

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2018

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2018

INDEX

	<u>Page No.</u>
INDEPENDENT AUDITORS' REPORT, BASIC FINANCIAL STATEMENTS AND ADDITIONAL INFORMATION	1 - 62
INDEPENDENT AUDITORS' REPORTS ON INTERNAL CONTROL AND ON COMPLIANCE	63 - 73

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Table of Contents
Year Ended September 30, 2018

	<u>Page No.</u>
I. Independent Auditors' Report	1
II. Management's Discussion and Analysis	4
III. Basic Financial Statements:	
Government-Wide Financial Statements:	
Statement of Net Position	11
Statement of Activities	12
Governmental Fund Financial Statements:	
Balance Sheet	13
Statement of Revenues, Expenditures, and Changes in Fund Balances	14
Reconciliation of Statement of Revenues, Expenditures and Changes in Fund Balances of Governmental Funds to the Statement of Activities	15
Discretely Presented Component Unit Financial Statements:	
Combining Statement of Net Position	16
Combining Statement of Revenues, Expenses and Changes in Net Position	17
Notes to the Basic Financial Statements	18
IV. Required Supplementary Information - Other than Management's Discussion and Analysis	46
Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual - General Fund	47
Note to Required Supplementary Information - Budgetary Reporting	48
V. Other Supplementary Information	49
Combining Schedule of Expenditures by Account - Governmental Funds	50
General Fund:	
Statement of Revenues, Expenditures by Function, and Changes in Fund Balance	51
Statement of Revenues, Expenditures by Function, and Changes in Fund Balance - Budget and Actual	53
Nonmajor Governmental Funds - Special Revenue Funds:	
Combining Balance Sheet	54
Combining Statement of Revenues, Expenditures by Function, and Changes in Fund Balances	55
Combining Statement of Revenues, Expenditures by Account, and Changes in Fund Balances	56

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Table of Contents, Continued
Year Ended September 30, 2018

	<u>Page No.</u>
V. Other Supplementary Information, Continued	
Major Governmental Funds – Grant Assistance Funds:	
Combining Balance Sheet	57
Combining Statement of Expenditures by Function, and Changes in Fund Balances	59
Combining Statement of Expenditures by Account, and Changes in Fund Balances	61
VI. Independent Auditors' Reports on Internal Control and on Compliance	
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 <i>Government Auditing Standards</i>	63
Independent Auditors' Report on Compliance for Each Major Federal Program: Report on Internal Control Over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance	65
Summary Schedule of Expenditures of Federal Awards, By Grantor	68
Schedule of Expenditures of Federal Awards	69
Notes to Schedule of Expenditures of Federal Awards	71
Schedule of Findings and Questioned Costs	72
Summary Schedule of Prior Audit Findings and Questioned Costs	73

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2018

INDEPENDENT AUDITORS' REPORT

Honorable Carson K. Sigrah
Governor, State of Kosrae
Federated States of Micronesia:

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae (the State), as of and for the year ended September 30, 2018, and the related notes to the financial statements, which collectively comprise the State's basic financial statements as set forth in Section III of the foregoing table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae, as of September 30, 2018, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matter

Receivables from the FSM National Government

As discussed in Note 3 to the financial statements, the State is in discussion with the FSM National Government to determine the ultimate collectability of certain receivables due from the FSM National Government in consultation with the grantor agency arising from Compact sector grant transactions.

Other Matters

Required Supplementary Information

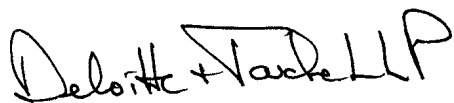
Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 10 as well as the Schedule of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual - General Fund and notes thereto, on pages 47 and 48, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board (GASB) who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 11, 2019 on our consideration of the State's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the State's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the State's internal control over financial reporting and compliance.

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

June 11, 2019

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2018

This analysis, prepared by the Department of Administration and Finance, offers readers of the Kosrae State Government's ("Kosrae State") financial statements a narrative overview of the activities of the government for the fiscal year ended September 30, 2018. We encourage readers to consider this information in conjunction with Kosrae State's financial statements, which follow. Fiscal year 2017 comparative information has been included, where appropriate. This analysis is required by the Governmental Accounting Standards Board (GASB) which provides guidelines on what must be included and excluded from this analysis.

FINANCIAL HIGHLIGHTS

- Kosrae State's total net position for fiscal year ended September 30, 2018 decreased by \$348,073 (or 0.9%) from \$38,762,762 in the prior year to \$38,414,689 in the current year. The decrease is mainly due to depreciation expense exceeding capital acquisition costs.
- For the fiscal year ended September 30, 2018, the State's General Fund unassigned fund deficit has decreased to \$(706,933) from \$(1,248,199) in the prior year or a decrease of \$541,266. GASB defines unassigned fund balance as a residual fund balance that is not restricted, committed and assigned.
- For the year ended September 30, 2018, the General Fund total fund balance increased by \$380,737 from \$1,573,633 in fiscal year 2017 to \$1,954,370 in fiscal year 2018. The increase was mainly due to a \$503,905 contribution from the FSM National Government.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

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

Government-Wide Financial Statements

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

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

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2018

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

- Governmental activities- Most of Kosrae State's basic services are included here, such as education, health, special appropriations, finance, judiciary, and general administration. Compact sector and other federal grants finance most of these activities.
- Component Units-Kosrae State includes the operating results of the Kosrae Utilities Authority, Kosrae Port Authority and Kosrae Housing Authority in its report. Although separate, these "component units" are important because Kosrae State is financially accountable for them.

Fund Financial Statements

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

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

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

FINANCIAL ANALYSIS OF KOSRAE STATE AS A WHOLE

Kosrae State's assets at the end of fiscal year 2018 exceeded liabilities by \$38,414,689. The bulk of the amount is from net investment in capital assets, although \$7,896,037 million are restricted. Kosrae State uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although Kosrae State's net investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2018

The following summary of Kosrae State's net position as of September 30, 2018, with comparable balances for the fiscal year 2017, discloses this relationship:

	Governmental Activities			
	2018	2017	Change	%
ASSETS				
Current and other assets	\$ 10,875,436	\$ 10,625,034	\$ 250,402	2.36%
Capital assets	<u>33,885,918</u>	<u>35,613,650</u>	<u>(1,727,732)</u>	<u>-4.85%</u>
Total assets	\$ <u>44,761,354</u>	\$ <u>46,238,684</u>	\$ <u>(1,477,330)</u>	<u>-3.20%</u>
LIABILITIES				
Current and other liabilities	\$ 2,043,747	\$ 2,815,080	\$ (469,261)	-16.67%
Long-term debts	<u>4,302,918</u>	<u>4,660,842</u>	<u>(659,996)</u>	<u>-14.16%</u>
Total liabilities	<u>6,346,665</u>	<u>7,475,922</u>	<u>(1,129,257)</u>	<u>-15.11%</u>
NET POSITION				
Net investment in capital assets	32,175,511	33,741,566	(1,566,056)	-4.64%
Restricted	7,896,037	7,427,614	468,423	6.31%
Unrestricted	<u>(1,656,859)</u>	<u>(2,406,418)</u>	<u>749,560</u>	<u>-31.15%</u>
Total Net Position	\$ <u>38,414,689</u>	\$ <u>38,762,762</u>	\$ <u>(348,073)</u>	<u>-0.90%</u>

At the end of fiscal year 2018, Kosrae State's unrestricted net position showed a deficit of \$(1,656,859), a decrease of \$749,560 as compared with the prior year. The decrease in overall net position of \$(348,073) was due primarily to a decrease in net investment in capital assets of \$(1,566,056) offset by the increase in restricted assets of \$468,423 and the increase in unrestricted assets of \$749,560. The unrestricted deficit, however, is the result of having current and long-term commitments that are greater than currently available resources. Specifically, Kosrae State did not include in past annual budgets the full amounts needed to finance its current liabilities to vendors and others or its long-term liabilities arising from Asian Development Bank (ADB) loans and unused employee leave balances. Kosrae State will include these amounts in future year's budgets as funding permits.

The net position decreased by \$348,073 compared with prior year, and the key elements of the differences from the prior year are shown in the following schedule.

	Governmental Activities			
	2018	2017	Change	%
Revenues:				
Operating grants and contributions	\$ 11,135,197	\$ 9,366,320	\$ 1,768,877	18.89%
Capital grants and contributions	17,372	614,718	(597,346)	-97.17%
Charges for services	668,957	637,837	31,120	4.88%
Revenue sharing	1,196,299	1,143,172	53,127	4.65%
Unrestricted investment earnings	200,058	197,333	2,725	1.38%
Taxes	420,843	447,431	(26,588)	-5.94%
Contribution from the FSM National Government	503,905	-	503,905	
Others	<u>65,245</u>	<u>86,742</u>	<u>(21,497)</u>	<u>-24.78%</u>
Total revenues	<u>14,207,876</u>	<u>12,493,553</u>	<u>1,714,323</u>	<u>13.72%</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2018

	Governmental Activities			
	2018	2017	Change	%
Expenses:				
General government	3,742,387	2,084,103	1,658,284	79.57%
Education	4,652,099	4,407,210	244,889	5.56%
Health services	3,506,173	3,402,433	103,740	3.05%
Economic development	546,840	487,887	58,953	12.08%
Boards, commissions and other	1,763,367	2,186,207	(422,840)	-19.34%
Environment protection	295,365	449,899	(154,534)	-34.35%
Public order and safety	349,569	399,158	(49,589)	-12.42%
Others	<u>83,210</u>	<u>76,850</u>	<u>6,360</u>	<u>8.28%</u>
Total expenses	<u>14,939,010</u>	<u>13,493,747</u>	<u>1,445,263</u>	<u>10.71%</u>
Deficiency of revenues under expenses	(731,134)	(1,000,194)	269,060	-26.90%
Special item - SDR foreign exchange	64,586	(5,333)	69,919	-1311.06%
Special item - Write-off of receivables	(38,041)	(583,293)	545,252	-93.48%
Contribution to permanent fund	<u>356,516</u>	<u>636,947</u>	<u>(280,431)</u>	<u>-44.03%</u>
Change in net position	<u>(348,073)</u>	<u>(951,873)</u>	<u>603,800</u>	<u>-63.43%</u>
Net position at the beginning of the year	<u>38,762,762</u>	<u>39,714,635</u>	<u>(951,873)</u>	<u>-2.40%</u>
Net position at the end of the year	\$ <u>38,414,689</u>	\$ <u>38,762,762</u>	\$ <u>(348,073)</u>	<u>-0.90%</u>

Total revenues in fiscal year 2018 of \$14,207,876 increased by \$1,714,323 (or 14%) from the prior year's \$12,493,553. The increase was primarily due to a \$1,768,877 increase in operating grants and contributions and a \$503,905 contribution from the FSM National Government. In fiscal year 2018, Grants Assistance Fund revenues comprised 67% of total revenues of the governmental funds whereas the General Fund revenues comprised 19%.

Total expenses of \$14,939,010 reflected an 11% increase from the prior year expenses of \$13,493,747.

FINANCIAL ANALYSIS OF KOSRAE STATE'S GOVERNMENTAL FUNDS

As noted earlier, Kosrae State uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. As of the end of fiscal year 2018, Kosrae State governmental funds reported a combined fund balance of \$9,129,617, which represents a \$1,026,558 increase from the \$8,103,059 recorded at the end of fiscal 2017. The increase was attributable mainly to the following: positive change in fund balances for General Fund of \$380,737, for Grant Assistance Fund of \$185,287, for Compact Trust of \$356,516 and for Other Governmental funds of \$104,018 or a total of \$1,026,558. Of the total combined fund balance of \$9,129,617, \$7,424,410 is designated as non-spendable fund balance; \$1,810,464 is restricted fund balance; \$601,676 is for committed fund balance and \$(706,933) for unassigned fund deficit. Encumbrances identified in Note 10 are classified as restricted and committed fund balances depending on the revenue constraints of the particular programs.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2018

The General Fund is the main operating fund of the State. At the end of the current fiscal year, the unassigned fund deficit was \$(706,933), which increased by \$541,266 from \$(1,248,199) of the prior year. Consequently, the total fund balance for the General Fund increased by \$380,737 from \$1,573,633 in fiscal year 2017 to \$1,954,370 in the current year.

The Grants Assistance Fund has a total fund balance of \$702,025. The net increase in fund balance during the current year was \$185,287 or (36%), which primarily was the result of a grant from a foreign government in the amount of \$199,970.

Compact Trust Fund has a total fund balance of \$5,333,257, all of which is restricted for the funding of future operations of the primary government commencing in fiscal year 2023. The increase in fund balance during the current year was \$356,516 or 7% which corresponds to the net increase in the fair value of investments for the year.

GENERAL FUND BUDGETARY HIGHLIGHTS

During the course of the fiscal year, management and elected officials of Kosrae State Government made several revisions to the General Fund budget. For the year ended September 30, 2018, General Fund operating revenues of \$2,844,995 exceeded operating expenditures of \$2,476,758 by \$368,237.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Kosrae State's investment in capital assets for the primary government as of September 30, 2018 amounted to \$79,643,414, net of accumulated depreciation of \$45,757,496, resulted in a net book value of \$33,885,918. The decrease in capital assets of \$(1,727,732) was mainly due to depreciation expense of \$1,831,972, which exceeded capital acquisition of \$104,240.

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

	Governmental Activities			
	2018	2017	Change	%
Capital Assets:				
Buildings	\$ 11,404,456	\$ 11,752,972	\$ (348,516)	-2.97%
Infrastructure	20,611,594	21,413,326	(801,732)	-3.74%
Machinery, equipment and others	<u>1,869,868</u>	<u>2,447,352</u>	<u>(577,484)</u>	<u>-23.60%</u>
	<u>\$ 33,885,918</u>	<u>\$ 35,613,650</u>	<u>\$ (1,727,732)</u>	<u>-4.85%</u>

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2018

Long-Term Debt

The following schedule shows Kosrae State's long-term obligations for fiscal year 2018 with comparative balances from fiscal year 2017.

	Governmental Activities			
	2018	2017	Change	%
Long-term Debt:				
ADB loans	\$ 3,900,508	\$ 4,290,193	\$ (389,685)	-9.08
Malem water	100,338	103,754	(3,416)	-3.29
Claims	-	<u>110,000</u>	<u>(110,000)</u>	<u>-100.00</u>
	<u>\$ 4,000,846</u>	<u>\$ 4,503,947</u>	<u>\$ (503,101)</u>	<u>-11.17</u>

The State's long-term debt decreased by \$503,101 or 9% due primarily to repayments of ADB loans. Kosrae State's long-term debt obligations can be found in notes 6 and 7 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

General Fund

Revenues for the six months ending March 31, 2019 are \$748,029, a slight increase of \$10,674 or 1% as compared to \$737,355 revenues for the same period ending March 2018. Expenditures, however, for the six months ending March 31, 2019 are \$1,110,980, an increase of \$129,694 or 13% as compared to \$981,286 of expenditures for the same period ending March 2018. This could result in a deficiency of revenues under expenditures at the end of fiscal year 2019.

The leaders of Kosrae State are aware of the current financial situation of the government and have taken steps for the implementation of the Long-term Fiscal Framework (LTFF) through a task force created in the 2012 Kosrae Leadership Conference. The LTFF identified steps for reforms to remedy the financial burden of the State in the ensuing years. The LTFF has been implemented in FY 2014.

Other measures are also being considered to increase general fund revenues.

Grant Assistance Funds

Grants Assistance Funds (specifically compact funding) will continue to be the major funding source for Kosrae State in fiscal year 2019 with total approved funding of \$7,547,131 as follows:

Education Sector	\$2,959,508
Health Sector	\$2,431,597
Environment Sector	\$ 250,775
Private Sector	\$ 378,548
Capacity Building Sector	\$ 180,593
SEG	\$1,151,635
ERA	\$ 194,475

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2018

CONTACTING KOSRAE STATE'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors, a general overview of Kosrae State's finances to demonstrate its accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Director of Administration and Finance; P.O. Box 878, Kosrae, FM, 96944.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Statement of Net Position
September 30, 2018

	Primary Government	Component Units
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 463,335	\$ 362,301
Time certificate of deposit	-	167,119
Investments	-	750,952
Receivables, net	676,348	706,262
Inventories	-	229,009
Prepayments	493,470	9,461
Advances	66,486	-
Due from component units	23,780	-
Other current assets	820,000	280,821
Restricted assets:		
Cash and cash equivalents	668,813	-
Time certificate of deposit	-	200,000
Total current assets	<u>3,212,232</u>	<u>2,705,925</u>
Noncurrent assets:		
Capital assets:		
Nondepreciable capital assets	-	62,560
Capital assets, net of accumulated depreciation	33,885,918	17,518,828
Investments	1,210,438	-
Restricted assets:		
Time certificates of deposit	356,359	-
Investments	<u>6,096,407</u>	<u>-</u>
Total noncurrent assets	<u>41,549,122</u>	<u>17,581,388</u>
Total assets	<u>\$ 44,761,354</u>	<u>\$ 20,287,313</u>
<u>LIABILITIES</u>		
Current liabilities:		
Current portion of long-term obligations	\$ 247,928	\$ -
Accounts payable	387,988	131,104
Contracts payable	-	-
Other liabilities and accruals	359,829	77,664
Due to primary government	-	95,954
Loans payable	-	149,912
Unearned revenues	<u>1,048,002</u>	<u>17,461</u>
Total current liabilities	<u>2,043,747</u>	<u>472,095</u>
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	3,752,918	-
Unearned revenues	550,000	-
Other noncurrent liabilities	<u>-</u>	<u>-</u>
Total noncurrent liabilities	<u>4,302,918</u>	<u>-</u>
Total liabilities	<u>6,346,665</u>	<u>472,095</u>
Commitments and contingencies		
<u>NET POSITION</u>		
Net investment in capital assets	32,175,511	17,581,388
Restricted for:		
Nonexpendable:		
Future operations	5,333,257	-
Expendable:		
Debt service	763,150	-
Compact related	48,979	-
Other purposes	1,750,651	587,718
Unrestricted	<u>(1,656,859)</u>	<u>1,646,112</u>
Total net position	<u>38,414,689</u>	<u>19,815,218</u>
Total liabilities and net position	<u>\$ 44,761,354</u>	<u>\$ 20,287,313</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Statement of Activities
Year Ended September 30, 2018

Functions/Programs	Expenses	Program Revenues		Net (Expenses) Revenues and Changes in Net Position	
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government
Primary government:					Component Units
Governmental activities:					
General government	\$ 3,742,387	\$ 314,505	\$ 2,973,181	\$ 17,372	\$ (437,329)
Economic development	546,840	26,447	447,202	-	(73,191)
Education	4,652,099	-	4,135,172	-	(516,927)
Health services	3,506,173	235,470	3,284,277	-	13,574
Public order and safety	349,569	-	-	-	(349,569)
Environment protection and sanitation	295,365	-	295,365	-	-
Boards, commissions and other	1,763,367	92,535	-	-	(1,670,832)
Unallocated interest on long-term debt	83,210	-	-	-	(83,210)
Total primary government	<u>\$ 14,939,010</u>	<u>\$ 668,957</u>	<u>\$ 11,135,197</u>	<u>\$ 17,372</u>	<u>(3,117,484)</u>
Component units:					
Kosrae Port Authority	\$ 1,162,024	\$ 523,099	\$ -	\$ -	- (638,925)
Kosrae Utilities Authority	2,905,089	2,690,903	-	-	- (214,186)
Kosrae Housing Authority	206,903	71,993	-	-	- (134,910)
Total component units	<u>\$ 4,274,016</u>	<u>\$ 3,285,995</u>	<u>\$ -</u>	<u>\$ -</u>	<u>(988,021)</u>
General revenues:					
Taxes:					
FSM revenue sharing:					
Gross revenue taxes					342,350 -
Import taxes					375,255 -
Income taxes					380,665 -
Other taxes					98,029 -
State taxes					420,843 -
Unrestricted investment earnings					200,058 80,176
Contribution from the FSM National Government					503,905 -
Other					65,245 312,439
Total general revenues					2,386,350 392,615
Special item - gain on SDR foreign exchange					64,586 -
Special item - write off of receivables					(38,041) -
Contributions to permanent fund					356,516 -
Total general revenues, special item and contributions					2,769,411 392,615
Change in net position					(348,073) (595,406)
Net position at the beginning of the year					38,762,762 20,410,624
Net position at the end of the year					<u>\$ 38,414,689</u> <u>\$ 19,815,218</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Balance Sheet

Governmental Funds
September 30, 2018

		Special Revenue	Permanent		
	General	Grants Assistance	Compact Trust	Other Governmental Funds	Total
ASSETS					
Cash and cash equivalents	\$ 463,335	\$ -	\$ -	\$ -	\$ 463,335
Investments	1,210,438	-	-	-	1,210,438
Receivables, net:					
General	12,231	-	-	42,661	54,892
Federal agencies	-	33,352	-	-	33,352
Due from FSM National Government	10,000	348,506	-	-	358,506
Taxes	229,598	-	-	-	229,598
Loans	-	-	-	-	-
Due from component units	23,780	-	-	-	23,780
Due from other funds	381,906	1,532,270	-	661,675	2,575,851
Prepaid items	-	491,709	-	1,761	493,470
Advances	36,935	29,551	-	-	66,486
Other assets	627,000	100,000	-	93,000	820,000
Restricted assets:					
Cash and cash equivalents	627,164	-	-	41,649	668,813
Time certificates of deposit	-	-	-	356,359	356,359
Investments	763,150	-	5,333,257	-	6,096,407
Total assets	<u>\$ 4,385,537</u>	<u>\$ 2,535,388</u>	<u>\$ 5,333,257</u>	<u>\$ 1,197,105</u>	<u>\$ 13,451,287</u>
LIABILITIES AND FUND BALANCES					
Liabilities:					
Accounts payable	\$ 52,001	\$ 280,872	\$ -	\$ 55,115	\$ 387,988
Contracts payable	-	-	-	-	-
Other liabilities and accruals	155,935	201,902	-	1,992	359,829
Due to other funds	2,193,945	381,906	-	-	2,575,851
Unearned revenues	29,286	968,683	-	33	998,002
Total liabilities	<u>2,431,167</u>	<u>1,833,363</u>	<u>-</u>	<u>57,140</u>	<u>4,321,670</u>
Fund balances:					
Non-spendable	1,898,153	100,000	5,333,257	93,000	7,424,410
Restricted	763,150	602,025	-	445,289	1,810,464
Committed	-	-	-	601,676	601,676
Unassigned:					
General fund	(706,933)	-	-	-	(706,933)
Total fund balances	<u>1,954,370</u>	<u>702,025</u>	<u>5,333,257</u>	<u>1,139,965</u>	<u>9,129,617</u>
Total liabilities and fund balances	<u>\$ 4,385,537</u>	<u>\$ 2,535,388</u>	<u>\$ 5,333,257</u>	<u>\$ 1,197,105</u>	

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

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

33,885,918

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

Long-term debt payable (4,000,846)
Advance lease payment (600,000)

(4,600,846)

Net position of governmental activities

\$ 38,414,689

See accompanying notes to financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds
Year Ended September 30, 2018

		Special Revenue	Permanent	Other Governmental Funds	Total
	General	Grants Assistance	Compact Trust		
Revenues:					
Compact funding	\$ -	\$ 7,838,647	\$ -	\$ -	\$ 7,838,647
Net change in the fair value of investments	141,068	-	356,516	-	497,584
Federal contributions	-	1,826,647	-	-	1,826,647
FSM revenue sharing	1,196,299	-	-	-	1,196,299
State taxes	420,843	-	-	-	420,843
CFSM grants	-	-	-	1,269,933	1,269,933
Fees and charges	464,504	-	-	354,452	818,956
Other grants	-	199,970	-	-	199,970
Interest income	57,002	-	-	1,988	58,990
Contribution from the FSM National Government	503,905	-	-	-	503,905
Other	61,374	-	-	3,871	65,245
Total revenues	<u>2,844,995</u>	<u>9,865,264</u>	<u>356,516</u>	<u>1,630,244</u>	<u>14,697,019</u>
Expenditures:					
Current:					
General government	1,051,341	1,517,961	-	1,240,431	3,809,733
Economic development	46,555	447,202	-	46,250	540,007
Education	25,115	4,135,172	-	-	4,160,287
Health services	-	3,284,277	-	184,091	3,468,368
Public order and safety	335,344	-	-	-	335,344
Environment protection and sanitation	-	295,365	-	-	295,365
Boards, commissions and other	553,160	-	-	58,431	611,591
Debt service	<u>411,725</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>411,725</u>
Total expenditures	<u>2,423,240</u>	<u>9,679,977</u>	<u>-</u>	<u>1,529,203</u>	<u>13,632,420</u>
Excess of revenues over expenditures	<u>421,755</u>	<u>185,287</u>	<u>356,516</u>	<u>101,041</u>	<u>1,064,599</u>
Special item:					
Write off of receivables	(38,041)	-	-	-	(38,041)
Other financing sources (uses):					
Operating transfers in	-	-	-	2,977	2,977
Operating transfers out	<u>(2,977)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(2,977)</u>
Total other financing sources (uses), net	<u>(2,977)</u>	<u>-</u>	<u>-</u>	<u>2,977</u>	<u>-</u>
Net change in fund balances	<u>380,737</u>	<u>185,287</u>	<u>356,516</u>	<u>104,018</u>	<u>1,026,558</u>
Fund balances at the beginning of the year	<u>1,573,633</u>	<u>516,738</u>	<u>4,976,741</u>	<u>1,035,947</u>	<u>8,103,059</u>
Fund balances at the end of the year	<u>\$ 1,954,370</u>	<u>\$ 702,025</u>	<u>\$ 5,333,257</u>	<u>\$ 1,139,965</u>	<u>\$ 9,129,617</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Reconciliation of the Statement of Revenues, Expenditure, and Changes in Fund
Balances of Governmental Funds to the Statement of Activities
Year Ended September 30, 2018

Amounts reported for governmental activities in the statement of activities are different from changes in fund balances because:

Net change in fund balances - total governmental funds	\$ 1,026,558
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which the sum of depreciation (\$1,831,972) exceeded capital outlays (\$86,868) in the current period.	(1,745,104)
Some capital assets were donated by the Japan Government.	17,372
Governmental funds report advance lease payment as revenues. However, in the statement of net position, such is reported as unearned revenues.	(150,000)
Special item associated with gain on SDR foreign exchange adjustment.	64,586
Recovery of provision for claims	110,000
The incurrence of long-term debt (e.g. bonds, leases) provides current financial resources to governmental funds, while the repayment of principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction has any effect on net position. For the current year, these amounts consist of:	
Repayment of ADB loans	325,099
Repayment of RUS loan	<u>3,416</u>
	<u>328,515</u>
Change in net position of governmental activities	\$ <u>(348,073)</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Combining Statement of Net Position

Component Units
September 30, 2018

<u>ASSETS</u>	<u>Kosrae Port Authority</u>	<u>Kosrae Utilities Authority</u>	<u>Kosrae Housing Authority</u>	<u>Total</u>
Current assets:				
Cash and cash equivalents	\$ 9,025	\$ 345,641	\$ 7,635	\$ 362,301
Time certificate of deposit	-	167,119	-	167,119
Investments	-	750,952	-	750,952
Time certificate of deposit - restricted	-	-	200,000	200,000
Receivables:				
General	60,180	244,607	23,478	328,265
Loan	-	-	1,889,946	1,889,946
	<u>60,180</u>	<u>244,607</u>	<u>1,913,424</u>	<u>2,218,211</u>
Allowance for doubtful debts	(12,904)	(65,985)	(1,433,060)	(1,511,949)
Net receivables	<u>47,276</u>	<u>178,622</u>	<u>480,364</u>	<u>706,262</u>
Inventories	-	229,009	-	229,009
Prepayments	-	9,461	-	9,461
Total current assets	<u>56,301</u>	<u>1,680,804</u>	<u>687,999</u>	<u>2,425,104</u>
Noncurrent assets:				
Prepayments	-	28,021	-	28,021
Deposit for fuel purchase contract	-	252,800	-	252,800
Capital assets:				
Nondepreciable capital assets	-	62,560	-	62,560
Capital assets, net of accumulated depreciation	<u>15,337,621</u>	<u>2,081,366</u>	<u>99,841</u>	<u>17,518,828</u>
Total assets	\$ <u>15,393,922</u>	\$ <u>4,105,551</u>	\$ <u>787,840</u>	\$ <u>20,287,313</u>
<u>LIABILITIES AND NET POSITION</u>				
Current liabilities:				
Accounts payable	\$ 15,198	\$ 108,287	\$ 7,619	\$ 131,104
Accrued liabilities	16,265	52,429	8,970	77,664
Due to primary government	72,174	-	23,780	95,954
Loans payable	-	-	149,912	149,912
Unearned revenues	-	17,461	-	17,461
Total current liabilities	<u>103,637</u>	<u>178,177</u>	<u>190,281</u>	<u>472,095</u>
Total liabilities	<u>103,637</u>	<u>178,177</u>	<u>190,281</u>	<u>472,095</u>
Net position:				
Net investment in capital assets	15,337,621	2,143,926	99,841	17,581,388
Restricted	-	90,000	497,718	587,718
Unrestricted	<u>(47,336)</u>	<u>1,693,448</u>	<u>-</u>	<u>1,646,112</u>
Total net position	<u>15,290,285</u>	<u>3,927,374</u>	<u>597,559</u>	<u>19,815,218</u>
Total liabilities and net position	\$ <u>15,393,922</u>	\$ <u>4,105,551</u>	\$ <u>787,840</u>	\$ <u>20,287,313</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

Component Units
Year Ended September 30, 2018

	Kosrae Port Authority	Kosrae Utilities Authority	Kosrae Housing Authority	Total
Operating revenues:				
Charge for services	\$ 523,099	\$ 2,690,903	\$ 71,993	\$ 3,285,995
Operating expenses:				
Cost of services	-	1,589,009	-	1,589,009
Depreciation and amortization	700,915	381,904	10,163	1,092,982
Administration and general	461,109	934,176	196,740	1,592,025
Total operating expenses	1,162,024	2,905,089	206,903	4,274,016
Operating income (loss)	(638,925)	(214,186)	(134,910)	(988,021)
Nonoperating revenues (expenses):				
Interest income	-	1,047	-	1,047
Net change in fair value of investments	-	79,129	-	79,129
Operating grant from FSM National Government	-	-	24,100	24,100
World Bank project grant	-	89,674	-	89,674
Interest expense	-	-	(3,164)	(3,164)
Total nonoperating revenues (expenses), net	-	169,850	20,936	190,786
Capital contributions from Kosrae State Government	-	-	97,950	97,950
Capital contributions from foreign government	103,879	-	-	103,879
Change in net position	(535,046)	(44,336)	(16,024)	(595,406)
Net position at beginning of year	15,825,331	3,971,710	613,583	20,410,624
Net position at end of year	\$ 15,290,285	\$ 3,927,374	\$ 597,559	\$ 19,815,218

See accompanying notes to financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2018

(1) Summary of Significant Accounting Policies

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

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

A. Reporting Entity

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

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

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

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

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

Discretely Presented Component Units:

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

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

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

Kosrae Housing Authority (KHA): KHA was created by KSL No. 10-113 and is responsible for managing and investing funds of Kosrae Home Improvement Program and other funds of the Kosrae Housing Authority and lending money to qualified Kosraeans who wish to build and maintain residential homes in Kosrae. KHA is governed by a five-member Board of Directors, of which four members are appointed by the Governor subject to the advice and consent of the Legislature. The State has the ability to impose its will on KHA.

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

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

B. Government-Wide Financial Statements

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

Primary government activities are defined as either governmental or business-type activities. Governmental activities, which normally are supported by taxes, intergovernmental revenues and other non-exchange revenues, are reported separately from business-type activities, which rely to a significant extent on fees charged to external parties for goods or services. As such, business-type activities account for operations similarly to a for-profit business. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable. Discretely presented component unit activities are presented with their business-type focus.

The Statement of Net Position presents all of the reporting entity's non-fiduciary assets, deferred outflows of resources, liabilities, and deferred inflows of resources, with the difference reported as net position. Net position is reported in the following categories:

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

The government-wide Statement of Net Position reports \$7,896,037 of restricted net position, of which \$1,750,651 is restricted by enabling legislation.

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(1) Summary of Significant Accounting Policies, Continued

C. Fund Financial Statements

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

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

D. Measurement Focus and Basis of Accounting

Government-wide Financial Statements:

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

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

Governmental Fund Financial Statements:

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

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Component Unit Financial Statements:

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

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

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

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

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

E. Cash and Cash Equivalents and Time Certificates of Deposit

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(1) Summary of Significant Accounting Policies, Continued

F. Investments

Investments and related investment earnings of the primary government and the discretely presented component units are recorded at fair value using quoted market prices. Fair value is the price that would be received to sell an asset or paid to transfer a liability (i.e., the exit price) in an orderly transaction between market participants at the date as of which the fair value of an asset or liability is determined.

The State categorizes its fair value measurements within the fair value hierarchy established by GAAP. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs. In certain instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy is based on the lowest level of input that is significant to the fair measurement. Investments not categorized under the fair value hierarchy are shown at either Net Asset Value (NAV) or amortized cost.

G. Receivables

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

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

H. Prepaid Items

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

I. Interfund Receivables/Payables

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

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(1) Summary of Significant Accounting Policies, Continued

J. Inventories

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

K. Restricted Assets

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through loan agreements or enabling legislation. Specifically, the State has collateralized investments in the amount of \$763,150 for the Early Retirement Scheme. Furthermore, investments recorded in the Compact Trust Fund of \$5,333,257 are restricted in that they are not available to be used in current operations.

As of September 30, 2018, cash and cash equivalents and time certificates of deposit were restricted for the following uses:

Primary Government:

Deposit account established for the purpose of receiving payments pursuant to the Compact of Free Association, as amended.	\$ 627,164
Deposit account established for the Gifford scholarship fund.	41,649
Time certificate of deposit with a local bank restricted for scholarships for post-secondary students.	<u>356,359</u>
	\$ <u>1,025,172</u>

Discretely Presented Component Units:

Time certificate of deposit for the Loan Guarantee Escrow Account established for the sole purpose of loan collateralization made through the USDA Rural Development. The escrow account may be drawn down in the event of a borrower's default on the obligation under the terms of the promissory note and the deed of trust security instrument supporting such note and for which such note is guaranteed by the State, the trustee of the Loan Guarantee Escrow Account.	\$ <u>200,000</u>
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L. Other Assets

The State holds approximately 8.79% of the outstanding shares of Pacific Islands Development Bank with a carrying value of \$820,000. This equity interest does not meet the definition of an investment as the assets are held primarily for economic development and is presented as other assets in the accompanying financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(1) Summary of Significant Accounting Policies, Continued

M. Capital Assets

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

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

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

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

N. Deferred Outflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. The State has no items that qualify for reporting in this category.

O. Compensated Absences

It is the government's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since the government does not have a policy to pay any amounts when employees separate from service with the government. All vacation pay is accrued when incurred in the government-wide financial statements. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements. Annual leave accumulates at 200 hours per year. All unused annual leave is cancelled at the end of each fiscal year. Accordingly, no liability is recorded for compensated absences in the accompanying financial statements.

P. Unearned Revenues

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(1) Summary of Significant Accounting Policies, Continued

Q. Deferred Inflows of Resources

In addition to liabilities, the statements of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. The State has no items that qualify for reporting in this category.

R. Fund Balance

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

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

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

A formal minimum fund balance policy has not been adopted.

S. Interfund/Intrafund Transactions

As a general rule, the effect of interfund activity has been eliminated in the government-wide statements. Exceptions to this rule are: 1) activities between funds reported as governmental activities and funds reported as business-type activities and 2) activities between funds that are reported in different functional categories in either the governmental or business-type activities column. Elimination of these activities would distort the direct costs and program revenues for the functions concerned.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(1) Summary of Significant Accounting Policies, Continued

T. New Accounting Standards

During the year ended September 30, 2018, the State implemented the following pronouncements:

- GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments.
- GASB Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement.
- GASB Statement No. 85, *Omnibus 2017*, which addresses practice issues that have been identified during implementation and application of certain GASB Statements including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits).
- GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt.

The implementation of these statements did not have a material effect on the State's financial statements.

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

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

In June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(1) Summary of Significant Accounting Policies, Continued

T. New Accounting Standards, Continued

In April 2018, GASB issued Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, which improves the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. The provisions in Statement No. 88 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, which requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. The provisions in Statement No. 89 are effective for fiscal years beginning after December 15, 2019. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2018, GASB issued Statement No. 90, *Majority Equity Interests – an Amendment of GASB Statements No. 14 and No. 61*, which improves the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and the relevance of financial statement information for certain component units. The provisions in Statement No. 90 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

U. Risk Financing

The State is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. It is the policy of the primary government not to purchase commercial insurance for the risks of loss to which it is exposed. Instead, the State management believes it is more economical to manage its risks internally. In the event of claim settlements and judgments, the State reports all of its risk management activities in its General Fund. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. However, no material losses have been sustained from this practice in the last three years.

V. Estimates

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(1) Summary of Significant Accounting Policies, Continued

W. Total Columns

Total columns are presented primarily to facilitate financial analysis. The Management's Discussion and Analysis includes certain prior year summarized comparative information in total. Such information does not include sufficient detail to constitute a full comparative presentation. Accordingly, such information should be read in conjunction with the State's financial statements for the year ended September 30, 2017 from which summarized information was derived.

(2) Deposits and Investments

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

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

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

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

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

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2018

(2) Deposits and Investments, Continued

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

The investment policy for the Compact Trust Fund (the Trust Fund), which was adopted by the Trust Fund Committee on September 15, 2010 and amended through January 9, 2017 requires the Trust Fund to allocate its managed investment portfolios among domestic and foreign equity and fixed income securities. All or a portion of the Trust Fund may be invested in exchange traded funds ("ETFs"), mutual funds, real estate investment trusts ("REITs"), separate accounts and common trust funds (commingled vehicles), hedge funds, private equity funds, and other pooled investment vehicles ("pooled vehicles"). A common trust fund is similar to an open-ended investment company or mutual fund, but participation is limited to investors with trust accounts. Commingled and pooled vehicles that invest exclusively in marketable fixed income securities are considered to be fixed income securities for the purpose of compliance with the Trust Fund's investment policy.

The fair values of ETFs, mutual funds, and common trust funds are generally determined by the fair value of the underlying marketable equity and debt securities owned, which are principally common stocks and bonds, respectively. Publicly traded ETFs, mutual funds, and similar vehicles may trade at prices above or below the fair values of the underlying investments held; therefore the fair value of such investments may differ from the sum of the fair values of the underlying investments owned. The core fixed income portfolios may be invested in debt securities issued by the U.S. government and government agencies, foreign governments, domestic and international corporate securities, including asset-backed and mortgage-backed obligations. The fixed income portfolio may invest in convertible and high yield debt securities; however the average quality of the fixed income portfolio must be rated "investment grade" by at least one nationally recognized rating agency at the time of purchase. The Trust Fund's fixed income investment objective is for each portfolio to achieve total return similar to a relevant index, such as Barclays Capital Aggregate Index and the Bank of America Merrill Lynch Global High Yield Index.

The Trust Fund's equity investment objective is for its various portfolios to achieve total returns similar to their benchmark equity indices. Benchmark indices include the Russell 3000, the S&P 500 and the MSCI EAFE.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(2) Deposits and Investments, Continued

Private equity funds are a form of pooled investment vehicle, typically limited partnerships controlled by a private equity firm that acts as general partner. The general partner seeks to obtain specific dollar commitments from qualified institutional and accredited investors to invest capital in the fund as limited partners. The passive limited partners fund pro rata portions of their commitments when the general partner has identified an appropriate opportunity, which may be venture capital in the form of equity securities, convertible debt securities, or real estate for which no active markets exist. Venture capital is often used to finance new products and technologies, expand working capital, make acquisitions, or finance leveraged buyouts. A typical private equity fund could make between 15 and 25 separate investments over a ten-year life, with no single investment exceeding 10% of the total capital commitment. The fair values of the underlying investments held by each private equity fund are generally determined by management of the equity investee or as determined by the general partner or manager of the private equity fund and is based upon the Trust Fund's percentage ownership of the underlying investments. Investments in private equity funds generally tend to be illiquid for significant periods of time.

Hedge funds are a form of pooled investment vehicle, generally a limited partnership or a foreign (off-shore) investment corporation, that seeks to maximize absolute returns whose offering memorandum allows for the fund to take both long and short positions, use leverage and derivatives, and invest in many markets. Hedge funds often take large risks using a broad range of speculative strategies, including investing in unconventional and illiquid investments. The fair value of the Trust Fund's investment in a hedge fund is determined by the hedge fund manager and is based upon the Trust Fund's percentage ownership of the underlying investments.

Commingled separate accounts invested in real estate and related assets are carried at fair value of the underlying investments. The fair value of separate account investments in real property real estate partnerships are generally determined based on independent appraisals obtained no less frequently than annually. The fair value of separate account investments in real estate partnerships are generally determined based upon the equity method of accounting, and the fair value of underlying investments in real estate loans and mortgages are generally determined through the use of cash flow forecasting or other models by management of the insurance company that manages the separate account.

Derivatives, options and future contracts are permitted investments for the purpose of reducing risk and efficient portfolio management. Derivatives, options and futures may not be used for speculative purposes.

A. Deposits

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

As of September 30, 2018, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit was \$1,488,507 and the corresponding bank balance was \$1,807,635, which is maintained in financial institutions subject to FDIC insurance. As of September 30, 2018, bank deposits in the amount of \$442,989 were FDIC insured. The State does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Therefore, these deposits are exposed to custodial credit risk.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(2) Deposits and Investments, Continued

A. Deposits, Continued

As of September 30, 2018, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit was \$729,420 and the corresponding bank balance was \$788,757, which were maintained in financial institutions subject to FDIC insurance. As of September 30, 2018, bank deposits in the amount of \$551,712 were FDIC insured. The component units do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Therefore, these deposits are exposed to custodial credit risk.

B. Investments

Primary Government

As of September 30, 2018, the State's investments are as follows:

General Fund:	
Fixed income	\$ 217,594
Domestic equities	1,210,438
Common equities	520,369
Cash management account	<u>25,187</u>
	<u>1,973,588</u>
Compact Trust Fund:	
Common trust funds:	
Domestic Equity	738,978
International Equity	1,066,510
Fixed Income	2,218,528
Global Equity	508,100
Private Equity	250,646
Hedge Fund	206,258
Real Estate	337,961
Money market funds	<u>6,276</u>
	<u>5,333,257</u>
	\$ <u>7,306,845</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

As of September 30, 2018, the State's fixed income securities, including their Moody's investors service credit ratings, had the following maturities:

Investment Type	Fair Value	Investment Maturities (In Years)				Credit Ratings
		Current	1-5	6-10	Over 10	
U.S. Treasury Notes and Bonds	\$ 73,427	\$ 9,270	\$ 43,171	\$ 1,988	\$ 18,998	Aaa
U.S. Government Agencies Obligations:						
Federal Farm Credit Union	4,204	-	4,204	-	-	Aaa
Federal Home Loan Bank	5,690	-	1,450	4,240	-	Aaa
Federal Home Loan Mortgage Corporation	2,008	8	43	-	1,957	Aaa
Federal National Mortgage Association	7,363	2,004	-	-	5,359	Aaa
Freddie Home Loan Mortgage Corporation	5,416	-	5,416	-	-	Aaa
Private Export Funding Corporation	5,715	-	5,715	-	-	Aaa
Tennessee Valley Authority	9,486	-	3,049	-	6,437	Aaa
Overseas Private Investment Corporation	13,467	-	-	13,467	-	No rating
Government National Mortgage Association	149	-	-	-	149	No rating
Municipal Obligations	807	-	807	-	-	Aaa
Municipal Obligations	9,692	-	9,042	-	650	Aa1
Municipal Obligations	3,734	-	1,406	842	1,486	Aa2
Corporate Bonds	14,390	-	12,759	-	1,631	Aaa
Corporate Bonds	10,073	7,790	2,283	-	-	Aa1
Corporate Bonds	4,567	-	4,567	-	-	Aa2
Corporate Bonds	4,881	-	4,881	-	-	Aa3
Corporate Bonds	5,400	-	3,186	828	1,386	A1
Corporate Bonds	12,301	-	12,301	-	-	A2
Corporate Bonds	4,592	-	3,459	-	1,133	A3
Corporate Bonds	6,930	-	853	2,824	3,253	Baa1
Corporate Bonds	1,289	-	-	-	1,289	Baa2
Corporate Bonds	2,637	-	-	-	2,637	Baa3
Corporate Bonds	2,287	-	-	2,287	-	Ba1
Corporate Bonds	7,089	-	1,433	5,656	-	No Rating
	<u>\$ 217,594</u>	<u>\$ 19,072</u>	<u>\$ 120,025</u>	<u>\$ 32,132</u>	<u>\$ 46,365</u>	

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

The State has the following recurring fair value measurements as of September 30, 2018:

General Fund:

	<u>Total</u>	<u>Fair Value Measurements Using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments by fair value level:				
Fixed income:				
U.S. Treasury obligations	\$ 73,427	\$ -	\$ 73,427	\$ -
U.S. Government Agencies	53,498	-	53,498	-
Municipal obligations	14,233	-	14,233	-
Corporate notes	<u>76,436</u>	-	<u>76,436</u>	-
	217,594	-	217,594	-
Equity securities:				
U.S. equities	<u>520,369</u>	<u>520,369</u>	-	-
Total investments at fair value	737,963	\$ <u>520,369</u>	\$ <u>217,594</u>	\$ -
Investments measured at NAV:				
Equity investment in Bank of the FSM	1,210,438			
Investments measured at amortized cost:				
Cash management account	<u>25,187</u>			
	<u>\$ 1,973,588</u>			

Compact Trust Fund:

	<u>Total</u>	<u>Fair Value Measurements Using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments by fair value level:				
Common trust funds:				
Domestic Equity	\$ 738,978	\$ 738,978	\$ -	\$ -
International Equity	1,066,510	1,066,510	-	-
Global Equity	508,100	508,100	-	-
Fixed Income	2,218,528	2,218,528	-	-
Private Equity	<u>250,646</u>	-	-	<u>250,646</u>
Total investments at fair value	<u>4,782,762</u>	\$ <u>4,532,116</u>	\$ -	\$ <u>250,646</u>
Investments measured at NAV:				
Hedge Fund	206,258			
Real Estate	337,961			
Investments measured at amortized cost:				
Money market funds	<u>6,276</u>			
	<u>\$ 5,333,257</u>			

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. With the exception of investments in U.S. government securities, which are explicitly or implicitly guaranteed by the United States government, all other investments must be rated in accordance with the State's investment policy.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the State will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The State's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the State's name by the State's custodial financial institutions at September 30, 2018.

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

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

The Trust Fund's fixed income allocation consists of a Mercer Investment Management Opportunistic Fixed Income mutual fund ("MIM OFI") and a Mercer Investment Management Core Fixed Income Fund ("MIM CFI"); the performance of these funds is expected to closely replicate the performance of 50% of the JP Morgan Government Bond Index Emerging Market Global Diversified Index and 50% Bank of America/Merrill Lynch Global High Yield and the Barclays Capital U.S. Aggregate Bond Index, respectively. The bonds held by MIM CFI vary in credit quality with an average overall rating of "Aa3" as rated by Moody's as of September 30, 2018. High yield debt receiving a credit rating below "A" comprises approximately 29.2% of the MIM CFI fixed income portfolio as rated by Moody's at September 30, 2018. At September 30, 2018, the weighted average maturity of the bonds comprising MIM CFI is 10.62 years.

The bonds held by MIM OFI vary in credit quality with an average overall rating of "Baa1" as rated by Moody's as of September 30, 2018. High yield debt receiving a credit rating below "A" comprises approximately 49.3% of the MIM OFI fixed income portfolio as rated by Moody's at September 30, 2018. At September 30, 2018, the weighted average maturity of the bonds comprising MIM OFI is 6.79 years.

The Trust Fund's investment policy does not require direct investment in fixed maturity securities ("Bonds") as a means of managing its exposure to loss of principal due to increasing interest rates. The Trust Fund's investment policy requires the performance of each investment class to be periodically compared with an associated benchmark. Bonds and bond funds generally decrease in value in response to rising interest rates. Bonds, however, have a fixed date of maturity and do not have exposure to loss of principal from rising interest rates, whereas shares of a common trust fund, ETF, or similar investment vehicle have no maturity date.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

The Trust Fund's exposure to foreign currency risk is derived from its investment in common trust funds, ETFs and REITs that hold investments in securities of foreign issuers and sovereigns. Foreign currency risk is the risk that changes in foreign exchange rates will adversely affect the fair values of an investment or deposit. At September 30, 2018, the Trust Fund held approximately \$208,518,000 in securities of foreign issuers held in common trust funds. Of this amount, approximately \$40,065,000 was held in securities whose functional currency is the Euro, \$18,462,000 whose functional currency is the British pound, \$28,017,000 whose functional currency is the Japanese yen, and \$121,974,000 in functional currencies of 36 other countries. Foreign currency exposure data is not available for the Trust Fund's investment in the Hedge Funds and its investments in Global Private Equity Funds, which comprise 12.8% of invested assets at September 30, 2018.

The Trust Fund's investment in hedge funds includes ownership of the Mercer Hedge Fund Series A ("Mercer Hedge Fund") and the Blackstone Partners Offshore Fund Ltd. Mercer Hedge Funds Investors SPC, who incorporated the Mercer Hedge Fund, and the Blackstone Partners Offshore Fund Ltd. are registered under the Mutual Funds Law of the Cayman Islands. The fair value of the Trust Fund's position in the hedge fund pools are equivalent to the value of the pool shares.

The State owns 50,000 shares of the outstanding common stock of the Bank of the Federated States of Micronesia, which engages in commercial banking services in the FSM. An equity investment in the common stock of the Bank of the Federated States of Micronesia (investee) is stated at the net asset value (NAV). The NAV is used as a practical expedient to estimate fair value. The NAV is determined based on the total shareholders' equities reported by the investee.

Discretely Presented Component Units

Kosrae Utilities Authority (KUA):

As of September 30, 2018, investments comprise the following:

Money market funds	\$ 14,391
Common equities	493,067
Fixed income	<u>243,494</u>
	\$ <u>750,952</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units, Continued

Kosrae Utilities Authority (KUA), Continued:

As of September 30, 2018, the fixed income securities consist of the following:

			Investment maturities (In Years)		
		Fair Value	Less Than 1 Year	1 to 5 Years	6 to 10 Years
U.S. Treasury obligations	Aaa	\$ 115,317	\$ -	\$ 82,983	\$ 32,334
U.S. Government agencies	Aaa	41,691	-	41,691	-
Corporate notes	A2	14,091	-	7,199	6,892
Corporate notes	A3	37,434	-	21,702	15,732
Corporate notes	Baa1	12,939	-	7,958	4,981
Corporate notes	Baa2	<u>22,022</u>	<u>-</u>	<u>7,835</u>	<u>14,187</u>
		\$ <u>243,494</u>	\$ <u>-</u>	\$ <u>169,368</u>	\$ <u>74,126</u>

KUA has the following recurring fair value measurements as of September 30, 2018:

	Total	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Investments by fair value level:				
Fixed income:				
U.S. Treasury obligations	\$ 115,317	\$ -	\$ 115,317	\$ -
U.S. Government agencies	41,691	-	41,691	-
Corporate notes	<u>86,486</u>	<u>-</u>	<u>86,486</u>	<u>-</u>
Total fixed income	<u>243,494</u>	<u>-</u>	<u>243,494</u>	<u>-</u>
Equity securities:				
U.S. equities	481,263	481,263	-	-
Non U.S. equities	<u>11,804</u>	<u>11,804</u>	<u>-</u>	<u>-</u>
	<u>493,067</u>	<u>493,067</u>	<u>-</u>	<u>-</u>
Total investments at fair value	\$ <u>736,561</u>	\$ <u>493,067</u>	\$ <u>243,494</u>	\$ <u>-</u>
Investments measured at amortized cost:				
Money market funds	<u>14,391</u>			
	\$ <u>750,952</u>			

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(3) Receivables

Primary Government

Receivables as of September 30, 2018, for the primary government's individual major funds and nonmajor funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	<u>General</u>	<u>Grants Assistance</u>	<u>Compact Trust</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Receivables:					
General	\$ 113,184	\$ -	\$ -	\$ 1,009,655	\$ 1,122,839
Federal agencies	-	33,352	-	-	33,352
Due from FSM National Government	10,000	348,506	-	-	358,506
Taxes	229,598	-	-	-	229,598
Loans	<u>397,500</u>	<u>395,130</u>	<u>-</u>	<u>32,282</u>	<u>824,912</u>
	750,282	776,988	-	1,041,937	2,569,207
Less: Allowance for uncollectible accounts	<u>(498,453)</u>	<u>(395,130)</u>	<u>-</u>	<u>(999,276)</u>	<u>(1,892,859)</u>
Net receivables	\$ <u>251,829</u>	\$ <u>381,858</u>	\$ <u>-</u>	\$ <u>42,661</u>	\$ <u>676,348</u>

The final settlement of receivables due from the FSM National Government arising from Compact sector grant transactions can be determined only by final action of the FSM National Government in consultation with the grantor agency. Management is of the opinion that collection efforts will be favorable, and thus no allowance for uncollectible accounts is considered necessary.

During the year ended September 30, 2018, the final balances of Compact sector grant receivables from, payables to, the FSM National Government were determined by the FSM National Government due to grant closeout for funding years 2016 and 2017. As a result, the State recorded \$503,905 as a contribution from the FSM National Government in the general fund to reconcile its records to those of the FSM National Government.

Loans receivable of the primary government as of September 30, 2018 are as follows:

General Fund

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

Loan receivable due from Tropical Waters, Inc., uncollateralized and interest free. This loan has been fully provided for in the allowance for uncollectible accounts. \$ 30,000

\$ 397,500

Grants Assistance Fund

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(3) Receivables, Continued

Nonmajor Governmental Funds

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

\$ 32,282

(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, 2018, are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Grants Assistance	General	\$ 1,532,270
Nonmajor governmental funds	General	661,675
General	Grants Assistance	<u>381,906</u>
		\$ <u>2,575,851</u>

(5) Capital Assets

Capital asset activities for the year ended September 30, 2018, are as follows:

Primary Government

	<u>Balance October 1, 2017</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance September 30, 2018</u>
Depreciable assets:				
Buildings	\$ 27,433,910	\$ -	\$ -	\$ 27,433,910
Infrastructure	44,397,384	-	-	44,397,384
Machinery, equipment, others	<u>7,707,880</u>	<u>104,240</u>	<u>-</u>	<u>7,812,120</u>
	<u>79,539,174</u>	<u>104,240</u>	<u>-</u>	<u>79,643,414</u>
Less accumulated depreciation:				
Buildings	(15,398,938)	(630,516)	-	(16,029,454)
Infrastructure	(22,984,058)	(801,732)	-	(23,785,790)
Machinery, equipment, others	<u>(5,542,528)</u>	<u>(399,724)</u>	<u>-</u>	<u>(5,942,252)</u>
	<u>(43,925,524)</u>	<u>(1,831,972)</u>	<u>-</u>	<u>(45,757,496)</u>
	\$ <u>35,613,650</u>	\$ <u>(1,727,732)</u>	\$ <u>-</u>	\$ <u>33,885,918</u>

During the year ended September 30, 2018, depreciation expense was charged as follows:

General government	\$ 70,052
Economic development	6,833
Education	502,877
Health services	86,205
Public safety	14,225
Boards, commissions and others	<u>1,151,780</u>
	\$ <u>1,831,972</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(5) Capital Assets, Continued

Primary Government, Continued

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

Annual amortization of the lease prepayments received as of September 30, 2018, is as follows:

<u>Year ending September 30</u>	
2019	\$ 50,000
2020	50,000
2021	50,000
2022	50,000
2023	50,000
2024 – 2028	250,000
2029 - 2030	<u>100,000</u>
	\$ <u>600,000</u>

Discretely Presented Component Units

	Balance October <u>1, 2017</u>	<u>Increases</u>	<u>Decreases</u>	Balance September <u>30, 2018</u>
Depreciable assets:				
Buildings	\$ 11,941,369	\$ 79,000	\$ -	\$ 12,020,369
Utility plant	10,878,531	251,045	(270,838)	10,858,738
Infrastructure	37,972,012	-	-	37,972,012
Machinery, equipment, others	<u>950,844</u>	<u>127,899</u>	<u>-</u>	<u>1,078,743</u>
	61,742,756	457,944	(270,838)	61,929,862
Less accumulated depreciation	<u>(43,588,890)</u>	<u>(1,092,982)</u>	<u>270,838</u>	<u>(44,411,034)</u>
	18,153,866	(635,038)	-	17,518,828
Nondepreciable assets:				
Construction work-in-progress	<u>29,281</u>	<u>119,879</u>	<u>(86,600)</u>	<u>62,560</u>
	\$ <u>18,183,147</u>	\$ <u>(515,159)</u>	\$ <u>(86,600)</u>	\$ <u>17,581,388</u>

(6) Long-Term Obligations

Primary Government

Malem Wastewater System Project (MWSP) Loan:

The State borrowed \$145,000 from the U.S. Department of Agriculture Rural Utilities Services for the Malem Wastewater System Project, payable in annual installments of \$8,119 commencing September 28, 2001, interest at 4.5% per annum, due September 28, 2040. As of September 30, 2018, the balance payable on this loan amounted to \$100,338.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(6) Long-Term Obligations, Continued

Primary Government, Continued

Asian Development Bank (ADB) Loans:

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

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

Funds for the repayment of the ADB loan are expected to be derived from the annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The Financing Agreement requires the State to continue to appropriate salaries for the abolished positions and deposit the appropriated funds into the ERS Trust Account. These funds had not been deposited to the Trust Account as of September 30, 2002. Of the required \$2,000,000 identified for future debt service payments, \$763,150 is deposited in an investment account held jointly with the FSM National Government. That investment account is restricted for the repayment of this debt. As of September 30, 2018, the balance payable on this loan amounted to \$1,512,826.

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Program Loan with ADB (Loan Number 1816 FSM (SF)) for the purpose of funding the Basic Social Services Project, with interest at 1% to 1.5% per annum. Principal payments shall be made semiannually commencing February 1, 2009, with a maturity date of August 1, 2032. As of September 30, 2018, the balance payable on this loan amounted to \$56,656.

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Program Loans with ADB (Loan Number 1873 (SF) and Loan Number 1874 FSM (SF)) for the purpose of promoting private sector development in Kosrae, with interest at 1% to 1.5% per annum. Principal payments shall be made in 32 equal semi-annual payments with the first payment due on May 15, 2010 and the last payment on November 15, 2025. As of September 30, 2018, the balances payable on these loans amounted to \$335,932 and \$385,025, respectively.

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Program Loan with ADB (Loan Number 2099 FSM (SF)) for the purpose of funding the Omnibus Infrastructure Development Project, with interest at 1% to 1.5% per annum. Principal payments shall be made semiannually commencing 2013, with a maturity date of 2037. As of September 30, 2018, the balance payable on this loan amounted to \$1,610,069.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(6) Long-Term Obligations, Continued

Primary Government, Continued

Asian Development Bank (ADB) Loans, Continued:

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	\$ 247,928	\$ 50,483	\$ 298,411
2020	248,090	49,482	297,572
2021	248,259	44,474	292,733
2022	248,437	41,457	289,894
2023	248,622	38,433	287,055
2024 – 2028	1,134,206	147,464	1,281,670
2029 – 2033	1,024,232	80,312	1,104,544
2034 – 2038	<u>601,072</u>	<u>18,411</u>	<u>619,483</u>
	\$ <u>4,000,846</u>	\$ <u>470,516</u>	\$ <u>4,471,362</u>

(7) Change in Long-Term Obligations

Primary Government

Long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2018, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net position:

	<u>Balance October 1, 2017</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance September 30, 2018</u>	<u>Due Within One Year</u>
Loans payable:					
ADB loans:					
Loan 1520	\$ 1,612,148	\$ -	\$ (99,322)	\$ 1,512,826	\$ 79,628
Loan 1816	79,946	-	(23,290)	56,656	4,047
Loan 1873	390,421	-	(54,489)	335,932	44,791
Loan 1874	439,348	-	(54,323)	385,025	24,840
Loan 2099	<u>1,768,330</u>	<u>-</u>	<u>(158,261)</u>	<u>1,610,069</u>	<u>91,017</u>
	4,290,193	-	(389,685)	3,900,508	244,323
MWSP loan	<u>103,754</u>	<u>-</u>	<u>(3,416)</u>	<u>100,338</u>	<u>3,605</u>
	4,393,947	-	(393,101)	4,000,846	247,928
Other:					
Claims	<u>110,000</u>	<u>-</u>	<u>(110,000)</u>	<u>-</u>	<u>-</u>
	\$ <u>4,503,947</u>	\$ <u>-</u>	\$ <u>(503,101)</u>	\$ <u>4,000,846</u>	\$ <u>247,928</u>

When the ADB extends credit to a particular country, the loan is issued in Special Drawing Rights (SDRs) but the actual loan is delivered in the currency of the borrower, at the current exchange rate between the currency and the SDR. The value of the SDR is subject to periodic review by the International Monetary Fund, which may result in the recognition of a foreign exchange gain or loss. During the year ended September 30, 2018, the State recognized a foreign exchange gain of \$64,586 associated with valuation of the SDR, which is presented as a special item in the accompanying financial statements, and which results in a reduction in ADB loans payable.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(8) Fund Balances

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

	General <u>Fund</u>	Grants Assistance <u>Fund</u>	Compact Trust <u>Fund</u>	Nonmajor <u>Funds</u>	Total Governmental <u>Funds</u>
Non-spendable:					
General government	\$ 36,935	\$ -	\$ -	\$ -	\$ 36,935
Pacific Islands Development Bank	627,000	100,000	-	93,000	820,000
Due from component units	23,780	-	-	-	23,780
Bank of the FSM	1,210,438	-	-	-	1,210,438
Permanent fund principal	-	-	5,333,257	-	5,333,257
Restricted for:					
General government	-	553,046	-	-	553,046
Debt service	763,150	-	-	-	763,150
Capital projects	-	48,979	-	47,281	96,260
Scholarships	-	-	-	398,008	398,008
Committed for:					
Health services	-	-	-	409,371	409,371
Economic development	-	-	-	40,960	40,960
Board, commissioners, others	-	-	-	151,345	151,345
Unassigned	(706,933)	-	-	-	(706,933)
	<u>\$ 1,954,370</u>	<u>\$ 702,025</u>	<u>\$ 5,333,257</u>	<u>\$ 1,139,965</u>	<u>\$ 9,129,617</u>

(9) Operating Transfers In/Out

Primary Government

Operating transfers in/out for General Fund and nonmajor governmental funds in the aggregate, for the year ended September 30, 2018, are as follows:

<u>Source</u>	<u>Recipient</u>	<u>Transfers Out</u>	<u>Transfers In</u>
General Fund	Nonmajor Funds	\$2,977	\$2,977

Transfers are used to 1) move revenues from the fund that enabling legislation or budget requires to collect them to the fund that enabling legislation or budget requires to expend them, 2) use unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations, and 3) record reductions in interfund loans for amounts that are not expected to be repaid. Specifically, the State transferred \$2,977 from the General Fund to the nonmajor funds representing the amounts that were not expected to be repaid from the Gifford Scholarship fund to the General Fund.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(10) Commitments and Contingencies

Encumbrances

The State utilizes encumbrance accounting to identify fund obligations. Encumbrances represent commitments related to unperformed contracts for goods. At September 30, 2018, the State has significant encumbrances summarized as follows:

	<u>General</u>	<u>Grants Assistance</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Encumbrances	\$ <u>53,518</u>	\$ <u>1,570,481</u>	\$ <u>275,194</u>	\$ <u>1,899,193</u>

Sick Leave

It is the policy of the State to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave as of September 30, 2018 is \$561,127.

Insurance Coverage

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

Federal Grants

Pursuant to Title I, Section 105 of United States Public Law 99-239, the Government of the Federated States of Micronesia (FSM) (which includes the State) is no longer liable for debts to U.S. federal agencies arising prior to the date of the implementation of the Compact of Free Association. This matter has not yet been officially resolved with the U.S. Government.

Litigation

The State is party to numerous legal proceedings, many of which are normal recurrences in governmental operations. The State's Attorney General is of the opinion that the probable outcome of suits existing at September 30, 2018, 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.

Other

The State issued certain reduction-in-force checks to State employees without withholdings. This matter is being discussed between the State and the FSM National Government and State management believes that no adverse impact on the accompanying financial statements will result.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2018

(11) Budgetary Compliance

For the year ended September 30, 2018, significant over-expenditures exceeded appropriations within the General Fund for the following:

Debt service	\$ 411,725
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These over-expenditures of the General Fund have not been funded by legislative authorization.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2018

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual
General Fund
Year Ended September 30, 2018

	Budgeted Amounts		Actual - Budgetary Basis	Variance with
	Original	Final	(see Note 1)	Final Budget -
Revenues:				
FSM revenue sharing	\$ 1,158,533	\$ 1,158,533	\$ 1,196,299	\$ 37,766
State taxes	437,807	437,807	420,843	(16,964)
Licenses and fees	90,838	90,838	464,504	373,666
Net change in fair value of investments	-	-	141,068	141,068
Interest and dividends	-	-	57,002	57,002
Contribution from the FSM National Government	-	-	503,905	503,905
Other	236,558	236,558	61,374	(175,184)
Total revenues	1,923,736	1,923,736	2,844,995	921,259
Expenditures:				
Current:				
General government	1,137,954	1,122,903	1,079,576	43,327
Education	26,781	26,781	26,103	678
Public order and safety	345,300	345,300	340,655	4,645
Economic development	53,339	53,339	49,319	4,020
Boards, commissions and other	566,072	544,452	981,105	(436,653)
Total expenditures	2,129,446	2,092,775	2,476,758	(383,983)
Deficiency of revenues under expenditures	(205,710)	(169,039)	368,237	537,276
Special item:				
Write off of receivables	-	-	(38,041)	(38,041)
Other financing sources:				
Operating transfers in	-	-	(2,977)	(2,977)
	-	-	(2,977)	(2,977)
Net change in fund balance	(205,710)	(169,039)	327,219	496,258
Encumbrances	68,978	68,978	53,518	(15,460)
Fund balance at the beginning of the year	1,573,633	1,573,633	1,573,633	-
Fund balance at the end of the year	\$ 1,436,901	\$ 1,473,572	\$ 1,954,370	\$ 480,798

See Accompanying Independent Auditors' Report and Notes to Required Supplementary Information - Budgetary Reporting.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Required Supplementary Information – Budgetary Reporting
September 30, 2018

(1) Budgetary Information

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

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

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

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2018

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Combining Schedule of Expenditures by Account
Governmental Funds
Year Ended September 30, 2018

		Special Revenue	Permanent	Other Governmental Funds	Total
	General	Grants Assistance	Compact Trust		
Expenditures:					
Salaries and wages:					
Regular	\$ 1,187,874	\$ 3,861,291	\$ -	\$ 11,579	\$ 5,060,744
Overtime	21,031	141,096	-	-	162,127
Fringe benefits	145,478	502,928	-	7,208	655,614
Other personnel costs	-	5,093	-	-	5,093
Travel and transportation	197,959	379,846	-	183,057	760,862
Communications	40,358	88,728	-	-	129,086
Dues, membership, and subscriptions	13,061	11,005	-	-	24,066
Food stuffs	19,721	20,584	-	-	40,305
Port charges	-	17,066	-	-	17,066
Office supplies and materials	82,431	892,180	-	134,962	1,109,573
POL	22,456	107,684	-	8,222	138,362
Printing and reproduction	1,325	18,819	-	-	20,144
Rental services	1,008	6,122	-	-	7,130
Repairs and maintenance	1,937	40,692	-	-	42,629
Utilities	99,415	333,958	-	15	433,388
Subsidies and contributions	77,845	-	-	33,814	111,659
Medical referral	-	-	-	-	-
Medical supplies	-	412,265	-	58,117	470,382
Contractual services	28,202	1,668,757	-	1,041,272	2,738,231
Professional services	-	344,108	-	-	344,108
Scholarships and allowances	-	197,824	-	-	197,824
Training	8,911	230,810	-	-	239,721
Leased housing, buildings and land	7,530	88,697	-	-	96,227
Nonpayroll compensation	8,275	-	-	-	8,275
Equipment	6,866	268,805	-	50,365	326,036
Principal repayment	328,515	-	-	-	328,515
Interest payments	83,210	-	-	-	83,210
Miscellaneous	39,832	41,619	-	592	82,043
	<u>\$ 2,423,240</u>	<u>\$ 9,679,977</u>	<u>\$ -</u>	<u>\$ 1,529,203</u>	<u>\$ 13,632,420</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures by Function,
and Changes in Fund Balance
General Fund
Year Ended September 30, 2018
(with comparative totals for the year ended September 30, 2017)

	<u>2018</u>	<u>2017</u>
Revenues:		
FSM revenue sharing:		
Gross revenue taxes	\$ 342,350	\$ 354,156
Import taxes	375,255	356,775
Income taxes	380,665	352,805
Other taxes	98,029	79,436
	<u>1,196,299</u>	<u>1,143,172</u>
State taxes:		
Sales tax	<u>420,843</u>	<u>447,431</u>
Fees and charges:		
Licenses and fees	<u>464,504</u>	<u>268,855</u>
Net change in fair value of investments	<u>141,068</u>	<u>144,362</u>
Interest and dividend income	<u>57,002</u>	<u>50,509</u>
Contribution from the FSM National Government	<u>503,905</u>	<u>-</u>
Other	<u>61,374</u>	<u>86,742</u>
Total revenues	<u>2,844,995</u>	<u>2,141,071</u>
Expenditures:		
Current:		
General government:		
Office of the Governor	158,254	170,151
Department of Administration and Finance	95,598	89,669
Judiciary Branch	169,762	180,729
Legislative Branch	614,894	574,559
Election	12,833	4,529
	<u>1,051,341</u>	<u>1,019,637</u>
Economic development:		
Land management and preservation	46,555	52,854
Agriculture development program	-	11,435
	<u>46,555</u>	<u>64,289</u>
Education:		
Scholarship board	<u>25,115</u>	<u>26,776</u>
Public order and safety:		
Office of the Attorney General	335,004	389,571
Parole board	340	320
	<u>335,344</u>	<u>389,891</u>
Boards, Commissions and Other:		
Department of Transportation and Infrastructure	245,745	1,103,790
Broadcast Authority	51,476	45,813
Sports Council	18,420	15,502
RM Small Business Development Center	5,811	2,960
Land Court	133,604	134,831
Municipal governments	19,949	8,000
Micro Games	56,347	-
Other	21,808	3,146
	<u>553,160</u>	<u>1,314,042</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function,
and Changes in Fund Balance, Continued
General Fund
Year Ended September 30, 2018
(with comparative totals for the year ended September 30, 2017)

	<u>2018</u>	<u>2017</u>
Expenditures, continued:		
Debt service:		
Principal payments	328,515	279,231
Interest charges	<u>83,210</u>	<u>76,850</u>
	<u>411,725</u>	<u>356,081</u>
Total expenditures	<u>2,423,240</u>	<u>3,170,716</u>
Excess (deficiency) of revenues over (under) expenditures	<u>421,755</u>	<u>(1,029,645)</u>
Special items		
Write off of receivables	<u>(38,041)</u>	<u>-</u>
Other financing sources:		
Operating transfers in	-	22,042
Operating transfers out	(2,977)	-
Advance lease payment	-	450,000
Proceeds from issuance of long-term debt	<u>-</u>	<u>213,490</u>
	<u>(2,977)</u>	<u>685,532</u>
Net change in fund balance	380,737	(344,113)
Fund balance at the beginning of the year	<u>1,573,633</u>	<u>1,917,746</u>
Fund balance at the end of the year	<u>\$ 1,954,370</u>	<u>\$ 1,573,633</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures by Function,
and Changes in Fund Balance - Budget and Actual
General Fund
Year Ended September 30, 2018

	Budgeted Amounts		Actual Amounts - Budgetary Basis	Variance
	Original	Final		
Revenues:				
FSM revenue sharing:	\$ 1,158,533	\$ 1,158,533	\$ 1,196,299	\$ 37,766
State taxes:				
Sales tax	437,807	437,807	420,843	(16,964)
Fees and charges:				
Licences and fees	90,838	90,838	464,504	373,666
Net change in fair value of investments	-	-	141,068	141,068
Interest and dividend income	-	-	57,002	57,002
Contribution from the FSM National Government	-	-	503,905	503,905
Other:				
Other	236,558	236,558	61,374	(175,184)
Total revenues	1,923,736	1,923,736	2,844,995	921,259
Expenditures:				
Current:				
General government:				
Office of the Governor	159,159	161,159	162,793	(1,634)
Department of Administration and Finance	98,618	98,618	101,042	(2,424)
Judiciary Branch	216,499	199,448	178,720	20,728
Legislative Branch	646,178	646,178	621,998	24,180
Election	17,500	17,500	15,023	2,477
	1,137,954	1,122,903	1,079,576	43,327
Education:				
Scholarship board	26,781	26,781	26,103	678
Public order and safety:				
Office of the Attorney General	344,550	344,550	340,315	4,235
Parole board	750	750	340	410
	345,300	345,300	340,655	4,645
Economic development:				
Land management and preservation	53,339	53,339	49,319	4,020
Boards, commissions and other:				
Department of Transportation and Infrastructure	254,027	255,027	250,731	4,296
Broadcast Authority	53,822	53,822	51,476	2,346
Sports Council	31,033	31,033	22,024	9,009
Small Business Development Center	-	-	5,811	(5,811)
Land Court	170,490	155,490	141,234	14,256
Municipal governments	20,000	20,000	19,949	51
Micro Games	10,000	10,000	56,347	(46,347)
Other	26,700	19,080	21,808	(2,728)
Debt Service:				
Principal payments	-	-	328,515	(328,515)
Interest charges	-	-	83,210	(83,210)
	566,072	544,452	981,105	(436,653)
Total expenditures	2,129,446	2,092,775	2,476,758	(383,983)
Deficiency of revenues under expenditures	(205,710)	(169,039)	368,237	537,276
Special item:				
Write off of receivables	-	-	(38,041)	(38,041)
Other financing sources:				
Operating transfer out	-	-	(2,977)	(2,977)
Advance lease payment	-	-	-	-
	-	-	(2,977)	(2,977)
Net change in fund balance	(205,710)	(169,039)	327,219	496,258
Encumbrances	68,978	68,978	53,518	(15,460)
Fund balances at the beginning of the year	1,573,633	1,573,633	1,573,633	-
Fund balance at the end of the year	\$ 1,436,901	\$ 1,473,572	\$ 1,954,370	\$ 480,798

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

Combining Balance Sheet
September 30, 2018

	38	37/39	36	33	35	32	25	88	40	
	Scholarship Revolving Loan	Production and Development Loan	Health Care	Sports Council	Broadcasting Authority	Aluminum Recycling	CFSM Grants	Gifford Scholarship	Land Administration	Total
ASSETS										
Receivables:										
General	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 42,661	\$ -	\$ -	\$ 42,661
Due from other funds	5,476	21,082	410,262	534	9,577	135,758	53,113	-	25,873	661,675
Prepaid items	-	5	1,756	-	-	-	-	-	-	1,761
Other assets	-	-	-	-	-	-	93,000	-	-	93,000
Restricted:										
Cash and equivalents	-	-	-	-	-	-	-	41,649	-	41,649
Time certificates of deposit	-	-	-	-	-	-	-	356,359	-	356,359
Total assets	<u>\$ 5,476</u>	<u>\$ 21,087</u>	<u>\$ 412,018</u>	<u>\$ 534</u>	<u>\$ 9,577</u>	<u>\$ 135,758</u>	<u>\$ 188,774</u>	<u>\$ 398,008</u>	<u>\$ 25,873</u>	<u>\$ 1,197,105</u>
LIABILITIES AND FUND										
BALANCES										
Liabilities:										
Accounts payable	\$ -	\$ 6,000	\$ 2,647	\$ -	\$ -	\$ -	\$ 46,468	\$ -	\$ -	\$ 55,115
Other liabilities and accruals	-	-	-	-	-	-	1,992	-	-	1,992
Due to other funds	-	-	-	-	-	-	-	-	-	-
Unearned revenue	-	-	-	-	-	-	33	-	-	33
Total liabilities	<u>-</u>	<u>6,000</u>	<u>2,647</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>48,493</u>	<u>-</u>	<u>-</u>	<u>57,140</u>
Fund balances:										
Non-spendable	-	-	-	-	-	-	93,000	-	-	93,000
Restricted	-	-	-	-	-	-	47,281	398,008	-	445,289
Committed	<u>5,476</u>	<u>15,087</u>	<u>409,371</u>	<u>534</u>	<u>9,577</u>	<u>135,758</u>	<u>-</u>	<u>-</u>	<u>25,873</u>	<u>601,676</u>
Total fund balances	<u>5,476</u>	<u>15,087</u>	<u>409,371</u>	<u>534</u>	<u>9,577</u>	<u>135,758</u>	<u>140,281</u>	<u>398,008</u>	<u>25,873</u>	<u>1,139,965</u>
Total liabilities and fund balances	<u>\$ 5,476</u>	<u>\$ 21,087</u>	<u>\$ 412,018</u>	<u>\$ 534</u>	<u>\$ 9,577</u>	<u>\$ 135,758</u>	<u>\$ 188,774</u>	<u>\$ 398,008</u>	<u>\$ 25,873</u>	<u>\$ 1,197,105</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures By Function,
and Changes in Fund Balances
Year Ended September 30, 2018

	38	37/39	36	33	35	32	25	88	40	
	Scholarship Revolving Loan	Production and Development Loan	Health Care	Sports Council	Broadcasting Authority	Aluminum Recycling	CFSM Grants	Gifford Scholarship	Land Administration	Total
Revenues:										
Fees and charges	\$ -	\$ 8,852	\$ 235,470	\$ 50	\$ 1,606	\$ 90,879	\$ -	\$ -	\$ 17,595	\$ 354,452
CFSM grants	-	-	-	-	-	-	1,269,933	-	-	1,269,933
Interest income	-	32	52	-	-	45	-	1,859	-	1,988
Other revenues	3,871	-	-	-	-	-	-	-	-	3,871
Total revenues	3,871	8,884	235,522	50	1,606	90,924	1,269,933	1,859	17,595	1,630,244
Expenditures by function:										
Current:										
General Government	-	-	-	-	-	-	1,240,431	-	-	1,240,431
Economic development	-	16,748	-	-	-	-	29,502	-	-	46,250
Health services	-	-	184,091	-	-	-	-	-	-	184,091
Boards, commissions and other	-	-	-	-	-	58,431	-	-	-	58,431
Total expenditures	-	16,748	184,091	-	-	58,431	1,269,933	-	-	1,529,203
Excess of revenues over expenditures	3,871	(7,864)	51,431	50	1,606	32,493	-	1,859	17,595	101,041
Other financing uses:										
Operating transfer in	-	-	-	-	-	-	-	2,977	-	2,977
Net change in fund balances	3,871	(7,864)	51,431	50	1,606	32,493	-	4,836	17,595	104,018
Fund balances at the beginning of the year	1,605	22,951	357,940	484	7,971	103,265	140,281	393,172	8,278	1,035,947
Fund balances at the end of the year	\$ 5,476	\$ 15,087	\$ 409,371	\$ 534	\$ 9,577	\$ 135,758	\$ 140,281	\$ 398,008	\$ 25,873	\$ 1,139,965

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures By Account,
and Changes in Fund Balances
Year Ended September 30, 2018

	38	37/39	36	33	35	32	25	88	40	
	Scholarship Revolving Loan	Production and Development Loan	Health Care	Sports Council	Broadcasting Authority	Aluminum Recycling	CFSM Grants	Gifford Scholarship	Land Administration	Total
Revenues:										
Fees and charges	\$ -	\$ 8,852	\$ 235,470	\$ 50	\$ 1,606	\$ 90,879	\$ -	\$ -	\$ 17,595	\$ 354,452
CFSM Grants	-	-	-	-	-	-	1,269,933	-	-	1,269,933
Interest income	-	32	52	-	-	45	-	1,859	-	1,988
Other revenues	3,871	-	-	-	-	-	-	-	-	3,871
Total revenues	3,871	8,884	235,522	50	1,606	90,924	1,269,933	1,859	17,595	1,630,244
Expenditures by account:										
Salaries and wages:										
Regular	-	-	(3,775)	-	-	-	15,354	-	-	11,579
Fringe benefits	-	-	(471)	-	-	-	7,679	-	-	7,208
Travel and transportation	-	-	127,595	-	-	-	55,462	-	-	183,057
Food stuffs	-	-	-	-	-	-	-	-	-	-
Office supplies and materials	-	7,937	2,625	-	-	58,431	65,969	-	-	134,962
POL	-	-	-	-	-	-	8,222	-	-	8,222
Contractual services	-	8,219	-	-	-	-	1,033,053	-	-	1,041,272
Utilities	-	-	-	-	-	-	15	-	-	15
Medical supplies	-	-	58,117	-	-	-	-	-	-	58,117
Equipment	-	-	-	-	-	-	50,365	-	-	50,365
Payment to component unit	-	-	-	-	-	-	-	-	-	-
Subsidies and contributions	-	-	-	-	-	-	33,814	-	-	33,814
Miscellaneous	-	592	-	-	-	-	-	-	-	592
Total expenditures	-	16,748	184,091	-	-	58,431	1,269,933	-	-	1,529,203
Excess of revenues over expenditures	3,871	(7,864)	51,431	50	1,606	32,493	-	1,859	17,595	101,041
Other financing uses:										
Operating transfer in	-	-	-	-	-	-	-	2,977	-	2,977
Net change in fund balances	3,871	(7,864)	51,431	50	1,606	32,493	-	4,836	17,595	104,018
Fund balances at the beginning of the year	1,605	22,951	357,940	484	7,971	103,265	140,281	393,172	8,278	1,035,947
Fund balances at the end of the year	\$ 5,476	\$ 15,087	\$ 409,371	\$ 534	\$ 9,577	\$ 135,758	\$ 140,281	\$ 398,008	\$ 25,873	\$ 1,139,965

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet
September 30, 2018

	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Section 211(a)(5) Environment	Section 211(a)(6) Infrastructure
<u>ASSETS</u>						
Receivables:						
FSM National Government	\$ 174,183	\$ 6,482	\$ 31,661	\$ -	\$ -	\$ 26,195
Federal agencies	-	-	-	-	-	-
Advances	-	3,689	3,315	8,238	1,285	-
Prepayments	478,925	225	-	-	-	-
Due from other funds	-	450,819	34,801	80,945	94,698	117,903
Other assets	-	-	-	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total assets	<u>\$ 653,108</u>	<u>\$ 461,215</u>	<u>\$ 69,777</u>	<u>\$ 89,183</u>	<u>\$ 95,983</u>	<u>\$ 144,098</u>
<u>LIABILITIES AND FUND BALANCES</u>						
Liabilities:						
Accounts payable	\$ 16,445	\$ 191,083	\$ 2,191	\$ 376	\$ 11,567	\$ 48
Other liabilities and accruals	63,187	57,753	12,468	6,422	4,583	1,795
Due to other funds	318,664	-	-	-	-	24,271
Unearned revenues	<u>254,812</u>	<u>212,379</u>	<u>55,118</u>	<u>82,385</u>	<u>79,833</u>	<u>69,005</u>
	<u>653,108</u>	<u>461,215</u>	<u>69,777</u>	<u>89,183</u>	<u>95,983</u>	<u>95,119</u>
Total liabilities	<u>653,108</u>	<u>461,215</u>	<u>69,777</u>	<u>89,183</u>	<u>95,983</u>	<u>95,119</u>
Fund balances:						
Non-spendable	-	-	-	-	-	-
Restricted	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>48,979</u>
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>48,979</u>
Total fund balances	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>48,979</u>
Total liabilities and fund balances	<u>\$ 653,108</u>	<u>\$ 461,215</u>	<u>\$ 69,777</u>	<u>\$ 89,183</u>	<u>\$ 95,983</u>	<u>\$ 144,098</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet, Continued
September 30, 2018

	Section 211(a)(7) Supplemental Education	Enhanced Reporting Accountability	U.S. Federal Grants	Foreign Assistance	Total
<u>ASSETS</u>					
Receivables:					
FSM National Government	\$ -	\$ 10,839	\$ 99,146	\$ -	\$ 348,506
Federal agencies	-	-	33,352	-	33,352
Advances	1,338	-	11,686	-	29,551
Prepayments	12,559	-	-	-	491,709
Due from other funds	163,036	1,732	35,290	553,046	1,532,270
Other assets	-	-	-	100,000	100,000
	<u>-</u>	<u>-</u>	<u>-</u>	<u>100,000</u>	<u>100,000</u>
Total assets	<u>\$ 176,933</u>	<u>\$ 12,571</u>	<u>\$ 179,474</u>	<u>\$ 653,046</u>	<u>\$ 2,535,388</u>
<u>LIABILITIES AND FUND BALANCES</u>					
Liabilities:					
Accounts payable	\$ 17,293	\$ -	\$ 41,869	\$ -	\$ 280,872
Other liabilities and accruals	7,239	8,100	40,355	-	201,902
Due to other funds	-	-	38,971	-	381,906
Unearned revenues	152,401	4,471	58,279	-	968,683
	<u>176,933</u>	<u>12,571</u>	<u>179,474</u>	<u>-</u>	<u>1,833,363</u>
Total liabilities	<u>176,933</u>	<u>12,571</u>	<u>179,474</u>	<u>-</u>	<u>1,833,363</u>
Fund balances:					
Non-spendable	-	-	-	100,000	100,000
Restricted	-	-	-	553,046	602,025
	<u>-</u>	<u>-</u>	<u>-</u>	<u>553,046</u>	<u>602,025</u>
Total fund balances	<u>-</u>	<u>-</u>	<u>-</u>	<u>653,046</u>	<u>702,025</u>
Total liabilities and fund balances	<u>\$ 176,933</u>	<u>\$ 12,571</u>	<u>\$ 179,474</u>	<u>\$ 653,046</u>	<u>\$ 2,535,388</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances
Year Ended September 30, 2018

	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Section 211(a)(5) Environment	Section 211(a)(6) Infrastructure
Revenues:						
Compact funding	\$ 2,445,324	\$ 2,148,695	\$ 447,202	\$ 283,473	\$ 295,365	\$ 846,392
Federal contributions	-	-	-	-	-	-
Other grants	-	-	-	-	-	-
Total revenues	<u>2,445,324</u>	<u>2,148,695</u>	<u>447,202</u>	<u>283,473</u>	<u>295,365</u>	<u>846,392</u>
Expenditures by function:						
Current:						
General government	-	-	-	283,473	-	846,392
Economic development	-	-	447,202	-	-	-
Education	2,445,324	-	-	-	-	-
Health services	-	2,148,695	-	-	-	-
Environment protection and sanitation	-	-	-	-	295,365	-
Total expenditures	<u>2,445,324</u>	<u>2,148,695</u>	<u>447,202</u>	<u>283,473</u>	<u>295,365</u>	<u>846,392</u>
Excess of revenues over expenditures	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net change in fund balances	-	-	-	-	-	-
Fund balances at the beginning of the year	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>48,979</u>
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 48,979</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances, Continued
Year Ended September 30, 2018

	Section 211(a)(7) Supplemental Education	Enhanced Reporting Accountability	U.S. Federal Grants	Foreign Assistance	Total
Revenues:					
Compact funding	\$ 1,173,325	\$ 198,871	\$ -	\$ -	\$ 7,838,647
Federal contributions	-	-	1,826,647	-	1,826,647
Other grants	-	-	-	199,970	199,970
Total revenues	<u>1,173,325</u>	<u>198,871</u>	<u>1,826,647</u>	<u>199,970</u>	<u>9,865,264</u>
Expenditures by function:					
Current:					
General government	-	198,871	174,542	14,683	1,517,961
Economic development	-	-	-	-	447,202
Education	1,173,325	-	516,523	-	4,135,172
Health services	-	-	1,135,582	-	3,284,277
Environment protection and sanitation	-	-	-	-	295,365
Total expenditures	<u>1,173,325</u>	<u>198,871</u>	<u>1,826,647</u>	<u>14,683</u>	<u>9,679,977</u>
Excess of revenues over expenditures	<u>-</u>	<u>-</u>	<u>-</u>	<u>185,287</u>	<u>185,287</u>
Net change in fund balances	-	-	-	185,287	185,287
Fund balances at the beginning of the year	<u>-</u>	<u>-</u>	<u>-</u>	<u>467,759</u>	<u>516,738</u>
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 653,046</u>	<u>\$ 702,025</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances
Year Ended September 30, 2018

	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Section 211(a)(5) Environment	Section 211(a)(6) Infrastructure
Revenues:						
Compact funding	\$ 2,445,324	\$ 2,148,695	\$ 447,202	\$ 283,473	\$ 295,365	\$ 846,392
Federal contributions	-	-	-	-	-	-
Other grants	-	-	-	-	-	-
Total revenues	<u>2,445,324</u>	<u>2,148,695</u>	<u>447,202</u>	<u>283,473</u>	<u>295,365</u>	<u>846,392</u>
Expenditures by account:						
Salaries and wages:						
Regular	1,479,847	686,160	200,188	96,044	141,050	12,981
Overtime	-	124,658	12,088	-	10	-
Fringe benefits	190,727	94,806	28,571	11,024	19,022	1,096
Other personnel costs	-	1,000	-	-	-	-
Travel and transportation	-	30,295	37,007	40,211	31,360	5,606
Communications	12,820	6,281	14,370	11,408	5,034	329
Dues, membership, and subscriptions	-	20	-	3,435	-	-
Food stuffs	589	19,995	-	-	-	-
Port charges	279	3,757	-	-	36	-
Office supplies and materials	299,999	70,195	34,343	9,089	25,374	8,826
POL	24,347	10,183	8,659	1,016	18,836	793
Printing and reproduction	210	5,497	2,831	-	340	1,811
Rental services	131	30	37	-	25	-
Repairs and maintenance	6,708	5,100	2,298	246	1,648	-
Utilities	85,066	161,348	16,809	2,500	8,924	2,495
Medical referral	-	-	-	-	-	-
Medical supplies	-	398,397	-	-	-	-
Contractual services	113,676	144,529	72,484	66,428	29,436	756,440
Professional services	-	234,797	-	-	-	27,467
Scholarships and allowances	194,244	-	880	-	1,340	-
Training	-	49,949	3,296	27,605	5,000	-
Leased housing, buildings and land	21,420	27,901	-	13,351	1,733	-
Equipment	13,660	73,372	-	1,056	6,197	28,548
Miscellaneous	1,601	425	13,341	60	-	-
Total expenditures	<u>2,445,324</u>	<u>2,148,695</u>	<u>447,202</u>	<u>283,473</u>	<u>295,365</u>	<u>846,392</u>
Excess of revenues over expenditures	-	-	-	-	-	-
Net change in fund balances	-	-	-	-	-	-
Fund balances at the beginning of the year	-	-	-	-	-	48,979
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 48,979</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances, Continued
Year Ended September 30, 2018

	Section 211(a)(7) Supplemental Education	Enhanced Reporting Accountability	U.S. Federal Grants	Foreign Assistance	Total
Compact funding	\$ 1,173,325	\$ 198,871	\$ -	\$ -	\$ 7,838,647
Federal contributions	-	-	1,826,647	-	1,826,647
Other grants	-	-	-	199,970	199,970
Total revenues	<u>1,173,325</u>	<u>198,871</u>	<u>1,826,647</u>	<u>199,970</u>	<u>9,865,264</u>
Expenditures by account:					
Salaries and wages:					
Regular	168,317	172,811	903,893	-	3,861,291
Overtime	-	4,340	-	-	141,096
Fringe benefits	19,738	21,720	116,224	-	502,928
Other personnel costs	-	-	4,093	-	5,093
Travel and transportation	44,418	-	190,949	-	379,846
Communications	15,800	-	22,686	-	88,728
Dues, membership, and subscriptions	-	-	7,550	-	11,005
Food stuffs	-	-	-	-	20,584
Port charges	12,951	-	43	-	17,066
Office supplies and materials	348,224	-	96,130	-	892,180
POL	22,322	-	21,528	-	107,684
Printing and reproduction	628	-	7,502	-	18,819
Rental services	595	-	5,304	-	6,122
Repairs and maintenance	6,541	-	18,151	-	40,692
Utilities	26,610	-	30,206	-	333,958
Medical referral	-	-	-	-	-
Medical supplies	-	-	13,868	-	412,265
Contractual services	332,117	-	138,964	14,683	1,668,757
Professional services	1,770	-	80,074	-	344,108
Scholarships and allowances	-	-	1,360	-	197,824
Training	101,046	-	43,914	-	230,810
Leased housing, buildings and land	19,094	-	5,198	-	88,697
Equipment	46,516	-	99,456	-	268,805
Miscellaneous	6,638	-	19,554	-	41,619
Total expenditures	<u>1,173,325</u>	<u>198,871</u>	<u>1,826,647</u>	<u>14,683</u>	<u>9,679,977</u>
Excess of revenues over expenditures	-	-	-	185,287	185,287
Net change in fund balances	-	-	-	185,287	185,287
Fund balances at the beginning of the year	-	-	-	467,759	516,738
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 653,046</u>	<u>\$ 702,025</u>

See Accompanying Independent Auditors' Report.

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING
STANDARDS**

Honorable Carson K. Sigrah
Governor, the State
Federated States of Micronesia:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae (the State), as of and for the year ended September 30, 2018, and the related notes to the financial statements, which collectively comprise the State's basic financial statements, and have issued our report thereon dated June 11, 2019.

For purposes of this report, our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts and grants, and other matters did not include the Kosrae Port Authority, the Kosrae Utilities Authority, and the Kosrae Housing Authority, which were all audited by us. We have issued separate reports on our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters for these entities. The findings, if any, included in those reports are not included herein.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the State's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

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

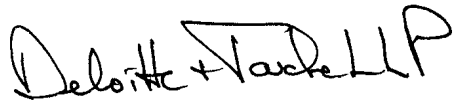
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Deloitte + State LLP". The signature is stylized, with the "D" and "S" being particularly large and prominent.

June 11, 2019

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS REQUIRED BY THE UNIFORM GUIDANCE

Honorable Carson K. Sigrah
Governor, the State
Federated States of Micronesia:

Report on Compliance for Each Major Federal Program

We have audited the State of Kosrae's (the State) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the State's major federal programs for the year ended September 30, 2018. The State's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs.

As discussed in note 3B to the Schedule of Expenditures of Federal Awards, the State's basic financial statements include the operations of certain entities whose federal awards are not included in the accompanying Schedule of Expenditures of Federal Awards for the year ended September 30, 2018. Our audit, described below, did not include the operations of the entities identified in note 3B as these entities conducted separate audits in accordance with Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance), if required.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the State's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of the Uniform Guidance. Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the State's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the State's compliance.

Opinion on Each Major Federal Program

In our opinion, the State complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2018.

Report on Internal Control Over Compliance

Management of the State is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the State's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the State's internal control over compliance.

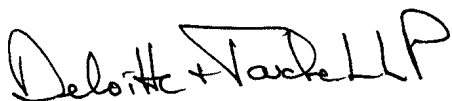
A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State as of and for the year ended September 30, 2018, and the related notes to the financial statements, which collectively comprise the State's basic financial statements. We issued our report thereon dated June 11, 2019, which contained unmodified opinions on those financial statements. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of Federal Awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

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

June 11, 2019

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Summary Schedule of Expenditures of Federal Awards, by Grantor
Year Ended September 30, 2018

Agency	Expenditures
U.S. Department of Agriculture	\$ 58,259
U.S. Department of the Interior	7,954,930
U.S. Department of Education	516,523
U.S. Department of Health and Human Services	<u>1,135,582</u>
GRAND TOTAL	<u>\$ 9,665,294</u>

Reconciliation to the basic financial statements:

Grants Assistance Fund expenditures	\$ 9,679,977
Less:	
Foreign Assistance Fund expenditures	<u>(14,683)</u>
	<u>\$ 9,665,294</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2018

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
U.S. DEPARTMENT OF AGRICULTURE:			
Direct Program:			
Forest Legacy Program	10.676		27,900
Subtotal U.S. Department of Agriculture Direct Program			27,900
Pass-Through From the FSM National Government:		A3	
Cooperative Forestry Assistance	10.664		13,843
Urban and Community Forestry Program	10.675		9,920
Forest Stewardship Program	10.678		6,596
Subtotal U.S. Department of Agriculture Pass-Through Programs			30,359
Total U.S. Department of Agriculture			\$ 58,259
U.S. DEPARTMENT OF THE INTERIOR:			
Direct Program:			
Economic, Social and Political Development of the Territories:	15.875		
Compact of Free Association Sector Grants:			
Public Auditor Grant Fund			46,351
Subtotal U.S. Department of the Interior Direct Program			46,351
Pass-Through From the FSM National Government:		A3	
Economic, Social and Political Development of the Territories:			
Compact of Free Association Sector Grants:	15.875		
Compact II Education Sector			\$ 2,445,324
Compact II Health Sector			2,148,695
Compact II Private Sector Development			447,202
Compact II Capacity Building			283,473
Compact II Environment			295,365
Compact II Infrastructure Sector			846,392
Supplemental Education Grant			1,173,325
Compact II Enhanced Reporting Accountability			198,871
Historic Preservation Fund Grants-In Aid	15.904		69,932
Subtotal U.S. Department of the Interior Pass-Through Programs			7,908,579
Total U.S. Department of the Interior			\$ 7,954,930
U.S. DEPARTMENT OF EDUCATION:			
Pass-Through From the FSM National Government:		A3	
Special Education Cluster (IDEA):			
Special Education - Grants to States	84.027A		\$ 516,523
Total Special Education Cluster (IDEA) and			
Total U.S. Department of Education			\$ 516,523
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES:			
Direct Programs:			
Health Center Program Cluster:			
Health Center Program (Community Health Centers, MHC, HCH and PHPC)	93.224		687,828
Subtotal Health Center Program Cluster			687,828
PPHF: Racial and Ethnic Approaches to Community Health Program Financed Solely By Public Prevention And Health Funds	93.738		3,055
State Targeted Response to the Opioid Crisis Grants	93.788		2,576
Subtotal U.S. Department of Health and Human Services Direct Programs			693,459

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2018

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
Pass-Through From the FSM National Government:		A3	
Affordable Care Act (ACA) Personal Responsibility Education Program	93.092		\$ 22,047
Maternal and Child Health Federal Consolidated Programs	93.110		10,506
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116		-
Family Planning - Services	93.217		33,913
Substance Abuse and Mental Health Services - Projects of Regional and National Significance	93.217		34,337
Immunization Cooperative Agreements	93.243		-
Centers for Disease Control and Prevention Investigations and Technical Assistance	93.268		106,433
Preventive Health & Health Services Block Grant funded solely with PPHF	93.283		49,336
Cancer Prevention and Control Programs for State, Territorial and Tribal Org	93.758		-
Assistance Programs for Chronic Disease Prevention & Control	93.898		27,959
Block Grants for Community Mental Health Service	93.945		588
Block Grants for Prevention and Treatment of Substance Abuse	93.958		16,186
Maternal and Child Health Services Block Grant to the States	93.959		39,979
	93.994		264
			61,618
			38,957
Subtotal U.S. Department of Health and Human Services Pass-Through Programs			442,123
Total U.S. Department of Health and Human Services			\$ 1,135,582
TOTAL EXPENDITURES OF FEDERAL AWARDS			\$ 9,665,294

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2018

1. Scope

The State is one of the four States of the Federated States of Micronesia. All significant operations of the State are included in the scope of the Single Audit. The U.S. Department of the Interior has been designated as the State's cognizant agency for the Single Audit.

2. Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards (the Schedule) includes the federal grant activity of the State under programs of the federal government for the year ended September 30, 2018. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the State, it is not intended to and does not present the financial positions or changes in financial positions of the State.

3. Summary of Significant Accounting Policies

A. Basis of Accounting

Expenditures reported on the Schedule are reported on the modified accrual basis of accounting, consistent with the manner in which the State maintains its accounting records. All expenditures and capital outlays that represent the federal share are reported as expenditures. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Pass-through entity identifying numbers are presented, where available.

B. Reporting Entity

For purposes of complying with the Single Audit Act of 1984, as amended in 1996, the State's reporting entity is defined in Note 1A to its September 30, 2018 basic financial statements; and all of the discretely presented component units are excluded and did not expend federal awards during the year ended September 30, 2018. Accordingly, the accompanying Schedule presents the federal award programs administered by the State, as defined above, for the year ended September 30, 2018.

C. Matching Costs

Matching costs, i.e., the non-federal share of certain program costs, are not included in the accompanying Schedule.

D. Indirect Cost Allocation

The State did not receive any indirect cost allocation. The State did not elect to use the de minimis indirect cost rate allowed under the Uniform Guidance and did not charge indirect costs against federal programs.

E. CFDA #15.875

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2018

Section I - Summary of Auditors' Results

Financial Statements

- | | |
|---|---------------|
| 1. Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP: | Unmodified |
| Internal control over financial reporting: | |
| 2. Material weakness(es) identified? | No |
| 3. Significant deficiency(ies) identified? | None reported |
| 4. Noncompliance material to financial statements noted? | No |

Federal Awards

Internal control over major federal programs:

- | | |
|---|------------|
| 5. Material weakness(es) identified? | No |
| 6. Significant deficiency(ies) identified? | None noted |
| 7. Type of auditors' report issued on compliance for major federal programs: | Unmodified |
| 8. Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? | No |
| 9. Identification of major federal programs: | |

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
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15.875	Economic, Social and Political Development of the Territories – Compact of Free Association Compact Sector Grants
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- | | |
|--|-----------|
| 10. Dollar threshold used to distinguish between Type A and Type B Programs: | \$750,000 |
| 11. Auditee qualified as low-risk auditee? | Yes |

Section II – Financial Statements Findings

No matters were reported.

Section III - Federal Award Findings and Questioned Costs

No matters were reported.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Summary Schedule of Prior Audit Findings and Questioned Costs
Year Ended September 30, 2018

There are no unresolved prior audit findings and questioned costs.