



FEDERATED STATES OF MICRONESIA

Office of The National Public Auditor

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August 2, 2007

His Excellency Manny Mori
President
Federated States of Micronesia
FSM National Government
Palikir, Pohnpei, FM, 9641

RE: Audit of Private Sector Development Project – ADB Loan 1874-FSM

We have audited the accompanying statement of project account of the Federated States of Micronesia Asian Development Bank Loans 1874-FSM (SF) (the Project) as of and for the year ended September 30, 2006. This financial statement is the responsibility of the Project's management. Our responsibility is to express an opinion on this financial statement 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 statement is free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Project's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 2, this financial statement was prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statement presents fairly, in all material respects, the cash receipts and disbursements of the Project as of and for the year ended September 30, 2008, on the basis of accounting described in note 2. However, we are not taking full responsibility for all years since certain prior data, as discussed in note 6, which formed part of the cumulative totals were audited by Deloitte Touche Tohmatsu, who, in their reports on 2004 and 2003 financial statements dated April 12, 2005 and September 15, 2004, respectively, expressed an unqualified opinion on those financials.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 2, 2007, on our consideration of the Project's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.



Haser Hainrick
National Public Auditor

**FEDERATED STATES OF MICRONESIA
ASIAN DEVELOPMENT BANK LOAN 1874 FSM (SF)**

**Statement of Project Account
Year Ended September 30, 2006 and Cumulative**

	Fiscal Year 2006			Cumulative (Audited - note 6)		
	ADB Share	FSM Share	Total	ADB Share	FSM Share	Total
Cash receipts:						
Loan proceeds – Direct	\$1,387,184	\$	\$ 1,387,184	\$ 2,536,080	\$ -	\$ 2,536,080
Loan proceeds - Imprest Account	555,585		555,585	881,399	-	881,399
Contributions from FSM		20,923	20,923		77,882	77,882
Total cash receipts	\$1,942,769	\$ 20,923	\$ 1,963,692	\$3,417,479	\$ 77,882	\$3,495,361
Cash disbursements:						
Civil Works						
Secured Transactions	\$ 45,720	\$	\$ 45,720	\$ 45,720	\$	\$ 45,720
Land Administration	172,890	-	172,890	364,173	-	364,173
Small Business Dev. Center	165,523		165,523	165,523		165,523
FSMDB Strengthening	0		0			
Project Implementing Unit	0		0			
Equipment and Materials						
Land Adm. & Management	360,390	-	360,390	367,380	302	367,682
Project Implementation Unit	7,340	-	7,340	15,480	-	15,480
Small Business Dev. Center	11,439		11,439	11,439		11,439
FSMDB Strengthening	173,543		173,543	173,543		173,543
Consulting Services						
Secured Transactions	61,205	-	61,205	197,606	-	197,606
Land Administration & Management	488,208	-	488,208	891,523	-	891,523
Small Business Dev. Center	57,334		57,334	57,334		57,334
FSMDB Strengthening	91,351	-	91,351	364,669	-	364,669
Project Implementation Unit	181,472	-	181,472	582,689	-	582,689
Audit	0	-	0	7,000	-	7,000
Operating Costs	36	20,923	20,959	298	77,580	77,878
Total cash disbursements	\$ 1,816,451	\$ 20,923	\$ 1,837,374	\$ 3,244,377	\$ 77,882	\$ 3,322,259
Net change in cash	\$ 126,318	-	\$ 126,318			
Cash at beginning of year	46,784	-	46,784			
Cash at end of year	\$ 173,102	-	\$ 173,102	\$ 173,102		\$ 173,102

**FEDERATED STATES OF MICRONESIA
ASIAN DEVELOPMENT BANK LOAN 1874 FSM (SF)**

Notes to Statement of Project Account
September 30, 2006

(1) Organization

On January 24, 2002, the Federated States of Micronesia (FSM) National Government entered into a loan agreement (Loan Number 1874 FSM (SF) (the Project)) with the Asian Development Bank (ADB) in the amount equivalent to Special Drawing Rights (SDR) 6,273,000 for the purpose of developing the private sector for the Federated States of Micronesia. The accumulated drawn amount for this loan is US\$3,417,479 as of September 30, 2006. The FSM National Government Department of Finance and Administration is the Project Executing Agency and is responsible for the establishment of the ADB Imprest Account to facilitate the implementation of the Project through timely release of funds. The FSM National Government Department of Economic Affairs is the Implementing Agency and is responsible for the carrying out of the Project, including authorization of payments to be made from the Imprest Account. The Imprest account is required to be operated and liquidated in accordance with ADB regulations. The accompanying statement of project account is prepared for the year ended September 30, 2006, and solely incorporates the activities of the Project.

(2) Summary of Significant Accounting Principles

Basis of Accounting

The Project's policy is to maintain its accounts and prepare its financial statement on the cash receipts and disbursements basis of accounting. All transactions are recognized as receipts or disbursements. Non-cash transactions are not recognized. The cash basis differs from accounting principles generally accepted in the United States of America primarily because receipts/revenues are recognized when received rather than when earned and disbursements/ expenses are recognized when paid rather than when the obligation is incurred.

Cash

For the purpose of the statement of project account, the Project considers cash to be cash in deposit accounts. As of September 30, 2006, the carrying amount of the Project's total cash was \$173,103 which is maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2006, the Project's deposits were fully FDIC insured.

(3) ADB Imprest Fund Account

A reconciliation of the ADB Imprest Account to cash as of September 30, 2006, is as follows:

ADB Imprest Account Bank Balance as of September 30, 2006	\$ 180,085
Outstanding checks	6,983
	<u>173,102</u>

(4) FSM Contributions

Under the provisions of the loan agreement, FSM is required to provide counterpart funding for expenditures incurred under certain categories of the Project. During the year FSM made

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ASIAN DEVELOPMENT BANK LOAN 1874 FSM (SF)**

available amount of \$20,923 in counterpart funding. The accumulated amount as of September 30, 2006 for the said counter part funding is \$77,882.

Additional in-kind assistance was provided in terms of an office for the Project Implementation Unit, staff assistance in both the National and State governments. A numerical value for this assistance has not been computed and is therefore not included in the accompanying statement of project account.

(5) Compliance with the Debt Covenants

Management is of the opinion that compliance with applicable debt covenants has occurred.

(6) Cumulative Amounts

The amounts in the cumulative cash receipts columns were calculated using the Deloitte Touche Tohmatsu's audited Financial Statements for Fiscal Years 2004 and 2003 dated April 12, 2005 and September 15, 2005, respectively, with unqualified opinion on those financials and using our audited Financial Statements for Fiscal Year 2005 and this report for 2006. The amounts in the cumulative cash disbursement subcategories were calculated using audited reports from the loan project manager for 2003, 2004, 2005 and this report for 2006. The total cash disbursements in the cumulative columns agree with the calculation of total cash disbursements using the predecessor auditor's audited Financial Statements for Fiscal Years 2003, and 2004, and our audit report for fiscal year 2005 and this report for 2006.



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RE: Audit of Private Sector Development Project – ADB Loan1874-FSM

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

We have audited the financial statement of project account of Federated States of Micronesia Asian Development Bank Loan 1874-FSM (SF) (the Project) as of and for the year ended September 30, 2006, and have issued our report thereon dated August 2, 2007. 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.

Internal Control Over Financial Reporting

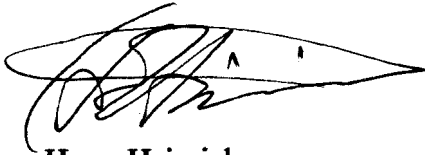
In planning and performing our audit, we considered the Project's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statement and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weakness.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatement in amounts that would be material in relation to the financial statement being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions, and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. We noted no matters involving internal control over financial reporting and its operations that we consider to be material weaknesses.

Compliance

As part of obtaining reasonable assurance about whether the Project's financial statement is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 that are required to be reported under *Government Auditing Standards*.

This report is intended for the information of the management of project account of Federated States of Micronesia Asian Development Bank Loan 1874-FSM (SF).

A handwritten signature in black ink, appearing to read 'Haser Hainrick', written over a horizontal line.

Haser Hainrick
National Public Auditor