

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

YEAR ENDED SEPTEMBER 30, 2012

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

YEAR ENDED SEPTEMBER 30, 2012

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**FEDERATED STATES OF MICRONESIA
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**INDEPENDENT AUDITORS' REPORT AND
ADDITIONAL INFORMATION
AND FINANCIAL STATEMENTS**

YEAR ENDED SEPTEMBER 30, 2012

INDEPENDENT AUDITORS' REPORT

His Excellency Emmanuel Mori
President
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 Federated States of Micronesia (FSM) National Government as of and for the year ended September 30, 2012, which collectively comprise the FSM National Government'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 FSM National Government. Our responsibility is to express opinions on these financial statements based on our audit.

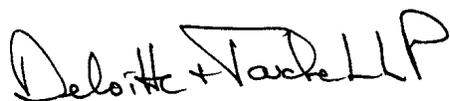
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and 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 FSM National Government'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 aspects, 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 FSM National Government as of September 30, 2012, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 30, 2013, on our consideration of the FSM National Government's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 11, 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, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

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

June 30, 2013

FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT

Management's Discussion and Analysis
September 30, 2012

This discussion and analysis of the FSM National Government's financial performance provides an overview of the financial activities of the FSM National Government for the year ended September 30, 2012 and of the financial position of the FSM National Government at September 30, 2012. This report is to be read in conjunction with the financial statements of the FSM National Government which begin on page 12. Fiscal Year 2011 comparative information has been included, where appropriate. This MD&A is prepared in compliance with GASB-34 requirement.

FINANCIAL HIGHLIGHTS

- For the fiscal year ended September 30, 2012, FSM National Government has total net assets of \$279,824,588 (FY11 \$218,340,487). The increase is primarily due to the receipt of Compact of Infrastructure Sector grants pertaining to infrastructure and construction in progress for airport improvement and infrastructure projects and increase in the fishing access collections.
- During the year, FSM National Government expenses for governmental activities were \$61,782,904 (FY11 \$51,997,110) and were funded by program revenues of \$75,395,542 (FY11 \$67,713,491) and were further funded with taxes and other general revenues that totaled \$47,076,189 (FY11 \$34,903,562).
- During the year, FSM National Government recovered \$400,000 from old accounts receivable balances previously written-off in prior years. During the year, the FSM National Government wrote-off old receivables of \$1,158,594 (FY2011 \$3,896,617).
- The net change in governmental funds increased by \$13,972,579 (FY11 \$5,877,780). Total revenues reported are \$124,420,059 with total expenditures of \$112,499,157. Total loan proceeds from ADB Loan are \$3,210,271.
- At September 30, 2012, the General Fund reported an unassigned fund balance of \$7,182,424 (FY11 \$1,851,719).

OVERVIEW OF THE FINANCIAL STATEMENTS

This Financial Statements for the Year Ended September 30, 2012 consists of four parts - management's discussion and analysis (this section), the basic financial statements, required supplementary information, and notes to financial statements.

The basic financial statements include two kinds of statements that present different views of the National Government.

The Government-Wide Financial Statements

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

The Statement of Net Assets includes all of the Government's assets and liabilities. The difference between the two is called net assets. Overtime, increases or decreases in the Government's net assets serve as an indicator to measure the Government's financial position.

The Statement of Activities, on the other hand, accounts for the National Government's current year revenues and expenses regardless of when cash is received or paid.

FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT

Management's Discussion and Analysis
September 30, 2012

The Statement of Net Assets and the Statement of Activities are divided into two reporting units:

- **Governmental Activities** - Most of the FSM National Government's basic services are reported here. These include the services provided by the Executive Branch such as health, education, foreign affairs, transportation, resources and development, finance, the Attorney General's office, and general administration; the Judicial Branch; the Legislative Branch; other National Government programs; Boards and Commissions; and other legislative appropriations. These services are funded by Compact of Association funds, US Federal grants, FSM tax revenues, licenses, fees and investment earnings.
- **Components Units** – The FSM National Government has nine (9) component units namely, College of Micronesia - FSM, National Fisheries Corporation, FSM Telecommunications Corporation, FSM Development Bank, FSM Social Security Administration, the FSM Coconut Development Authority, FSM Petroleum Corporation, MiCare Plan and the Caroline Islands Air, Inc. These components units are entities which are legally separate from the FSM National Government, but are financially accountable to the FSM National Government, or whose relationships with the FSM National Government is such that exclusion would cause the FSM National Government's basic financial statements to be misleading or incomplete.

Fund Financial Statements

The analysis of the FSM National Government's major funds begins on page 14. The Fund Financial Statements provide detailed information about the most significant funds - not the FSM National Government as a whole. Some funds are required to be established by FSM law. However, the FSM National Government establishes many other funds to help control and manage funds provided for particular purposes to see that expenditures meet the legal requirements for using certain taxes, grants, and other grant funds received from outsiders. The FSM National Government has two kinds of funds - government and fiduciary – each using different accounting approaches.

- **Governmental funds** - Most of the National Government's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view of the National Government general operations and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the National Government's program. We describe the relationship (or differences) between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds in reconciliation on pages 14 and 16.
- **Fiduciary funds** - These funds are used to account for assets held by a Government unit in a trustee capacity for individuals, private organizations, and other governmental resources. This fund is used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent is that costs (expenses, including amortization and depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

FEDERATED STATES OF MICRONESIA
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Management's Discussion and Analysis
September 30, 2012

THE NATIONAL GOVERNMENT AS A WHOLE

Net Assets may serve overtime as a useful indicator of government's financial position. At the end of Fiscal Year 2012, FSM National Government assets exceeded liabilities by \$279,824,588. Of the total net assets, \$241,316,218 is restricted as to purposes for which they may be used including invested in capital assets of \$224,647,554. National Government uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although National Government investments 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.

Table 1 shows the schedule of National Government's net assets as of September 30, 2012.

Table 1 - Net Assets

	Governmental Activities			
	<u>2012</u>	<u>2011</u>	<u>Change</u>	<u>%</u>
Current Assets	\$ 81,317,082	\$ 64,848,621	\$ 16,468,461	25.04
Other Assets	62,594,000	58,497,486	4,096,514	7.00
Capital Assets	<u>224,647,554</u>	<u>175,384,128</u>	<u>49,263,426</u>	28.09
Total assets	<u>368,558,636</u>	<u>298,730,235</u>	<u>69,828,401</u>	23.38
Current Liabilities	33,382,988	26,508,179	6,874,809	25.93
Other Liabilities	<u>55,351,060</u>	<u>53,881,569</u>	<u>1,469,491</u>	2.73
Total Liabilities	<u>88,734,048</u>	<u>80,389,748</u>	<u>8,344,300</u>	10.38
Net Assets:				
Invested in capital assets	224,647,554	175,384,128	49,263,426	28.09
Restricted	16,668,664	14,303,410	2,365,254	16.54
Unrestricted	<u>38,508,370</u>	<u>28,652,949</u>	<u>9,855,421</u>	34.40
Net Assets	<u>\$279,824,588</u>	<u>\$218,340,487</u>	<u>\$ 61,484,101</u>	28.16

At the end of FY11, the FSM National Government unrestricted assets show a surplus of \$38,508,370 compared to \$28,652,949 at the end of FY11.

Table 2 shows the changes in Net Assets of the National Government for the years ended September 30, 2012 and 2011.

Table 2
Changes in Net Assets

	Governmental Activities			
	<u>2012</u>	<u>2011</u>	<u>Change</u>	<u>%</u>
Revenues:				
Program Revenues:				
Charges for Services	\$ 3,920,145	\$ 2,667,880	\$ 1,252,265	46.94
Operating grants and contributions	14,696,096	13,585,074	1,111,022	8.18
Capital grants and contributions	56,779,301	51,460,537	5,318,764	10.34
Total program revenues	75,395,542	67,713,491	7,682,051	11.34

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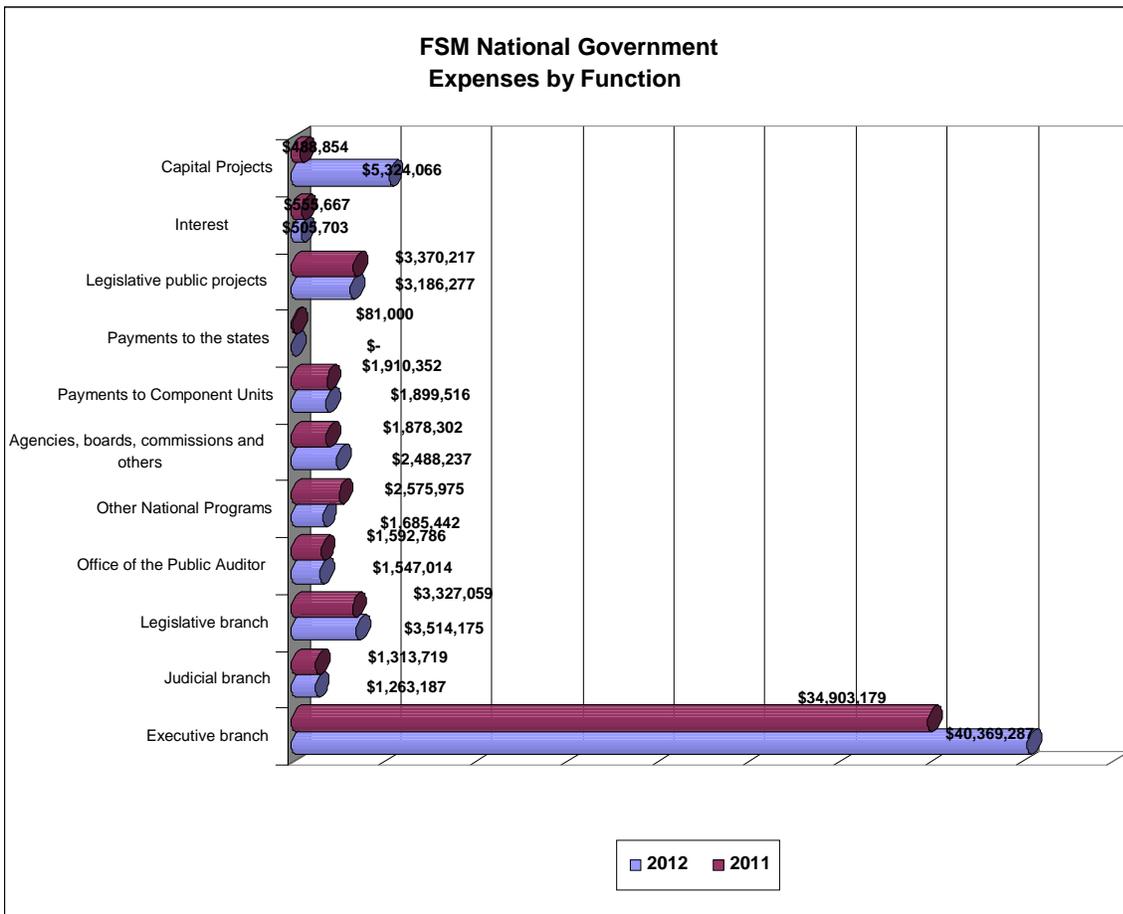
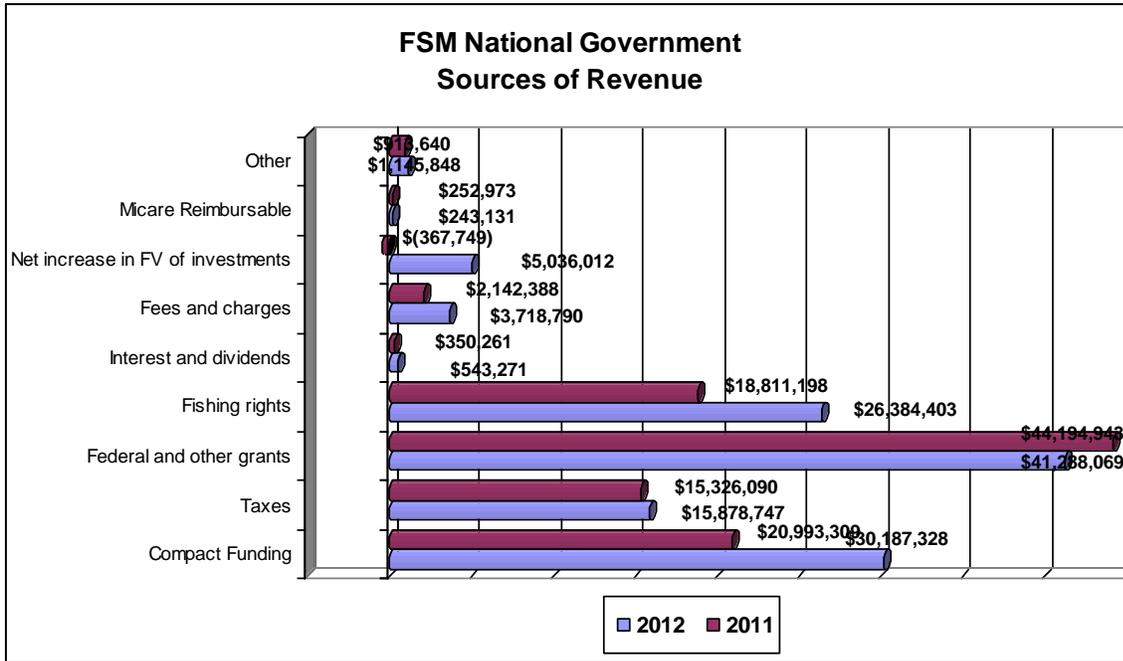
Management's Discussion and Analysis
September 30, 2012

	Governmental Activities			
	<u>2012</u>	<u>2011</u>	<u>Change</u>	<u>%</u>
General Revenues:				
Income tax	3,898,238	3,780,425	117,813	3.12
Fishing rights fees	26,384,403	18,811,198	7,573,205	40.26
Fuel	142,027	148,157	(6,130)	(4.14)
Import	4,413,047	4,774,857	(361,810)	(7.58)
Gross receipt	4,855,287	4,530,534	324,753	7.17
Corporate tax	2,570,148	2,092,117	478,031	22.85
Unrestricted investment earnings	3,625,415	111,285	3,514,130	3157.78
Other	<u>1,187,624</u>	<u>654,989</u>	<u>532,635</u>	81.32
Total general revenues	<u>47,076,189</u>	<u>34,903,562</u>	<u>12,172,627</u>	34.88
Expenses:				
Executive	40,369,287	34,903,179	5,466,108	15.66
Judicial	1,263,187	1,313,719	(50,532)	(3.85)
Legislative	3,514,175	3,327,059	187,116	5.62
Office of Public Auditor	1,547,014	1,592,786	(45,772)	(2.87)
Other National government program	1,685,442	2,575,975	(890,533)	(34.57)
Agencies, boards and commissions	2,488,237	1,878,302	609,935	32.47
Payments to components units	1,899,516	1,910,352	(10,836)	(0.57)
Payments to the states	-	81,000	(81,000)	(100.00)
Legislative Public projects	3,186,277	3,370,217	(183,940)	(5.46)
Capital projects	5,324,066	488,854	4,835,212	989.09
Unallocated interest	<u>505,703</u>	<u>555,667</u>	<u>(49,964)</u>	(8.99)
Total expenses	<u>61,782,904</u>	<u>51,997,110</u>	<u>9,785,794</u>	18.82
Excess before special items	<u>62,642,695</u>	<u>50,619,943</u>	<u>12,022,752</u>	23.75
Special items:				
Receivable written off	(1,158,594)	(3,896,617)	2,738,023	(70.27)
Revaluation ADB shares	<u>-</u>	<u>4,618,522</u>	<u>(4,618,522)</u>	(100.00)
Change in Net Assets	61,484,101	51,341,848	<u>10,142,253</u>	19.75
Net Assets at the beginning of the year, as previously reported	<u>218,340,487</u>	<u>159,475,601</u>	58,864,886	36.91
Prior period adjustment	-	7,523,038	(7,523,038)	(100.00)
Net Assets, beginning of year, as restated	<u>218,340,487</u>	<u>166,998,639</u>	<u>51,341,848</u>	30.74
Net Assets, end of year	\$ <u>279,824,588</u>	\$ <u>218,340,487</u>	\$ <u>61,484,101</u>	28.16%

National Government revenues from governmental activities, including local revenues, gain on investments, Compact and other grants funding totaled \$122,471,737 (FY11 \$102,617,053). In FY12, the cost of governmental activities totaled \$61,782,904 (FY11 \$51,997,110). The difference between the two including special items represents an increase in net assets of \$61,484,101 (FY11 \$51,341,848). To assist in appreciating the details of governmental activities, the above governmental activities information is shown in pictorial form in the following graph.

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As noted earlier, the FSM National Government uses fund accounting to ensure and demonstrate compliance with finance related requirements.

Governmental Funds

The focus of FSM National Government governmental funds is to provide information on near-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing FSM National Government financing requirements. In particular, unassigned fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the FSM National Government governmental funds reported combined ending fund balances of \$108.5 million, which represents an increase of \$13.9 million (or 13%) in comparison with the prior year. This increase is primarily attributable to an increase in fund balance of the Grants Assistance Fund, the Compact Trust Fund, Other Governmental fund and the General Fund.

Of the total combined fund balance, (1) \$65.6 million is reserved for non-spendable. The non spendable includes amounts that cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact such as loans receivable from States of \$41.7 million, equity investments of \$5.2 million, equity shares for membership of \$8.1 million, and permanent fund \$12.3 million; (2) \$2.8 million is reserved for restricted as to its use of resources by laws through constitutional provisions or enabling legislation for the general government; (3) \$28.9 million is restricted to be committed for specific purposes pursuant to constraints imposed by Congress (a) to indicate that it is not available for new spending because it has already been committed such as the IDF operations of \$4.7 million, loan payments of \$2.3 million, \$11.5 million for future operations-FSM Trust Fund, and \$2.7 for revolving funds (b) to continuing appropriations through grant awards or enabling legislation and general governments of \$8 million; and (4) \$4 million is restricted as assigned to be used for specific purposes but are neither restricted nor committed to liquidate contracts and purchase orders of the prior period. The combined Unassigned Fund Balance of FSM National Government Governmental funds are \$7.1 million, an increase of \$5.4 million from the prior year. The increase in unassigned fund balance was due to the increase in local domestic collection specifically in fishing access fees.

The General Fund is the chief operating fund of FSM National Government. At the end of the current fiscal year, the unassigned fund balance of the General Fund was \$7.1 million as compared with the prior year ending unassigned fund balance \$1.8 million, an increase of \$5.3 million (or 294%), while total fund balance was \$91.4 million compared with a total fund balance of \$80.4 million at the end of the prior fiscal year, an increase of \$11 million. The increase in the overall fund balance in the General Fund was due to the increase in domestic revenue specifically in the fishing access fees and increase in the fair market value of the investments.

The Grants Assistance Fund has a total fund balance of \$2 million compared to prior year ending fund balance of \$1.2 million.

The Compact Trust Fund has a total fund balance of \$12.3 million, all of which is reserved for the funding of future operations of the primary government commencing in fiscal year 2023. The net increase in fund balance during the current year in the Compact Trust Fund was \$2 million or 20%, due to the increase in the fair market value of the investments.

The Other governmental funds have a total fund balance of \$2.7 million, all of which is committed or assigned for future operations of the primary government.

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Management's Discussion and Analysis
September 30, 2012

Table 3 shows The National Governmental Fund changes in fund balances for the years ended September 30, 2012 and 2011.

Table 3
Changes in Fund Balances

	General Fund		Other Funds		Total	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Revenues						
Compact funding	\$ -	\$ -	\$30,187,328	\$20,993,309	\$30,187,328	\$20,993,309
Federal and other grants	-	-	41,288,069	44,181,075	41,288,069	44,194,943
Taxes	15,707,414	15,079,493	171,333	246,597	15,878,747	15,326,090
Fishing Rights Fees	26,384,403	18,811,198	-	-	26,384,403	18,811,198
Net increase in fair value of investments	3,082,144	(244,133)	1,953,868	(128,773)	5,036,012	(372,906)
Other	<u>2,377,250</u>	<u>2,254,754</u>	<u>3,268,250</u>	<u>1,423,533</u>	<u>5,645,500</u>	<u>3,664,419</u>
Total revenues	<u>47,551,211</u>	<u>35,901,312</u>	<u>76,868,848</u>	<u>66,715,741</u>	<u>124,420,059</u>	<u>102,617,053</u>
Expenditures	<u>39,125,123</u>	<u>35,580,589</u>	<u>73,374,034</u>	<u>67,377,202</u>	<u>112,499,157</u>	<u>102,957,791</u>
Excess of revenues over expenditures	<u>8,426,088</u>	<u>320,723</u>	<u>3,494,814</u>	<u>(661,461)</u>	<u>11,920,902</u>	<u>(340,738)</u>
Net Transfers	<u>3,782,006</u>	<u>4,501,111</u>	<u>(571,735)</u>	<u>995,502</u>	<u>3,210,271</u>	<u>5,496,613</u>
Special Items	<u>(1,158,594)</u>	<u>721,905</u>	<u>-</u>	<u>-</u>	<u>(1,158,594)</u>	<u>721,905</u>
Net Change in fund balance	<u>\$11,049,500</u>	<u>\$5,543,739</u>	<u>\$ 2,923,079</u>	<u>\$ 334,041</u>	<u>\$ 13,972,579</u>	<u>\$ 5,877,780</u>

Analysis of Budgetary Variations- General Fund:

During the year, the FSM National Government revised its budget several times to accommodate supplemental funding for departments and offices. As can be seen in the following table, actual revenue collection exceeded budgets by \$2,233,393 or 5.14% while expenditures were less than budgets by \$10,353,908 or 21%. There were no material budget overruns at any level.

	Budget Original	Budget Final	Actual Amounts	Variance Positive(Negative)
Revenues	\$37,150,000	\$43,370,028	\$45,603,421	\$ 2,233,393
Expenditures	43,399,850	48,904,995	38,551,087	10,353,908
Excess of Revenues	(6,249,850)	(5,534,967)	7,052,334	12,587,301
Other Financing sources (uses) and special items	(3,091,857)	(2,791,003)	(2,087,703)	703,300
Net Changed Unassigned	<u>\$ (9,341,707)</u>	<u>\$ (8,325,970)</u>	<u>\$ 4,964,631</u>	<u>\$13,290,601</u>

During the year, the FSM National Government revised its revenue projection to increase the fishing rights fees and investment earnings that resulted to an increase in final by \$6,220,028. During the year, the FSM National Government were authorized additional supplemental appropriations for operations and CFSM Projects under Public laws Nos. 17-28, 17-31, 17-36, 17-52, 17-56, 17-59 and 17-60 totaling to \$5,800,188. Included in the original and final budget are the prior year's encumbrance of \$2,611,150 and continuing appropriations of \$7,282,567 for a total amount of \$9,893,717. The inclusion of the prior years encumbrance and continuing appropriations in the original and final budget resulted to a negative net change of Unassigned deficit of (\$9,341,707) and (\$8,325,970) respectively while the actual shows positive of \$4,964,631.

FEDERATED STATES OF MICRONESIA
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Management's Discussion and Analysis
September 30, 2012

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At the end of the September 30, 2012, FSM National Government had invested \$224,647,554 (FY11 \$175,354,128) in capital assets. These assets consist basically of infrastructure, office equipment and machinery, buildings, ship, and motor vehicles and construction in progress. The summary of capital assets of the year is shown below:

	<u>Governmental Activities</u>			
	<u>2012</u>	<u>2011</u>	<u>Change</u>	<u>%</u>
Buildings	\$ 51,683,323	\$ 31,537,774	\$ 20,145,549	63.88
Boats and ships	22,553,312	22,553,101	211	0.00
Infrastructure	77,863,804	58,864,169	18,999,635	32.28
Motor vehicles	6,213,233	5,934,684	278,549	4.69
Computer equipment	4,809,303	4,702,358	106,945	2.27
Aircraft	709,207	709,207	-	0.00
Furniture, fixture, equipment	<u>9,097,720</u>	<u>8,823,902</u>	<u>273,818</u>	3.10
Total assets	<u>172,929,902</u>	<u>133,125,195</u>	<u>39,804,707</u>	29.90
Less: Accumulated depreciation	<u>(44,029,879)</u>	<u>(36,442,756)</u>	<u>(7,587,123)</u>	20.82
Construction in progress	<u>95,747,531</u>	<u>78,701,689</u>	<u>17,045,842</u>	21.66
Total Assets	<u>\$ 224,647,554</u>	<u>\$ 175,384,128</u>	<u>\$ 49,263,426</u>	28.09

During the year, the FSM National Government recorded additional construction in progress of \$56,278,056 while retirements and reclassification amounts \$39,336,080. Further information on the FSM National Government's capital assets can be obtained from note 5 to the accompanying financial statements.

Long Term Debt

At the end of fiscal year 2012, National Government had long term debt of \$57,569,113 (FY11 \$55,817,207) relating to Governmental Activities as shown below:

<u>Description</u>	<u>No.</u>	<u>Governmental Activities</u>			
		<u>2012</u>	<u>2011</u>	<u>Change</u>	<u>%</u>
General Revenues:					
Fisheries	1257	\$ 5,216,110	\$ 5,343,276	\$ (127,166)	(2.38)
Water and Sanitation	1459	9,200,668	9,409,639	(208,971)	(2.22)
Early retirement	1520	18,308,254	18,715,129	(406,875)	(2.17)
Private Sector	1816	3,478,521	3,652,449	(173,928)	(4.76)
Private Sector	1873	3,284,075	3,527,341	(243,266)	(6.90)
Basic Social Services	1874	6,436,067	6,735,419	(299,352)	(4.44)
Omnibus (OIDP)	2099	7,287,460	5,762,177	1,525,283	26.47
Omnibus (OCR)	2100	<u>3,119,233</u>	<u>1,457,771</u>	<u>1,661,462</u>	113.97
Total		56,330,388	54,603,201	1,727,187	3.16
Compensated absences payable		<u>1,238,725</u>	<u>1,214,006</u>	<u>24,719</u>	2.04
Total		<u>\$ 57,569,113</u>	<u>\$ 55,817,207</u>	<u>\$ 1,751,906</u>	3.14

FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT

Management's Discussion and Analysis
September 30, 2012

During the year, FSM National Government received loan proceeds of \$3,210,271 for loans under 2100 FSM (SF) and 2099 FSM (SF) Omnibus Infrastructure Development Project. During the year, the FSM National Government paid a total loan amounts of \$1,483,084, included in the loan payment is a foreign exchange adjustment due SDR of \$68,538. Of this amount, \$51,033 was allocated to the States, which also resulted in decrease in loans receivable from the States of the same amount.

Further information on the FSM National Government's long term obligations can be obtained from note 7 to the accompanying financial statements.

Economic Factors and Next year's Budget:

Fiscal year 2012 represents the eight full year the FSM is implementing the economic assistance provisions available under the Amended compact. The total funds appropriated for the National Government operations and programs during the fiscal year amounted to \$ 50 million. Funding under the amended Compact represents 16% of the National Government FY12 annual budget. The remaining 84% came from locally generated tax revenues, fishing access fees, investment earnings and related government services fees.

The FSM National Government ended fiscal year 2012 with a positive unassigned general fund surplus.

For FY2013, the total revenue projection is approximately \$57,079,288, of which \$43,054,800 or 75% will come from domestic source, \$9,318,401 or 16% will come from the amended compact sector grants and \$4,706,087 or 8% from the federal programs & other foreign grants.

In the beginning of FY2013, the first annual appropriation amounts to \$40,491,992 of which \$33,834,849 or 84% is to be funded by locally generated revenues of the FSM National Government and \$6,657,143 or 16% will come from amended sector grants. It is anticipated that FY2013 budget will reflect an increase from FY12 budgetary level due to the increase in the collection of corporate taxes and a substantial estimated increase in fishing access fees and other local taxes.

In addition to receiving compact grant assistance, the FSM receives substantial programs assistance from agencies of the United States Federal Government, Peoples Republic of China, Japan and other foreign governments. Grants and other technical assistance programs are also made available to the FSM from the international and regional organizations. In FY12, assistance received from these sources was estimated at approximately \$71.5 million and in FY2013 we estimate to receive approximately the same amount.

FINANCIAL MANAGEMENT CONTACT –NATIONAL GOVERNMENT

This financial report is designed to provide all interested users with a general overview of the National Government's finances. Inquiries concerning this report, if any, may be directed to the Secretary of the Department of Finance and Administration, P.O. Box PS 158, Palikir, Pohnpei, FM 96941.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Statement of Net Assets
September 30, 2012

	Primary Government	Component Units
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 8,202,522	\$ 20,252,074
Cash and cash equivalents - restricted	7,715,310	-
Time certificates of deposit	2,226,076	3,543,374
Investments	31,787,154	2,936,344
Receivables, net of allowance for uncollectibles	30,886,020	15,101,965
Due from primary government	-	182,993
Due from component units	500,000	-
Inventories	-	6,917,499
Other current assets	-	4,530,179
Total current assets	81,317,082	53,464,428
Noncurrent assets:		
Investments	-	16,542,725
Investments - restricted	12,331,258	-
Receivables, net of current portion	42,185,450	14,118,559
Capital assets:		
Nondepreciable capital assets	95,747,531	7,147,501
Capital assets, net of accumulated depreciation	128,900,023	64,878,583
Deposits and other assets	8,077,292	3,290,671
Total noncurrent assets	287,241,554	105,978,039
Total assets	\$ 368,558,636	\$ 159,442,467
<u>LIABILITIES</u>		
Current liabilities:		
Current portion of long-term obligations	\$ 1,839,966	\$ 6,114,880
Accounts payable	9,884,731	3,965,964
Due to component units	182,993	-
Current portion of compensated absences payable	378,087	-
Other liabilities and accruals	1,726,033	5,827,084
Tax refunds payable	506,727	-
Retention payable	7,673,871	-
Due to federal agencies	1,126,478	-
Due to FSM State Governments	6,914,884	-
Due to primary government	-	500,000
Deferred revenue	3,149,218	2,755,285
Total current liabilities	33,382,988	19,163,213
Noncurrent liabilities:		
Long-term obligations, net of current portion	54,490,422	30,500,364
Compensated absences payable, net of current portion	860,638	-
Total noncurrent liabilities	55,351,060	30,500,364
Total liabilities	88,734,048	49,663,577
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	224,647,554	43,012,266
Restricted for:		
Nonexpendable:		
Future operations	12,331,258	-
Other purposes	-	3,438,961
Expendable:		
Compact related	1,619,697	-
Other purposes	2,717,709	85,866
Unrestricted	38,508,370	63,241,797
Total net assets	279,824,588	109,778,890
Total liabilities and net assets	\$ 368,558,636	\$ 159,442,467

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Statement of Activities
Year Ended September 30, 2012

Functions/Programs	Expenses	Program Revenues			Net (Expenses) Revenues and Changes in Net Assets	
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government	Component Units
Primary government:						
Governmental activities:						
Office of the President	\$ 3,539,264	\$ -	\$ 349,302	\$ -	\$ (3,189,962)	\$ -
Foreign affairs	3,941,202	-	-	-	(3,941,202)	-
Finance and administration	3,640,673	-	893,269	-	(2,747,404)	-
Resources and development	1,565,301	-	202,806	-	(1,362,495)	-
Transportation, communication and infrastructure	8,747,676	135,314	1,200,155	-	(7,412,207)	-
Health and social affairs	6,922,745	4,650	6,459,822	-	(458,273)	-
Education	4,754,733	555	2,867,317	-	(1,886,861)	-
Justice	4,298,792	2,348,206	-	-	(1,950,586)	-
Office of the Public Defender	668,254	-	-	-	(668,254)	-
SBOC Office	1,327,330	-	120,635	-	(1,206,695)	-
Environment and emergency management	703,736	-	376,248	-	(327,488)	-
National archives, cultural and historic preservation	259,581	-	148,840	-	(110,741)	-
Legislature	3,514,175	-	-	-	(3,514,175)	-
Judiciary	1,263,187	-	-	-	(1,263,187)	-
Office of the National Public Auditor	1,547,014	-	548,931	-	(998,083)	-
National government programs	1,685,442	-	1,409,681	-	(275,761)	-
Agencies, boards and commissions	2,488,237	1,431,420	1,143	-	(1,055,674)	-
Payments to component units	1,899,516	-	89,955	-	(1,809,561)	-
Legislative public projects	3,186,277	-	27,992	-	(3,158,285)	-
Capital projects	5,324,066	-	-	56,779,301	51,455,235	-
Unallocated interest	505,703	-	-	-	(505,703)	-
Total primary government	\$ 61,782,904	\$ 3,920,145	\$ 14,696,096	\$ 56,779,301	13,612,638	-
Component units:						
FSM Telecommunications Corporation	\$ 16,307,231	\$ 13,986,609	\$ -	\$ 360,000	-	(1,960,622)
FSM Development Bank	1,846,415	2,624,055	250,000	-	-	1,027,640
National Fisheries Corporation	262,114	266,309	-	-	-	4,195
College of Micronesia - FSM	22,580,161	22,029,281	-	-	-	(550,880)
FSM Coconut Development Authority	455,318	255,727	201,608	-	-	2,017
FSM Petroleum Corporation	57,029,892	61,575,499	-	-	-	4,545,607
Vital Energy Inc. (FSMPC CU)	513,254	393,910	-	-	-	(119,344)
Caroline Islands Air, Inc.	451,564	380,050	-	-	-	(71,514)
MiCare Plan, Inc.	5,935,506	5,470,437	100,000	-	-	(365,069)
Total component units	\$ 105,381,455	\$ 106,981,877	\$ 551,608	\$ 360,000	-	2,512,030
General revenues:						
Taxes:						
Income					3,898,238	-
Import					3,899,020	-
Gross receipts					4,855,287	-
Corporate tax					2,570,148	-
Fuel					142,027	-
Tobacco revenue share					514,027	-
Fishing rights					26,384,403	-
Unrestricted investment earnings					3,625,415	1,866,468
Other					1,187,624	222,732
Total general revenues					47,076,189	
Special item:						
Write-off of receivables					(1,158,594)	-
Contributions to permanent funds					1,953,868	-
Total general revenues, special items and contributions					47,871,463	2,089,200
Change in net assets					61,484,101	4,601,230
Net assets at the beginning of the year					218,340,487	105,177,660
Net assets at the end of the year					\$ 279,824,588	\$ 109,778,890

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Balance Sheet
Governmental Funds
September 30, 2012

	Special Revenue		Permanent		Other Governmental Funds	Total
	General	Grants Assistance	Compact Trust			
ASSETS						
Cash and cash equivalents	\$ 8,202,522	\$ -	\$ -	\$ -	\$ -	\$ 8,202,522
Time certificates of deposit	2,226,076	-	-	-	-	2,226,076
Equity in internal investment pool	16,646,292	1,789,605	-	-	-	18,435,897
Investments	13,351,257	-	-	-	-	13,351,257
Receivables, net:						
General	171,347	-	-	-	-	171,347
Taxes	4,490,812	-	-	-	-	4,490,812
Federal agencies	486,043	21,267,683	-	-	-	21,753,726
Loans	42,170,953	-	-	-	-	42,170,953
Advances	240,671	20,477	-	-	-	261,148
Accrued interest	3,612	-	-	-	-	3,612
Due from component units	500,000	-	-	-	-	500,000
Due from other funds	3,484,693	3,230,116	-	-	2,768,065	9,482,874
Deposits and other assets	8,077,292	-	-	-	-	8,077,292
Restricted assets:						
Cash and cash equivalents	7,715,310	-	-	-	-	7,715,310
Investments	-	-	12,331,258	-	-	12,331,258
Total assets	\$ 107,766,880	\$ 26,307,881	\$ 12,331,258	\$ 2,768,065	\$ -	\$ 149,174,084
LIABILITIES AND FUND BALANCES						
Liabilities:						
Accounts payable	\$ 2,848,447	\$ 7,028,802	\$ -	\$ 7,482	\$ -	\$ 9,884,731
Retention payable	218,701	7,455,170	-	-	-	7,673,871
Other liabilities and accruals	1,726,033	-	-	-	-	1,726,033
Tax refunds payable	506,727	-	-	-	-	506,727
Due to component units	176,993	6,000	-	-	-	182,993
Due to federal agencies	-	1,126,478	-	-	-	1,126,478
Due to FSM State Governments	4,854,411	2,060,473	-	-	-	6,914,884
Due to other funds	5,998,181	3,484,693	-	-	-	9,482,874
Deferred revenue	-	3,149,218	-	-	-	3,149,218
Total liabilities	16,329,493	24,310,834	-	7,482	-	40,647,809
Fund balances:						
Non-spendable	53,240,400	-	12,331,258	-	-	65,571,658
Restricted	826,703	2,022,379	-	-	-	2,849,082
Committed	26,670,026	-	-	2,269,893	-	28,939,919
Assigned	3,517,834	-	-	490,690	-	4,008,524
Unassigned:						
General fund	7,182,424	-	-	-	-	7,182,424
Special revenue funds	-	(25,332)	-	-	-	(25,332)
Total fund balances	91,437,387	1,997,047	12,331,258	2,760,583	-	108,526,275
Total liabilities and fund balances	\$ 107,766,880	\$ 26,307,881	\$ 12,331,258	\$ 2,768,065	\$ -	\$ 149,174,084

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

224,647,554

Loans receivable from FSM State Governments

4,219,872

Long-term liabilities, including loans payable, are not due and payable in the current period and, therefore, are not reported in the funds.

These liabilities include:

Loans payable

(56,330,388)

Compensated absences payable

(1,238,725)

171,298,313

Net assets of governmental activities

\$ 279,824,588

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

	General	Special Revenue	Permanent	Other	Total
		Grants Assistance	Compact Trust	Governmental Funds	
Revenues:					
Compact funding	\$ -	\$ 30,187,328	\$ -	\$ -	\$ 30,187,328
Taxes	15,707,414	-	-	171,333	15,878,747
Federal and other grants	-	41,288,069	-	-	41,288,069
Fishing rights	26,384,403	-	-	-	26,384,403
Interest and dividends	543,271	-	-	-	543,271
Fees and charges	651,895	-	-	3,066,895	3,718,790
Net change in the fair value of investments	3,082,144	-	1,953,868	-	5,036,012
MiCare reimbursible	243,131	-	-	-	243,131
Other	938,953	-	-	201,355	1,140,308
Total revenues	47,551,211	71,475,397	1,953,868	3,439,583	124,420,059
Expenditures:					
Current:					
General government:					
Office of the President	3,503,155	-	-	-	3,503,155
Foreign affairs	3,931,460	-	-	-	3,931,460
Finance and administration	2,705,816	893,269	-	-	3,599,085
Resources and development	1,326,272	202,806	-	3,343	1,532,421
Transportation, communication and infrastructure	4,923,517	1,200,155	-	1,407,301	7,530,973
Health and social affairs	319,338	6,459,822	-	6,816	6,785,976
Education	1,686,522	2,867,317	-	180,989	4,734,828
Justice	3,392,106	-	-	524,993	3,917,099
Office of the Public Defender	653,439	-	-	-	653,439
SBOC Office	1,125,319	120,635	-	-	1,245,954
Environment and emergency management	320,725	376,248	-	-	696,973
National archives, cultural and historic preservation	100,342	148,840	-	-	249,182
Legislature	3,528,507	-	-	-	3,528,507
Judiciary	1,268,396	-	-	-	1,268,396
Office of the National Public Auditor	984,132	548,931	-	-	1,533,063
National government programs	9,476	1,409,681	-	-	1,419,157
Agencies, boards and commissions	2,048,970	1,143	-	410,522	2,460,635
Payments to component units and fiduciary fund	1,809,219	89,955	-	-	1,899,174
Legislative public projects	3,499,625	27,992	-	-	3,527,617
Capital projects	-	56,493,276	-	-	56,493,276
Debt service:					
Principal and interest payments	1,988,787	-	-	-	1,988,787
Total expenditures	39,125,123	70,840,070	-	2,533,964	112,499,157
Excess of revenues over expenditures	8,426,088	635,327	1,953,868	905,619	11,920,902
Other financing sources (uses):					
Proceeds from issuance of long-term debt	3,210,271	-	-	-	3,210,271
Operating transfers in	1,962,741	200,000	-	1,191,006	3,353,747
Operating transfers out	(1,391,006)	-	-	(1,962,741)	(3,353,747)
Total other financing sources (uses), net	3,782,006	200,000	-	(771,735)	3,210,271
Special items:					
Write-off of receivable balances	(1,158,594)	-	-	-	(1,158,594)
Total special items	(1,158,594)	-	-	-	(1,158,594)
Net change in fund balances	11,049,500	835,327	1,953,868	133,884	13,972,579
Fund balances at the beginning of the year	80,387,887	1,161,720	10,377,390	2,626,699	94,553,696
Fund balances at the end of the year	\$ 91,437,387	\$ 1,997,047	\$ 12,331,258	\$ 2,760,583	\$ 108,526,275

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

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

Net change in fund balances - total governmental funds	\$ 13,972,579
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Capital outlays are reported as expenditures in governmental funds. However, in the statement of activities, the cost of capital assets is allocated over their estimated useful lives and reported as depreciation expense. For the current year, these amounts consist of:

Capital outlays, net of disposals	\$ 57,105,393	
Depreciation expense, net	<u>(7,841,965)</u>	49,263,428

The issuance 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.

This is the additional loan proceeds received from ADB loans.	(3,210,271)
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This is the repayment of ADB loans (see Note 7).	1,483,084
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Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds. These expenses include accrued annual leave and claims and judgments payable that are reported in the statement of activities, but not in funds

	<u>(24,719)</u>
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Change in net assets of governmental activities	\$ <u>61,484,101</u>
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See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Combining Statement of Fiduciary Net Assets
Fiduciary Funds - Private Purpose Trusts
September 30, 2012

	<u>FSM Social Security Administration</u>	<u>Pohnpei State Development Loan Fund</u>	<u>Yap State Development Loan Fund</u>	<u>Total</u>
<u>ASSETS</u>				
Cash and cash equivalents	\$ 2,440,547	\$ 275,223	\$ 106,729	\$ 2,822,499
Time certificates of deposit	-	577,890	146,363	724,253
Receivables, net:				
Contributions	2,842,350	-	-	2,842,350
Accrued interest	63,599	847	835	65,281
Loans	-	19,816	21,858	41,674
Other	18,125	-	15,764	33,889
Investments	37,206,732	-	-	37,206,732
Due from primary government	500,000	-	-	500,000
Capital assets, net of accumulated depreciation	102,841	-	-	102,841
	<u>\$ 43,174,194</u>	<u>\$ 873,776</u>	<u>\$ 291,549</u>	<u>\$ 44,339,519</u>
<u>LIABILITIES</u>				
Accounts payable	\$ 305,286	\$ 142,782	\$ 41,207	\$ 489,275
Other liabilities and accruals	29,372	-	-	29,372
	<u>334,658</u>	<u>142,782</u>	<u>41,207</u>	<u>518,647</u>
<u>NET ASSETS</u>				
Held in trust for:				
Social security benefits	42,839,536	-	-	42,839,536
Restricted	-	19,816	21,858	41,674
Other purposes	-	711,178	228,484	939,662
	<u>42,839,536</u>	<u>730,994</u>	<u>250,342</u>	<u>43,820,872</u>
	<u>\$ 43,174,194</u>	<u>\$ 873,776</u>	<u>\$ 291,549</u>	<u>\$ 44,339,519</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Combining Statement of Changes in Fiduciary Net Assets
Fiduciary Funds - Private Purpose Trusts
Year Ended September 30, 2012

	<u>FSM Social Security Administration</u>	<u>Pohnpei State Development Loan Fund</u>	<u>Yap State Development Loan Fund</u>	<u>Total</u>
Additions:				
Contributions	\$ 16,371,874	\$ -	\$ -	\$ 16,371,874
Investment earnings:				
Net change in the fair value of investments	3,102,803	-	-	3,102,803
Interest and dividends	<u>736,904</u>	<u>4,913</u>	<u>4,547</u>	<u>746,364</u>
Total investment earnings	3,839,707	4,913	4,547	3,849,167
Less investment expense	<u>(169,274)</u>	<u>-</u>	<u>-</u>	<u>(169,274)</u>
Net investment earnings	<u>3,670,433</u>	<u>4,913</u>	<u>4,547</u>	<u>3,679,893</u>
Contributions from primary government	1,000,000	-	-	1,000,000
Other	<u>487,874</u>	<u>(12,076)</u>	<u>-</u>	<u>475,798</u>
Total additions	<u>21,530,181</u>	<u>(7,163)</u>	<u>4,547</u>	<u>21,527,565</u>
Deductions:				
Benefits	17,982,093	-	-	17,982,093
Refunds	34,551	-	-	34,551
Administrative expenses	<u>1,083,370</u>	<u>-</u>	<u>-</u>	<u>1,083,370</u>
Total deductions	<u>19,100,014</u>	<u>-</u>	<u>-</u>	<u>19,100,014</u>
Change in net assets	2,430,167	(7,163)	4,547	2,427,551
Net assets at the beginning of the year	<u>40,409,369</u>	<u>738,157</u>	<u>245,795</u>	<u>41,393,321</u>
Net assets at the end of the year	<u>\$ 42,839,536</u>	<u>\$ 730,994</u>	<u>\$ 250,342</u>	<u>\$ 43,820,872</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Combining Statement of Net Assets (Deficiency)
Component Units
September 30, 2012

	FSM Tele- Communications Corporation	FSM Development Bank	National Fisheries Corporation	College of Micronesia- FSM	FSM Coconut Development Authority	FSM Petroleum Corporation	Vital Energy Inc. (FSMPC CU)	Caroline Islands Air, Inc.	MiCare Plan, Inc.	Total
ASSETS										
Current assets:										
Cash and cash equivalents	\$ 1,254,195	\$ 4,391,374	\$ 70,733	\$ 6,385,567	\$ 137,550	\$ 7,720,743	\$ 1,000	\$ 14,071	\$ 276,841	\$ 20,252,074
Time certificates of deposit	176,315	2,851,042	-	-	-	516,017	-	-	-	3,543,374
Investments	1,292,090	-	389,363	-	-	-	-	-	1,254,891	2,936,344
Receivables, net:										
General	630,631	526,119	1,516	3,443,380	27,577	2,010,177	139,856	12,886	230,986	7,023,128
Loans	-	5,667,000	-	-	-	-	-	-	-	5,667,000
Interest	185,244	247,935	-	-	-	-	-	-	-	433,179
Other	12,779	-	-	1,960,250	5,629	-	-	-	-	1,978,658
Due from primary government	-	-	-	182,993	-	-	-	-	-	182,993
Inventories	680,442	-	-	1,388,192	83,144	4,731,901	-	33,820	-	6,917,499
Prepaid expenses	399,237	4,647	-	419,568	743	3,454,791	25,577	-	225,616	4,530,179
Total current assets	<u>4,630,933</u>	<u>13,688,117</u>	<u>461,612</u>	<u>13,779,950</u>	<u>254,643</u>	<u>18,433,629</u>	<u>166,433</u>	<u>60,777</u>	<u>1,988,334</u>	<u>53,464,428</u>
Noncurrent assets:										
Indefeasible right of use	3,290,671	-	-	-	-	-	-	-	-	3,290,671
Capital assets:										
Nondepreciable capital assets	371,314	-	-	1,455,685	-	5,320,502	-	-	-	7,147,501
Capital assets, net of accumulated depreciation	47,798,662	1,409,335	9,909	8,672,024	103,999	6,796,880	61,691	3,740	22,343	64,878,583
Investments	-	13,103,764	-	3,438,961	-	-	-	-	-	16,542,725
Loans receivable, net	-	14,118,559	-	-	-	-	-	-	-	14,118,559
Total noncurrent assets	<u>51,460,647</u>	<u>28,631,658</u>	<u>9,909</u>	<u>13,566,670</u>	<u>103,999</u>	<u>12,117,382</u>	<u>61,691</u>	<u>3,740</u>	<u>22,343</u>	<u>105,978,039</u>
Total assets	<u>\$ 56,091,580</u>	<u>\$ 42,319,775</u>	<u>\$ 471,521</u>	<u>\$ 27,346,620</u>	<u>\$ 358,642</u>	<u>\$ 30,551,011</u>	<u>\$ 228,124</u>	<u>\$ 64,517</u>	<u>\$ 2,010,677</u>	<u>\$ 159,442,467</u>
LIABILITIES										
Current liabilities:										
Current portion of long-term debt	\$ 1,510,566	\$ 416,685	\$ 3,600,000	\$ -	\$ -	\$ 587,629	\$ -	\$ -	\$ -	\$ 6,114,880
Accounts payable	731,281	94,354	57,090	375,893	2,944	1,023,335	19,158	8,832	1,653,077	3,965,964
Other liabilities and accruals	746,789	129,498	10,927	1,660,495	11,381	3,240,377	22,525	5,092	-	5,827,084
Due to primary government	-	-	-	-	-	500,000	-	-	-	500,000
Deferred revenue	170,055	-	28,328	2,556,902	-	-	-	-	-	2,755,285
Total current liabilities	<u>3,158,691</u>	<u>640,537</u>	<u>3,696,345</u>	<u>4,593,290</u>	<u>14,325</u>	<u>5,351,341</u>	<u>41,683</u>	<u>13,924</u>	<u>1,653,077</u>	<u>19,163,213</u>
Noncurrent liabilities:										
Noncurrent portion of long-term debt	28,987,140	294,070	-	-	-	1,219,154	-	-	-	30,500,364
Total noncurrent liabilities	<u>28,987,140</u>	<u>294,070</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,219,154</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>30,500,364</u>
Total liabilities	<u>32,145,831</u>	<u>934,607</u>	<u>3,696,345</u>	<u>4,593,290</u>	<u>14,325</u>	<u>6,570,495</u>	<u>41,683</u>	<u>13,924</u>	<u>1,653,077</u>	<u>49,663,577</u>
NET ASSETS (DEFICIENCY)										
Invested in capital assets, net of related debt	20,962,941	1,409,335	9,909	10,127,709	103,999	10,310,599	61,691	3,740	22,343	43,012,266
Restricted for:										
Expendable	85,866	-	-	-	-	-	-	-	-	85,866
Nonexpendable	-	-	-	3,438,961	-	-	-	-	-	3,438,961
Unrestricted	2,896,942	39,975,833	(3,234,733)	9,186,660	240,318	13,669,917	124,750	46,853	335,257	63,241,797
Total net assets (deficiency)	<u>23,945,749</u>	<u>41,385,168</u>	<u>(3,224,824)</u>	<u>22,753,330</u>	<u>344,317</u>	<u>23,980,516</u>	<u>186,441</u>	<u>50,593</u>	<u>357,600</u>	<u>109,778,890</u>
Total liabilities and net assets	<u>\$ 56,091,580</u>	<u>\$ 42,319,775</u>	<u>\$ 471,521</u>	<u>\$ 27,346,620</u>	<u>\$ 358,642</u>	<u>\$ 30,551,011</u>	<u>\$ 228,124</u>	<u>\$ 64,517</u>	<u>\$ 2,010,677</u>	<u>\$ 159,442,467</u>

See accompanying notes to basic financial statements.

FEDERATED STATES OF MICRONESIA

Combining Statement of Revenues, Expenses, and Changes in Net Assets (Deficiency)
Component Units
Year Ended September 30, 2012

	FSM Tele- Communications Corporation	FSM Development Bank	National Fisheries Corporation	College of Micronesia- FSM	FSM Coconut Development Authority	FSM Petroleum Corporation	Vital Energy Inc. (FSMPC CU)	Caroline Islands Air, Inc.	MiCare Plan, Inc.	Total
Operating revenues:										
Charges for services	\$ 13,790,822	\$ 2,475,957	\$ 248,333	\$ 21,617,739	\$ 255,727	\$ 61,564,075	\$ 393,910	\$ 380,050	\$ 5,470,437	\$ 106,197,050
Other	195,787	148,098	17,976	411,542	-	11,424	-	-	-	784,827
Total operating revenues	13,986,609	2,624,055	266,309	22,029,281	255,727	61,575,499	393,910	380,050	5,470,437	106,981,877
Operating expenses:										
Cost of services	419,076	953,806	-	-	207,209	49,649,654	-	394,861	5,430,561	57,055,167
Depreciation and amortization	4,752,297	113,557	4,438	988,117	37,310	867,004	7,202	880	11,256	6,782,061
Administrative costs	9,622,724	731,732	257,676	21,592,044	210,799	6,513,234	506,052	55,823	493,689	39,983,773
Total operating expenses	14,794,097	1,799,095	262,114	22,580,161	455,318	57,029,892	513,254	451,564	5,935,506	103,821,001
Operating income (loss)	(807,488)	824,960	4,195	(550,880)	(199,591)	4,545,607	(119,344)	(71,514)	(465,069)	3,160,876
Nonoperating revenues (expenses):										
Net change in the fair value of investments	282,748	844,318	314,363	409,099	-	(2,386)	-	-	18,326	1,866,468
Interest income (expense)	(1,513,134)	(47,320)	-	-	-	-	-	-	-	(1,560,454)
Contributions from primary government	-	250,000	-	-	201,608	-	-	-	100,000	551,608
Other income (expense)	-	(17,195)	216,567	-	-	(305,785)	305,785	22,242	1,118	222,732
Total nonoperating revenues (expenses), net	(1,230,386)	1,029,803	530,930	409,099	201,608	(308,171)	305,785	22,242	119,444	1,080,354
Net income (loss)	(2,037,874)	1,854,763	535,125	(141,781)	2,017	4,237,436	186,441	(49,272)	(345,625)	4,241,230
Capital grants	360,000	-	-	-	-	-	-	-	-	360,000
Net assets (deficiency) at the beginning of the year	25,623,623	39,530,405	(3,759,949)	22,895,111	342,300	19,743,080	-	99,865	703,225	105,177,660
Net assets (deficiency) at the end of the year	\$ 23,945,749	\$ 41,385,168	\$ (3,224,824)	\$ 22,753,330	\$ 344,317	\$ 23,980,516	\$ 186,441	\$ 50,593	\$ 357,600	\$ 109,778,890

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies

The Federated States of Micronesia (FSM) was constituted on July 12, 1978 under the provisions of the FSM Constitution (the Constitution) as approved by the people of Chuuk, Kosrae, Pohnpei and Yap. The ratification of the Constitution by these four districts recognized their sovereign right to form the Federated States of Micronesia and make the FSM Constitution the supreme law of the land. The Constitution provides for the separation of powers of the executive, legislative, and judicial branches of the government.

The accompanying financial statements of the FSM 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 FSM National Government's accounting policies are described below.

A. Reporting Entity

The FSM is an independent sovereign nation made up of the four states of Chuuk, Kosrae, Pohnpei, and Yap (the States). The FSM National Government is a constitutional government comprised of three branches: the Legislative Branch (the Congress), consisting of 14 members (one from each State who are elected for a term of four years, and ten who are elected for a term of two years, whose seats are apportioned by population); the Executive Branch, headed by the President and Vice President who are primarily responsible for executing the laws and administering national government services; and the Judiciary Branch made up of the FSM Supreme Court, which consists of a Chief Justice and up to five Associate Justices. The Congress elects two of its four-year members at its first session following an election to serve as President and Vice President.

For financial reporting purposes, the FSM National Government has included all funds, organizations, agencies, boards, commissions and institutions. The FSM National Government 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 FSM National Government are such that exclusion would cause the FSM National Government's financial statements to be misleading or incomplete. The criteria to be considered in determining financial accountability include whether the FSM National Government, 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 FSM National Government. 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 FSM National Government has a September 30 year-end except for the FSM Development Bank, FSM Petroleum Corporation and the FSM Social Security Administration, which each have a December 31 year-end.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

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 FSM National Government, are deemed to be related organizations. The nature and relationship of the FSM National Government's component units and related organizations are disclosed in the following section.

Blended component units are entities that are legally separate from the FSM National Government, but are so related to the FSM National Government that they are, in substance, the same as the FSM National Government or entities providing services entirely or almost entirely to the FSM National Government. The net assets and results of operations of the following legally separate entities are presented as part of the FSM National Government's operations:

Blended Component Units

The following component unit is blended within the primary government:

FSM Social Security Administration (FSMSSA), a Fiduciary Fund Type - Private Purpose Trust Fund. FSMSSA was established under FSM Public Law No. 2-74 to provide retirement, disability and survivor benefits for the citizens of the FSM. FSMSSA is governed by a five-member Board of Directors appointed by the President with the advice and consent of the Congress.

Discretely Presented Component Units

Discretely presented component units are entities which are legally separate from the FSM National Government, but are financially accountable to the FSM National Government, or whose relationships with the FSM National Government are such that exclusion would cause the FSM National Government'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:

FSM Telecommunications Corporation (FSMTC): FSMTC was incorporated under FSM Public Law No. 2-10 to engage in the business of providing telecommunications services, except radio and television broadcasting, throughout the FSM and to points outside the FSM. FSMTC is governed by a five-member Board of Directors, which includes one appointee by the President (with the advice and consent of the Congress) and four appointees by the Governor of each State (with the advice and consent of the respective State legislatures).

FSM Development Bank (FSMDB): FSMDB was established under FSM Public Law No. 8-47 to advance the economic development of the FSM through the provision of economic development loans. FSMDB is governed by a seven-member Board of Directors appointed by election at the annual shareholders meeting by the plurality of votes thereof. As of December 31, 2012, FSMDB has issued 2,997,883 shares to the FSM National Government (98.7%), the State of Chuuk (1%), and the State of Kosrae (0.3%).

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

Discretely Presented Component Units, Continued

National Fisheries Corporation (NFC): NFC was established under FSM Public Law No. 3-14 to promote the development of pelagic fisheries and related industries within the extended fishery zone for the benefit of the people of the FSM. NFC is governed by a seven-member Board of Directors, which includes one appointee by the President (with the advice and consent of the Congress), four appointees by the Governor of each State (with the advice and consent of the respective State legislatures), the Executive Director of the Micronesian Maritime Authority, and the Secretary of the Department of Economic Affairs.

College of Micronesia-FSM (COM-FSM): COM-FSM was established under FSM Public Law No. 7-79 to serve the varied post-secondary and adult educational needs of the FSM. COM-FSM is governed by a five-member Board of Regents appointed by the President with the advice and consent of the Congress.

FSM Coconut Development Authority (CDA): CDA was established under FSM Public Law No. 1-156 to engage in the manufacture and processing of all products derived from the coconut tree; to buy, collect, market, sell, export, inspect, improve the quality, and deal with, in general, all products derived from the coconut tree; to establish prices to producers or sellers of coconut products in the FSM; to collect and receive all monies derived from the sales of coconut products; and to stabilize the price of these products. CDA is governed by a five-member Board of Directors, which includes one appointee by the President (with the advice and consent of the Congress) and four appointees by the Governor of each State (with the advice and consent of the respective State legislatures).

FSM Petroleum Corporation (FSMPC): FSMPC was established under FSM Public Law 15-08 for the purpose of providing oil and gas distribution for the entire FSM. FSMPC is governed by a seven-member Board of Directors, which includes one appointee by the President (with the advice and consent of the Congress) and four appointees by the Governor of each State (with the advice and consent of the respective State legislatures), and two appointees from the private sector by the President (with the advice and consent of the Congress).

Caroline Islands Air, Inc. (CIA): CIA was established under FSM Public Law No. 10-72 to operate, maintain, and administer an inter-island air service based in Pohnpei State. CIA is governed by a five-member Board of Directors, which includes one appointee by the President (with the advice and consent of the Congress) and four appointees by the Governor of each State (with the advice and consent of the respective State Legislatures).

MiCare Plan, Inc. (the Plan): The Plan was established under FSM Public Law No. 12-77 to provide, arrange, pay, or reimburse the costs of medical, dental and vision treatment and care, hospitalization, surgery, prescription drugs, medicine, prosthetic appliances, out-patient care, and other medical care benefits. The Plan is governed by a seven-member Board of Directors appointed by the President with the advice and consent of the Congress.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

Discretely Presented Component Units, Continued

Vital Energy, Inc. (Vital) (a component unit of FSMPC) was incorporated on February 10, 2012 for the purpose of carrying on the operation of importation and sale of petroleum products, and operation, management and maintenance of petroleum storage terminals, international marine bunkering services, operation of road and aviation bridging tankers, and aviation refueling operations.

The FSM National Government'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 FSM National Public Auditor:

P.O. Box PS05
Palikir, Pohnpei State, FM, 96941

B. Government-Wide Financial Statements

The Statement of Net Assets and the Statement of Activities report financial information on all 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. The FSM National Government did not report any business-type activities during the year ended September 30, 2012. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable. Discretely presented component unit activities are presented with their business-type focus.

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

- Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets.
- Restricted net assets - nonexpendable consists of permanent funds in which donors or other outside sources have stipulated that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to the principal.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

- Restricted net assets - expendable consists of resources in which the FSM National Government 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 two 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 \$16,668,664 of restricted net assets, of which \$2,717,709 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 and offset or supplant the net operating deficit or surplus from governmental operations.

C. Fund Financial Statements

Separate financial statements are provided for governmental funds and fiduciary funds even though the latter are excluded from the government-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements pursuant to GASB reporting standards, with nonmajor governmental funds being combined into a single column.

The FSM National Government 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 full accrual basis of accounting, as are the fiduciary fund and component unit financial statements. 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 revenues as soon as all eligibility requirements imposed by the provider have been met.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Government-Wide Financial Statements, Continued:

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 FSM National Government 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 FSM National Government considers most revenues to be available if they are collected within 90 days of the end of the current fiscal period. Federal grants and assistance awards made on the basis of entitlement periods are recorded as revenues when available and entitlement occurs, which is generally within 12 months of the end of the current fiscal period.

Significant revenues susceptible to accrual include income and gross receipts 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. 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. 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.

Fiduciary Fund and 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 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 expenses not meeting this definition are reported as nonoperating and expenses.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

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. The FSM National Government has elected to add an additional major fund that is of specific public interest, namely the Compact Trust Fund. 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 FSM National Government reports the following major funds:

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

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

Section 215 Compact Trust Fund - a Permanent Fund that accounts for the FSM National Government'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 FSM National Government's discretely presented component units follow all GASB pronouncements and those Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

F. Cash and Cash Equivalents and Time Certificates of Deposit

Cash and cash equivalents of the primary government and the discretely presented component units include cash held in demand accounts as well as short-term investments with a maturity date within three months of the date acquired by the FSM National Government. Deposits maintained in time certificates of deposit with original maturity dates greater than ninety days are separately classified on the statement of net assets.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

G. Investments

Investments and related investment earnings of the primary government and the discretely presented component units are carried at fair value, which is the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

An investment of 20% or more of the voting stock of an investee is presumed to give the investor significant influence. Under the equity method, the investor records, as earnings or loss, its proportionate share of the investee's earnings or loss.

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. Reimbursements due to the FSM National Government for expenditures on federally funded reimbursement and grant programs are reported as "receivables from federal agencies" on the governmental funds balance sheet.

Receivables of the primary government and the discretely presented component units are primarily due from businesses and individuals residing in the FSM. The allowance for uncollectible amounts primarily represents estimated allowances for uncollectible amounts that are determined based upon past collection experience and aging of the accounts.

I. Prepaid Items

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

J. Interfund Receivables/Payables

During the course of its operations, the FSM National Government 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 funds 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 recorded by the discretely presented component units are determined by physical count and are valued at the lower of cost (principally average cost) or market.

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Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

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. Investments recorded in the Compact Trust Fund of \$12,331,258 are restricted in that they are not available to be used in current operations.

As of September 30, 2012, cash and cash equivalents of the primary government were restricted for the following uses:

Deposit accounts established for the purpose of receiving payments pursuant to the Compact of Free Association, as amended	\$ 5,165,793
Deposit accounts maintained for certain non-U.S. donor agencies (ADB, Peoples Republic of China, Japan, European Union)	942,242
Deposit account established for the Airport Improvement Program	780,572
Deposit account maintained for proceeds from dormant bank accounts established in accordance with Public Law 13-56	510,158
Deposit accounts established for imprest funds in accordance with ADB Loans 2099 and 2100	303,689
Other miscellaneous deposit accounts	<u>12,856</u>
	\$ <u>7,715,310</u>

M. Indefeasible Right of Use

The FSM National Government has capitalized the cost of acquisition of the executive right to use a specified amount of fiber capacity for a period of time, which is amortized over the length of the term of the capacity agreement on the straight line method.

N. 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. Singular pieces of equipment, vehicles, computer equipment and software that equal or exceed \$1,000 are capitalized. Buildings and infrastructure projects with a cost that equals or exceeds \$50,000 are capitalized. Such 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.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

N. Capital Assets, Continued

Property, plant and equipment of the primary government and the 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 and improvements	20 - 50 years
Infrastructure	20 years
Computer equipment	5 years
Furniture, equipment and machinery	3 - 20 years
Boats	25 years
Aircraft	20 years
Motor vehicles	3 - 10 years

O. Interfund/Intrafund Transactions

As a general rule, the effect of interfund activity has been eliminated in the government-wide financial 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.

P. Deferred Revenue

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 types has primarily resulted from grants assistance funds received in advance of eligible expenditures.

Q. 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 and fiduciary fund 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 the rate of 4 hours bi-weekly, if less than 3 years of service, 6 hours bi-weekly, if between 3 and 10 years of service, and 8 hours bi-weekly if over 10 years of service, limited to 45 working days.

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

R. Fund Balance

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

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

The FSM National Government 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 FSM National Government is to use committed resources first, followed by assigned, and then unassigned. The use of restricted/committed resources may be deferred based on a review of the specific transaction.

A formal minimum fund balance policy has not been adopted.

S. Risk Financing

The FSM National Government 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 FSM National Government management believes it is more economical to manage its risks internally. In the event of claim settlements and judgments, the FSM National Government 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. No losses have occurred as a result of these risks in any of the past three fiscal years.

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

T. New Accounting Standards

During fiscal year 2012, the FSM National Government implemented the following pronouncements:

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

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

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 FSM National Government.

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

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

T. New Accounting Standards, Continued

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

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

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

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

U. 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.

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2012

(1) Summary of Significant Accounting Policies, Continued

V. 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 FSM National Government's financial statements for the year ended September 30, 2011 from which summarized information was derived.

(2) Deposits and Investments

The FSM National Government pools cash resources of its various funds in order to facilitate the management of cash. Unless otherwise required by law, interest income received on pooled cash accrues to the General Fund. Cash and cash equivalents applicable to a particular fund are readily identifiable. The FSM National Government has invested the majority of its excess funds in a pooled investment fund which is managed under the control of the Federated Development Authority (FDA), an entity comprised of the FSM National Government and its four component States. Investment income originating from the pool accrues to the various funds.

The deposit and investment policies of the FSM National Government are governed by legislation enacted by the Congress. The Secretary of Finance 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. Furthermore, the Secretary of Finance is responsible for the investment of any monies of the FSM National Government that are deemed not necessary for immediate use.

FDA 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 & Poor 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.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(2) Deposits and Investments, Continued

The equity portfolio shall be diversified among issues and industry classifications. No more than 25% of the equity portfolio may be invested in any single classification, as described by the Standard and Poor 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.

A. Deposits

Custodial credit risk is the risk that in the event of a bank failure, the FSM National Government'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 FSM National Government does not have a deposit policy for custodial credit risk.

As of September 30, 2012, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit was \$18,143,908 and the corresponding bank balances were \$25,004,304. Of the bank balances, \$18,075,181 is maintained in financial institutions subject to FDIC insurance while \$5,359,955 represents short-term investments held and administered by FSM National Government's trustees in accordance with various trust agreements and bond indentures. Based on negotiated trust and custody contracts, all of these investments were held in FSM National Government's name by FSM National Government's custodial financial institutions at September 30, 2012 while the remaining amount of \$1,569,168 is maintained in financial institutions not subject to FDIC insurance. As of September 30, 2012, bank deposits in the amount of \$13,232,610 were FDIC insured. The FSM National Government does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

As of September 30, 2012, the carrying amount of the fiduciary funds' total cash and cash equivalents and time certificates of deposit was \$3,546,752 and the corresponding bank balances were \$3,904,809. Of the bank balances, \$2,475,868 is maintained in financial institutions subject to FDIC insurance. The remaining amount of \$1,428,491 represents short-term investments held and administered by the fiduciary funds' trustees in accordance with various trust agreements. Based on negotiated trust and custody contracts, all of these investments were held in the fiduciary funds' name by the fiduciary funds' custodial financial institutions at September 30, 2012. As of September 30, 2012, bank deposits in the amount of \$1,178,505 were FDIC insured. The fiduciary funds do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(2) Deposits and Investments, Continued

A. Deposits, Continued

As of September 30, 2012, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit was \$23,795,448 and the corresponding bank balances were \$24,274,986. Of this amount, \$18,240,676 is maintained in financial institutions subject to FDIC insurance and \$3,539,423 is maintained in financial institution subject to coverage by Securities Investor Protection Corporation (SIPC). As of September 30, 2012, bank deposits in the amount of \$4,514,138 were FDIC insured and \$250,000 is subject to coverage by SIPC. The component units do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

The FSM National Government maintains equity membership shares in the International Monetary Fund of \$1,149,850 and the Asian Development Bank of \$6,927,442 (SDR 4,260,000), which are recorded as deposits and other assets.

B. Investments

Primary Government

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

Fixed income securities:	
Domestic fixed income	\$ <u>8,073,265</u>
Other investments:	
Equities	27,124,368
Money market funds	20,160
Cash management accounts	<u>3,715,471</u>
	<u>30,859,999</u>
	\$ <u>38,893,394</u>

Additionally, the primary government owns 50,000 shares of the outstanding common stock of a commercial enterprise located in the Commonwealth of the Northern Marianas. The investment of \$1,500,000 is accounted for at cost since the investment constitutes less than a 20% ownership share. Furthermore, the primary government owns 288,092 shares of the outstanding common stock of the Bank of the Federated States of Micronesia, which engages in commercial banking services in the FSM. The investment of \$3,685,148 is accounted for at cost since management is of the opinion that the FSM National Government does not exert significant influence over the investee.

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2012

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

As of September 30, 2012, the primary government's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

Investment Type	Rating Type	Maturity (in years)				Total
		Less than 1	1-5	6-10	Over	
U.S. Treasury Notes and Bonds	AAA	\$ 249,955	\$ 914,522	\$ 266,114	\$ -	\$ 1,430,591
U.S. Government Agencies Obligations:						
Federal Home Loan Banks	AAA	10,245	-	-	-	10,245
Federal Home Loan Mortgage Corporation	AAA	-	22,158	176,429	157,679	356,266
Government National Mortgage Association	AAA	440,927	-	-	1,273,382	1,714,309
Federal National Mortgage Association	AAA	157,914	37,942	-	86,878	282,734
Tennessee Valley Authority	AAA	-	-	12,602	11,354	23,956
Small Business Administration	No rating	-	-	-	118,315	118,315
National Credit Union Admin	AAA	-	-	86,115	-	86,115
Housing Urban Development	No rating	-	17,763	-	-	17,763
FISCO Debentures	No rating	-	-	92,749	-	92,749
AID-Tunisia	AAA/No rating	-	12,271	13,772	-	26,043
Financing Corporation	No rating	-	-	146,220	-	146,220
Municipal Obligations	A1	107,253	-	-	194,695	301,948
Municipal Obligations	A2	-	-	-	7,586	7,586
Municipal Obligations	Aa1	-	5,130	16,221	164,346	185,697
Municipal Obligations	Aa2	-	-	-	9,027	9,027
Municipal Obligations	Aa3	-	-	-	74,529	74,529
Municipal Obligations	No rating	12,861	-	143,067	-	155,928
Municipal Obligations	WR	6,174	-	-	-	6,174
Corporate Bonds	A1	14,795	176,951	-	65,538	257,284
Corporate Bonds	A2	5,188	178,114	98,751	-	282,053
Corporate Bonds	A3	36,694	234,571	220,004	-	491,269
Corporate Bonds	Aa1	15,523	5,433	3,521	-	24,477
Corporate Bonds	Aa2	-	110,346	190,782	13,203	314,331
Corporate Bonds	Aa3	3,886	107,910	163,586	-	275,382
Corporate Bonds	Aaa	48,446	19,006	11,762	19,726	98,940
Corporate Bonds	Ba1	-	9,732	8,613	-	18,345
Corporate Bonds	Ba2/Ba3	-	-	-	2,180	2,180
Corporate Bonds	Baa1	58,785	179,675	207,170	58,152	503,782
Corporate Bonds	Baa2	58,410	90,423	67,261	108,314	324,408
Corporate Bonds	Baa3	5,829	15,652	8,183	-	29,664
Corporate Bonds	No rating	<u>22,906</u>	<u>32,524</u>	<u>211,581</u>	<u>137,944</u>	<u>404,955</u>
		<u>\$ 1,255,791</u>	<u>\$ 2,170,123</u>	<u>\$ 2,144,503</u>	<u>\$ 2,502,848</u>	<u>\$ 8,073,265</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 FSM National Government'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 FSM National Government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The FSM National Government's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the FSM National Government's name by the FSM National Government's custodial financial institutions at September 30, 2012.

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2012

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, 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. As of September 30, 2012, the FSM National Government did not hold an investment in any one issuer that represented more than 5% of the FSM National Government's total investments.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. The FSM National Government 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.

Fiduciary Funds

FSM Social Security Administration (FSMSSA):

The deposit and investment policies are governed by the FSMSSA enabling legislation. The FSMSSA Board is required to engage one or more fund custodians to assume responsibility for the physical possession of their investments. Legally authorized investments are as follows:

- i. Government obligations - Obligations issued or guaranteed as to principal and interest by the FSM National Government and/or State governments of the FSM or by the Government of the United States, provided that the principal and interest on each obligation are payable in the currency of the United States.
- ii. Corporate obligations and mortgage-backed securities - Obligations of any public or private entity or corporation created or existing under the laws of the FSM or of the United States or any state, territory or commonwealth thereof, or obligations of any other government or economic community which are payable in United States dollars, or pass through and other mortgage-backed securities provided that the obligation is issued by an agency of the United States Government, the FSM National Government, or is rated in one of the three highest categories by two nationally recognized rating agencies. No investment under this heading shall exceed ten percent of the market value of the FSMSSA Retirement Fund or ten percent of the outstanding value of the issue at the time of purchase.
- iii. Preferred and common stocks - Shares of preferred or common stocks of any corporation created or existing under the laws of the FSM or under the laws of the United States or any state, territory or commonwealth thereof provided that the purchase of such shares shall be considered reasonable and prudent by the respective investment advisors at the time of purchase, that not more than five percent of the market value of the FSMSSA Retirement Fund shall be invested in the stock of any one corporation, and that not more than ten percent of the market value of the FSMSSA Retirement Fund shall be invested in any one industry group.

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2012

(2) Deposits and Investments, Continued

B. Investments, Continued

Fiduciary Funds, Continued

FSM Social Security Administration (FSMSSA), Continued:

- iv. Insurance company obligations - Contracts and agreements supplemental thereto providing for participation in one or more accounts of a life insurance company authorized to do business in the FSM or in any state, territory or commonwealth of the United States provided that the total market value of these investments at no time shall exceed ten percent of all investments of the FSMSSA Retirement Fund.

As of December 31, 2012, the FSMSSA's investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ <u>13,033,746</u>
Other investments:	
Domestic equities	18,357,176
International equities	<u>5,815,810</u>
	<u>24,172,986</u>
	\$ <u>37,206,732</u>

As of December 31, 2012, FSMSSA's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

	<u>Investment Maturities (In Years)</u>				
	Less <u>Than 1</u>	<u>1 to 5</u>	<u>6 to 10</u>	Greater <u>Than 10</u>	Fair <u>Value</u>
U.S. Treasury obligations	\$ 1,999,980	\$ 1,660,123	\$ -	\$ 423,914	\$ 4,084,017
Mortgage and asset-backed securities	-	-	-	3,740,030	3,740,030
Corporate notes and bonds	<u>374,450</u>	<u>1,346,992</u>	<u>2,430,375</u>	<u>1,057,882</u>	<u>5,209,699</u>
	<u>\$ 2,374,450</u>	<u>\$ 3,007,115</u>	<u>\$ 2,430,375</u>	<u>\$ 5,221,826</u>	<u>\$ 13,033,746</u>

FSMSSA's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in FSMSSA's name by FSMSSA's custodial financial institutions at December 31, 2012.

As of December 31, 2012, FSMSSA did not hold an investment in any one issuer that represented more than 5% of FSMSSA's total investments.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. FSMSSA 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.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units

The deposit and investment policies of the discretely presented component units' generally follow those of the primary government.

FSM Telecommunications Corporation (FSMTC):

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

Fixed income securities:		
U.S. Treasury obligations	\$	159,280
U.S. Government agencies		55,738
Corporate notes		<u>201,701</u>
		416,719
Other investments:		
Domestic and international equities		829,140
Money market funds		<u>36,231</u>
		<u>\$ 1,282,090</u>

As of September 30, 2012, FSMTC's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

	Moody's Credit Rating	Investment Maturities (In Years)				Fair Value
		Less Than 1	1 to 5	6 to 10	Greater Than 10	
U.S. Treasury obligations	Aaa/P-1	\$ 45,711	\$ 80,299	\$ 33,270	\$ -	\$ 159,280
U.S. Government agencies	Aaa/P-1	20,870	34,868	-	-	55,738
International bonds	Aa1/P-1	20,905	32,513	18,688	-	72,06
Corporate notes	A1/P-1	-	53,380	27,461	-	80,841
Corporate notes	A2/P-1	15,629	-	-	-	15,629
Corporate notes	Aa3/P-1	<u>15,214</u>	<u>-</u>	<u>17,911</u>	<u>-</u>	<u>33,125</u>
		<u>\$ 118,329</u>	<u>\$ 201,060</u>	<u>\$ 97,330</u>	<u>\$ -</u>	<u>\$ 416,719</u>

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2012

(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units, Continued

College of Micronesia - FSM (COM-FSM):

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

Fixed income securities:		
Domestic fixed income		\$ <u>829,454</u>
Other investments:		
Common equities		2,470,806
Money market funds		<u>138,701</u>
		<u>2,609,507</u>
		<u>\$ 3,438,961</u>

As of September 30, 2012, COM-FSM's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment Maturities (in years)</u>			
		<u>Less than 1</u>	<u>1-5</u>	<u>5-10</u>	<u>more than 10</u>
Corporate bond	\$ 273,324	\$ 38,725	\$ 52,831	\$ 86,922	\$ 94,846
Government bond	<u>556,130</u>	<u>-</u>	<u>342,800</u>	<u>108,308</u>	<u>105,022</u>
	<u>\$ 829,454</u>	<u>\$ 38,725</u>	<u>\$ 395,631</u>	<u>\$ 195,230</u>	<u>\$ 199,868</u>
<u>Moody's Rating</u>		<u>Total</u>	<u>Domestic</u>	<u>International</u>	
AAA/AAA		\$ 498,804	\$ 498,804	\$ -	
AA1/AA		11,642	11,642	-	
AA2/AA+		7,425	7,425	-	
AA2/AA		11,461	11,461	-	
AA2/AA-		9,435	9,435	-	
AA3/AA		20,509	20,509	-	
A1/A+		30,840	30,840	-	
A2/AA-		10,414	10,414	-	
A2/A		17,105	17,105	-	
A2/A-		10,918	10,918	-	
A2/A+		8,629	8,629	-	
A3/A-		10,675	10,675	-	
BAA1/A-		8,303	8,303	-	
BAA1/BBB+		51,486	51,486	-	
BAA2/A-		8,268	8,268	-	
BAA2/BBB		27,456	27,456	-	
BAA2/BBB+		3,071	3,071	-	
BAA3/BBB-		11,026	11,026	-	
BA2/BBB		9,925	9,925	-	
Not Rated		<u>62,062</u>	<u>62,062</u>	<u>-</u>	
Total credit risk debt securities		<u>\$ 829,454</u>	<u>\$ 829,454</u>	<u>\$ -</u>	

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units, Continued

FSM Development Bank (FSMDB):

As of December 31, 2012, FSMDB's investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ 4,606,478
Other investments:	
Domestic equities	6,113,756
Money market funds	<u>1,221,342</u>
	<u>\$ 11,941,576</u>

As of December 31, 2012, FSMDB's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

	<u>Less Than 1 Year</u>	<u>1 to 5 Years</u>	<u>6 to 10 Years</u>	<u>Greater Than 10 Years</u>	<u>Fair Value</u>
U.S. Treasury obligations	\$ 690,450	\$ 1,630,144	\$ 343,343	\$ 2,663,937	\$ 2,663,937
U.S. Government agency obligations	<u>214,925</u>	<u>1,727,616</u>	<u>-</u>	<u>1,942,541</u>	<u>1,942,541</u>
	<u>\$ 905,375</u>	<u>\$ 3,357,760</u>	<u>\$ 343,343</u>	<u>\$ 4,606,478</u>	<u>\$ 4,606,478</u>

Domestic

Moody's Rating – AAA

\$ 4,606,478

FSMDB owns 150,000 shares of the outstanding common stock of the Bank of the Federated States of Micronesia. The investment of \$1,162,188 is accounted for at cost since the investment constitutes a 16.1% ownership share.

National Fisheries Corporation (NFC):

NFC owns 50,493 shares of the outstanding common stock of the Micronesia Longline Fishing Company, Inc., an unconsolidated entity, representing a 97% ownership share. Additionally, NFC owns 50% of the shares of the outstanding common stock of the following unconsolidated entities: Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc. These investments have been written down to a nil value. In addition, NFC holds 25% of the outstanding shares of Taiyo Micronesia Corporation, totaling \$389,363, which is accounted for under the equity method.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units, Continued

MiCare Plan, Inc. (the Plan):

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

Fixed income securities:	
Domestic fixed income	\$ 1,207,076
Other investments:	
Money market funds	<u>47,815</u>
	<u>\$ 1,254,891</u>

As of September 30, 2012, the Plan's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

	Moody's Credit Rating	Less Than 1 Year	1 to 5 Years	6 to 10 Years	Greater Than 10 Years	Fair Value
U.S. Treasury obligations	AAA	\$ 51,302	\$ 248,741	\$ -	\$ -	\$ 300,043
U.S. Government agencies obligations	AAA	229,887	385,606	-	-	615,493
Corporate bonds	AAA	3,159	-	-	-	3,159
Corporate bonds	AA	60,174	12,032	-	-	72,206
Corporate bonds	A	-	169,610	-	-	169,610
Corporate bonds	BBB	-	41,422	-	-	41,422
Corporate bonds	Not Rated	-	5,143	-	-	5,143
		<u>\$ 344,522</u>	<u>\$ 862,554</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,207,076</u>

(3) Receivables

Receivables as of September 30, 2012, for the primary government's individual major governmental funds, and nonmajor governmental and fiduciary funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	General	Grants Assistance	Compact Trust	Nonmajor and Fiduciary Funds	Totals
Receivables:					
General	\$ 1,041,920	\$ -	\$ -	\$ -	\$ 1,041,920
Taxes	4,490,812	-	-	-	4,490,812
Government agencies	1,938,099	23,553,525	-	15,764	25,507,388
Contributions	-	-	-	2,842,350	2,842,350
Loans	55,563,979	-	-	1,648,627	57,212,606
Advances	2,166,519	176,579	-	-	2,343,098
Accrued interest	3,612	-	-	65,281	68,893
Other	-	-	-	18,125	18,125
	<u>65,204,941</u>	<u>23,730,104</u>	<u>-</u>	<u>4,590,147</u>	<u>93,525,192</u>
Less: allowance for uncollectable accounts	<u>(17,641,503)</u>	<u>(2,441,944)</u>	<u>-</u>	<u>(1,606,953)</u>	<u>(21,690,400)</u>
Net receivables	<u>\$ 47,563,438</u>	<u>\$ 21,288,160</u>	<u>\$ -</u>	<u>\$ 2,983,194</u>	<u>\$ 71,834,792</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(3) Receivables, Continued

Loans receivable of the primary government are as follows:

General Fund:

Notes receivable from the National Fisheries Corporation (NFC), payable in various annual installments of \$1,962 to \$86,639, non-interest bearing, and due on various dates ranging from July 2007 through April 2014. These notes have been fully provided for in the allowance for uncollectable accounts. \$ 3,600,000

Loan receivable from the State of Chuuk, payable in quarterly installments of \$416,667, non-interest bearing with a service charge of 1% per annum, due on September 30, 2001. This loan has been fully provided for in the allowance for uncollectable accounts. 737,563

Loan receivable from the State of Kosrae, payable in quarterly installments of \$37,500, non-interest bearing, on each of the first day of the month of October, January, April and July starting on October 1, 2009 and ending on July 1, 2019. 1,310,000

Loans receivable from businesses and individuals at varying terms and conditions administered by the FSM Development Bank. 6,919,148

Loan receivable from Micronesia Longline Fishing Company, a majority-owned subsidiary of NFC, in the amount of SDR 3,514,000, interest at 6.64% per annum, repayments commencing January 15, 1998, with a maturity date of July 15, 2007. The loan is a subsidiary loan of a loan agreement (Loan Number 1257 FSM (SF)) between the FSM National Government and the ADB. This loan has been fully provided for in the allowance for uncollectible accounts. 4,893,527

Loans receivable from the State of Chuuk (CSG), the Pohnpei Utilities Corporation (PUC), and the Yap State Public Service Corporation (YSPSC). These loans are subsidiary loans of a loan agreement (Loan Number 1459 FSM (SF)) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States of Chuuk, Pohnpei and Yap whereby a portion of the loan proceeds under this ADB loan were relent under the same terms and conditions imposed by the ADB. The States (with the exception of CSG) in turn relent the loan proceeds to PUC and YSPSC, respectively, as follows:

	<u>Gov Fund</u>	<u>Gov-Wide</u>	
State of Chuuk	\$ 3,482,435	\$ 569,737	
Pohnpei Utilities Corporation	2,138,731	348,769	
Yap State Public Service Corporation	<u>2,287,288</u>	<u>373,707</u>	
	<u>\$ 7,908,454</u>	<u>\$ 1,292,213</u>	9,200,667

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(3) Receivables, Continued

General Fund, Continued

Loans receivable from the States to assist in the implementation of an Early Retirement Scheme (ERS) in which employees holding certain nonessential positions as identified by the States were retired early with a payout of the equivalent of two-years wages. These loans are subsidiary loans of a loan agreement (Loan Number 1520 FSM (SF)) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States whereby a portion of the loan proceeds under this ADB loan were relent under the same terms and conditions imposed by the ADB. The amounts outstanding from the States are as follows:

	<u>Gov Fund</u>	<u>Gov-Wide</u>	
State of Chuuk	\$ 4,732,573	\$ 779,681	
State of Yap	3,125,943	514,977	
State of Kosrae	1,785,629	294,185	
State of Pohnpei	<u>3,750,258</u>	<u>617,849</u>	
	<u>\$ 13,394,403</u>	<u>\$ 2,206,692</u>	15,601,095

Loans receivable from the States to assist in the implementation of the Basic Social Services Program. These loans are subsidiary loans of a loan agreement (Loan Number 1816 FSM (SF)) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States whereby a portion of the loan proceeds under this ADB loan were relent under the same terms and conditions imposed by the ADB. The amounts outstanding from the States are as follows:

	<u>Gov Fund</u>	<u>Gov-Wide</u>	
State of Chuuk	\$ 853,578	\$ 66,726	
State of Yap	328,624	22,357	
State of Kosrae	<u>220,441</u>	<u>15,993</u>	
	<u>\$ 1,402,643</u>	<u>\$ 105,076</u>	1,507,719

Loans receivable from the States to assist in the implementation of the Private Sector Development Program. These loans are subsidiary loans of loan agreements (Loan Number 1873 FSM (SF) and Loan Number 1874 FSM (SF)) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States whereby a portion of the loan proceeds under these ADB loans were relent under the same terms and conditions imposed by the ADB. The amounts outstanding from the States are as follows:

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(3) Receivables, Continued

General Fund, Continued

	<u>Gov Fund</u>	<u>Gov-Wide</u>	
State of Chuuk	\$ 1,645,311	\$ 174,195	
State of Yap	1,112,860	143,846	
State of Kosrae	1,368,206	195,531	
State of Pohnpei	<u>1,178,021</u>	<u>102,319</u>	
	<u>\$ 5,304,398</u>	<u>\$ 615,891</u>	5,920,289

Loans receivable from the States and the states' component units to enhance public health and the environment through assistance to improve water supply infrastructure in Kosrae and Yap, and wastewater infrastructure in Pohnpei; and to support economic growth and poverty reduction in Chuuk through improvements to the electrical power sector. These loans are subsidiary loans of loan agreements Loan Number 2099 FSM (SF) and Loan Number 2100 FSM (SF) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States whereby a portion of the loan proceeds under these ADB loans were relent under the same terms and conditions imposed by the ADB. The amounts outstanding from the States and the States' component units are as follows:

State of Pohnpei/PUC	\$ 5,351,859		
State of Chuuk/CPUC	2,256,213		
State of Yap/GTWA	2,196,077		
State of Kosrae/KUA	<u>289,694</u>		
	<u>\$ 10,093,843</u>	<u>10,093,843</u>	
			<u>\$ 59,783,851</u>

Nonmajor Governmental and Fiduciary Funds

Student Loan Fund:

Loans receivable from students under a student financial assistance loan program, interest at 4% per annum, with repayment commencing ten years and nine months after completion of study. These loans have been fully provided for in the allowance for uncollectible accounts. \$ 1,606,953

Pohnpei Development Loan Fund:

Loans receivable from businesses and individuals at varying terms and conditions administered by the FSM Development Bank. 19,816

Yap Development Loan Fund:

Loans receivable from businesses and individuals at varying terms and conditions administered by the FSM Development Bank. 21,858

\$ 1,648,627

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2012

(3) Receivables, Continued

Nonmajor Governmental and Fiduciary Funds, Continued

Receivables as of September 30, 2012, for the discretely presented component units, including applicable allowances for uncollectible accounts, are as follows:

	FSM Tele- Communications Corporation	FSM Development Bank	National Fisheries Corporation	College of Micronesia- FSM	FSM Coconut Development Authority	FSM Petroleum Corporation	Vital Energy Inc.	Caroline Islands Air, Inc.	MiCare Plan, Inc.	Total
Receivables:										
General	\$ 1,711,364	\$ 50,243	\$ 1,040,173	\$5,444,916	\$ 29,944	\$2,010,177	\$139,856	\$ 12,886	\$ 223,714	\$10,663,273
Loans	-	24,412,424	-	-	-	-	-	-	-	24,412,424
Interest	185,244	247,935	-	-	-	-	-	-	-	433,179
Other	<u>12,779</u>	<u>475,876</u>	<u>-</u>	<u>2,135,118</u>	<u>43,773</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>169,679</u>	<u>2,837,225</u>
	1,909,387	25,186,478	1,040,173	7,580,034	73,717	2,010,177	139,856	12,886	393,393	38,346,101
Less: allowance for uncollectible accounts	(1,080,733)	(4,626,865)	(1,038,657)	(2,176,404)	(40,511)	-	-	-	(162,407)	(9,125,577)
	<u>\$ 828,654</u>	<u>\$ 20,559,613</u>	<u>\$ 1,516</u>	<u>\$5,403,630</u>	<u>\$33,206</u>	<u>\$2,010,177</u>	<u>\$139,856</u>	<u>\$ 12,886</u>	<u>\$230,986</u>	<u>\$29,220,524</u>

(4) Interfund Receivables and Payables

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

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Grants Assistance	\$ 3,484,693
Grants Assistance	General	3,230,116
Nonmajor governmental funds	General	<u>2,768,065</u>
		<u>\$ 9,482,874</u>

Receivables and payables between funds reflected as due to/due from component units in the statement of net assets at September 30, 2012, are summarized as follows:

<u>Primary Government</u>	<u>Due From</u>	<u>Due To</u>
General Fund:		
FSM Petroleum Corporation	\$ 500,000	\$ -
College of Micronesia-FSM	<u>-</u>	<u>182,993</u>
	<u>\$ 500,000</u>	<u>\$ 182,993</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(5) Capital Assets

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

Primary Government

	Balance October 1, 2011	<u>Additions and Reclassifications</u>	<u>Retirements and Reclassifications</u>	Balance September 30, 2012
Depreciable assets:				
Buildings and improvements	\$ 31,537,774	\$ 20,208,955	\$ (63,406)	\$ 51,683,323
Boats	22,553,101	4,000	(3,789)	22,553,312
Infrastructure	58,864,169	18,999,635	-	77,863,804
Motor vehicles	5,934,684	407,713	(129,164)	6,213,233
Computer equipment	4,702,358	218,664	(111,719)	4,809,303
Aircraft	709,207	-	-	709,207
Furniture, equipment and machinery	<u>8,823,902</u>	<u>324,450</u>	<u>(50,632)</u>	<u>9,097,720</u>
	<u>133,125,195</u>	<u>40,163,417</u>	<u>(358,710)</u>	<u>172,929,902</u>
Less accumulated depreciation:				
Buildings and improvements	(5,333,891)	(1,234,852)	-	(6,568,743)
Boats	(13,704,659)	(932,313)	1,200	(14,635,772)
Infrastructure	(2,315,366)	(3,848,917)	-	(6,164,283)
Motor vehicles	(4,776,262)	(506,385)	103,534	(5,179,113)
Computer equipment	(3,884,671)	(349,706)	99,727	(4,134,650)
Aircraft	(442,189)	(35,460)	-	(477,649)
Furniture, equipment and machinery	<u>(5,985,720)</u>	<u>(934,332)</u>	<u>50,383</u>	<u>(6,869,669)</u>
	<u>(36,442,756)</u>	<u>(7,841,965)</u>	<u>254,844</u>	<u>(44,029,879)</u>
Nondepreciable assets:				
Construction in progress	<u>78,701,688</u>	<u>56,278,056</u>	<u>(39,232,214)</u>	<u>95,747,531</u>
	<u>\$ 175,384,126</u>	<u>\$ 88,599,508</u>	<u>\$ (39,336,080)</u>	<u>\$ 224,647,554</u>

The primary government has assumed a construction management role for various infrastructure capital projects. These capital projects are accounted for at the government-wide level as construction in progress until completion of the project and resulting turnover to the applicable beneficiary. Until formal turnover occurs, the assets are capitalized and are depreciated by the primary government.

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2012

(5) Capital Assets, Continued

Primary Government, Continued

Depreciation expense was charged to functions/programs of the primary government's governmental activities as follows:

Office of the President	\$ 41,002
Foreign affairs	38,168
Health and social affairs	342,582
Education	77,900
Resources and development	44,680
Office of National Archives, Cultural and Historic	10,209
Transportation, communication and infrastructure	1,257,912
Finance and administration	45,036
Justice	387,215
Office of the Public Defender	13,791
SBOC Office	76,228
Judiciary	11,078
Legislature	48,297
Office of the National Public Auditor	89,901
Environment and emergency management	13,477
National government programs	273,081
Agencies, Boards and commissions	49,595
Capital projects	<u>5,021,813</u>
	<u>\$ 7,841,965</u>

Discretely Presented Component Units

	Balance October 1, 2011	Additions	Deletions	Balance September 30, 2012
Depreciable assets:				
Building and Leasehold Improvements	\$ 33,665,254	\$ 943,846	\$ -	\$ 34,609,100
Plant and Equipment	60,017,958	1,341,938	-	61,359,896
Machinery and Equipment	23,998,053	1,063,112	-	25,061,165
Others	<u>20,123,267</u>	<u>672,606</u>	(193,957)	<u>20,601,916</u>
	137,804,532	4,021,502	(193,957)	141,632,077
Accumulated Depreciation	<u>(70,632,742)</u>	<u>(6,314,709)</u>	<u>193,957</u>	<u>(76,753,494)</u>
	<u>67,171,790</u>	<u>(2,293,207)</u>	-	<u>64,878,583</u>
Nondepreciable assets:				
Construction in Progress	3,396,242	3,043,081	(747,507)	5,691,816
Land	<u>1,455,685</u>	-	-	<u>1,455,685</u>
	<u>4,851,927</u>	<u>3,043,081</u>	<u>(747,507)</u>	<u>7,147,501</u>
	<u>\$ 72,023,717</u>	<u>\$ 749,874</u>	<u>\$ (747,507)</u>	<u>\$ 72,026,084</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(6) Indefeasible Right of Use (IRU)

On January 12, 2009, the FSM Telecommunications Corporation (FSMTC) entered into an IRU Capital Lease agreement with a third party for the exclusive use of 8 wave lengths of fiber capacity of the two fibers of the Kwajalein Cable System (KCS) which runs between Guam and Kwajalein and which is known as the "HANTRU1 System". Under the terms of the agreement, FSMTC made certain payments of \$3,656,301. The initial term of the agreement is for a period of 10 years commencing on the date FSMTC is initially granted access, and which term is automatically renewable for a further 10 year period and an additional 5 year period thereafter. Prior to the tenth and twentieth anniversary dates, FSMTC has the option to terminate this agreement; however, such is subject to prior approval of the Rural Utilities Services (RUS) of the U.S. Department of Agriculture. FSMTC's policy is to amortize the right of use over the 25 year period. As of September 30, 2012, accumulated amortization expense of \$365,630 has been recorded.

(7) Long-Term Obligations

Primary Government

Asian Development Bank (ADB) Loan Number 1257 FSM (SF) - Fisheries Development Project Loan (SDR 3,792,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semi-annually commencing January 15, 2004 in an amount of SDR 46,100 increasing to SDR 92,400 on January 15, 2014, with a maturity date of July 15, 2033.	\$ 5,216,110
ADB Loan Number 1459 FSM (SF) - Water Supply and Sanitation Project Loan (SDR 7,233,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semi-annually commencing February 1, 2007 in an amount of SDR 69,200, increasing to SDR 138,500 on February 1, 2017, with a maturity date of August 1, 2036.	9,200,668
ADB Loan Number 1520 FSM (SF) - Public Sector Reform Program Loan (SDR 12,979,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semi-annually commencing February 1, 2008 in an amount of SDR 129,800, increasing to SDR 259,600 on February 1, 2018, with a maturity date of August 1, 2037.	18,308,254
ADB Loan Number 1816 FSM (SF) - Basic Social Services Project Loan (SDR 6,199,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semi-annually commencing February 1, 2009 in an amount of SDR 129,145, at which time the service charge increases to 1.5% per annum, with a maturity date of August 1, 2032.	3,478,521

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(7) Long-Term Obligations, Continued

Primary Government, Continued

ADB Loan Number 1873 FSM (SF) - Private Sector Development Program Loan (SDR 3,912,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semi-annually commencing May 15, 2010 in an amount of SDR 122,250, at which time the service charge increases to 1.5% per annum, with a maturity date of November 15, 2025. 3,284,075

ADB Loan Number 1874 FSM (SF) - Private Sector Development Project Loan (SDR 6,273,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semi-annually commencing May 15, 2010 in an amount of SDR 130,687, at which time the service charge increases to 1.5% per annum, with a maturity date of November 15, 2033. 6,436,067

ADB Loan Number 2100 FSM (SF) - Omnibus Infrastructure Development Project (SDR 9,686,000), interest bearing equivalent to the sum of LIBOR and .60% per annum on the amount of the loan withdrawn from the Loan account with a loan term of 25 years including a grace period of 5 years. The loan is payable semi-annually commencing January 15, 2010, in an amount of .83% of the outstanding loan balance and incrementing at certain years between .04% - .16% up to the maturity date of July 15, 2029. 3,119,233

ADB Loan Number 2099 FSM (SF) - Omnibus Infrastructure Development Project (SDR 9,686,000), interest bearing at the rate of 1% per annum on the amount of the loan withdrawn from the Loan Account during the grace period. The loan is payable semi-annually commencing January 15, 2013 in an amount of SDR 201,791, at which time the interest rate increases to 1.5% per annum, with a maturity date of July 15, 2036. 7,287,460

\$ 56,330,388

The abovementioned ADB loans payable are uncollateralized and are backed by the full faith and credit of the FSM National Government.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(7) Long-Term Obligations, Continued

Primary Government, Continued

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest Service Charge</u>	<u>Total</u>
2013	\$ 1,839,966	\$ 662,082	\$ 2,502,048
2014	1,975,116	638,662	2,613,778
2015	1,984,547	613,909	2,598,456
2016	1,994,396	589,073	2,583,469
2017	2,214,686	564,150	2,778,836
2018-2022	13,324,509	2,362,846	15,687,355
2023-2027	13,545,666	1,574,823	15,120,489
2028-2032	11,790,085	827,076	12,617,161
2033-2037	<u>7,661,417</u>	<u>220,904</u>	<u>7,882,321</u>
	<u>\$ 56,330,388</u>	<u>\$ 8,053,525</u>	<u>\$ 64,383,913</u>

Other long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2012, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net assets:

	Balance October 1, <u>2011</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, <u>2012</u>	Due Within <u>One Year</u>
Loans payable:					
ADB Loan 1257 FSM (SF)	\$ 5,343,276	\$ -	\$ (127,166)	\$ 5,216,110	\$ 127,166
ADB Loan 1459 FSM (SF)	9,409,639	-	(208,971)	9,200,668	208,971
ADB Loan 1520 FSM (SF)	18,715,129	-	(406,875)	18,308,254	406,875
ADB Loan 1816 FSM (SF)	3,652,449	-	(173,928)	3,478,521	173,927
ADB Loan 1873 FSM (SF)	3,527,341	-	(243,266)	3,284,075	243,265
ADB Loan 1874 FSM (SF)	6,735,419	-	(299,352)	6,436,067	299,352
ADB Loan 2099 FSM (SF)	5,762,177	1,525,283	-	7,287,460	303,644
ADB Loan 2100 FSM (SF)	<u>1,457,771</u>	<u>1,684,988</u>	<u>(23,526)</u>	<u>3,119,233</u>	<u>76,766</u>
	54,603,201	3,210,271	(1,483,084)	56,330,388	1,839,966
Other:					
Compensated absences payable	<u>1,214,006</u>	<u>377,356</u>	<u>(352,637)</u>	<u>1,238,725</u>	<u>378,087</u>
	<u>\$ 55,817,207</u>	<u>\$ 3,587,627</u>	<u>\$ (1,835,721)</u>	<u>\$ 57,569,113</u>	<u>\$ 2,218,053</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(7) Long-Term Obligations, Continued

Discretely Presented Component Units

As of September 30, 2012, the discretely presented component units had the following long-term debt outstanding:

FSM Telecommunications Corporation (FSMTC):

Loan with the Rural Utilities Service (RUS) (formerly the Rural Electrification Administration) from the Rural Electrification and Telephone Revolving Fund, dated August 1, 1990 of \$39.6 million, with interest at 5% per annum. Mortgages over specific FSMTC ground leases and essentially all assets of FSMTC collateralize the loan. \$ 30,497,706

National Fisheries Corporation (NFC):

Notes payable to the FSM National Government, due in various annual installments of \$1,962 to \$86,639, non-interest bearing, with final maturities due on various dates ranging from July 2007 through April 2014. These notes are all delinquent as payments should have commenced in 1994 and 1995. However, no repayments have been made. Therefore, these notes are classified as current. 3,600,000

FSM Development Bank (FSMDB):

Bank line of credit agreement with Export and Import Bank of China in the amount of \$2,000,000, due July 21, 2013, for the purpose of funding loan programs. The loan is uncollateralized, bears interest at 7.38% per annum. Repayment of principal and interest commenced January 21, 2008 in semi-annual installments of \$200,000. 710,755

FSM Petroleum Corporation (FSMPC):

Note payable to bank for purposes of acquiring capital assets, due in monthly installments of \$57,949, with interest at 7.75% per annum, final payment due on March 2019, unconditionally guaranteed by the FSM National Government. The loan is essentially collateralized by all assets of FSMPC. 1,806,783

\$ 36,615,244

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(7) Long-Term Obligations, Continued

Discretely Presented Component Units, Continued

Annual the 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>
2013	\$ 6,114,880	\$ 1,609,450	\$ 7,724,330
2014	2,233,719	1,481,533	3,715,252
2015	2,274,008	1,354,801	3,628,809
2016	1,769,496	1,250,374	3,019,870
2017	1,861,145	1,158,725	3,019,870
2018-2023	10,818,727	4,280,623	15,099,350
2024-2028	11,501,098	1,276,494	12,777,592
2029-2030	<u>42,171</u>	<u>682</u>	<u>42,853</u>
	<u>\$ 36,615,244</u>	<u>\$ 12,412,682</u>	<u>\$ 49,027,926</u>

Changes in long-term liabilities of the discretely presented component units for the year ended September 30, 2012, are as follows:

	Balance October 1, 2011	Additions	Reductions	Balance September 30, 2012	Due Within One Year
Loans payable:					
FSMTC	\$ 31,932,858	\$ -	\$ (1,435,152)	\$ 30,497,706	\$ 1,510,566
NFC	3,600,000	-	-	3,600,000	3,600,000
FSMDB	1,110,755	-	(400,000)	710,755	416,685
FSMPC	<u>2,651,195</u>	<u>-</u>	<u>(844,412)</u>	<u>1,806,783</u>	<u>587,629</u>
	<u>\$ 39,294,808</u>	<u>\$ -</u>	<u>\$ (2,679,564)</u>	<u>\$ 36,615,244</u>	<u>\$ 6,114,880</u>

(8) Short-Term Obligations

Discretely Presented Component Units

FSM Telecommunications Corporation (FSMTC):

FSMTC has a line of credit facility with a bank of \$4,464,580 with interest at 5.25% per annum, collateralized by investment securities.

FSM Petroleum Corporation (FSMPC):

FSMPC has a line of credit facility with a bank of \$4,300,000 with interest at 5.25% per annum, collateralized by an executed Pledge and Security Agreement for the assignment of the Reserve Bank Account and Revenue, an executed Notice of Security Interest and Chattel Mortgage and guaranteed by the FSM National Government. No drawdowns have been made against this facility.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(8) Short-Term Obligations, Continued

Discretely Presented Component Units, Continued

Changes in short-term borrowings during the year were as follows:

Line of credit:	<u>Beginning Balance</u>	<u>Increases</u>	<u>Reductions</u>	<u>Ending Balance</u>
FSMTC	\$ <u>2,331,054</u>	\$ <u> -</u>	<u>(2,331,054)</u>	\$ <u> -</u>

(9) Operating Transfers In/Out

Operating transfers in/out for each major governmental fund and nonmajor governmental funds in the aggregate, for the year ended September 30, 2012, are as follows:

<u>Source</u>	<u>Recipient</u>	<u>Transfers Out</u>	<u>Transfers In</u>
<u>General Fund</u>			
General Fund	Nonmajor governmental funds	\$ 1,191,006	\$ -
General Fund	Grants Assistance Fund	200,000	-
Nonmajor governmental funds	General Fund	<u> -</u>	<u>1,962,741</u>
		<u>1,391,006</u>	<u>1,962,741</u>
<u>Grants Assistance Funds</u>			
General Fund	Grants Assistance Fund	<u> -</u>	<u>200,000</u>
<u>Nonmajor Governmental Funds</u>			
General Fund	Nonmajor governmental funds	-	1,191,006
Nonmajor governmental funds	General Fund	<u>1,962,741</u>	<u> -</u>
		<u>1,962,741</u>	<u>1,191,006</u>
		<u>\$ 3,353,747</u>	<u>\$ 3,353,747</u>

Transfers are used to 1) move revenues from the fund that enabling legislation or budget requires to collect them to the fund that enabling legislation or budget requires to expend them, 2) use unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations, and 3) record reductions in interfund loans for amounts that are not expected to be repaid.

(10) Contingencies and Commitments

Sick Leave

It is the policy of the FSM National Government 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.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(10) Contingencies and Commitments, Continued

FSM Petroleum Corporation (FSMPC) Loan Guarantee

The FSM National Government is a full faith and credit guarantor of FSMPC's loan to a bank. The FSM National Government is jointly and severally liable for FSMPC's obligations under the loan and waives the sovereign immunity of the FSM National Government with regard to any legal action arising from the guaranty.

FSMPC Due to States and Primary Government

FSMPC has received a grant from Japan to fund fuel acquisition. At an undetermined time, FSMPC will distribute the grant to the States; however, the amount and time at which the amount would be distributable is currently undeterminable and therefore the FSM National Government and the States have not recorded a corresponding receivable.

Insurance Coverage

The FSM National Government does not maintain insurance coverage for a significant amount of fixed assets. In the event of a catastrophe, the FSM National Government may be self-insured to a material extent.

Federal Grants

The FSM National Government participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs exist and have been set forth in the FSM National Government's Single Audit Report as of September 30, 2012. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements. In addition, a material amount of questioned costs may exist from the four States, which receive federal funds in a subrecipient capacity. If these questioned costs are sustained, such will be funded by State resources.

Pursuant to Title I, Section 105 of United States Public Law 99-290, the FSM National Government 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. Accordingly, the States have made no adjustment to the above questioned costs for amounts which were incurred prior to the implementation of the Compact of Free Association.

The FSM National Government is pursuing long outstanding receivables from federal grant agencies. Uncollectible accounts, if any, that result from this exercise will be accounted for prospectively.

Leases

The FSM National Government has entered into house lease agreements varying from one to five years. The aggregate amount of future lease payments has not been accumulated as renewal is subject to annual appropriation.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(10) Contingencies and Commitments, Continued

Litigation

The FSM National Government is party to various legal proceedings, many of which are normal recurrences in governmental operations. The Attorney General of the FSM National Government is of the opinion that the probable outcome of suits existing at September 30, 2012, is not predictable. No provision for any liability has been made in the accompanying financial statements because management believes that no unfavorable outcome is likely to occur.

Encumbrances

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

	<u>General</u>	<u>Grants Assistance</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Encumbrances	\$3,346,355	\$21,256,177	\$492,627	\$25,095,159

Asian Development Bank (ADB) Loans

On November 5, 2004, the FSM National Government entered into two loan agreements (Loan Number 2099 FSM (SF) and Loan Number 2100 FSM (SF)) with the Asian Development Bank in the combined amount of \$19,000,000 for the Omnibus Infrastructure Development Project. The proceeds are to be used to enhance public health and the environment through assistance to improve water supply infrastructure in Kosrae and Yap, and wastewater infrastructure in Pohnpei; and to support economic growth and poverty reduction in Chuuk through improvements to the electrical power sector, which will include on lending a portion of the loan proceeds to the States under separate Financing Agreements. As of September 30, 2012, the FSM National Government had drawn down \$10,406,693 against these loans. A substantial portion of the ADB loans are subject to currency exchange adjustments that can ultimately impact the carrying values of the debt.

(11) Special Items

Special items consist of the write-off of certain loan receivables in the amount of \$1,158,594.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

(12) Fund Balance

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

	General <u>Fund</u>	Grants Assistance <u>Fund</u>	Compact Trust <u>Fund</u>	Nonmajor <u>Funds</u>	Total Governmental <u>Funds</u>
Non-spendable:					
Loans receivable from States	\$ 39,413,740	\$ -	\$ -	\$ -	\$ 39,413,740
Loan receivable from FSMPC	524,350	-	-	-	524,350
United Micronesia Dev. Assn.	1,500,000	-	-	-	1,500,000
Bank of the FSM	3,725,018	-	-	-	3,725,018
Asian Development Bank contribution	6,927,442	-	-	-	6,927,442
Int. Monetary Fund contribution	1,149,850	-	-	-	1,149,850
Permanent Fund	-	-	12,331,258	-	12,331,258
Restricted for:					
ADB Imprest Funds	303,689	-	-	-	303,689
General government	523,014	2,022,379	-	-	2,545,393
Committed:					
ADB	2,286,310	-	-	-	2,286,310
IDF operations loan	2,768,453	-	-	-	2,768,453
IDF operations	2,002,135	-	-	-	2,002,135
CFSM public projects	4,640,316	-	-	-	4,640,316
Office of the President	20,296	-	-	-	20,296
Department of TC&I	1,885,009	-	-	-	1,885,009
Department of Finance & Adm.	203,638	-	-	-	203,638
Department of Justice	385,164	-	-	-	385,164
Department of Resources & Dev.	157,206	-	-	-	157,206
Office of SBOC	335,319	-	-	-	335,319
Office of EEM	12,806	-	-	-	12,806
National Historic & Preservation	135,630	-	-	-	135,630
Judiciary	143,733	-	-	-	143,733
Future operations-FSM Trust	11,461,145	-	-	-	11,461,145
Other functions and programs	232,866	-	-	2,269,893	2,502,759
Assigned:					
Presidents	1,230,754	-	-	-	1,230,754
Legislative branch	516,737	-	-	-	516,737
Judiciary	88,654	-	-	-	88,654
National program	195,686	-	-	-	195,686
Other functions and programs	1,486,003	-	-	490,690	1,976,693
Unassigned	<u>7,182,424</u>	<u>(25,332)</u>	<u>-</u>	<u>-</u>	<u>7,157,092</u>
	<u>\$91,437,387</u>	<u>\$1,997,047</u>	<u>\$12,331,258</u>	<u>\$2,760,583</u>	<u>\$108,526,275</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2012

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**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

YEAR ENDED SEPTEMBER 30, 2012

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

	Budgeted Amounts		Actual Amounts	Variance with Final Budget -
	Original	Final		Positive (Negative)
Revenues:				
Taxes	\$ 16,350,000	\$ 14,704,088	\$ 15,707,414	\$ 1,003,326
Fishing rights	17,000,000	26,405,340	26,384,403	(20,937)
Postal revenues	500,000	469,920	504,035	34,115
Investment earnings	1,700,000	1,311,473	2,064,250	752,777
Fees and charges	100,000	119,549	147,860	28,311
Micare reimbursable	-	-	243,131	243,131
Other	1,500,000	359,658	552,328	192,670
Total revenues	37,150,000	43,370,028	45,603,421	2,233,393
Expenditures:				
Executive Branch - Core Operational	15,238,076	15,311,892	14,120,182	1,191,710
Executive Branch - Non-Core Operational	6,191,217	7,601,408	6,229,810	1,371,598
Judicial Branch-Core Operational	1,334,254	1,334,254	1,223,117	111,137
Judicial Branch-Non-Core Operational	299,122	299,122	138,788	160,334
Legislative Branch-Core Operational	3,966,905	4,196,905	4,040,243	156,662
Office of the National Public Auditor-Core Operational	777,483	777,483	625,786	151,697
Office of the National Public Auditor-Non-Core Operational	329,250	329,250	329,250	-
Other National Programs	7,102,024	7,533,162	4,781,660	2,751,502
Boards and Commissions	1,739,530	1,739,530	1,587,939	151,591
Payments to Component Units	2,219,433	2,219,433	2,208,265	11,168
Legislative Appropriations	4,202,556	7,562,556	3,266,047	4,296,509
Total expenditures	43,399,850	48,904,995	38,551,087	10,353,908
Excess (deficiency) of revenues over (under) expenditures	(6,249,850)	(5,534,967)	7,052,334	12,587,301
Other financing sources (uses):				
Operating transfers in	500,000	800,854	1,962,741	1,161,887
Operating transfers out	(3,591,857)	(3,964,312)	(4,050,444)	(86,132)
Total other financing sources (uses), net	(3,091,857)	(3,163,458)	(2,087,703)	1,075,755
Net change in fund balance	\$ (9,341,707)	\$ (8,698,425)	\$ 4,964,631	\$ 13,663,056

See accompanying notes to required supplementary information - budgetary reporting.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

(1) Budgetary Information

The Congress of the Federated States of Micronesia (CFSM) enacts the budget through passage of specific departmental appropriations. Before signing the Appropriations Act, the President may veto or reduce any specific appropriation, subject to Congressional override. Under the Compact of Free Association, which went into effect November 3, 1986, approval of all CFSM Laws is vested with the President of the Federated States of Micronesia.

During fiscal year 2012, supplemental appropriations were also made for both operating and capital purposes, to reflect the evolving priorities of the FSM National Government.

Budgetary control is maintained at the departmental level. Budget revisions during the year, reflecting program changes, may be effected by CFSM approval.

Formal budget integration is employed as a management control device during the year for all funds. The Congress of the FSM 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.

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

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.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Required Supplementary Information - Budgetary Reporting, Continued
September 30, 2012

(2) Reconciliation - GAAP and Budgetary Bases of Accounting

The Budget Act for fiscal year 2012, Public Law No. 16-43, was approved for the Executive branch and the Legislative branch. Budgets for Special Revenue Funds are generally not submitted. Accordingly, a budget to actual presentation for Special Revenue Funds is not required or presented. Project length financial plans are adopted for capital projects funds. The accompanying Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual - General Fund presents solely the financial activities of the General Fund administered by the Department of Finance and Administration, and does not include other financial activities administered by that Department and the impact of implementation of Governmental Accounting Standards Board Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions.

Accounting principles used in developing data on a budgetary basis differ from those used in preparing the financial statements in conformity with GAAP. The net change in fund balance on a budgetary basis reconciled to the net change in fund balance for the General Fund is as follows:

Net change in fund balance - Budgetary basis	\$ 4,964,631
Add:	
Encumbrances and commitments	\$ 3,116,205
Less:	
GAAP expenditures considered as 2013 budgetary expenditures	<u>(1,399,367)</u>
Net change in fund balance (Fund 1)	6,681,469
Add:	
Net change in fund balance - GAAP for GASB 54 Funds:	
ADB Loan Fund (Fund 91)	2,234,132
IDF Fund	(1,365,704)
FSM Trust Fund	<u>3,499,603</u>
Net change in fund balance - GAAP	\$ <u>11,049,500</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2012

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Combined Schedule of Expenditures by Account -
Governmental Fund Types
Year Ended September 30, 2012

	General	Special Revenue	Permanent	Other	Total
		Grants Assistance	Compact Trust	Governmental Funds	
Expenditures:					
Personnel	\$ 10,944,192	\$ 5,556,229	\$ -	\$ 591,574	\$ 17,091,995
Travel and transportation	3,020,915	2,874,635	-	20,535	5,916,085
Books and library materials	10,803	5,421	-	-	16,224
Communications	661,970	190,389	-	15,586	867,945
Customs and taxes	10,590	87,143	-	343	98,076
Dues, membership and subscription	383,687	32,937	-	10,025	426,649
Food stuffs	412,684	65,705	-	111,347	589,736
Freight	46,176	53,923	-	9,330	109,429
Expendable equipment	302,651	172,132	-	7,318	482,101
Office supplies and materials	1,056,959	630,077	-	63,622	1,750,658
POL	1,090,140	338,693	-	937,176	2,366,009
Advertising, printing and reproduction	111,046	131,673	-	1,882	244,601
Rental services	245,441	245,700	-	892	492,033
Repair and maintenance	146,832	27,052	-	1,940	175,824
Utilities	1,072,565	296,850	-	-	1,369,415
Miscellaneous goods and services	107,080	31,614	-	-	138,694
Medical supplies	4,997	163,248	-	332	168,577
Medical claims and referrals	3,282	-	-	-	3,282
Contributions, subsidies and grants	2,426,181	1,169	-	-	2,427,350
General contractual services	5,799,982	49,099,054	-	442,769	55,341,805
Professional services	908,976	8,131,651	-	14,610	9,055,237
Employee housing and household storage	840,676	97,975	-	4,368	943,019
Recruit and repatriation	181,142	-	-	-	181,142
Compensation-nonpayroll	106,340	52,360	-	-	158,700
Educational allowance	41,718	-	-	-	41,718
Training and registration fees	136,985	29,323	-	-	166,308
Scholarships	1,060,103	28,760	-	180,989	1,269,852
Official and meeting allowances	57,818	23,910	-	-	81,728
Representation	1,165,876	778	-	-	1,166,654
Insurance and fees	97,306	2,191	-	82,529	182,026
Leased housing, offices, buildings and land	1,280,307	180,377	-	17,457	1,478,141
Bank charges	27,945	2,000	-	375	30,320
Construction management	-	660,649	-	-	660,649
Architecture and design	-	1,297,337	-	-	1,297,337
Equipment	423,629	288,444	-	18,965	731,038
Furnitures and fixtures	(1,213)	(9,645)	-	-	(10,858)
Vehicle and vessels	228,519	48,770	-	-	277,289
Court settlement	2,453,364	-	-	-	2,453,364
Other	268,672	1,546	-	-	270,218
Principal and interest payments	1,988,787	-	-	-	1,988,787
Total expenditures	<u>\$ 39,125,123</u>	<u>\$ 70,840,070</u>	<u>\$ -</u>	<u>\$ 2,533,964</u>	<u>\$ 112,499,157</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

GENERAL FUND (FUND 1)
Schedule of Revenues, Expenditures by Function and Department,
and Changes in Fund Balance
Year Ended September 30, 2012
(with comparatives for the year ended September 30, 2011)

	2012	2011
Revenue:		
Taxes:		
Import	\$ 3,727,687	\$ 4,528,260
Fuel	142,027	148,157
Corporate tax	2,570,148	2,092,117
Income tax, individuals, net of tax refunds	3,898,238	3,780,425
Gross receipts tax, businesses	4,855,287	4,530,534
Tobacco revenue share	514,027	-
	15,707,414	15,079,493
Federal and other grants	-	13,868
Fishing rights	26,384,403	18,811,198
Fees and charges:		
Postal collections	504,035	427,986
Business license and various fees	129,610	127,149
Other	18,250	163,720
	651,895	718,855
Investment earnings:		
Net change in the fair value of investments	1,575,822	109,035
Dividend and interest income	488,428	232,455
	2,064,250	341,490
MiCare reimbursible	243,131	252,973
Other	552,328	511,624
Total revenues	45,603,421	35,729,501
Expenditures:		
Executive Branch:		
Core operational:		
President's Office	649,571	816,036
Department of External Affairs and LNO's	3,856,460	3,874,757
Department of Health and Social Affairs	219,318	152,374
Department of Education	233,565	29,825
Office of Resources and development	798,452	700,859
National archives, cultural and historic prevention	96,032	166,702
Office of SBOC	871,101	1,045,926
Office of Environment and emergency management	306,044	252,044
Department of Transportation, Communication and Infrastructure	2,757,956	1,068,638
Department of Finance and Administration	1,919,607	1,686,963
Department of Justice	3,028,052	3,458,888
Office of the Public Defender	653,439	757,041
Sub-total	15,389,597	14,010,053

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

GENERAL FUND (FUND 1)
Schedule of Revenues, Expenditures by Function and Department,
and Changes in Fund Balance, Continued
Year Ended September 30, 2012
(with comparatives for the year ended September 30, 2011)

	2012	2011
Expenditures, continued:		
Executive Branch:		
Non-core operational:		
President's Office	2,853,584	594,828
Department of External Affairs and LNO's	75,000	172,000
Department of Health and Social Affairs	100,020	109,147
Department of Education	1,452,957	1,020,583
Office of Resources and development	507,532	238,090
National archives, cultural and historic prevention	4,310	5,768
Office of SBOC	254,218	202,265
Office of Environment and emergency management	14,681	243,878
Department of Transportation, Communication and Infrastructure	2,182,307	909,873
Department of Finance and Administration	760,633	1,086,410
Department of Justice	364,054	606,965
Sub-total	8,569,296	5,189,807
Total Executive Branch	23,958,893	19,199,860
Judicial Branch-core operational	1,144,511	1,211,646
Judicial Branch-non-core operational	123,885	130,032
Total Judicial Branch	1,268,396	1,341,678
Legislative Branch:		
Office of the Speaker and members	1,682,240	1,545,076
Congress staff	1,358,042	1,254,017
Delegation offices	488,225	482,705
Total Legislative Branch	3,528,507	3,281,798
Office of the National Public Auditor-Core operational	580,278	634,220
Office of the National Public Auditor-Non-Core operational	403,854	429,671
Total Office of the Public Auditor	984,132	1,063,891
Other National Government Programs	9,476	1,004,904
Agencies, Boards and Commissions	2,048,970	1,700,921
Payments to Component Units:		
College of Micronesia-FSM	25,438	25,000
FSM Social Security Administration	1,200,000	1,200,000
FSM Coconut Development Authority	201,609	219,433
Micare Plan, Inc.	100,000	100,000
Payment to Component Units-Non operational	13,500	12,000
	1,540,547	1,556,433
Legislative public projects	3,499,625	3,934,137
Total expenditures	36,838,546	33,083,622
Excess of revenues over expenditures	8,764,875	2,645,879

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

GENERAL FUND (FUND 1)
Schedule of Revenues, Expenditures by Function and Department,
and Changes in Fund Balance, Continued
Year Ended September 30, 2012
(with comparatives for the year ended September 30, 2011)

	2012	2011
Other financing sources (uses):		
Operating transfers in:		
Student loan fund	614,448	-
Fisheries Observer Revolving Fund	173,066	83,197
Passport Revolving Fund	468,738	202,547
Maritime Surveillance Revolving Fund	706,489	-
Other Transfers In	3,446	-
	1,966,187	285,744
Operating transfers out:		
FSM Trust Fund	(2,000,000)	-
Early Retirement Program Fund	(224,913)	(659,661)
Asian Development Bank Loan Fund	(282,686)	(270,285)
Maritime Operations Revolving Fund	(1,134,702)	(1,134,702)
ICQ Revolving Fund	(146,544)	(146,544)
Disaster Emergency Fund	(200,000)	-
Other transfers out	(60,748)	-
	(4,049,593)	(2,211,192)
Total other financing sources (uses), net	(2,083,406)	(1,925,448)
Special items:		
Revaluation of ADB shares	-	4,618,522
Write-off of receivable balances	-	(1,393,936)
	-	3,224,586
Net change in fund balance	6,681,469	3,945,017
Fund balance at the beginning of the year	27,428,837	23,483,820
Fund balance at the end of the year	\$ 34,110,306	\$ 27,428,837

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

NONMAJOR GOVERNMENTAL FUNDS

**Combining Balance Sheet
September 30, 2012**

	27	28	29	31	32	33	34	35	36	38	39	41	Total
	Permit Revolving	Filling Office Revolving	Maritime Operations Revolving	Passport Revolving	Aquaculture Revolving	Fisheries Observer Revolving	Medical Revolving	Nurse Board Revolving	ICQ Overtime Revolving	Student Loans	Scholarship	Maritime Surveillance Revolving	Total
<u>ASSETS</u>													
Due from other funds	\$ 1,235,164	\$ 31,961	\$ 28,150	\$ 101,503	\$ 29,026	\$ 666,061	\$ 1,503	\$ 9,379	\$ 77,068	\$ -	\$ 88,250	\$ 500,000	\$ 2,768,065
Total assets	<u>1,235,164</u>	<u>31,961</u>	<u>28,150</u>	<u>101,503</u>	<u>29,026</u>	<u>666,061</u>	<u>1,503</u>	<u>9,379</u>	<u>77,068</u>	<u>-</u>	<u>88,250</u>	<u>500,000</u>	<u>2,768,065</u>
<u>LIABILITIES AND FUND BALANCES</u>													
Liabilities:													
Accounts payable	\$ -	\$ -	\$ 4,377	\$ 1,503	\$ -	\$ 1,202	\$ 400	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 7,482
Total liabilities	<u>-</u>	<u>-</u>	<u>4,377</u>	<u>1,503</u>	<u>-</u>	<u>1,202</u>	<u>400</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,482</u>
Fund balances:													
Committed	1,235,164	31,961	-	98,230	29,026	199,979	983	9,232	77,068	-	88,250	500,000	2,269,893
Assigned	<u>-</u>	<u>-</u>	<u>23,773</u>	<u>1,770</u>	<u>-</u>	<u>464,880</u>	<u>120</u>	<u>147</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>490,690</u>
Total fund balances	<u>1,235,164</u>	<u>31,961</u>	<u>23,773</u>	<u>100,000</u>	<u>29,026</u>	<u>664,859</u>	<u>1,103</u>	<u>9,379</u>	<u>77,068</u>	<u>-</u>	<u>88,250</u>	<u>500,000</u>	<u>2,760,583</u>
Total liabilities and fund balances	<u>\$ 1,235,164</u>	<u>\$ 31,961</u>	<u>\$ 28,150</u>	<u>\$ 101,503</u>	<u>\$ 29,026</u>	<u>\$ 666,061</u>	<u>\$ 1,503</u>	<u>\$ 9,379</u>	<u>\$ 77,068</u>	<u>\$ -</u>	<u>\$ 88,250</u>	<u>\$ 500,000</u>	<u>\$ 2,768,065</u>

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

NONMAJOR GOVERNMENTAL FUNDS

**Combining Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances
Year Ended September 30, 2012**

	27	28	29	31	32	33	34	35	36	38	39	41	Total
	Permit Revolving	Filling Office Revolving	Maritime Operations Revolving	Passport Revolving	Aquaculture Revolving	Fisheries Observer Revolving	Medical Revolving	Nurse Board Revolving	ICQ Overtime Revolving	Student Loans	Scholarship	Maritime Surveillance Revolving	Total
Revenues:													
Taxes	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 171,333	\$ -	\$ 171,333
Fees and charges	201,355	9,216	126,098	524,569	-	779,525	1,695	2,955	-	-	-	1,421,482	3,066,895
Other	-	-	-	-	-	-	-	-	200,800	555	-	-	201,355
Total revenues	201,355	9,216	126,098	524,569	-	779,525	1,695	2,955	200,800	555	171,333	1,421,482	3,439,583
Expenditures by function:													
Current:													
General government:													
Resources and development	-	-	-	-	3,343	-	-	-	-	-	-	-	3,343
Transportation, communication and infrastructure	-	-	1,407,301	-	-	-	-	-	-	-	-	-	1,407,301
Health and social affairs	-	-	-	-	-	-	1,100	5,716	-	-	-	-	6,816
Education	-	-	-	-	-	-	-	-	-	-	180,989	-	180,989
Justice	-	-	-	55,831	-	-	-	-	254,169	-	-	214,993	524,993
Agencies, boards and commissions	-	-	-	-	-	410,522	-	-	-	-	-	-	410,522
Total expenditures	-	-	1,407,301	55,831	3,343	410,522	1,100	5,716	254,169	-	180,989	214,993	2,533,964
Excess (deficiency) of revenues over (under) expenditures	201,355	9,216	(1,281,203)	468,738	(3,343)	369,003	595	(2,761)	(53,369)	555	(9,656)	1,206,489	905,619
Other financing sources (uses):													
Operating transfers in	-	-	1,191,006	-	-	-	-	-	-	-	-	-	1,191,006
Operating transfers out	-	-	-	(468,738)	-	(173,066)	-	-	-	(614,448)	-	(706,489)	(1,962,741)
Total other financing sources (uses), net	-	-	1,191,006	(468,738)	-	(173,066)	-	-	-	(614,448)	-	(706,489)	(771,735)
Net change in fund balances	201,355	9,216	(90,197)	-	(3,343)	195,937	595	(2,761)	(53,369)	(613,893)	(9,656)	500,000	133,884
Fund balances at the beginning of the year	1,033,809	22,745	113,970	100,000	32,369	468,922	508	12,140	130,437	613,893	97,906	-	2,626,699
Fund balances at the end of the year	\$ 1,235,164	\$ 31,961	\$ 23,773	\$ 100,000	\$ 29,026	\$ 664,859	\$ 1,103	\$ 9,379	\$ 77,068	\$ -	\$ 88,250	\$ 500,000	\$ 2,760,583

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

NONMAJOR GOVERNMENTAL FUNDS

**Combining Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances
Year Ended September 30, 2012**

	27	28	29	31	32	33	34	35	36	38	39	41	Total
	Permit Revolving	Filling Office Revolving	Maritime Operations Revolving	Passport Revolving	Aquaculture Revolving	Fisheries Observer Revolving	Medical Revolving	Nurse Board Revolving	ICQ Overtime Revolving	Student Loans	Scholarship	Maritime Surveillance Revolving	
Revenues:													
Taxes	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 171,333	\$ -	\$ 171,333
Fees and charges	201,355	9,216	126,098	524,569	-	779,525	1,695	2,955	-	-	-	1,421,482	3,066,895
Other	-	-	-	-	-	-	-	-	200,800	555	-	-	201,355
Total revenues	201,355	9,216	126,098	524,569	-	779,525	1,695	2,955	200,800	555	171,333	1,421,482	3,439,583
Expenditures by account:													
Personnel	-	-	308,395	-	-	29,010	-	-	254,169	-	-	-	591,574
Travel and transportation	-	-	395	-	-	17,286	-	2,854	-	-	-	-	20,535
Communications	-	-	8,182	7,180	-	24	200	-	-	-	-	-	15,586
Customs and taxes	-	-	343	-	-	-	-	-	-	-	-	-	343
Dues, membership and subscription	-	-	10,025	-	-	-	-	-	-	-	-	-	10,025
Food stuffs	-	-	108,094	-	-	3,253	-	-	-	-	-	-	111,347
Freight	-	-	196	5,791	3,343	-	-	-	-	-	-	-	9,330
Expendable equipment	-	-	5,433	400	-	-	700	785	-	-	-	-	7,318
Office supplies and materials	-	-	42,601	7,910	-	12,641	200	270	-	-	-	-	63,622
POL	-	-	722,121	-	-	62	-	-	-	-	-	214,993	937,176
Advertising, printing and reproduction	-	-	382	1,500	-	-	-	-	-	-	-	-	1,882
Rental Services	-	-	82	-	-	-	-	810	-	-	-	-	892
Repair and maintenance	-	-	1,275	-	-	-	-	665	-	-	-	-	1,940
Medical supplies	-	-	-	-	-	-	-	332	-	-	-	-	332
General Contractual Services	-	-	63,974	32,975	-	345,820	-	-	-	-	-	-	442,769
Professional Services	-	-	14,610	-	-	-	-	-	-	-	-	-	14,610
Employee housing and household storage	-	-	4,368	-	-	-	-	-	-	-	-	-	4,368
Scholarships	-	-	-	-	-	-	-	-	-	-	180,989	-	180,989
Insurance and fees	-	-	80,178	-	-	2,351	-	-	-	-	-	-	82,529
Leased housing and office	-	-	17,457	-	-	-	-	-	-	-	-	-	17,457
Bank charges	-	-	225	75	-	75	-	-	-	-	-	-	375
Equipment	-	-	18,965	-	-	-	-	-	-	-	-	-	18,965
Total expenditures	-	-	1,407,301	55,831	3,343	410,522	1,100	5,716	254,169	-	180,989	214,993	2,533,964
Excess (deficiency) of revenues over (under) expenditures	201,355	9,216	(1,281,203)	468,738	(3,343)	369,003	595	(2,761)	(53,369)	555	(9,656)	1,206,489	905,619
Other financing sources (uses):													
Operating transfers in	-	-	1,191,006	-	-	-	-	-	-	-	-	-	1,191,006
Operating transfers out	-	-	-	(468,738)	-	(173,066)	-	-	-	(614,448)	-	(706,489)	(1,962,741)
Total other financing sources (uses), net	-	-	1,191,006	(468,738)	-	(173,066)	-	-	-	(614,448)	-	(706,489)	(771,735)
Net change in fund balances	201,355	9,216	(90,197)	-	(3,343)	195,937	595	(2,761)	(53,369)	(613,893)	(9,656)	500,000	133,884
Fund balances at the beginning of the year	1,033,809	22,745	113,970	100,000	32,369	468,922	508	12,140	130,437	613,893	97,906	-	2,626,699
Fund balances (deficit) at the end of the year	\$ 1,235,164	\$ 31,961	\$ 23,773	\$ 100,000	\$ 29,026	\$ 664,859	\$ 1,103	\$ 9,379	\$ 77,068	\$ -	\$ 88,250	\$ 500,000	\$ 2,760,583

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

GRANTS ASSISTANCE FUND

Combining Balance Sheet
September 30, 2012

	10	11	12	13	14	15	18	19	20	23	26	Total
	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(5) Environment	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Supplemental Education	Infrastructure Maintenance	Section 211(a)(6) Infrastructure	U.S. Federal Grants	Non-U.S. Grants	Disaster Assistance Emergency	Total
ASSETS												
Equity in internal investment pool	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 352,148	\$ -	\$ -	\$ -	\$ 1,437,457	\$ 1,789,605
Receivables:												
Federal agencies	-	157,856	22,084	-	1,133,685	42,363	-	6,525,070	13,386,625	-	-	21,267,683
Due from other funds	8,445	-	-	13,153	-	-	-	-	-	3,088,015	120,503	3,230,116
Advances	-	14,617	-	-	-	-	-	4,783	-	1,077	-	20,477
	<u>\$ 8,445</u>	<u>\$ 172,473</u>	<u>\$ 22,084</u>	<u>\$ 13,153</u>	<u>\$ 1,133,685</u>	<u>\$ 42,363</u>	<u>\$ 352,148</u>	<u>\$ 6,529,853</u>	<u>\$ 13,386,625</u>	<u>\$ 3,089,092</u>	<u>\$ 1,557,960</u>	<u>\$ 26,307,881</u>
LIABILITIES AND FUND BALANCES (DEFICIT)												
Liabilities:												
Accounts payable	\$ 8,445	\$ 37,106	\$ -	\$ -	\$ 49,034	\$ 1,961	\$ -	\$ 1,794,293	\$ 5,103,902	\$ 34,061	\$ -	\$ 7,028,802
Retention payable	-	-	-	-	-	-	-	3,293,852	4,161,318	-	-	7,455,170
Due to component units	-	-	-	-	-	-	-	-	6,000	-	-	6,000
Due to FSM State Governments	-	-	-	-	-	-	-	-	2,060,473	-	-	2,060,473
Due to Federal Governments	-	-	-	-	-	-	-	-	1,126,478	-	-	1,126,478
Due to other funds	-	135,367	22,084	-	1,084,651	40,402	-	1,267,864	934,325	-	-	3,484,693
Deferred revenues	-	-	-	-	-	-	-	-	-	3,074,492	74,726	3,149,218
Total liabilities	<u>8,445</u>	<u>172,473</u>	<u>22,084</u>	<u>-</u>	<u>1,133,685</u>	<u>42,363</u>	<u>-</u>	<u>6,356,009</u>	<u>13,392,496</u>	<u>3,108,553</u>	<u>74,726</u>	<u>24,310,834</u>
Fund balances (deficit):												
Restricted	-	-	-	13,153	-	-	352,148	173,844	-	-	1,483,234	2,022,379
Unassigned	-	-	-	-	-	-	-	-	(5,871)	(19,461)	-	(25,332)
Total fund balances (deficits)	<u>-</u>	<u>-</u>	<u>-</u>	<u>13,153</u>	<u>-</u>	<u>-</u>	<u>352,148</u>	<u>173,844</u>	<u>(5,871)</u>	<u>(19,461)</u>	<u>1,483,234</u>	<u>1,997,047</u>
Total liabilities and fund balances	<u>\$ 8,445</u>	<u>\$ 172,473</u>	<u>\$ 22,084</u>	<u>\$ 13,153</u>	<u>\$ 1,133,685</u>	<u>\$ 42,363</u>	<u>\$ 352,148</u>	<u>\$ 6,529,853</u>	<u>\$ 13,386,625</u>	<u>\$ 3,089,092</u>	<u>\$ 1,557,960</u>	<u>\$ 26,307,881</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT
GRANTS ASSISTANCE FUND**

Combining Statement of Revenues and Expenditures by Function,
and Changes in Fund Balances (Deficit)
Year Ended September 30, 2012

	10	11	12	13	14	15	18	19	20	23	26	Total
	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(5) Environment	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Supplemental Education	Infrastructure Maintenance	Section 211(a)(6) Infrastructure	U.S. Federal Grants	Non-U.S. Grants	Disaster Assistance Emergency	Total
Revenues:												
Compact funding	\$ 484,031	\$ 605,227	\$ -	\$ -	\$ 1,031,846	\$ 388,464	\$ -	\$ 27,528,546	\$ -	\$ -	\$ 149,214	\$ 30,187,328
Federal and other grants	-	-	-	-	-	-	-	-	39,700,446	1,387,623	200,000	41,288,069
	<u>484,031</u>	<u>605,227</u>	<u>-</u>	<u>-</u>	<u>1,031,846</u>	<u>388,464</u>	<u>-</u>	<u>27,528,546</u>	<u>39,700,446</u>	<u>1,387,623</u>	<u>349,214</u>	<u>71,475,397</u>
Expenditures by function:												
Current:												
General government:												
Finance and administration	-	-	-	-	893,269	-	-	-	-	-	-	893,269
Resources and development	-	-	-	-	-	-	-	-	205,090	(2,284)	-	202,806
Transportation, communication and infrastructure	-	-	-	-	-	-	-	825,349	-	374,806	-	1,200,155
Health and social affairs	-	605,227	-	-	-	-	-	-	5,350,794	503,801	-	6,459,822
National archives, cultural and historic preservation	-	-	-	-	-	-	-	-	127,492	21,348	-	148,840
Education	484,031	-	-	-	-	388,464	-	-	1,992,842	1,980	-	2,867,317
SBOC Office	-	-	-	-	25,646	-	-	-	9,849	85,140	-	120,635
Environment and emergency management	-	-	-	-	-	-	-	-	2,551	373,697	-	376,248
Office of the National Public Auditor	-	-	-	-	112,931	-	-	-	436,000	-	-	548,931
Legislative	-	-	-	-	-	-	-	-	-	27,992	-	27,992
National government programs	-	-	-	-	-	-	-	26,126	1,383,555	-	-	1,409,681
Payments to component units	-	-	-	-	-	-	-	-	89,955	-	-	89,955
Boards and commissions	-	-	-	-	-	-	-	-	-	1,143	-	1,143
Capital Projects	-	-	-	-	-	-	-	26,391,046	30,102,230	-	-	56,493,276
Total expenditures	<u>484,031</u>	<u>605,227</u>	<u>-</u>	<u>-</u>	<u>1,031,846</u>	<u>388,464</u>	<u>-</u>	<u>27,242,521</u>	<u>39,700,358</u>	<u>1,387,623</u>	<u>-</u>	<u>70,840,070</u>
Excess of revenues over expenditures	-	-	-	-	-	-	-	286,025	88	-	349,214	635,327
Other financing sources:												
Operating transfers in	-	-	-	-	-	-	-	-	-	-	200,000	200,000
Total other financing sources (uses), net	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>200,000</u>	<u>200,000</u>
Net change in fund balances (deficit)	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>286,025</u>	<u>88</u>	<u>-</u>	<u>549,214</u>	<u>835,327</u>
Fund balances (deficit) at the beginning of the year	-	-	-	13,153	-	-	352,148	(112,181)	(5,959)	(19,461)	934,020	1,161,720
Fund balances (deficit) at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 13,153</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 352,148</u>	<u>\$ 173,844</u>	<u>\$ (5,871)</u>	<u>\$ (19,461)</u>	<u>\$ 1,483,234</u>	<u>\$ 1,997,047</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT
GRANTS ASSISTANCE FUND**

**Combining Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances (Deficits)
Year Ended September 30, 2012**

	10	11	12	13	14	15	18	19	20	23	26	Total
	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(5) Environment	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Supplemental Education	Infrastructure Maintenance	Section 211(a)(6) Infrastructure	U.S. Federal Grants	Non-U.S. Grants	Disaster Assistance Emergency	Total
Revenues:												
Compact funding	\$ 484,031	\$ 605,227	\$ -	\$ -	\$ 1,031,846	\$ 388,464	\$ -	\$ 27,528,546	\$ -	\$ -	\$ 149,214	\$ 30,187,328
Federal and other grants	-	-	-	-	-	-	-	-	39,700,446	1,387,623	200,000	41,288,069
	<u>484,031</u>	<u>605,227</u>	<u>-</u>	<u>-</u>	<u>1,031,846</u>	<u>388,464</u>	<u>-</u>	<u>27,528,546</u>	<u>39,700,446</u>	<u>1,387,623</u>	<u>349,214</u>	<u>71,475,397</u>
Expenditures by account:												
Personnel	140,170	265,261	-	-	328,526	191,046	-	652,997	3,860,328	117,901	-	5,556,229
Travel and transportation	70,645	131,224	-	-	161,851	78,306	-	71,013	1,956,369	405,227	-	2,874,635
Books and library materials	-	-	-	-	-	-	-	-	5,421	-	-	5,421
Communications	15,394	12,422	-	-	11,554	739	-	14,186	130,091	6,003	-	190,389
Customs and taxes	1,523	-	-	-	173	-	-	78,836	5,867	744	-	87,143
Dues, membership and subscription	69	-	-	-	-	-	-	-	32,868	-	-	32,937
Food stuffs	-	-	-	-	-	-	-	-	16,921	48,784	-	65,705
Freight	2,394	48	-	-	1,247	-	-	1,093	35,736	13,405	-	53,923
Expendable equipment/furniture	5,681	1,644	-	-	9,952	1,870	-	7,496	130,561	14,928	-	172,132
Office supplies and materials	16,925	6,899	-	-	28,901	3,472	-	16,382	361,326	196,172	-	630,077
POL	7,529	7,418	-	-	19,006	-	-	9,530	246,280	48,930	-	338,693
Advertising, printing and reproduction	8,882	798	-	-	5,081	7,145	-	2,857	74,826	32,084	-	131,673
Rental services	7,429	4,005	-	-	2,997	-	-	214	181,431	49,624	-	245,700
Repair and maintenance	1,970	422	-	-	9,907	474	-	1,479	11,043	1,757	-	27,052
Utilities	5,000	16,400	-	-	40,477	-	-	-	234,504	469	-	296,850
Miscellaneous goods and services	-	-	-	-	-	-	-	-	23,526	8,088	-	31,614
Medical supplies	-	-	-	-	-	-	-	-	150,690	12,558	-	163,248
Contributions, subsidies and grants	-	-	-	-	-	-	-	-	1,169	-	-	1,169
General Contractual services	4,066	97,798	-	-	127,403	44,927	-	22,106,914	26,379,333	338,613	-	49,099,054
Professional services	168,164	40,148	-	-	193,382	56,000	-	2,205,447	5,468,510	-	-	8,131,651
Employee housing and household storage	-	-	-	-	49,500	-	-	30,475	18,000	-	-	97,975
Compensation-nonpayroll	-	-	-	-	-	-	-	-	33,656	18,704	-	52,360
Training and registration fees	-	-	-	-	350	-	-	-	28,857	116	-	29,323
Scholarships	-	-	-	-	-	-	-	-	-	28,760	-	28,760
Official and meeting allowances	-	-	-	-	-	-	-	-	23,250	660	-	23,910
Representation	-	-	-	-	-	-	-	-	360	418	-	778
Insurance and fees	-	-	-	-	-	-	-	1,173	1,018	-	-	2,191
Leased housing, offices, buildings and land	-	8,190	-	-	19,600	-	-	58,853	83,534	10,200	-	180,377
Bank charges	-	50	-	-	425	-	-	-	975	550	-	2,000
Construction management	-	-	-	-	-	-	-	660,649	-	-	-	660,649
Architecture and design	-	-	-	-	-	-	-	1,297,337	-	-	-	1,297,337
Equipment	8,190	6,500	-	-	9,759	4,485	-	19,390	195,862	44,258	-	288,444
Furniture and fixtures	-	-	-	-	1,685	-	-	-	-	(11,330)	-	(9,645)
Vehicle	20,000	6,000	-	-	10,070	-	-	6,200	6,500	-	-	48,770
Other	-	-	-	-	-	-	-	-	1,546	-	-	1,546
Total expenditures	<u>484,031</u>	<u>605,227</u>	<u>-</u>	<u>-</u>	<u>1,031,846</u>	<u>388,464</u>	<u>-</u>	<u>27,242,521</u>	<u>39,700,358</u>	<u>1,387,623</u>	<u>-</u>	<u>70,840,070</u>
Excess of revenues over expenditures	-	-	-	-	-	-	-	286,025	88	-	349,214	635,327
Other financing sources:												
Operating transfers in	-	-	-	-	-	-	-	-	-	-	200,000	200,000
Total other financing sources (uses), net	-	-	-	-	-	-	-	-	-	-	200,000	200,000
Net change in fund balances (deficit)	-	-	-	-	-	-	-	286,025	88	-	549,214	835,327
Fund balances (deficit) at the beginning of the year	-	-	-	13,153	-	-	352,148	(112,181)	(5,959)	(19,461)	934,020	1,161,720
Fund balances (deficit) at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 13,153</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 352,148</u>	<u>\$ 173,844</u>	<u>\$ (5,871)</u>	<u>\$ (19,461)</u>	<u>\$ 1,483,234</u>	<u>\$ 1,997,047</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

GENERAL FUND

**Statement of Revenues, Expenditures and Changes in Fund Balance -
Budget and Actual, Budgetary Basis
Year Ended September 30, 2012**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
Revenues:				
Local taxes	\$ 16,350,000	\$ 14,704,088	\$ 15,707,414	\$ 1,003,326
Fishing right fees	17,000,000	26,405,340	26,384,403	(20,937)
Postal revenues	500,000	469,920	504,035	34,115
Investment earnings	1,700,000	1,311,473	2,064,250	752,777
Fees and charges	100,000	119,549	147,860	28,311
MiCare reimbursible	-	-	243,131	243,131
Other	1,500,000	359,658	552,328	192,670
Total revenues	<u>37,150,000</u>	<u>43,370,028</u>	<u>45,603,421</u>	<u>2,233,393</u>
Expenditures-budgetary basis by department:				
Executive Branch-Core Operational:				
Office of the President	502,619	610,038	582,651	27,387
President's Office - Personnel	146,347	146,547	133,515	13,032
Public Information	183,174	182,974	180,156	2,818
Total Office of the President	<u>832,140</u>	<u>939,559</u>	<u>896,322</u>	<u>43,237</u>
Department of External Affairs				
Administration	342,065	371,937	332,400	39,537
Division of APA & Multilateral Affairs	105,426	105,426	107,852	(2,426)
Division of American and European Affairs	85,104	85,104	84,390	714
FSM Consulate - China	518,398	518,398	518,547	(149)
FSM Consulate - Guam	327,810	327,810	287,984	39,826
FSM Consulate - Honolulu	335,363	335,363	288,745	46,618
FSM Embassy - Tokyo	972,351	972,351	974,840	(2,489)
FSM Embassy - Washington D.C.	466,702	466,702	400,293	66,409
FSM Embassy - Fiji	236,247	236,247	226,539	9,708
FSM Permanent Mission - New York	773,821	773,821	686,676	87,145
Total Department of External Affairs	<u>4,163,287</u>	<u>4,193,159</u>	<u>3,908,266</u>	<u>284,893</u>
Department of Health and Social Affairs:				
Administration	137,138	151,938	142,460	9,478
Women's Interests Unit	30,833	30,833	19,287	11,546
Sports & Youth Unit	85,927	85,927	88,704	(2,777)
Total Health and Social Affairs	<u>253,898</u>	<u>268,698</u>	<u>250,451</u>	<u>18,247</u>
Department of Education:				
Administration	44,137	44,137	43,519	618
Total Department of Education	<u>44,137</u>	<u>44,137</u>	<u>43,519</u>	<u>618</u>
Department of Resources and Development-Core operational:				
Administration	151,780	197,580	191,814	5,766
Division of Sectoral Development	578,745	578,745	503,970	74,775
Division of Trade and Investment	60,908	60,908	43,822	17,086
Division of Energy	110,029	110,029	108,415	1,614
Total Department of R&D	<u>901,462</u>	<u>947,262</u>	<u>848,021</u>	<u>99,241</u>
Office of National archives, cultural and historic prevention	143,536	112,982	99,928	13,054
SBOC Office:				
Office of the Director	58,186	58,186	56,751	1,435
Division of Statistics	332,506	325,311	327,248	(1,937)
Division of Overseas Development	54,838	56,838	55,438	1,400
Division of Budget and Economic Management	232,646	227,046	210,145	16,901
Division of Compact Management	389,729	386,265	352,464	33,801
Total SBOC	<u>1,067,905</u>	<u>1,053,646</u>	<u>1,002,046</u>	<u>51,600</u>
Office of Environment and Emergency Management:				
Office of the Director	128,173	128,173	128,200	(27)
Division of Sustainable Development	174,351	174,351	150,377	23,974
Division of Emergency Management	89,098	89,098	79,720	9,378
Total EEM	<u>391,622</u>	<u>391,622</u>	<u>358,297</u>	<u>33,325</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Statement of Revenues, Expenditures and Changes in Fund Balance -
Budget and Actual, Budgetary Basis, Continued
Year Ended September 30, 2011

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
Expenditures-budgetary basis by department, continued:				
Department of Transportation, Communication & Infrastructure:				
Administration	157,094	150,152	157,482	(7,330)
Division of Marine Transportation	115,363	115,363	110,004	5,359
Division of Infrastructure	502,755	488,808	469,325	19,483
Civil Aviation	188,721	190,409	161,815	28,594
Communication	202,075	180,095	219,851	(39,756)
Other National Programs	15,524	15,524	15,074	450
Total Department of TC&I	<u>1,181,532</u>	<u>1,140,351</u>	<u>1,133,551</u>	<u>6,800</u>
Department of Finance and Administration:				
Administration	207,848	207,848	176,929	30,919
Division of National Treasury	573,703	573,703	566,340	7,363
Division of Customs and Tax Administration	796,996	796,996	799,550	47,446
Investment & International Finance	155,547	155,547	152,565	2,982
Total Department of Finance & Administration	<u>1,734,094</u>	<u>1,734,094</u>	<u>1,645,384</u>	<u>88,710</u>
Department of Justice:				
Administration	206,195	208,383	162,672	45,711
Registry of Corporation	54,848	54,848	56,046	(1,198)
Division of Law	228,179	228,179	198,492	29,687
Division of Litigation	215,705	215,705	191,520	24,185
Division of Immigration & Labor	712,319	679,050	711,651	(32,601)
FSM National Police	2,257,510	2,250,510	1,883,598	366,912
Total Department of Justice	<u>3,674,756</u>	<u>3,636,675</u>	<u>3,203,979</u>	<u>432,696</u>
Office of the Public Defender				
	849,707	849,707	730,418	119,289
Total Executive Branch-Core Operational	<u>15,238,076</u>	<u>15,311,892</u>	<u>14,120,182</u>	<u>1,191,710</u>
Executive Branch-Non-Core Operational:				
President's Office	1,151,384	1,191,575	1,015,010	176,565
Department of External Affairs and LNO's	182,000	182,000	65,000	117,000
Department of Health and Social Affairs	561,342	571,342	157,703	413,639
Department of Education	1,681,798	1,681,798	1,524,522	157,276
Office of Resources and development	608,719	668,719	519,055	149,664
National archives, cultural and historic prevention	7,014	7,014	4,310	2,704
Office of Public Defender	12,000	12,000	12,000	-
Department of Transportation, Communication and Infrastructure	1,297,292	2,597,292	2,405,540	191,752
Department of Finance and Administration	164,000	164,000	127,165	36,835
Department of Justice	525,668	525,668	399,505	126,163
Total Executive Branch-Non-Core Operational	<u>6,191,217</u>	<u>7,601,408</u>	<u>6,229,810</u>	<u>1,371,598</u>
Total Executive Branch	<u>21,429,293</u>	<u>22,913,300</u>	<u>20,349,992</u>	<u>2,563,308</u>
Judicial Branch-core operational				
	1,334,254	1,334,254	1,223,117	111,137
Judicial Branch-noncore operational				
	299,122	299,122	138,788	160,334
Total Judicial Branch	<u>1,633,376</u>	<u>1,633,376</u>	<u>1,361,905</u>	<u>271,471</u>
Legislative Branch:				
Office of the Speaker and members	1,927,608	2,137,608	2,033,946	103,662
Congress staff	1,497,760	1,517,760	1,454,324	63,436
Delegation offices	541,537	541,537	551,973	(10,436)
Total Legislative Branch	<u>3,966,905</u>	<u>4,196,905</u>	<u>4,040,243</u>	<u>156,662</u>
Office of the National Public Auditor				
Public Auditor (Core)	777,483	777,483	625,786	151,697
Single Audit (Non-core)	329,250	329,250	329,250	-
Total Office of the Public Auditor	<u>1,106,733</u>	<u>1,106,733</u>	<u>955,036</u>	<u>151,697</u>
Other National Government Programs:				
GMP Court Settlement	2,439,557	2,453,366	2,453,366	-
National Election Director	294,986	309,986	310,630	(644)
Micronesia Legal Services Corporation	150,000	150,000	150,000	-
Other National Programs	4,217,481	4,619,810	1,867,664	2,752,146
Total Other National Government Programs	<u>7,102,024</u>	<u>7,533,162</u>	<u>4,781,660</u>	<u>2,751,502</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Statement of Revenues, Expenditures and Changes in Fund Balance -
Budget and Actual, Budgetary Basis, Continued
Year Ended September 30, 2011

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
Expenditures-budgetary basis by department, continued:				
Board and Commissions:				
National Oceanic Resource Management Authority	459,276	459,276	420,408	38,868
FSM Insurance	228,100	228,100	188,357	39,743
FSM Banking Board	179,465	179,465	129,525	49,940
Board of Regents-COM	75,000	75,000	75,000	-
Postal Services	797,689	797,689	774,649	23,040
Total Boards and Commissions	<u>1,739,530</u>	<u>1,739,530</u>	<u>1,587,939</u>	<u>151,591</u>
Payments to component units and fiduciary fund:				
FSM MiCare	100,000	100,000	100,000	-
FSM Social Security Authority	1,200,000	1,200,000	1,200,000	-
Copra Subsidy	113,500	113,500	113,500	-
Coconut Development Authority	115,823	115,823	104,217	11,606
Caroline Island Air	10,000	10,000	10,000	-
COM-FSM	25,000	25,000	25,438	(438)
Non-operational	655,110	655,110	655,110	-
Total payments to component units	<u>2,219,433</u>	<u>2,219,433</u>	<u>2,208,265</u>	<u>11,168</u>
Public Projects	<u>4,202,556</u>	<u>7,562,556</u>	<u>3,266,047</u>	<u>4,296,509</u>
Total expenditures	<u>43,399,850</u>	<u>48,904,995</u>	<u>38,551,087</u>	<u>10,353,908</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(6,249,850)</u>	<u>(5,534,967)</u>	<u>7,052,334</u>	<u>12,587,301</u>
Other financing sources (uses):				
Operating Transfers in:				
Passport Revolving Fund	300,000	444,847	468,738	23,891
Student loan fund	-	-	614,448	614,448
Maritime Surveillance Revolving Fund	-	356,007	706,489	350,482
Observer Revolving Fund	200,000	-	173,066	173,066
Total Operating Transfers in	<u>500,000</u>	<u>800,854</u>	<u>1,962,741</u>	<u>1,161,887</u>
Operating Transfers out:				
FSM Trust Fund	2,000,000	2,000,000	2,000,000	-
Disaster Assistance Emergency Fund	200,851	200,851	200,851	-
ADB loan fund	200,000	200,000	282,686	(82,686)
Compact I Fund	-	-	3,446	(3,446)
Early Retirement Program	-	372,455	372,455	-
Maritime Revolving Fund	1,191,006	1,191,006	1,191,006	-
Total Operating Transfers out	<u>3,591,857</u>	<u>3,964,312</u>	<u>4,050,444</u>	<u>(86,132)</u>
Total other financing sources (uses), net	<u>(3,091,857)</u>	<u>(3,163,458)</u>	<u>(2,087,703)</u>	<u>1,075,755</u>
Net change in fund balance	<u>\$ (9,341,707)</u>	<u>\$ (8,698,425)</u>	<u>\$ 4,964,631</u>	<u>\$ 13,663,056</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

His Excellency Emmanuel Mori
President
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 Federated States of Micronesia (FSM) National Government as of and for the year ended September 30, 2012, which collectively comprise the FSM National Government's basic financial statements and have issued our report thereon dated June 30, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

For purposes of this report, our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts and grants, and other matters did not include the FSM Social Security Administration or 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 FSM National Government is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the FSM National Government'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 FSM National Government's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the FSM National Government's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Questioned Costs (pages 90 through 115), we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 2012-04, 2012-10, and 2012-11 to be material weaknesses.

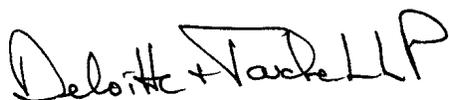
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the FSM National Government'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 FSM National Government in a separate letter dated June 30, 2013.

The FSM National Government's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the FSM National Government's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, the Honorable Members of the FSM Congress, others within the entity, federal awarding agencies, 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 30, 2013

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

His Excellency Emmanuel Mori
President
Federated States of Micronesia:

Compliance

We have audited the Federated States of Micronesia (FSM) National Government's compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the FSM National Government's major federal programs for the year ended September 30, 2012. The FSM National Government's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (pages 90 through 115). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the FSM National Government's management. Our responsibility is to express an opinion on the FSM National Government's compliance based on our audit.

As discussed in Note 2B to the Schedule of Expenditures of Federal Awards, the FSM National Government's basic financial statements include the operations of certain entities whose federal awards are not included in the Schedule of Expenditures of Federal Awards for the year ended September 30, 2012. Our audit, described below, did not include the operations of the entities identified in Note 2B as these entities conducted separate audits in accordance with OMB Circular A-133, if required.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the FSM National Government'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 FSM National Government's compliance with those requirements.

As described in items 2012-01 through 2012-9 in the accompanying Schedule of Findings and Questioned Costs, the FSM National Government did not comply with requirements regarding allowable costs/cost principles, cash management, equipment and real property management, period of availability of Federal funds, procurement and suspension and debarment, reporting, and special tests and provisions that are applicable to its Compact of Free Association, Compact Sector Grants (CFDA # 15.875) major program; regarding allowable costs/cost principles, cash management, and equipment and real property management that are applicable to its Airport Improvement Program (CFDA # 20.106) major program; and regarding allowable costs/cost principles, cash management, equipment and real property management, and procurement and suspension and debarment that are applicable to its Special Education-Grants to States (CFDA # 84.027) major program. Compliance with such requirements is necessary, in our opinion, for the FSM National Government to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the FSM National Government complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2012.

Internal Control Over Compliance

Management of the FSM National Government 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 FSM National Government'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 FSM National Government's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses.

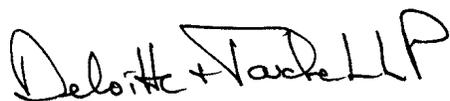
A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement 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. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 2012-01 through 2012-9 to be material weaknesses.

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 FSM National Government as of and for the year ended September 30, 2012, and have issued our report thereon dated June 30, 2013, which contained an unqualified opinion on those financial statements. Our audit was conducted for the purpose of forming our opinions on the financial statements that collectively comprise the FSM National Government's financial statements. The accompanying Schedule of Expenditures of Federal Awards (pages 83 through 87) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditure of Federal Awards is fairly stated in all material respects in relation to the financial statements as a whole.

The FSM National Government's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the FSM National Government's responses and, accordingly, we express no opinion on the responses.

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

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

June 30, 2013

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

<u>Agency/Program</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. Department of Agriculture	\$ 207,050	\$ 186,301
U.S. Department of Commerce	1,382,595	-
U.S. Department of the Interior	30,289,823	70,237,873
U.S. Department of Transportation	30,102,230	-
Institute of Museum and Library Services	35,607	-
U.S. Small Business Administration	-	29,521
U.S. Department of Education	1,991,842	1,794,789
U.S. Department of Health and Human Services	5,440,749	2,140,846
U.S. Department of Homeland Security	2,551	3,282
GRAND TOTAL	<u>\$ 69,452,447</u>	<u>\$ 74,392,612</u>

Note: All grant awards are received from the respective grantor agencies in a direct capacity.

Reconciliation to the basic financial statements:

Expenditures of the Grants Assistance Fund	\$ 70,840,070
Less:	
Expenditures of the Non U.S. Grants Fund (page 73)	<u>(1,387,623)</u>
Total expenditures per financial statements	<u>\$ 69,452,447</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2012

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF AGRICULTURE			
Resident Instruction Grants for Insular Area Activities	10.308	\$ -	\$ -
Rural Self-Help Housing Technical Assistance	10.420	-	-
Outreach and Assistance for Socially Disadvantaged Farmers and Ranchers	10.443	-	-
Cooperative Extension Service	10.500	-	-
Forestry Research	10.652	-	-
Cooperative Forestry Assistance	10.664	186,625	128,243
Urban and Community Forestry Program	10.675	20,425	-
Forest Stewardship Program	10.678	-	-
Community Facilities Loans and Grants	10.766	-	58,058
Rural Sanitation Project	10.999	-	-
U.S. DEPARTMENT OF AGRICULTURE TOTAL		<u>\$ 207,050</u>	<u>\$ 186,301</u>
U.S. DEPARTMENT OF COMMERCE			
Anadromous Fish Conservation Act Program	11.405	\$ -	\$ -
Financial Assistance for National Centers for Coastal Ocean Science	11.426	-	-
Special Oceanic and Atmospheric Projects -NOAA	11.460	1,382,595	-
U.S. DEPARTMENT OF COMMERCE		<u>\$ 1,382,595</u>	<u>\$ -</u>
U.S. DEPARTMENT OF THE INTERIOR			
Economic, Social and Political Development of the Territories	15.875		
Compact Sector Funds:			
Infrastructure and Infrastructure maintenance		\$ 27,242,521	\$ 2,507,817
Education		484,031	17,647,901
Health		605,227	18,387,347
Capacity Building		1,031,846	2,565,212
Environment		-	1,427,253
Private Sector		-	1,779,785
Compact Supplemental Education		388,464	13,297,103
Compact ERA		-	12,242,943
Subtotal Compact Sector Funds		<u>29,752,089</u>	<u>69,855,361</u>
Technical Assistance:			
Single Audit		436,000	-
Technical Assistance OIA/DOI Other		9,849	207,412
		<u>445,849</u>	<u>207,412</u>
Total CFDA #15.875		30,197,938	70,062,773
Historic Preservation Fund Grants-In-Aid	15.904	91,885	175,100
U.S. DEPARTMENT OF THE INTERIOR TOTAL		<u>\$ 30,289,823</u>	<u>\$ 70,237,873</u>
U.S. DEPARTMENT OF TRANSPORTATION			
Airport Improvement Program	20.106	\$ 30,102,230	\$ -
U.S. DEPARTMENT OF TRANSPORTATION TOTAL		<u>\$ 30,102,230</u>	<u>\$ -</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2012

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
INSTITUTE OF MUSEUM AND LIBRARY SERVICES			
Grants to States	45.310	\$ 35,607	\$ -
INSTITUTE OF MUSEUM AND LIBRARY SERVICES		<u>\$ 35,607</u>	<u>\$ -</u>
U.S. SMALL BUSINESS ADMINISTRATION			
Business Development Program	59.006	\$ -	<u>29,521</u>
U.S. DEPARTMENT OF EDUCATION			
Special Education - Grants to States	84.027A	\$ -	\$ 672,220
Special Education - Grants to States	84.027	1,991,842	1,121,845
Public Library Services (LSCA - Title I)	84.034	-	-
TRIO: Student Support Services	84.042	-	-
TRIO: Talent Search	84.044	-	-
TRIO: Upward Bound	84.047	-	-
Career and Technical Education -- Basic Grants to States	84.048B	-	315
Federal Pell Grant Program	84.063	-	-
Byrd Honors Scholarship	84.185A	-	-
Bilingual Education-Professional Development	84.195	-	-
Territories and Freely Associated States Education Grant Program	84.256A	-	-
Goals 2000-State and Local Education Systemic Improvement Grants	84.276A	-	-
School To Work Opportunities	84.278	-	-
Bilingual Education-Program Development and Implementation Grants	84.288	-	409
Bilingual Education-Comprehensive School Grants	84.290	-	-
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334	-	-
Teacher Quality Partnership Grants	84.336A	-	-
Vocational Education-Occupational and Employment Information State Grants	84.346A	-	-
Pacific Vocational Education Improvement Program	84.994	-	-
		<u>\$ 1,991,842</u>	<u>\$ 1,794,789</u>
U.S. DEPARTMENT OF EDUCATION TOTAL			

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2012

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES			
Public Health and Social Services Emergency Fund	93.003	\$ 137,174	\$ -
Public Health Emergency Preparedness	93.069	454,574	-
Emergency System for Advance Registration of Volunteer Health Professionals	93.089	22,078	-
Area Health Education Centers Point of Service Maintenance and Enhancement Awards	93.107	-	-
Maternal and Child Health Federal Consolidated Programs - SSDI Program	93.110	56,440	-
Maternal and Child Health Federal Consolidated Programs	93.110	-	-
Project Grants and Cooperative Agreements for Tuberculosis			-
Control Programs	93.116	126,292	57,271
Small Business Innovation Research (NIAAA, NIDA, NIMH)	93.126	-	-
Injury Prevention and Control Research and State and Community Based Programs	93.136	3,000	-
Health Activities Recommendation Panel Health Activities - Tobacco Use Prevention Programs	93.203	-	-
Family Planning-Services	93.217	567,168	89,551
Consolidated Health Centers (Community Health Centers, Migrant Health Centers, Health Care for the Homeless, Public Housing Primary Care, and School Based Health Centers)	93.224	-	827,655
Affordable Care Act (ACA) Abstinence Education Program	93.235	14,251	-
Substance Abuse and Mental Health Services - Projects of Regional and National Significance	93.243	385,452	41,022
Universal Newborn Hearing Screening	93.251	325,969	25,125
Immunization Cooperative Agreements	93.268	909,008	318,907
The Affordable Care Act: CDC and Prevention-Investigations and Technical Assistance	93.283	794,471	206,920
ARRA Grants to Health Center Programs	93.703	-	61,756
ARRA - Immunization	93.712	28,394	-
ARRA - Prevention and Wellness-State, Territories and Pacific Islands	93.723	44,314	8,306
National Bioterrorism Hospital Preparedness Program	93.889	345,003	-
HIV Care Formula Grants	93.917	45,155	2,379
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938	-	-
HIV Prevention Activities-Health Department Based	93.940	-	116,538
Epidemiologic Research Studies of AIDS and HIV Infection in Selected Population Groups	93.943	248,031	-
HIV/AIDS Surveillance	93.944	11,596	1,587
Occupational Health and Safety Surveillance	93.957	-	-
Block Grants for Community Mental Health Services	93.958	145,514	-
Block Grants for Prevention and Treatment of Substance Abuse	93.959	424,533	165,073
Preventive Health Services - Sexually Transmitted Diseases Control Grants	93.977	-	1,514
Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	93.988	-	12,246
Preventive Health and Health Services Block Grant	93.991	15,428	3,441
Maternal and Child Health Services Block Grant to the States	93.994	336,904	152,828
CCPI Cancer Program	93.999	-	23,950
Others	93.Unknown	-	24,777
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES TOTAL		<u>\$ 5,440,749</u>	<u>\$ 2,140,846</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2012

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF HOMELAND SECURITY			
Public Assistance Grants - Typhoon Fern HMGP/Subgrantee	83.544	\$ -	\$ -
Disaster Grants - Public Assistance (Presidentially Declared Disasters) (B)	97.036	24	-
Individual and Family Grants - FEMA 1427/IFG Admin. Cost	83.543	-	-
Hazard Mitigation Grant-State Management Cost	97.038	-	-
Hazard Mitigation Grant	97.039	-	3,282
Crisis Counseling	97.032	-	-
Emergency Management Performance Grants	97.042	<u>2,527</u>	<u>-</u>
U.S. DEPARTMENT OF HOMELAND SECURITY TOTAL		<u>\$ 2,551</u>	<u>\$ 3,282</u>
GRAND TOTAL		<u>\$ 69,452,447</u>	<u>\$ 74,392,612</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2012

1. Scope of Audit

The Federated States of Micronesia (FSM) National Government is a governmental entity governed by its own Constitution. All significant operations of the FSM National Government 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 FSM National Government's cognizant agency for Single Audit. All programs are received in a direct capacity from the specified grantor agency.

a. Programs Subject to Single Audit

- U.S. Department of Agriculture
- U.S. Department of Commerce
- U.S. Department of Education
- U.S. Department of Health and Human Services
- U.S. Department of Homeland Security
- U.S. Department of the Interior
- U.S. Department of Transportation
- Institute of Museum and Library Services
- U.S. Small Business Administration

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. The Schedule of Expenditures of Federal Awards is prepared on the accrual basis of accounting.

B. Reporting Entity

For purposes of complying with The Single Audit Act of 1984, as amended in 1996, the FSM National Government's reporting entity is defined in Note 1A to its September 30, 2012 basic financial statements, and 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 FSM National Government, as defined above, for the year ended September 30, 2012.

C. Indirect Cost Rate Agreement

The FSM National Government did not receive an indirect cost rate agreement and did not charge indirect costs against federal programs in fiscal year 2012.

D. CFDA #15.875

CFDA #15.875 represents the Office of Insular Affairs (OIA), U. S. Department of the Interior (DOI). 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 DOI Office of Inspector General (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.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2012

2. Summary of Significant Accounting Policies, Continued

E. Subgrantees

Certain program funds are passed through the FSM National Government to subrecipients. The Schedule of Expenditures of Federal Awards does not contain separate schedules disclosing how all subgrantees outside of the FSM National Government's control utilize these funds. However, the FSM National Government's primary subrecipients are its four component States and the College of Micronesia – FSM for the Compact Sector grants. Per the recommendation of the U.S. Department of the Interior, Office of Inspector General (OIG), the federal expenditures of these entities that were passed through from the FSM National Government are incorporated in the accompanying Schedule of Expenditures of Federal Awards. Direct U.S. federal awards received by the four States are not included in the accompanying Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Part I - Summary of Auditors' Results

Financial Statements

- | | |
|--|---------------|
| 1. Type of auditors' report issued: | Unqualified |
| Internal control over financial reporting: | |
| 2. Material weakness(es) identified? | Yes |
| 3. Significant deficiency(ies) identified? | None reported |
| 4. Noncompliance material to financial statements noted? | No |

Federal Awards

- | | |
|---|---------------|
| Internal control over major programs: | |
| 5. Material weakness(es) identified? | Yes |
| 6. Significant deficiency(ies) identified? | None reported |
| 7. Type of auditors' report issued on compliance for major programs: | Qualified |
| 8. Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? | Yes |
| 9. Identification of major programs: | |

<u>CFDA Number</u>	<u>Federal Program</u>
--------------------	------------------------

15.875	Economic, Social and Political Development of the Territories – Compact of Free Association, Compact Sector Grants
20.106	Airport Improvement Program
84.027	Special Education – Grants to States

- | | |
|--|--------------|
| 10. Dollar threshold used to distinguish between Type A and Type B Programs: | \$ 2,083,573 |
| 11. Auditee qualified as a low-risk auditee? | No |

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Part II - Financial Statement Findings Section

<u>Finding #</u>	<u>Findings</u>
2012-04	Fixed Asset Reconciliation
2012-10	Travel Advances
2012-11	Timely and Accurate Reconciliation, Record Maintenance

Part III - Federal Award Findings and Questioned Cost Section

<u>Finding #</u>	<u>CFDA #</u>	<u>Findings</u>	<u>Questioned Costs</u>
2012-01	20.106	Allowable Costs/Cost Principles	\$ 377,757
2012-02	15.875	Reporting	-
2012-03	15.875	Special Tests and Provisions-Contract Provisions	-
2012-04	15.875/ 20.106/ 84.027	Fixed Asset Reconciliation/Equipment and Real Property Management	-
2012-05	15.875	Allowable Costs/Cost Principles/Procurement and Suspension and Debarment	214,682
2012-06	20.106/ 15.875	Cash Management	37,094
2012-07	15.875	Period of Availability of Federal Funds	31,863
2012-08	84.027	Allowable Costs/Cost Principles/Procurement and Suspension and Debarment	48,387
2012-09	84.027	Cash Management	-
Total Questioned Costs			\$ <u><u>709,783</u></u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2012-01
 Federal Agency: U.S. Department of Transportation
 CFDA Program: 20.106 Airport Improvement Program
 Grant Number: Various Airport Improvement Projects
 Requirement: Allowable Costs/ Cost Principles
 Questioned Costs: \$377,757

Criteria: Expenditures should be necessary and reasonable for program needs and should be in accordance with program requirements. Furthermore, financial and programmatic records should be maintained on file for at least three years.

Condition:

1. For 1 (or 2%) of 49 transactions tested, a payment for the Pohnpei Runway Rehabilitation and ARFF Project (grant #: 3-64-0002-09-10) was made using the project grant for Pohnpei Runway Phase 2 (grant #: 3-64-0002-13). There was no documentation on file to document grantor approval of this payment.

LABEL	Full_Prg_No	Date	Ref_1	Ref_2	Trx No	Questioned Costs
1			CE02201	16964	10018	
AIP 9	1 20 80 84 27422 07	08/01/2012	1	-	-	\$ <u>377,757</u>

2. Travel for Government employees is included in the contract cost of CD0179. All billings to the CD0179 account are subject to fixed management costs; therefore, the Government incurs additional costs for government travel in addition to the costs that it would incur if it paid for the direct travel costs. This added cost could be eliminated if management of the travel budget was performed by the Government itself, and not by the contractor.
3. The entity hired a Project Management Unit (PMU) to oversee construction projects. Included in the contract scope is a requirement to determine the appropriateness of contractor billings. PMU review and approval of contractor billings was not clearly indicated on payment documents. However, we noted that all payments were duly authorized by the implementing Department; therefore, no questioned costs were raised.
4. For project payments, we noted certain instances of either a missing Description of Work (DOW) Invoice or inconsistencies between the DOW Invoice and the American Institute of Architect (AIA) Document. The AIA document indicates the completion and amount to be paid, as certified by both the Construction Managers (CM) and the constructor, while the DOW Invoice details the work done by the contractor. No questioned costs were raised as the payments were based on AIA amounts.

Cause: There appears to be a lack of controls over compliance with the criteria. For condition 3, the current process does not incorporate documentation of the PMU review.

Effect: The Government appears to be in noncompliance with the criteria, and questioned costs of \$377,757 result.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2012-01, Continued
Federal Agency: U.S. Department of Transportation
CFDA Program: 20.106 Airport Improvement Program
Grant Number: Various Airport Improvement Projects
Requirement: Allowable Costs/ Cost Principles
Questioned Costs: \$377,757

Recommendation: The Government should review reports to verify that they agree with applicable financial records prior to payment, and the review should be documented in writing. Additionally, budget proposals and NTPs should be on file.

Auditee Response and Corrective Action Plan: We disagree with this finding.

Facts:

Ck No. 150 is a payment to Penta Ocean Construction (POC) for Invoice no. 39 in an amount of \$1,526,454.25 which represents 95% of the total billed amount of \$1,606,793.94. The 95% or \$1,526,454.25 payment is broken down as follows: \$1,48,695.85 for Pohnpei ARFF Building Project (funded under grant no. 3-64-0002-09) including payment of retention and \$377,757.40 for Pohnpei Runway Rehabilitation project funded under grant no. 3-64-0002-06 THROUGH 13). The accounts payable voucher shows the following program accounts:

3-64-0002-09	A1-20-80-84-27422-07-8310	\$1,148,696.85
3-64—0002-06 through 13	A1-20-80-84-27423-10-8310	377,757.40

A questioned cost of \$ 377,757 is being raised as allowable costs.

Justification:

1. Grant no. 3-64-0002-06 THROUGH 13 is approved for change order no. 5 for POC under contract No. CE0220. The approved amount totals to \$521,834.59.
2. The approved changed order is the subject of a communication of Mr. Gordon Wong to Secretary of FSM Department of Transportation & Communication dated January 13, 2011 with the following title as follows:

Pohnpei International Airport
Runway 9/27, Taxiway & Apron Rehabilitation and ARFF Building
AIP Project NO. 3-64-0002-06 THROUGH -13
Change order no. 5

3. The approved change order no. 5 is to fund POC Invoice No. 39 which was not only a payment for the ARFF Building project but also for works related to PNI Runway Rehabilitation Project Phase 1.
4. Grant No. 3-64-0002- 06 THROUGH 13, (emphasis on the word “06 THROUGH-13) was made as change order to fund previously not funded from grant no. 3-64-0002-06 through 12).
5. Unfunded for phase 1 of Pohnpei ARFF building with grant no. 3-64-0002-09 is in part /included in the grant No. 3-64-0002-06 THROUGH 13.
6. The program account used by the auditor referring to the finding of \$377,757 is incorrect. The auditor used A1-20-80-84-27422-07 instead of A1-20-80-84-27323-10.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2012-01, Continued
Federal Agency: U.S. Department of Transportation
CFDA Program: 20.106 Airport Improvement Program
Grant Number: Various Airport Improvement Projects
Requirement: Allowable Costs/ Cost Principles
Questioned Costs: \$377,757

Auditee Response and Corrective Action Plan, Continued:

1. This finding has been resolved among Lyon Associates Inc., FAA, FSM Finance and DTC&I. During the meeting in September 2012, Lyon Associates Inc. agreed to waive any processing fee for the travels of FSM Government employees and this is evidence thru the approved Change Order No. 20 in FY2013.
2. Lyon Associates Inc. is not authorized by neither FAA nor FSM Government to sign on the contractor's billings. This is not Lyon's scope of work defined by FAA.
3. FSM Department of Transportation Communication & Infrastructure ensures that billings are fully supported with required documents before submission to FSM Finance for processing. FSM adopts standard procedures according to FAA Advisory Circulars, not AIA.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2012-02
 Federal Agency: U.S. Department of the Interior
 CFDA Program: 15.875 Economic, Social and Political Development of the Territories
 Grant Number: Compact of Free Association, Compact Sector Grants
 Requirement: Reporting
 Questioned Costs: \$0

Criteria: In accordance with the Compact Subsidiary Agreement:

(a) A Standard Form SF 269, or a reasonable facsimile thereof approved by the Government of the United States, shall be prepared quarterly and submitted within 30 days after the end of the quarter to which it applies. The report shall include accounting information and a status of progress for each project funded by the Grant;

(b) A Federal Cash Transactions Report, or Standard Form SF 272 of the Government of the United States, or a reasonable facsimile thereof approved by the Government of the United States, shall be submitted quarterly within 30 days of the end of the quarter to which it applies. Actual dates, project identification, and amounts of drawdowns for the quarter should be supplied in the "Remarks" section of the form.

Additionally, submitted reports should reconcile with underlying records.

Condition:

- Discrepancies were noted when comparing the 2011 Grant Final Closeout Report against the underlying general ledger accounts that covered the period to September 30, 2012. The National Government appears to have included expenditures posted in 2012 after the extension period that resulted in the \$22,763 difference described below. Though the grant contained an extension to March 31, 2012, the Closeout Report included expenditures that were posted past the period of availability.

	D11AF00035	D11AF0004	D11AF00078/D 11AF00009/DI 1AF00057	Total
	<u>Education</u>	<u>Health</u>	<u>Capacity</u>	
Expenditure				
Close-out report	\$ 544,739	\$ 596,601	\$ 654,263	\$ 1,795,603
General ledger	<u>539,663</u>	<u>600,721</u>	<u>677,982</u>	<u>1,818,366</u>
Difference	\$ <u>5,076</u>	\$ <u>(4,120)</u>	\$ <u>(23,719)</u>	\$ <u>(22,763)</u>

- Discrepancies were noted when comparing the SF-425 between expenditures and encumbrances as of September 30, 2012, for the following sub-grant awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2012-02, Continued
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
Grant Number: Compact of Free Association, Compact Sector Grants
Requirement: Reporting
Questioned Costs: \$0

Condition, Continued:

Grant Awards:

D11AF00126
GR770040
GR770041
GR670129
GR670188
GR670189
GR670127
GR670126
GR670131
GR670036
GR670039

3. Certain drawdowns reflected in the reports submitted to the grantor agency do not reconcile to the application of the drawdown against the compact sector and infrastructure receivable sub-ledgers. The drawdowns were not applied to the correct receivable sub-ledger, although all were applied within the compact sector program accounts.
4. As of September 30, 2012, the compact sector holding account has a balance of \$4M pending distribution to the States and National Government. The National Government accounts receivable ledger also reflected balances which could have been netted against the balance in the Compact Sector Holding account. A reclassification entry was proposed during the audit to correct this matter.

Cause: It appears that reconciliations between the general ledger and required reports did not occur prior to submission. Additionally, period of availability may not have been considered.

Effect: For items 1 and 3, noncompliance with reporting requirements results from this condition.

For conditions 3 and 4, specific program account receivable balances may not be valid, but the aggregate receivable balance does not appear to be materially misstated.

Prior Year Status: A finding on reporting was raised in the 2011 Single Audit as Finding No. 2011-08.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2012-02, Continued
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
Grant Number: Compact of Free Association, Compact Sector Grants
Requirement: Reporting
Questioned Costs: \$0

Conditions, Continued:

Recommendation: Reports submitted to the Grantor should be reconciled to underlying financial records.

Additionally, reconciliations should also occur for the accounts receivable sub-ledger maintained by Treasury against the compact sector drawdown records maintained by the Investment Division and against the SF425 reports submitted to determine remaining valid receivables. The reconciliation of the sector holding account should also encompass the FSM States.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation.

Condition 1. Certain liquidations were made after the close out that resulted to the difference. The obligations were not timely liquidated. We will ensure that timely liquidation of obligation is made and appropriate close out of encumbrance is timely.

Condition 2. The Discrepancies were due to timing of liquidation of encumbrance mostly travel related. The SF-425 reports are usually prepare a day before or on September 30 of which some of the incoming travel vouchers received during the last week of September 30 are being posted after the preparation of the SF-425. We will set a cut off method in the preparation of the SF-425 as well as the liquidation of travel and other obligations of the National Government.

Condition 3. Application of drawdown for compact sector to the receivable sub ledger is based on a communication provided by the investment division to the national treasury division not thru reports submitted to the grantor. National treasury will include additional procedure in the application of drawdown for compact sector to trace the drawdown based on reports submitted to grantor.

With regards to Infrastructure, we believe application of drawdown is properly applied to the receivable sub ledger as this is based on reports submitted to grantor.

Condition 4. The transfer of funds from the sector holding account to the general fund is not timely. We will ensure that timely transfer of fund is made every period for proper recording to appropriate general ledger account.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2012-03
Federal Agency: U.S. Department of the Interior
CFDA No.: 15.875 Economic, Social and Political Development of the Territories
Program Name: Compact of Free Association, Compact Sector Grants
Requirement: Special Tests and Provisions - Contract Provisions
Questioned Cost: \$0

Criteria: For all contracts, the following provisions should be included, as applicable:

- (i) For contracts in excess of \$100,000, administrative, contractual, or legal remedies in instances where contractors violate or breach contract terms, and the provision of such sanctions and penalties as appropriate;
- (ii) For contracts in excess of \$100,000, termination for cause and for convenience by the Grantee or Sub-Grantee, including the manner by which it will be effected and the basis for settlement;
- (iii) Compliance with local statutes regarding kickbacks and corrupt practices;
- (iv) Access by the Government of the Federated States of Micronesia and its Sub-Grantees, the Government of the United States, or any of their duly authorized representatives to any books, documents, papers, and records of the contractor which are directly pertinent to the contract for the purpose of making audit, examination, excerpts, and transcriptions;
- (v) Retention of all required records for three years after Grantees or Sub-Grantees make final payments and all other pending matters are closed; and
- (vi) Compliance with all applicable standards, orders, or requirements issued under local environmental laws.

Condition: Various contracts did not include all required contract provisions.

Cause: There appears to be lack of internal controls over compliance with the criteria.

Effect: The Government appears to be in noncompliance with the criteria.

The conditions cited relate to the provisions in the contracts and not to amounts incurred; therefore, no questioned costs result from this finding.

Prior Year Status: This condition was cited in prior year Single Audit reports.

Recommendation: We recommend that compliance with the criteria occur.

Auditee Response and Corrective Action Plan: The Project Management Unit (PMU) has its own legal staff to certify contract as to legal sufficiency. We will schedule a meeting to the legal staff to clear the matter with regards to the contract provision. There appears to be different interpretation as to the need to put certain provision in the contract when it comes to non construction related contract.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.:	2012-04
CFDA Program:	DOI 15.875 Economic, Social and Political Development of the Territories
CFDA Program:	DOT 20.106 Airport Improvement Program
CFDA Program:	ED 84.027 Special Education – Grants to States
Grant Number:	Various Grants
Requirement:	Fixed Asset Reconciliation
Requirement:	Equipment and Real Property Management
Questioned Costs:	\$0

Criteria: Fixed asset records should be periodically reconciled and be timely recorded. Property records must be maintained that include a description of the property, a serial number or other identification number, the source of property, who holds title, the acquisition date, cost of the property, percentage of Federal participation in the cost of the property, the location use and condition of the property, and any ultimate disposition data including the date of disposal and sale price of the property.

Capitalized construction costs should be supported by Engineer’s certification reports as to completion and be regularly monitored as to status.

Capital assets should be reported at historical cost. The cost of a capital asset should include ancillary charges necessary to place the asset into its intended location and condition for use. Ancillary charges include costs that are directly attributable to asset acquisition—such as freight and transportation charges, site preparation costs, and professional fees.

Assets that are deeded to other governments should be subject to formal agreements, and adequate maintenance of fixed assets should occur.

Condition:

1. The National Government did not timely and completely perform fixed asset reconciliations. The preliminary fixed asset inventory provided in February 2013 reflected various unidentified assets. The attendant reconciliation is ongoing and compliance with this requirement, therefore, has not been met.
2. No formal maintenance procedures for equipment are established, and we could not determine the manner in which maintenance responsibilities are carried out.
3. Included in the contract cost of the Construction Managers (CM) or Project Management Unit (PMU) are costs not directly related to the construction, such as travel other than for site inspection, office costs (e.g., office rent, utilities, vehicle maintenance, etc). These unrelated charges are currently included in construction-in-progress, capitalized projects, and a portion has been transferred to the States. The National Government allocated the administrative cost of contract CD0179 to the projects based on project grant funding availability, instead of by estimating reasonable costs allocable to each project.
4. Per the terms of Contract CD0179, all equipment purchased is the property of the National Government. Office equipment and vehicles purchased in prior years under the Contract were not appropriately capitalized and tagged.
5. Approximately \$2.7 million of projects were capitalized without final completion reports and were subsequently recorded back to construction-in-progress as a result of audit inquiry.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.:	2012-04, Continued
CFDA Program:	DOI 15.875 Economic, Social and Political Development of the Territories
CFDA Program:	DOT 20.106 Airport Improvement Program
CFDA Program:	ED 84.027 Special Education – Grants to States
Grant Number:	Various Grants
Requirement:	Fixed Asset Reconciliation
Requirement:	Equipment and Real Property Management
Questioned Costs:	\$0

Cause:

It appears that communication and compilation of completed projects and construction-in-progress data, project engineer's estimates, project completion reports, and asset receiving reports were not sufficiently utilized to determine the appropriateness and accuracy of underlying financial reports.

The absence of adequate maintenance procedures has been a recurring audit concern. Although, the National Government made plans to conduct a physical count, such was not completed as of fiscal year-end.

Effect: The effect of this condition is that inadequate accounting for fixed assets may occur and that complications between the National Government and the States may result due to potential misunderstandings concerning compliance with grant terms related to capital assets. Noncompliance has resulted with federal compliance requirements applicable to equipment maintenance.

For assets not capitalized and tagged, this condition will detract from monitoring and verification of existence, usage, condition and income derived from the disposal of the equipment.

Additionally, a possible immaterial misstatement of the capitalized cost could result from unrelated construction costs included in construction-in-progress.

Prior Year Status: The conditions were cited in the 2011 Single Audit

Recommendation: The Government should adhere to federal capital asset compliance requirements. Quarterly reconciliations and assessments of the status of construction-in-progress should occur. The reconciliation should also be subject to review and the review should be documented. A formal maintenance program that complies with federal maintenance requirements should also be developed.

Grant terms and conditions should also be incorporated in the Transfer of Property Document to formally delineate responsibilities associated with the assets. Fixed assets owned by the Government should be completely accounted for in the fixed asset register.

For contract costs of the CM and/or PMU, the National Government may consider assigning a unique expenditure code for the portion of contract costs that are non-construction related. Additionally, the National Government should develop a methodology to reasonably allocate the contract cost among the project. The contract cost of the project may be considered in this allocation.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2012-04, Continued
CFDA Program: DOI 15.875 Economic, Social and Political Development of the Territories
CFDA Program: DOT 20.106 Airport Improvement Program
CFDA Program: ED 84.027 Special Education – Grants to States
Grant Number: Various Grants
Requirement: Fixed Asset Reconciliation
Requirement: Equipment and Real Property Management
Questioned Costs: \$0

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation.

Condition 1. The inventory is currently on going and the procurement manager is currently working with the department to act on the unidentified assets which are fully depreciated and are more than 20 years. We recommended to survey these assets due to poor condition and are fully depreciated.

Condition 2. The formal maintenance procedure is in progress and will be in place in FY2013.

Condition 3. We will meet with the Construction Managers (CM) or the Project Management Unit (PMU) to identify which are cost not directly related to the construction to ensure that proper costing and capitalization of the project.

Condition 4. We believed this finding has been resolved. FAA has issued a resolution via email to this prior year finding. The email was forwarded to the auditor in support to the status of prior years audit finding schedule.

Condition 5. The capitalization of construction project was based on the Substantial Certificate of Completion not the final certificate of completion which the auditor is looking at.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2012-05
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
Grant Number: Compact of Free Association, Compact Sector Grants

Requirement: Allowable Costs/Cost Principles
Questioned Costs: \$18,830

Requirement: Procurement and Suspension and Debarment
Questioned Costs: \$195,852

Criteria: In accordance with applicable allowable costs/cost principles requirements, expenditures should be necessary and reasonable for program needs and should be in accordance with program requirements. Furthermore, financial and programmatic records should be maintained on file for at least three years.

In accordance with applicable procurement requirements, procurements shall provide full and open competition among vendors, and allowable exceptions should be approved and documented in procurement file.

Condition:

1. For 3 of 97 transactions tested, there was either only partial or no financial and/or programmatic records (e.g., contracts, receiving reports, invoices, boarding passes, trip reports etc.) on file to substantiate certain transactions.
2. For 1 (or 1%) of 97 samples tested, there was either insufficient documentation or none provided to support competitive procurement requirements.

No.	Label	Date	FD	PRG	YR	Ref_1	Ref_2	Trx_No	<u>Questioned Costs</u>	
									<u>Procurement</u>	<u>Allowable Costs</u>
1	CS 28	12/03/2011	11	11110	11	CH0341	146836	84738	\$ -	\$ 18,512
2	CS 33	08/28/2012	15	15110	11	CI0024	172162	101803	-	318
3	CS 64	09/30/2012	19	73215	11	CI0388	176942	105054	<u>195,852</u>	<u>-</u>
									\$ <u>195,852</u>	\$ <u>18,830</u>

3. The Infrastructure fund pays for a 5% matching cost of AIP projects. Travel for Government employees is included in the CD0179 contract cost. All billings to the CD0179 account are subject to fixed management costs; therefore the Government incurs additional costs on government travel in addition to the costs that it would incur if it paid for the direct costs. This added cost could be eliminated if management of the travel budget was performed by the Government itself and not by the contractor.
4. Evidence of title, leasehold agreement, or other legal authority for use of the land upon which the capital improvement project(s) are to be constructed was not on file to support project expenditures.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2012-05, Continued
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
Grant Number: Compact of Free Association, Compact Sector Grants

Requirement: Allowable Costs/Cost Principles
Questioned Costs: \$ 18,830

Requirement: Procurement and Suspension and Debarment
Questioned Costs: \$ 195,852

Cause: The cause of the condition appears to be due to the process of maintaining documentation in many disparate locales and lack of documentation supporting resolution of these matters with the affected federal agency.

Effect: The effect of this condition is questioned costs and potential noncompliance with the criteria.

Recommendation: We recommend that necessary communications and documentation in support of the above be retained in file.

Auditee Response and Corrective Action Plan: We disagree with the finding due to the following reasons.

1. During the audit period Ck No. 103365 for \$18,512 was provided to the auditor along with all the check selections being requested, however, the auditor claimed that she could not find the ck no. 103365. On June 28, 2013 we went to the training room where the auditors conducted their audit and found CK No. 103365 duly labeled per selection as requested by the auditor. We immediately called the auditor to review the check file as the check file has been sitting there waiting for her to review. She agreed to email the documents no later than 12:00 noon which we did.
2. During the audit period Ck No. 103885 for \$318 was provided to the auditor along with all the check selections being requested, however, the auditor claimed that she could not find the ck no. 103885. On June 28, 2013 we went to the training room where the auditors conducted their audit and found CK No. 103885 duly labeled per selection as requested by the auditor. We immediately called the auditor to review the check file as the check file has been sitting there waiting for her to review. She agreed to email the documents no later than 12:00 noon which we did.

Condition 2. We disagree with the finding due to the following reasons.

Records on file, which was provided to the auditor for review shows that a "Request for Quotation (RFQ)" was issued to the existing contractors of the FSM National Government and likewise posted to the Project Management Unit (PMU) website for possible new bidders. The RFQ further shows that this is a request to Supply and Installation of furnishings at Lelu and Utwe School Building Project at Kosrae State and that the evaluation of the proposal will be conducted by PMU and award will be given to the contractor with the lowest bidder.

There were three contractors responded to the RFQ as follows:

Scoobys Inc. with bid amount of \$279,789.22
Black Micro Corporation with bid amount of \$460,854.74
Pacific landscaping, Engineering and Construction with bid amount of \$497,495.09.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2012-05, Continued
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
Grant Number: Compact of Free Association, Compact Sector Grants

Requirement: Allowable Costs/Cost Principles
Questioned Costs: \$ 18,830

Requirement: Procurement and Suspension and Debarment
Questioned Costs: \$ 195,852

Auditee Response and Corrective Action Plan, Continued:

As stated in the RFQ, the evaluation is based on the criteria of lowest bidder hence Scoobys Inc. got the contract.

Condition 3. We disagree with this finding.

The auditor questioned the above transactions due to lack of communications from OIA lifting the suspension and authorization to pay obligation previously on hold. Apparently, the auditor is looking for a communication from OIA with the exact words such as “lifted or lifting of the suspension order” and “approved or approval to pay the two (2) contractors previously on hold”

However, looking at the chronological action made by PMU and the subsequent approval of OIA to complete the project, concurring to de-obligate old grants to issue a new grants (that consist the old balance of the grant and a new grant) and allowing the drawdown to pay the two (2) contractors impliedly lifted the suspension and approved the payment to previous contractors.

FSM National Government has a disbursement procedure which includes the grantor in the process. No Disbursement will be made to the contractor without proper review and drawdown coming from the grantor.

Based on the above information provided, it is the determination of the FSM National Government that the suspension for payment to the two (2) contractors has been lifted and the payment was approved.

Condition 4. This finding has been resolved among Lyon Associates Inc., FAA, FSM Finance and DTC&I. During the meeting in September 2012, Lyon Associates Inc. agreed to waive any processing fee for the travels of FSM Government employees and this is evidence thru the approved Change Order No. 20 in FY2013.

Condition 5. We agree with this finding. We will provide copy of land title, leasehold agreement relative to the capital improvement projects. PMU keeps copy of the title, leasehold agreement and other legal documents. There might be records at the state level prior to the implementation of the project and or other legal documents for use of the land. Some of the files are currently kept at their office. PMU is working in obtaining the documents to the state project.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2012-06

Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
Grant Number: Compact of Free Association, Compact Sector Grants, Infrastructure Projects
Questioned Costs: \$0

Federal Agency: U.S. Department of Transportation
CFDA Program: 20.106 Airport Improvement Program
Grant Number: Various Airport Improvement Program
Questioned Costs: \$37,094

Requirement: Cash Management

Criteria: In accordance with applicable cash management requirements, the time elapsed between the receipt of Federal funds and the clearing of the applicable check should be minimized, and any interest arising from advances in excess of the minimum allowable for retention should be returned to the Federal government.

In accordance with the Fiscal Procedures Agreement for the Amended Compact Sector, all infrastructure projects and projects that are not funded by Operational Grants will be paid on the basis of Accrued Expenditures, provided the Government of the Federated States of Micronesia maintains procedures to minimize the time elapsing between the transfer of funds and their disbursement.

Condition:

CFDA Number 15.875

1. For 17 (or 18%) of 97 samples tested, there was insufficient or incomplete supporting drawdown documentation available. As we were unable to examine the supporting drawdown documentation, an amount cannot be determined, and no questioned costs are presented for this condition.

CFDA Number 20.106

2. FSM National Government made payments of \$1,543,030 prior to construction management certification, which results in cash management-related questioned costs of \$19,098. These payments relate to contract number CE0220 and CE0204.
3. FSM National Government made a drawdown for a retention payment for a project that had not received final certification of completion and, as such, does not represent a valid drawdown. The estimated interest liability for the period between the drawdown receipt and final completion date and as of September 30, 2012, is \$9,787. These payments related to contract number CE0220.
4. FSM National Government received cash in excess of immediate needs, and an interest liability of \$8,209 results. For these items, the checks cleared three or more days after receipt of federal funds in the General Fund and/or AIP checking account.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2012-06, Continued

Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Compact of Free Association, Compact Sector Grants
Grant Number: Various Infrastructure Projects
Questioned Costs: \$0

Federal Agency: U.S. Department of Transportation
CFDA Program: 20.106 Airport Improvement Program
Grant Number: Various Airport Improvement Program
Requirement: Cash Management
Questioned Costs: \$37,094

Cause: For conditions 1 and 4, either the entity did not locate the files, or there is gap in the systematic recordkeeping of cash management documents (e.g., receipts, drawdown confirmation, drawdown requests, expenditure report, etc.) to allow practicable verification.

For condition 2, the FSM National Government did not monitor the completeness of the project prior to drawing down funds. However, the drawdown was not disbursed to the vendor, and the cash was in the AIP checking account from September 2011 to January 2012.

For condition 3, the FSM National Government did not monitor the completeness of the project prior to drawing down funds.

Effect:

For CFDA #15.875, the effect of the related conditions is potential interest liabilities and noncompliance with the criteria; however, due to insufficient documentation, a potential liability is not determinable.

For CFDA #20.106, the FSM National Government appears to be noncompliant with applicable cash management requirements. As a result of this condition, the assessed interest liability for the program is more than \$10,000, and therefore, a questioned cost for the program exists.

Recommendation: The FSM National Government should comply with the criteria.

Auditee Response and Corrective Action Plan: We agree with this Finding. The auditors are using a three days clearance pattern in calculating the interest due to the timing of clearing of checks from the time elapsed between the receipt of federal funds to the clearing of checks. The calculated interest with total amount of \$37,094 is an estimated amount of interest due to the 3 day rule of time elapsed required by EDGAR and not an amount due to the contractor nor an amount drawn from FAA. The questioned cost of \$37,094 is not cash received by FSM National Government from FAA.

Details show that the time elapsed ranges from 1 day to 14 days which is within the clearance pattern submitted by FSM National Government to FAA. During FY2012, the FSM National Government prepared a 10 day clearance pattern analysis which was submitted to FAA for approval to be used as a basis for clearing of checks. The analysis was received and accepted by FAA and in one of the meetings during FY2012 at the FSM Department of Transportation, Communications & Infrastructure, FAA official indicated that they will approve a fourteen (14) days clearance pattern for the Federated States of Micronesia.

We will follow up with FAA for an official approval of the clearance pattern for the FSM National Government.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No: 2012-07
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
Grant Number: Public Sector Capacity Building, Infrastructure - PMU
Requirement: Period of Availability (POA) of Federal Funds
Questioned Costs: \$31,863

Criteria: The Government of the Federated States of Micronesia shall liquidate all obligations incurred under a grant after the end of the funding period, or as otherwise mutually agreed.

Condition: The following grant expenditures were recorded in FY2012 past the period of availability:

14-14026-08	\$ 1,006
14-14028-09	1,137
14-14046-10	7,546
14-14048-10	17,143
14-14220-08	626
14-21360-09	457
14-91225-09	2,897
14-91225-10	468
19-70010-11	<u>583</u>
Total	\$ <u>31,863</u>

Cause: There appears to be a lack of monitoring over compliance with period of availability requirements.

Effect: Questioned costs result from the condition.

Prior Year Status: This condition was cited in the 2011 Single Audit as Finding No. 2011-09.

Recommendation: The Government should comply with program requirements and timely monitor compliance with period of availability requirements.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. We believe there was an extension of the grant for program accounts 14-14079-10 and 14-14048-10 however the extensions are not on file. We will locate the grant extension letter and will provide to the auditor no later than December 31, 2013.

We will ensure that timely monitoring of period of availability as required will be made during the year.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2012-08
 Federal Agency: U.S. Department of Education
 CFDA Program: 84.027 Special Education – Grants to States
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$48,387
 Requirement: Procurement and Suspension and Debarment
 Questioned Costs: \$0

Criteria: In accordance with applicable allowable costs/cost principles requirements, expenditures should be necessary and reasonable for program needs and should be in accordance with program requirements. Furthermore, financial and programmatic records should be maintained on file for at least three years.

In accordance with applicable procurement requirements, procurements shall provide full and open competition among vendors, and allowable exceptions should be approved and documented in the procurement files.

Condition:

1. For 7 (or 18%) of 39 transactions tested, there was either only partial or no financial and/or programmatic records (e.g., contracts, receiving reports, invoices, boarding passes, trip reports etc.) on file to substantiate certain transactions.
2. For 1 (or 3%) of 39 samples tested, there was either insufficient documentation or none was provided to support competitive procurement requirements.
3. For 1 (or 3%) of 39 samples tested, brand names were specified in the request for proposal, which provided insufficient documentation to support that adequate levels of competition occurred. The request for proposal did not state that an equivalent product was solicited.

No.	Label No	Date	Ref_1	ST_FD_DP_DV_PRG_YR	Questioned Costs	
					Allowable Costs	Procurement
1	SPED-EX 20	10/31/2011	L10C167	2-20-60-66-20010-10	\$ 1,794	\$ -
2	SPED-EX 21	12/22/2011	C11C038	2-20-60-66-20010-10	137	137
3	SPED-EX 22	12/14/2011	C11C045	2-20-60-66-20010-10	41,160	41,160
4	SPED-EX 24	7/4/2012	T12C249	2-20-60-66-20010-11	762	-
5	SPED-EX 32	7/25/2012	T12C235	2-20-60-66-20010-12	1,830	-
6	SPED-EX 33	10/10/2011	JVI0051	3-20-60-66-20010-10	1,349	-
7	SPED-EX 34	12/21/2011	TKH031	3-20-60-66-20010-12	<u>1,355</u>	<u>-</u>
					<u>\$ 48,387</u>	<u>\$ 41,297</u>

Cause: There appears to be a lack of control over ensuring compliance with the criteria which can be attributed to inconsistencies in recordkeeping.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.:	2012-08, Continued
Federal Agency:	U.S. Department of Education
CFDA Program:	84.027 Special Education – Grants to States
Requirement:	Allowable Costs/Cost Principles
Questioned Costs:	\$48,387
Requirement:	Procurement and Suspension and Debarment
Questioned Costs:	\$0

Effect: The Government appears to be in noncompliance with the criteria and questioned costs result. However, questioned costs associated with procurement noncompliance are already included in questioned costs associated with allowable cost noncompliance.

Prior Year Status: Noncompliance with applicable procurement requirements was cited in the 2011 Single Audit.

Recommendation: The Government should comply with grant requirements and should retain sufficient documentation on file to support compliance with those requirements. Trip reports should be consistently and timely submitted for travel-related expenditures.

Auditee Response and Corrective Action Plan: The transactions relative to the questioned costs occurred at the FSM field offices in Chuuk and Kosrae states. The FSM Department of Education is currently working at the state level on the documentation to support the transaction to resolve this finding. We will provide the needed documentation to the auditor on or before December 31, 2013.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No: 2012-09
 Federal Agency: U.S. Department of Education
 CFDA Program: 84.027 Special Education – Grants to States
 Grant Number: H027A090005, H027A100005, H027A110005
 Requirement: Cash Management
 Questioned Costs: \$0

Criteria: Where a funding period is specified, a grantee may charge to the award only costs resulting from obligations of the funding period unless carryover of unobligated balances is permitted, in which case the carryover balances may be charged for costs resulting from obligation of subsequent funding period.

The Government’s records should reconcile with the grantor agency’s records.

Condition: Drawdowns reflected in the website do not reconcile with the special education expense reimbursement sub-ledger. It appears the drawdowns were made against incorrect grant awards.

The Government was not able to provide drawdown documents supporting \$14,088 of excess drawdowns reflected by the FSM.

<u>Award No.</u>	<u>Last Date to Draw Funds</u>	<u>Drawdown per Website</u>	<u>Fundware Number</u>	<u>Drawdown FSM Wide</u>	<u>Difference</u>
			20010-05	\$ 60	\$ (60)
			20010-06	(424)	424
			20010-07	(722)	722
			20010-09	6,924	(6,924)
H027A090005	01/03/2012	\$ 254,865	20010-10	422,072	(167,207)
H027A100005	12/31/2012	1,600,057	20010-11	1,456,996	143,061
H027A110005	12/30/2013	<u>2,654,651</u>	20010-12	<u>2,638,755</u>	<u>15,896</u>
		\$ <u>4,509,573</u>		\$ <u>4,523,661</u>	\$ <u>(14,088)</u>

Cause: Either drawdowns were made against the wrong grant award due to insufficient funds, or there was an error in the application of drawdowns in the receivable sub-ledger, although all were applied within special education sub-ledger accounts.

In reconciling accounts receivable, the National Government does not utilize website reports to determine correct drawdown application.

Effect: The sub-ledger for special education accounts may not be accurate.

Prior Year Status: This condition was cited in the 2011 Single Audit.

Recommendation: The Government should comply with the criteria and monitor controls over funds availability.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No: 2012-09
Federal Agency: U.S. Department of Education
CFDA Program: 84.027 Special Education – Grants to States
Grant Number: H027A090005, H027A100005, H027A110005
Requirement: Cash Management
Questioned Costs: \$0

Auditee Response and Corrective Action Plan: We agree with this finding. We will revisit the drawdown and expenditure reports along with the application of drawdown in the receivable sub-ledger to determine proper application of drawdown.

National Treasury will likewise start using the website reports in the application of drawdown to the receivable sub-ledger to ensure correct application of the drawdown to the receivable account.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No. 2012-10 - Travel Advances

Criteria: In accordance with applicable Financial Management Regulations, the traveler must submit a travel claim voucher within 10 days of travel completion or of trip cancellation, and attach necessary receipts, trip reports and boarding passes or other evidence of the completion of travel. If the traveler does not liquidate the advance, alternative collection methods should be employed to recover the FSM National Government's funds. Furthermore, such records should be kept on file and be available for audit.

Condition: In the course of testing travel-related advances and encumbrances, we noted untimely liquidation of travel advances. There also appears to be a lack of aggressive effort to collect travel advances.

Fiscal Year 2012

	<u>Amount</u>	<u>Allowance</u>	<u>Net Realized Value (NRV)</u>
General Fund	\$ 1,498,215	\$ 1,305,002	\$ 193,123
Grants Fund	54,890	54,890	-
Sector	<u>121,688</u>	<u>102,288</u>	<u>19,400</u>
	<u>\$ 1,674,793</u>	<u>\$ 1,655,393</u>	<u>\$ 212,523</u>

Fiscal Year 2011

	<u>Amount</u>	<u>Allowance</u>	<u>NRV</u>
General Fund	\$ 1,516,706	\$ 1,516,706	\$ -
Sector	<u>116,331</u>	<u>-</u>	<u>116,331</u>
	<u>\$ 1,633,037</u>	<u>\$ 1,516,706</u>	<u>\$ 116,331</u>

Cause: It appears that additional effort is necessary to monitor travel advances and the completeness of documents required from travelers upon trip completion.

Effect: Expenditures per function, as reported, may be understated.

The National Government has provided a sufficient allowance to cover these uncollectible advances and therefore, this matter does not appear to have a material impact on the financial statements.

Prior Year Status: This condition was cited in the 2011 Single Audit.

Recommendation: We recommend that compliance with the Financial Management Regulations occur with respect to the collection of travel advances. Consideration of payroll deductions to collect outstanding receivables should be considered.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No. 2012-10 - Travel Advances, Continued

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation.

Liquidation of travel advances has been a challenge for this department. Over the years, there has been no significant decrease in the liquidation of prior years advances; however, we can say that there has been improvements in the liquidation of current year advances. Most of the outstanding travel advances are balances in prior years.

The National Treasury has identified travel advance account as its priority for FY2013 in clearing the prior years advances and aggressive effort to collect will be implemented by the general operations manager. Monitoring and monthly reconciliation of travel advances will be made to ensure timely liquidation of travel advance and collection is accordingly made.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No. 2012-11 - Timely and Accurate Reconciliation, Record Maintenance

Criteria: Reconciliations of accounts should be performed timely and accurately.

Documentation supporting the allocation of loan payments should be on file.

Condition:

1. Audit adjustments were proposed by the National Government to correct September 30 balances throughout the course of the audit and as late as in May and June 2013 to correct and reconcile various accounts (including capital assets, accounts payable, expenditures, revenues and transfers).
2. The prior-year agreement entered into between the FSM and ADB pertaining to the SDR adjustment is not available, although related amortizations are being paid.
3. During the year, loan payments for ADB Loan Number 1816 FSM (SF) –Basic Social Services Program were made. The National Government has allocated these loans to the three States and to the National Government. Consequently, the National Government may have an equitable share in the amortization of principal, which has been paid solely by the States. The Government was not able to provide documentation as to the basis of this allocation method. The project completion report provided by ADB did not specifically indicate the specific state beneficiary. Rather, the project appears to imply that the FSM as a whole is the beneficiary.
4. As of September 30, 2012, there exist unidentified federal funds of \$279,122 drawn from the Federal Holding Account in prior years that are included within General fund cash. Additionally, the Government has recorded deferred revenue included in accounts payable of \$146,050 in 2011 and \$112,000 in 2012.
5. Various grants receivables from 2010 and prior years have not yet been collected. Efforts are underway to collect and management represent that they will be successful.

Cause: Reconciliations of the accounts has not been timely or accurately performed.

Relative to the ADB Loan 1816, it is the National Government's understanding that related projects were for the benefit of the States, and as such, the States bear responsibility for loan repayments. However, the report provided by ADB does not necessarily support this understanding.

For condition 4, the unidentified cash resulted from a prior-year unreconciled balance that was transferred in 2009 to the general fund. It does not appear that subsequent attempts to reconcile this balance have occurred. Additionally, untimely monitoring of drawdowns in comparison to expenditures has not occurred to ascertain that drawdowns and applications of revenue are accurate and that cash is not drawn down prior to the incurrence of expenditures.

Effect: Related accounts may be misstated.

For conditions 2 and 3, there could be erroneous loan repayments charged to the States.

Condition 4 – There exists a potential liability for the return of the funds to the U. S. Federal Government. A liability has been duly recorded for this possibility.

Condition 5 – Failure to collect may result in future bad debt expense.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No. 2012-11 - Timely and Accurate Reconciliation, Record Maintenance, Continued

Recommendation: We recommend that the FSM National Government perform monthly account reconciliations to promptly identify reconciling items and to confirm the appropriateness of recording. Reconciliations should be reviewed by appropriate management to ascertain that such are timely and accurate.

For the ADB Loan 1816, the National Government may wish to consider obtaining a formal agreement with the States relative to repayment terms.

The National Government should pursue collection of all prior grants receivables.

Prior Year Status: The above conditions are reiterative of findings reported in the prior Single Audits.

Auditee Response and Corrective Action Plan: We agree with this finding. The accountants and financial advisor have been instructed to ensure that no recurring adjustment will be made after the submission of final trial balance. Monthly reconciliation and checklist of accounts to be reconciled will be made to ensure that all accounts are reconciled prior to the closing of accounts.

We will obtain copy of the FSM and ADB pertaining to the SDR adjustment and keep this on file for future references and for audit purposes.

We will revisit the loan agreement to determine whether or not National share is required for ADB loan no. 1816 FSM (SF).

We will discuss with Yap state on plans for the deferred revenue as this relates to the reimbursements of federal grants. Yap state is the only state that is currently following up on the previous federal grant reimbursements.

We will provide the expenditure reports for drawdown to Investment division on the uncollected federal grant receivables and work with the departments for grants that have been closed for a possible transfer of expenditure to allow the drawdown.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Unresolved Prior Audit Findings and Questioned Costs
Year Ended September 30, 2012

The following is a summary of unresolved federal questioned costs for the FSM National Government:

	Questioned Costs Set Forth in Prior Audit Report <u>2011</u>	Questioned Costs Resolved in Fiscal Year <u>2012</u>	Questioned Costs at <u>September 30, 2012</u>
Unresolved Questioned Costs FY09	\$ 2,861,600	\$ 2,861,600	\$ -
Unresolved Questioned Costs FY10	2,049,222	-	2,049,222
Unresolved Questioned Costs FY11	<u>301,014</u>	<u>-</u>	<u>301,014</u>
	\$ <u>5,211,836</u>	\$ <u>2,861,600</u>	2,350,236
Questioned cost for the year ended September 30, 2012			<u>709,783</u>
Total questioned costs			\$ <u>3,060,019</u>

The \$2,861,600 resolved during fiscal year 2012 was resolved per OMB Circular A-133, Section .315(b)(4).

The status of prior year findings is set forth in the accompanying Schedule of Findings and Questioned Costs (pages 90 through 115).