,617</u>	<u>\$ 177,754</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, 2011.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2011

(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, 2011, the General Fund holds 3.7% of the shares of the Pacific Islands Development Bank in the amount of \$262,000. As the fair market value of this investment is not readily available, such has been recorded at cost.

As of September 30, 2011, the Grants Assistance Fund holds 5.4% of the shares of the Bank of the Federated States of Micronesia in the amount of \$500,000 and 7.3% of the shares of the Pacific Islands Development Bank in the amount of \$400,000. As the fair market value of these investments is not readily available, such have been recorded at cost.

In addition, as of September 30, 2011, 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, 2011, 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, 2011, investments at fair value comprise the following:

Money market funds	\$ 224,714
Common stock	<u>235,577</u>
	\$ <u>460,291</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2011

**(3) Receivables**

Receivables as of September 30, 2011, 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	\$ 608,425	\$ -	\$ -	\$ 608,425
Federal agencies	-	76,802	605,353	682,155
Taxes	348,627	-	-	348,627
Loans	30,000	762,630	1,976,408	2,769,038
FSM National Government	-	2,308,917	-	2,308,917
Other	<u>-</u>	<u>23,235</u>	<u>362,638</u>	<u>385,873</u>
	987,052	3,171,584	2,944,399	7,103,035
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>\$ 211,961</u>	<u>\$ 376,516</u>	<u>\$ 441,082</u>	<u>\$ 1,029,559</u>

Loans receivable of the primary government as of September 30, 2011 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. \$ 1,941,980

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. 34,428

\$ 1,976,408

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2011

**(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, 2011, are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Grants Assistance	General	\$ 1,035,254
Nonmajor governmental funds	General	595,068
General	Nonmajor governmental funds	2,977
General	Grants Assistance	<u>204,527</u>
		<u>\$ 1,837,826</u>

**(5) Capital Assets**

Capital asset activities for the year ended September 30, 2011, are as follows:

**Primary Government**

	Balance October <u>1, 2010</u>	<u>Increases</u>	<u>Decreases</u>	Balance September <u>30, 2011</u>
Governmental activities:				
Buildings	\$ 19,441,367	\$ -	\$ -	\$ 19,441,367
Infrastructure	32,925,368	-	-	32,925,368
Machinery, equipment, others	<u>4,473,586</u>	<u>260,530</u>	<u>-</u>	<u>4,734,116</u>
	<u>56,840,321</u>	<u>260,530</u>	<u>-</u>	<u>57,100,851</u>
Less accumulated depreciation:				
Buildings	(11,643,072)	(421,066)	-	(12,064,138)
Infrastructure	(23,175,759)	(447,729)	-	(23,623,488)
Machinery, equipment, others	<u>(3,719,227)</u>	<u>(156,660)</u>	<u>-</u>	<u>(3,875,887)</u>
	<u>(38,538,058)</u>	<u>(1,025,455)</u>	<u>-</u>	<u>(39,563,513)</u>
	<u>\$ 18,302,263</u>	<u>\$ (764,925)</u>	<u>\$ -</u>	<u>\$ 17,537,338</u>

During the year ended September 30, 2011, depreciation expense was charged as follows:

General government	\$ 56,747
Economic development	8,992
Education	256,979
Health services	114,443
Public safety	11,090
Boards, commissions and others	<u>577,204</u>
	<u>\$ 1,025,455</u>



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2011

(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, 2011, the balance payable on this mortgage loan amounted to \$125,413.

Asian Development Bank (ADB) Loans:

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

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

Funds for the repayment of the ADB loan are expected to be derived from the annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The Financing Agreement requires the State to continue to appropriate salaries for the abolished positions and deposit the appropriated funds into the ERS Trust Account. These funds had not been deposited to the Trust Account as of September 30, 2002. Of the required \$2,000,000 identified for future debt service payments, \$1,318,586 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, 2011, the balance payable on this loan amounted to \$2,122,211.

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Programs Loan with ADB (Loan Number 1873 (SF) and Loan Number 1874 FSM (SF)) for the purpose of promoting private sector development in Kosrae, with interest at 1% to 1.5% per annum. Principal payments shall be made in 32 equal semi-annual payments with the first payment due on May 15, 2010 and the last payment on November 15, 2025. As of September 30, 2011, the balances payable on these loans amounted to \$825,120 and \$846,961, respectively.

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Program Loan with ADB (Loan Number 1816 FSM (SF)) for the purpose of funding the Basic Social Services Project, with interest at 1% to 1.5% per annum. Principal payments shall be made semiannually commencing February 1, 2009, with a maturity date of August 1, 2032. As of September 30, 2011, the balance payable on this loan amounted to \$259,367.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2011

(6) Long-Term Obligations, Continued

Primary Government, Continued

Asian Development Bank (ADB) Loans, Continued:

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Program Loan with ADB (Loan Number 2099 FSM (SF)) for the purpose of funding the Omnibus Infrastructure Development Project, with interest at 1% to 1.5% per annum. Principal payments shall be made semiannually commencing 2013, with a maturity date of 2037. As of September 30, 2011, the balance payable on this loan amounted to \$209,724.

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, 2011, 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, 2011, the balance payable on this loan amounted to \$88,272. This loan originated with a discontinued component unit and was assumed by the State through its dissolution.

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 367,822	\$ 62,342	\$ 430,164
2013	340,285	61,215	401,500
2014	314,459	54,490	368,949
2015	314,581	52,173	366,754
2016	314,708	49,850	364,558
2017 - 2021	1,570,214	210,507	1,780,721
2022 - 2026	1,032,059	141,311	1,173,370
2027 - 2031	781,187	80,375	861,562
2032 - 2036	644,173	31,075	675,248
2037 - 2039	<u>107,580</u>	<u>1,946</u>	<u>109,526</u>
	<u>\$ 5,787,068</u>	<u>\$ 745,284</u>	<u>\$ 6,532,352</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2011

(6) Long-Term Obligations, Continued

Discretely Presented Component Units

Kosrae Utilities Authority (KUA):

Term loan payable to bank, original amount of \$450,000, interest at 2.50% greater than TCD rate pledged as collateral, monthly repayment of \$8,523, collateralized by a first security interest in a time certificate of deposit. Interest rate effective as of September 30, 2011 ranges from 5.10% to 5.85% per annum. Loan proceeds were used to fund the acquisition of a 1.2MW generator.

\$ 69,312

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ <u>69,312</u>	\$ <u>861</u>	\$ <u>70,173</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, 2011, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net assets:

	<u>Balance October 1, 2010</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance September 30, 2011</u>	<u>Due Within One Year</u>
Loans payable:					
ADB loans:					
Loan 1520	\$ 2,163,958	\$ -	\$ 41,747	\$2,122,211	\$ 46,140
Loan 1816	282,616	-	23,249	259,367	12,349
Loan 1873	882,089	-	56,969	825,120	56,900
Loan 1874	898,337	-	51,376	846,961	37,628
Loan 2099	143,080	66,644	-	209,724	-
FSMDB loan	150,602	-	62,330	88,272	62,330
MWSP loan	127,781	-	2,368	125,413	2,475
FSMNG loan	<u>1,350,000</u>	<u>-</u>	<u>40,000</u>	<u>1,310,000</u>	<u>150,000</u>
	5,998,463	66,644	278,039	5,787,068	367,822
Other:					
Claims	<u>235,000</u>	<u>-</u>	<u>200,000</u>	<u>35,000</u>	<u>-</u>
	<u>\$ 6,233,463</u>	<u>\$ 66,644</u>	<u>\$478,039</u>	<u>\$5,822,068</u>	<u>\$367,822</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2011

(7) Change in Long-Term Obligations, Continued

Discretely Presented Component Units

During the year ended September 30, 2011, 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, 2010	Additions	Reductions	Balance September 30, 2011	Due Within One Year
KUA loan payable	\$ 167,919	\$ -	\$ 98,607	\$ 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	\$ 92,969	\$ 14,743	\$ -	\$ 3,166	\$ 110,878
Economic development	30,000	7,149	-	-	37,149
Education	-	6,658	-	-	6,658
Health services	-	28,631	-	-	28,631
Environment protection	-	78,769	-	-	78,769
Home improvement program	-	-	-	440,782	440,782
Pacific Islands Development Bank	262,000	400,000	-	38,000	700,000
Bank of the FSM	-	500,000	-	-	500,000
Permanent fund principal	-	-	2,803,053	-	2,803,053
Restricted for:					
General government	-	9,033	-	-	9,033
Education	-	204,202	-	-	204,202
Health services	-	245,740	-	-	245,740
Economic development	-	30,948	-	-	30,948
Debt service	1,318,586	-	-	-	1,318,586
Housing renovation program	117,942	-	-	-	117,942
USDA development loans	200,000	-	-	-	200,000
Capital projects	-	146,138	-	26,202	172,340
Housing improvement program	-	-	-	76,843	76,843
Scholarships	-	-	-	375,456	375,456
Other foreign assistance	-	22,103	-	-	22,103
Committed for:					
General government	2,716	-	-	-	2,716
Education	-	-	-	7,435	7,435
Health services	-	-	-	333,381	333,381
Environment protection	-	-	-	95,193	95,193
Board, commissioners, others	-	-	-	36,693	36,693
Unassigned	<u>(242,072)</u>	<u>(47,059)</u>	<u>-</u>	<u>-</u>	<u>(289,131)</u>
	<u>\$ 1,782,141</u>	<u>\$ 1,647,055</u>	<u>\$ 2,803,053</u>	<u>\$ 1,433,151</u>	<u>\$ 7,665,400</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 2011

(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, 2011, the State has significant encumbrances summarized as follows:

	<u>General</u>	<u>Grants Assistance</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Encumbrances	\$ 44,682	\$ 765,663	\$ 128,212	\$ 938,557

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, 2011 is \$437,453.

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, 2011, 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**

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

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**YEAR ENDED SEPTEMBER 30, 2011**

**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, 2011

	<u>Budgeted Amounts</u>		Actual - Budgetary	<u>Variance with Final Budget -</u>
	<u>Original</u>	<u>Final</u>	Basis (see Note 1)	
Revenues:				
FSM revenue sharing	\$ 917,688	\$ 917,688	\$ 1,325,147	\$ 407,459
State taxes	807,793	807,793	305,790	(502,003)
Licenses and fees	40,510	40,510	217,667	177,157
Interest and dividends	31,188	31,118	57,021	25,903
Other	<u>188,920</u>	<u>188,920</u>	<u>96,000</u>	<u>(92,920)</u>
Total revenues	<u>1,986,099</u>	<u>1,986,029</u>	<u>2,001,625</u>	<u>15,596</u>
Expenditures:				
Current:				
General government	1,174,403	1,214,403	1,196,230	18,173
Economic development	21,159	21,159	66,519	(45,360)
Public order and safety	293,454	293,454	297,159	(3,705)
Boards, commissions and other	<u>612,968</u>	<u>619,138</u>	<u>598,746</u>	<u>17,492</u>
Total expenditures	<u>2,101,984</u>	<u>2,148,154</u>	<u>2,158,654</u>	<u>(13,400)</u>
Deficiency of revenues under expenditures	<u>(115,885)</u>	<u>(162,125)</u>	<u>(157,029)</u>	<u>2,196</u>
Other financing sources:				
Operating transfers in	-	-	45,113	45,113
Total other financing sources	<u>-</u>	<u>-</u>	<u>45,113</u>	<u>45,113</u>
Net change in fund balance	<u>(115,885)</u>	<u>(162,125)</u>	<u>(111,916)</u>	<u>47,309</u>
GASB 54 implementation:				
Early Retirement Program Fund	-	-	1,318,586	1,318,586
Fund balance at the beginning of the year	<u>575,471</u>	<u>575,471</u>	<u>575,471</u>	<u>-</u>
Fund balance at the end of the year	<u>\$ 459,586</u>	<u>\$ 413,346</u>	<u>\$ 1,782,141</u>	<u>\$ 1,365,895</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, 2011

(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.

(2) GASB 54 Implementation

During the year ended September 30, 2011, the State implemented GASB Statement No. 54, which resulted in funds not meeting the special revenue fund definition being moved to the General Fund. Accordingly, the Early Retirement Program Fund that was previously presented as a special revenue fund has been moved to the General Fund. The effect on the fund balance of the General Fund is as follows:

Early Retirement Program Fund:	
Fund balance at the beginning of the year	\$ <u>1,493,065</u>
Revenues and other financing sources:	
Net change in fair value of investments	50,762
Proceeds from issuance of long-term debt	<u>66,644</u>
	<u>117,406</u>
Expenditures and other financing uses:	
Department of Administration and Finance	66,644
Debt Service	<u>225,241</u>
	<u>291,885</u>
Ending fund balance at the end of the year	\$ <u>1,318,586</u>



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

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**OTHER SUPPLEMENTARY INFORMATION**

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**YEAR ENDED SEPTEMBER 30, 2011**

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Combining Schedule of Expenditures by Account  
Governmental Funds  
Year Ended September 30, 2011

	General	Special Revenue Grants Assistance	Permanent Compact Trust	Other Governmental Funds	Total
Expenditures:					
Salaries and wages:					
Regular	\$ 1,284,796	\$ 2,915,799	\$ -	\$ 12,000	\$ 4,212,595
Overtime	38,030	143,526	-	-	181,556
Fringe benefits	160,378	371,981	-	-	532,359
Other personnel costs	1,090	4,237	-	-	5,327
Travel and transportation	95,581	289,943	-	3,452	388,976
Communications	45,645	70,026	-	4,929	120,600
Customs and tax expenses	-	4,591	-	-	4,591
Dues, membership, and subscriptions	11,500	7,974	-	-	19,474
Food stuffs	22,364	45,399	-	2,544	70,307
Port charges	-	12,629	-	7,331	19,960
Office supplies and materials	78,788	455,605	-	111,330	645,723
POL	25,984	128,866	-	4,252	159,102
Printing and reproduction	3,573	18,283	-	126	21,982
Rental services	2,502	3,216	-	-	5,718
Repairs and maintenance	2,005	17,933	-	-	19,938
Utilities	88,426	330,867	-	5,845	425,138
Subsidies and contributions	5,403	30,780	-	-	36,183
Medical referral	-	111,311	-	-	111,311
Medical supplies	-	538,100	-	38,449	576,549
Contractual services	74,995	826,583	-	11,902	913,480
Professional services	-	35,035	-	-	35,035
Non-payroll compensation	20,046	18,029	-	-	38,075
Scholarships and allowances	1,366	407,575	-	-	408,941
Training	20,540	437,000	-	-	457,540
Leased housing, buildings and land	33,585	143,781	-	-	177,366
Equipment	19,977	552,641	-	-	572,618
Non-Capital outlay	3,567	84,146	-	-	87,713
Principal repayment	290,395	-	-	-	290,395
Interest payments	53,127	-	-	-	53,127
Miscellaneous	66,876	1,703	-	77	68,656
	<u>\$ 2,450,539</u>	<u>\$ 8,007,559</u>	<u>\$ -</u>	<u>\$ 202,237</u>	<u>\$ 10,660,335</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, 2011  
(with comparative totals for the year ended September 30, 2010)

	2011	2010
Revenues:		
FSM revenue sharing:		
Gross revenue taxes	530,737	347,356
Import taxes	411,998	311,537
Income taxes	331,672	336,450
Other taxes	50,740	53,288
	1,325,147	1,048,631
State taxes:		
Sales tax	305,790	372,025
Fees and charges:		
Licenses and fees	217,667	200,701
Net change in fair value of investments	50,762	-
Interest and dividend income	57,021	35,440
Other:		
Other	96,000	719,358
Total revenues	2,052,387	2,376,155
Expenditures:		
Current:		
General government:		
Office of the Governor	149,308	186,061
Department of Administration and Finance	338,580	264,979
Judiciary Branch	190,951	161,978
Legislative Branch	548,135	537,764
Election	35,900	11,481
	1,262,874	1,162,263
Economic Development:		
Department of Resources and Economic Affairs	315	24,025
Farmer Extension	4,118	(250)
Land Management and Preservation	(618)	-
Private Sector Development Project	60,113	80,115
Mangrove Crab Project	-	40,375
Plant Protection	-	4,741
Fisheries Development	2,520	1,850
Marine Surveillance	71	-
Community affairs	-	(100)
	66,519	150,756
Public Order and Safety:		
Office of the Attorney General	296,164	301,103
Parole board	995	600
	297,159	301,703
Boards, Commissions and Other:		
Department of Transportation and Infrastructure	279,044	269,612
Broadcast Authority	42,293	41,688
Sports Council	8,266	15,214
Retirement Pension Program	16,676	52,123
RM Small Business Development Center	421	3,459
Land Court	104,406	81,047
Historic Preservation	-	38,414
USDA Rural Development	31,172	-
Stabilization loan repayment	40,000	150,000
Micronesia Petroleum Corporation debt service	68,935	156,528
Micronesia Legal Services	-	30,000
Micro Games	-	30,000
Municipal governments	7,503	5,000
Other	30	12,250
	598,746	885,335

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, 2011  
(with comparative totals for the year ended September 30, 2010)

	2011	2010
Expenditures, continued:		
Debt Service:		
Principal payments	173,341	-
Interest charges	51,900	-
	225,241	-
Total expenditures	2,450,539	2,500,057
Deficiency of revenues under expenditures	(398,152)	(123,902)
Other financing sources:		
Proceeds from issuance of long-term debt	66,644	-
Operating transfers in	45,113	42,865
	111,757	42,865
Net change in fund balance	(286,395)	(81,037)
Fund balance at the beginning of the year	2,068,536	656,508
Fund balance at the end of the year	\$ 1,782,141	\$ 575,471

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, 2011

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final	Budgetary Basis	
Revenues:				
FSM revenue sharing:	\$ 917,688	\$ 917,688	\$ 1,325,147	\$ 407,459
State taxes:				
Sales tax	807,793	807,793	305,790	(502,003)
Fees and charges:				
Licences and fees	40,510	40,510	217,667	177,157
Interest and dividend income	31,188	31,118	57,021	25,903
Other:				
Other	188,920	188,920	96,000	(92,920)
Total revenues	1,986,099	1,986,029	2,001,625	15,596
Expenditures:				
Current:				
General government:				
Office of the Governor	132,934	140,934	149,308	(8,374)
Department of Administration and Finance	256,447	280,447	271,936	8,511
Judiciary Branch	215,720	215,720	190,951	24,769
Legislative Branch	538,592	546,592	548,135	(1,543)
Election	30,710	30,710	35,900	(5,190)
	1,174,403	1,214,403	1,196,230	18,173
Economic development:				
Department of Resources and Economic Affairs	834	834	315	519
Farmer Extension	5,000	5,000	4,118	882
Land Management and Preservation	-	-	(618)	618
Private Sector Development Project	15,250	15,250	60,113	(44,863)
Fisheries development	-	-	2,520	(2,520)
Marine Surveillance	75	75	71	4
	21,159	21,159	66,519	(45,360)
Public order and safety:				
Office of the Attorney General	292,704	292,704	296,164	(3,460)
Parole board	750	750	995	(245)
	293,454	293,454	297,159	(3,705)
Boards, commissions and other:				
Department of Transportation and Infrastructure	280,889	280,889	279,044	1,845
Broadcast Authority	36,026	42,196	42,293	(97)
Sports Council	17,864	17,864	8,266	9,598
Retirement Pension Program	12,122	12,122	16,676	(4,554)
Small Business Development Center	2,432	2,432	421	2,011
Land Court	125,732	125,732	104,406	21,326
USDA Rural Development	18,500	18,500	31,172	(12,672)
Stabilization Loan Repayment	40,000	40,000	40,000	-
Micronesia Petroleum Corporation Debt Service	69,000	69,000	68,935	65
Municipal governments	10,403	10,403	7,503	-
Other	-	-	30	(30)
	612,968	619,138	598,746	17,492
Total expenditures	2,101,984	2,148,154	2,158,654	(13,400)
Deficiency of revenues under expenditures	(115,885)	(162,125)	(157,029)	2,196

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, Continued  
General Fund  
Year Ended September 30, 2011

	Budgeted Amounts		Amounts Budgetary Basis	Variance
	Original	Final		
Other financing sources:				
Operating transfers in	-	-	45,113	45,113
Total other financing sources	-	-	45,113	45,113
Net change in fund balance	(115,885)	(162,125)	(111,916)	47,309
GASB 54 implementation:				
Early Retirement Program Fund	-	-	1,318,586	1,318,586
Fund balance at the beginning of the year	<u>575,471</u>	<u>575,471</u>	<u>575,471</u>	<u>-</u>
Fund balance at the end of the year	<u>\$ 459,586</u>	<u>\$ 413,346</u>	<u>\$ 1,782,141</u>	<u>\$ 1,365,895</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS**

**Combining Balance Sheet  
September 30, 2011**

	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
<b>ASSETS</b>											
Investments	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 38,000	\$ -	\$ 38,000
Receivables:											
General	-	-	-	-	-	-	-	-	300	-	300
Loans	-	-	-	-	-	-	440,782	-	-	-	440,782
Due from other funds	8,132	24,610	345,510	1,090	3,541	7,538	80,069	97,757	26,821	-	595,068
Advances	-	-	-	-	-	-	-	-	3,166	-	3,166
Restricted:											
Cash and equivalents	-	-	-	-	-	-	-	-	-	24,050	24,050
Time certificates of deposit	-	-	-	-	-	-	-	-	-	354,383	354,383
Total assets	<u>\$ 8,132</u>	<u>\$ 24,610</u>	<u>\$ 345,510</u>	<u>\$ 1,090</u>	<u>\$ 3,541</u>	<u>\$ 7,538</u>	<u>\$ 520,851</u>	<u>\$ 97,757</u>	<u>\$ 68,287</u>	<u>\$ 378,433</u>	<u>\$ 1,455,749</u>
<b>LIABILITIES AND FUND BALANCES</b>											
<b>LIABILITIES:</b>											
Accounts payable	\$ 697	\$ -	\$ 12,129	\$ -	\$ 86	\$ -	\$ 3,226	\$ 2,564	\$ 886	\$ -	\$ 19,588
Due to other funds	-	-	-	-	-	-	-	-	-	2,977	2,977
Deferred revenue	-	-	-	-	-	-	-	-	33	-	33
Total liabilities	<u>697</u>	<u>-</u>	<u>12,129</u>	<u>-</u>	<u>86</u>	<u>-</u>	<u>3,226</u>	<u>2,564</u>	<u>919</u>	<u>2,977</u>	<u>22,598</u>
<b>Fund balances:</b>											
Non-spendable	-	-	-	-	-	-	440,782	-	41,166	-	481,948
Restricted	-	-	-	-	-	-	76,843	-	26,202	375,456	478,501
Committed	7,435	24,610	333,381	1,090	3,455	7,538	-	95,193	-	-	472,702
Total fund balances	<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>
Total liabilities and fund balances	<u>\$ 8,132</u>	<u>\$ 24,610</u>	<u>\$ 345,510</u>	<u>\$ 1,090</u>	<u>\$ 3,541</u>	<u>\$ 7,538</u>	<u>\$ 520,851</u>	<u>\$ 97,757</u>	<u>\$ 68,287</u>	<u>\$ 378,433</u>	<u>\$ 1,455,749</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS**

**Combining Statement of Revenues, Expenditures By Function,  
and Changes in Fund Balances  
Year Ended September 30, 2011**

	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
<b>Revenues:</b>											
Fees and charges	\$ -	\$ 32,140	\$ 138,014	\$ 4,090	\$ 2,353	\$ -	\$ 188	\$ 61,482	\$ -	\$ -	\$ 238,267
CFSM grants	-	-	-	-	-	-	-	-	15,051	-	15,051
Interest income	-	22	502	-	-	-	81,661	169	-	2,688	85,042
Total revenues	-	32,162	138,516	4,090	2,353	-	81,849	61,651	15,051	2,688	338,360
<b>Expenditures by function:</b>											
<b>Current:</b>											
Health services	-	-	38,449	-	-	-	-	-	-	-	38,449
Public order and safety	-	-	-	-	-	-	-	-	28,608	-	28,608
Environment, protection and sanitation	-	-	-	-	-	-	-	91,447	-	-	91,447
Boards, commissions and other	-	29,901	-	4,075	2,085	7,672	-	-	-	-	43,733
Total expenditures	-	29,901	38,449	4,075	2,085	7,672	-	91,447	28,608	-	202,237
Excess (deficiency) of revenues over (under) expenditures	-	2,261	100,067	15	268	(7,672)	81,849	(29,796)	(13,557)	2,688	136,123
<b>Other financing uses:</b>											
Operating transfers out	-	-	-	-	-	-	(45,113)	-	-	-	(45,113)
Net change in fund balances	-	2,261	100,067	15	268	(7,672)	36,736	(29,796)	(13,557)	2,688	91,010
<b>Fund balances at the beginning of the year</b>	7,435	22,349	233,314	1,075	3,187	15,210	480,889	124,989	80,925	372,768	1,342,141
<b>Fund balances at the end of the year</b>	\$ 7,435	\$ 24,610	\$ 333,381	\$ 1,090	\$ 3,455	\$ 7,538	\$ 517,625	\$ 95,193	\$ 67,368	\$ 375,456	\$ 1,433,151

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, 2011**

	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
<b>Revenues:</b>											
Fees and charges	\$ -	\$ 32,140	\$ 138,014	\$ 4,090	\$ 2,353	\$ -	\$ 188	\$ 61,482	\$ -	\$ -	\$ 238,267
CFSM Grants	-	-	-	-	-	-	-	-	15,051	-	15,051
Interest income	-	22	502	-	-	-	81,661	169	-	2,688	85,042
Total revenues	-	32,162	138,516	4,090	2,353	-	81,849	61,651	15,051	2,688	338,360
<b>Expenditures by account:</b>											
<b>Salaries and wages:</b>											
Regular	-	-	-	-	-	-	-	-	12,000	-	12,000
Travel and transportation	-	-	-	3,452	-	-	-	-	-	-	3,452
Communications	-	-	-	147	85	27	-	-	4,670	-	4,929
Food stuffs	-	-	-	216	-	-	-	-	2,328	-	2,544
Port charges	-	7,331	-	-	-	-	-	-	-	-	7,331
Office supplies and materials	-	10,656	-	23	-	2,577	-	91,447	6,627	-	111,330
POL	-	-	-	46	-	4,206	-	-	-	-	4,252
Contractual services	-	11,902	-	-	-	-	-	-	-	-	11,902
Utilities	-	-	-	-	2,000	862	-	-	2,983	-	5,845
Medical supplies	-	-	38,449	-	-	-	-	-	-	-	38,449
Printing and reproduction	-	-	-	126	-	-	-	-	-	-	126
Miscellaneous	-	12	-	65	-	-	-	-	-	-	77
Total expenditures	-	29,901	38,449	4,075	2,085	7,672	-	91,447	28,608	-	202,237
Excess (deficiency) of revenues over (under) expenditures	-	2,261	100,067	15	268	(7,672)	81,849	(29,796)	(13,557)	2,688	136,123
<b>Other financing uses:</b>											
Operating transfers out	-	-	-	-	-	-	(45,113)	-	-	-	(45,113)
Net change in fund balances	-	2,261	100,067	15	268	(7,672)	36,736	(29,796)	(13,557)	2,688	91,010
Fund balances at the beginning of the year	7,435	22,349	233,314	1,075	3,187	15,210	480,889	124,989	80,925	372,768	1,342,141
Fund balances at the end 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

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**GRANTS ASSISTANCE FUND**

Combining Balance Sheet  
September 30, 2011

	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	68,849	18,773	176,076	50,666	36,091
Advances	3,040	3,632	7,149	14,743	858
Prepayments	-	24,999	-	-	-
Due from other funds	49,883	235,854	-	-	-
	<u>\$ 121,772</u>	<u>\$ 283,258</u>	<u>\$ 183,225</u>	<u>\$ 65,409</u>	<u>\$ 36,949</u>
 <u>LIABILITIES AND FUND BALANCES</u>					
Liabilities:					
Accounts payable	\$ 21,418	\$ 98,616	\$ 3,593	\$ 1,842	\$ 2,473
Other liabilities and accruals	94,080	54,000	26,586	8,275	6,920
Due to other funds	-	-	102,699	42,814	27,556
Deferred revenues	-	-	12,250	12,478	-
	<u>115,498</u>	<u>152,616</u>	<u>145,128</u>	<u>65,409</u>	<u>36,949</u>
Fund balances:					
Non-spendable	3,040	28,631	7,149	14,743	858
Restricted	3,234	102,011	30,948	-	-
Unassigned	-	-	-	(14,743)	(858)
	<u>6,274</u>	<u>130,642</u>	<u>38,097</u>	<u>-</u>	<u>-</u>
Total liabilities and fund balances	<u>\$ 121,772</u>	<u>\$ 283,258</u>	<u>\$ 183,225</u>	<u>\$ 65,409</u>	<u>\$ 36,949</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**GRANTS ASSISTANCE FUND**

Combining Balance Sheet, Continued  
September 30, 2011

	<u>Section 211(a)(6) Infrastructure</u>	<u>Section 211(a)(7) Supplemental Education</u>	<u>U.S. Federal Grants</u>	<u>Compact Capital Projects</u>	<u>Foreign Assistance</u>
<b><u>ASSETS</u></b>					
Investments	\$ -	\$ -	\$ -	\$ 800,000	\$ 100,000
Receivables:					
Federal agencies	-	26,061	-	-	-
Advances	-	2,568	-	-	-
Prepayments	2,512	1,050	-	-	77,911
Due from other funds	<u>146,138</u>	<u>225,485</u>	<u>105,828</u>	<u>-</u>	<u>99,437</u>
	<u>\$ 148,650</u>	<u>\$ 255,164</u>	<u>\$ 105,828</u>	<u>\$ 800,000</u>	<u>\$ 277,348</u>
 <b><u>LIABILITIES AND FUND BALANCES</u></b>					
Liabilities:					
Accounts payable	\$ 2,512	\$ 13,480	\$ 15,545	\$ -	\$ 2,058
Other liabilities and accruals	-	8,372	2,958	-	1,783
Due to other funds	-	-	-	31,458	-
Deferred revenues	<u>-</u>	<u>48,593</u>	<u>87,325</u>	<u>-</u>	<u>73,493</u>
Total liabilities	<u>2,512</u>	<u>70,445</u>	<u>105,828</u>	<u>31,458</u>	<u>77,334</u>
Fund balances:					
Non-spendable	-	3,618	-	800,000	177,911
Restricted	146,138	181,101	-	-	22,103
Unassigned	<u>-</u>	<u>-</u>	<u>-</u>	<u>(31,458)</u>	<u>-</u>
Total fund balances	<u>146,138</u>	<u>184,719</u>	<u>-</u>	<u>768,542</u>	<u>200,014</u>
Total liabilities and fund balances	<u>\$ 148,650</u>	<u>\$ 255,164</u>	<u>\$ 105,828</u>	<u>\$ 800,000</u>	<u>\$ 277,348</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**GRANTS ASSISTANCE FUND**

Combining Balance Sheet, Continued  
September 30, 2011

	Compact Special Block 211(b)	Compact Health & Medical 216(a)(2)	Compact Scholarship 216(a)(3)	Compact Energy Block Grant 214	Compact Special Development 212(b)	Total
<u>ASSETS</u>						
Investments	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 900,000
Receivables:						
Federal agencies	-	-	-	-	-	376,516
Advances	-	-	-	-	-	31,990
Prepayments	-	-	-	-	-	106,472
Due from other funds	19,867	143,729	-	153	8,880	1,035,254
	\$ 19,867	\$ 143,729	\$ -	\$ 153	\$ 8,880	\$ 2,450,232
<u>LIABILITIES AND FUND BALANCES</u>						
Liabilities:						
Accounts payable	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 161,537
Other liabilities and accruals	-	-	-	-	-	202,974
Due to other funds	-	-	-	-	-	204,527
Deferred revenues	-	-	-	-	-	234,139
Total liabilities	-	-	-	-	-	803,177
Fund balances:						
Non-spendable	-	-	-	-	-	1,035,950
Restricted	19,867	143,729	-	153	8,880	658,164
Unassigned	-	-	-	-	-	(47,059)
Total fund balances	19,867	143,729	-	153	8,880	1,647,055
Total liabilities and fund balances	\$ 19,867	\$ 143,729	\$ -	\$ 153	\$ 8,880	\$ 2,450,232

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, 2011

	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	\$ 2,390,332	\$ 2,078,773	\$ 839,252	\$ 488,777	\$ 236,211
Federal contributions	-	-	-	-	-
Other grants	-	-	-	-	-
Interest income	-	-	-	-	-
	<u>2,390,332</u>	<u>2,078,773</u>	<u>839,252</u>	<u>488,777</u>	<u>236,211</u>
Expenditures by function:					
Current:					
General government	-	-	-	541,006	-
Economic development	-	-	801,155	-	-
Education	2,384,058	-	-	-	-
Health services	-	2,254,836	-	-	-
Environment protection and sanitation	-	-	-	-	236,211
	<u>2,384,058</u>	<u>2,254,836</u>	<u>801,155</u>	<u>541,006</u>	<u>236,211</u>
Total expenditures	<u>2,384,058</u>	<u>2,254,836</u>	<u>801,155</u>	<u>541,006</u>	<u>236,211</u>
Net change in fund balances	6,274	(176,063)	38,097	(52,229)	-
Fund balances at the beginning of the year	<u>-</u>	<u>306,705</u>	<u>-</u>	<u>52,229</u>	<u>-</u>
Fund balances at the end of the year	<u>\$ 6,274</u>	<u>\$ 130,642</u>	<u>\$ 38,097</u>	<u>\$ -</u>	<u>\$ -</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**GRANTS ASSISTANCE FUND**

Combining Statement of Revenues, Expenditures by Account,  
and Changes in Fund Balances, Continued  
Year Ended September 30, 2011

	Section 211(a)(6) Infrastructure	Section 211(a)(7) Supplemental Education	U.S. Federal Grants	Compact Capital Projects	Foreign Assistance
Revenues:					
Compact funding	\$ -	\$ 1,360,805	\$ -	\$ -	\$ -
Federal contributions	-	-	96,435	-	-
Other grants	-	-	-	-	286,241
Interest income	-	-	218	-	60
	<u>-</u>	<u>1,360,805</u>	<u>96,653</u>	<u>-</u>	<u>286,301</u>
Expenditures by function:					
Current:					
General government	53,944	-	-	-	(3,250)
Economic development	-	-	43,484	-	60,935
Education	-	1,346,734	-	-	-
Health services	-	-	11,227	-	(88)
Environment protection and sanitation	-	-	41,942	-	235,365
	<u>53,944</u>	<u>1,346,734</u>	<u>96,653</u>	<u>-</u>	<u>292,962</u>
Total expenditures					
Net change in fund balances	(53,944)	14,071	-	-	(6,661)
Fund balances at the beginning of the year	<u>200,082</u>	<u>170,648</u>	<u>-</u>	<u>768,542</u>	<u>206,675</u>
Fund balances at the end of the year	<u>\$ 146,138</u>	<u>\$ 184,719</u>	<u>\$ -</u>	<u>\$ 768,542</u>	<u>\$ 200,014</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, 2011

	Compact Special Block 211(b)	Compact Health & Medical 216(a)(2)	Compact Scholarship 216(a)(3)	Compact Energy Block Grant 214	Compact Special Development 212(b)	Total
Revenues:						
Compact funding	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 7,394,150
Federal contributions	-	-	-	-	-	96,435
Other grants	-	-	-	-	-	286,241
Interest income	-	-	-	-	-	278
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,777,104</u>
Expenditures by function:						
Current:						
General government	-	-	-	-	-	591,700
Economic development	-	-	-	-	-	905,574
Education	-	-	-	-	-	3,730,792
Health services	-	-	-	-	-	2,265,975
Environment protection and sanitation	-	-	-	-	-	513,518
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,007,559</u>
Total expenditures	-	-	-	-	-	8,007,559
Net change in fund balances	-	-	-	-	-	(230,455)
Fund balances at the beginning of the year	<u>19,867</u>	<u>143,729</u>	<u>-</u>	<u>153</u>	<u>8,880</u>	<u>1,877,510</u>
Fund balances at the end of the year	<u>\$ 19,867</u>	<u>\$ 143,729</u>	<u>\$ -</u>	<u>\$ 153</u>	<u>\$ 8,880</u>	<u>\$ 1,647,055</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, 2011

	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	\$ 2,390,332	\$ 2,078,773	\$ 839,252	\$ 488,777	\$ 236,211
Federal contributions	-	-	-	-	-
Other grants	-	-	-	-	-
Interest income	-	-	-	-	-
	<u>2,390,332</u>	<u>2,078,773</u>	<u>839,252</u>	<u>488,777</u>	<u>236,211</u>
Expenditures by account:					
Salaries and wages:					
Regular	1,400,375	735,827	356,678	130,335	105,035
Overtime	-	129,537	11,951	-	410
Fringe benefits	176,358	99,266	48,480	10,765	14,435
Other personnel costs	100	-	6,437	700	250
Travel and transportation	16,051	62,586	58,075	71,025	11,260
Communications	23,915	2,755	11,140	4,958	4,928
Customs and tax expenses	-	4,480	111	-	-
Dues, membership, and subscriptions	3,537	-	100	-	-
Food stuffs	2,764	35,177	400	-	950
Port charges	362	193	30	-	-
Office supplies and materials	123,664	61,385	56,543	16,907	45,674
POL	45,283	37,970	8,829	2,735	25,223
Printing and reproduction	2,437	11,125	1,566	-	912
Rental services	-	10	822	-	350
Repairs and maintenance	11,429	674	941	123	785
Utilities	74,714	191,300	29,863	7,601	3,571
Subsidies and contributions	500	-	25,000	-	-
Medical referral	-	111,311	-	-	-
Medical supplies	-	538,100	-	-	-
Contractual services	121,696	25,335	103,841	99,360	11,392
Professional services	-	-	-	35,035	-
Scholarships and allowances	213,713	1,340	-	3,348	1,180
Training	37,334	34,094	52,041	133,623	-
Leased housing, buildings and land	56,446	17,869	10,214	20,399	1,800
Nonpayroll compensation	15,910	-	-	-	580
Equipment	10,733	146,716	15,937	2,769	7,176
Non-Capital outlay	46,418	7,786	795	1,323	300
Miscellaneous	319	-	1,361	-	-
Total expenditures	<u>2,384,058</u>	<u>2,254,836</u>	<u>801,155</u>	<u>541,006</u>	<u>236,211</u>
Net change in fund balances	6,274	(176,063)	38,097	(52,229)	-
Fund balances at the beginning of the year	-	306,705	-	52,229	-
Fund balances at the end of the year	<u>\$ 6,274</u>	<u>\$ 130,642</u>	<u>\$ 38,097</u>	<u>\$ -</u>	<u>\$ -</u>

See Accompanying Independent Auditors' Report.



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**GRANTS ASSISTANCE FUND**

Combining Statement of Revenues, Expenditures by Account,  
and Changes in Fund Balances, Continued  
Year Ended September 30, 2011

	Section 211(a)(6) Infrastructure	Section 211(a)(7) Supplemental Education	U.S. Federal Grants	Compact Capital Projects	Foreign Assistance
Revenues:					
Compact funding	\$ -	\$ 1,360,805	\$ -	\$ -	\$ -
Federal contributions	-	-	96,435	-	-
Other grants	-	-	-	-	286,241
Interest income	-	-	218	-	60
	<u>-</u>	<u>1,360,805</u>	<u>96,653</u>	<u>-</u>	<u>286,301</u>
Expenditures by account:					
Salaries and wages:					
Regular	-	138,806	40,522	-	8,221
Overtime	-	-	1,628	-	-
Fringe benefits	-	17,365	4,352	-	960
Other personnel costs	-	-	-	-	(3,250)
Travel and transportation	-	32,688	5,359	-	32,899
Communications	-	20,518	868	-	944
Customs and tax expenses	-	-	-	-	-
Dues, membership, and subscriptions	-	4,337	-	-	-
Food stuffs	-	1,974	-	-	4,134
Port charges	-	12,000	-	-	44
Office supplies and materials	4,207	130,298	712	-	16,215
POL	-	9,241	1,145	-	(1,560)
Printing and reproduction	-	1,236	-	-	1,007
Rental services	-	360	-	-	1,674
Repairs and maintenance	-	3,856	125	-	-
Utilities	-	23,818	-	-	-
Subsidies and contributions	-	5,280	-	-	-
Medical referral	-	-	-	-	-
Medical supplies	-	-	-	-	-
Contractual services	49,737	321,907	41,942	-	51,373
Professional services	-	-	-	-	-
Scholarships and allowances	-	187,994	-	-	-
Training	-	179,908	-	-	-
Leased housing, buildings and land	-	37,053	-	-	-
Nonpayroll compensation	-	1,539	-	-	-
Equipment	-	189,032	-	-	180,278
Non-Capital outlay	-	27,524	-	-	-
Miscellaneous	-	-	-	-	23
	<u>53,944</u>	<u>1,346,734</u>	<u>96,653</u>	<u>-</u>	<u>292,962</u>
Net change in fund balances	(53,944)	14,071	-	-	(6,661)
Fund balances at the beginning of the year	200,082	170,648	-	768,542	206,675
Fund balances at the end of the year	<u>\$ 146,138</u>	<u>\$ 184,719</u>	<u>\$ -</u>	<u>\$ 768,542</u>	<u>\$ 200,014</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, 2011

	Compact Special Block 211(b)	Compact Health & Medical 216(a)(2)	Compact Scholarship 216(a)(3)	Compact Energy Block Grant 214	Compact Special Development 212(b)	Total
Revenues:						
Compact funding	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 7,394,150
Federal contributions	-	-	-	-	-	96,435
Other grants	-	-	-	-	-	286,241
Interest income	-	-	-	-	-	278
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,777,104</u>
Expenditures by account:						
Salaries and wages:						
Regular	-	-	-	-	-	2,915,799
Overtime	-	-	-	-	-	143,526
Fringe benefits	-	-	-	-	-	371,981
Other personnel costs	-	-	-	-	-	4,237
Travel and transportation	-	-	-	-	-	289,943
Communications	-	-	-	-	-	70,026
Customs and tax expenses	-	-	-	-	-	4,591
Dues, membership, and subscriptions	-	-	-	-	-	7,974
Food stuffs	-	-	-	-	-	45,399
Port charges	-	-	-	-	-	12,629
Office supplies and materials	-	-	-	-	-	455,605
POL	-	-	-	-	-	128,866
Printing and reproduction	-	-	-	-	-	18,283
Rental services	-	-	-	-	-	3,216
Repairs and maintenance	-	-	-	-	-	17,933
Utilities	-	-	-	-	-	330,867
Subsidies and contributions	-	-	-	-	-	30,780
Medical referral	-	-	-	-	-	111,311
Medical supplies	-	-	-	-	-	538,100
Contractual services	-	-	-	-	-	826,583
Professional services	-	-	-	-	-	35,035
Scholarships and allowances	-	-	-	-	-	407,575
Training	-	-	-	-	-	437,000
Leased housing, buildings and land	-	-	-	-	-	143,781
Nonpayroll compensation	-	-	-	-	-	18,029
Equipment	-	-	-	-	-	552,641
Non-Capital outlay	-	-	-	-	-	84,146
Miscellaneous	-	-	-	-	-	1,703
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,007,559</u>
Total expenditures	-	-	-	-	-	8,007,559
Net change in fund balances	-	-	-	-	-	(230,455)
Fund balances at the beginning of the year	19,867	143,729	-	153	8,880	1,877,510
Fund balances at the end of the year	<u>\$ 19,867</u>	<u>\$ 143,729</u>	<u>\$ -</u>	<u>\$ 153</u>	<u>\$ 8,880</u>	<u>\$ 1,647,055</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, 2011, which collectively comprise the State of Kosrae's basic financial statements and have issued our report thereon dated June 13, 2012. 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 above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying Schedule of Findings and Questioned Costs (pages 69 and 70) as item 2011-1 that we consider to be significant deficiencies in internal control over financial reporting. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

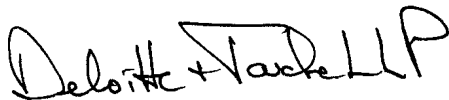
### Compliance and Other Matters

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

We noted certain matters that we reported to management of the State of Kosrae in a separate letter dated June 13, 2012.

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.



June 13, 2012

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

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

## Compliance

We have audited the State of Kosrae's compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on the State of Kosrae's major federal program for the year ended September 30, 2011. The State of Kosrae's major federal program is identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (pages 69 and 70). Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the State of Kosrae's management. Our responsibility is to express an opinion on the State of Kosrae's compliance based on our audit.

As discussed in Note 2B to the Schedule of Expenditures of Federal Awards, the State of Kosrae's basic financial statements include the operations of certain entities whose federal awards are not included in the Schedule of Expenditures of Federal Awards for the year ended September 30, 2011. Our audit, described below, did not include the operations of the entities identified in Note 2B as these entities conducted separate audits in accordance with OMB Circular A-133, if required.

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

In our opinion, the State of Kosrae complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended September 30, 2011.

## Internal Control Over Compliance

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

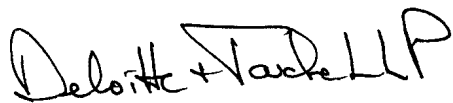
*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement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

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

## Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae as of and for the year ended September 30, 2011, and have issued our report thereon dated June 13, 2012. Our audit was performed for the purpose of forming our opinions on the financial statements that collectively comprise the State of Kosrae's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards (pages 66 and 67) is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the State of Kosrae. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

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



June 13, 2012

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

Summary Schedule of Expenditures of Federal Awards, by Grantor  
Year Ended September 30, 2011

Agency/Program	Expenditures
U.S. Department of Agriculture	\$ 85,426
U.S. Department of the Interior	7,617,944
U.S. Department of Health and Human Services	<u>11,227</u>
GRAND TOTAL	<u>\$ 7,714,597</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

Reconciliation to the basic financial statements:	
Grants Assistance Fund expenditures	\$ 8,007,559
Less:	
Foreign Assistance Fund expenditures	<u>(292,962)</u>
	<u>\$ 7,714,597</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, 2011

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF AGRICULTURE		
Rural Self-Help Housing Technical Assistance	10.420	\$ 43,484
Community Facilities Loans and Grants	10.766	<u>41,942</u>
Total U.S. Department of Agriculture		<u>\$ 85,426</u>
U.S. DEPARTMENT OF THE INTERIOR		
Economic, Social and Political Development of the Territories:	15.875	
Compact II Capacity Building		\$ 541,006
Compact II Education Sector		2,384,058
Compact II Environment		236,211
Compact II Health Sector		2,254,836
Compact II Private Sector Development		801,155
Compact II Infrastructure Sector		53,944
Supplemental Education Grant		<u>1,346,734</u>
Total U.S. Department of the Interior		<u>\$ 7,617,944</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES		
Cancer Prevention and Control Program (See Note)	93.U55/CCU923887.02	\$ 11,128
Breast and Cervical Cancer	93 Unknown	<u>99</u>
Total U.S. Department of Health and Human Services		<u>\$ 11,227</u>
GRAND TOTAL		<u>\$ 7,714,597</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, 2011

(1) Scope of Review

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

A. Programs Subject to Single Audit

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

(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, 2011 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, 2011.

C. CFDA #15.875

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

(3) Component Units

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

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2011

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

*Financial Statements*

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

*Federal Awards*

Internal control over major programs:

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

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

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

**Part II - Financial Statement Findings Section**

<u>Finding Number</u>	<u>Findings</u>
2011-1	Equity Investments

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

No matters are reportable.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Financial Statements Findings Section

Finding No.: 2011-1  
Area: Equity Investments

Criteria

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

Condition

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

Cause

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

Effect

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

Prior Year Status

This matter was reported in the State's Single Audit for the year ended September 30, 2010.

Recommendation

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

Auditee Response and Corrective Action Plan

The Director of Administration and Finance will actively pursue the final resolution of the above finding with the Attorney General; who recently came on board. The Director earnestly want this finding remove by the end of September 2012.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Unresolved Prior Years' Findings and Questioned Costs  
Year Ended September 30, 2011

Questioned Costs

There are no unresolved questioned costs of the State of Kosrae as of September 30, 2011 that are not otherwise included in the accompanying Schedule of Findings and Questioned Costs.

Prior Year Findings

The status of unresolved prior year findings is disclosed within the Schedule of Findings and Questioned Costs section of this report (pages 69 and 70).