

KOROR STATE GOVERNMENT

GENERAL PURPOSE FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEAR ENDED DECEMBER 31, 2003

INDEPENDENT AUDITORS' REPORT

Honorable Yositaka Adachi
Governor
Koror State Government:

We were engaged to audit the accompanying general purpose financial statements of the Koror State Government (the State) as of and for the year ended December 31, 2003. These financial statements are the responsibility of the State's management.

The State was unable to provide detailed property records to substantiate fixed assets in its General Fixed Assets Account Group. We were unable to ensure the propriety of fixed asset balances through the use of alternative auditing procedures.

Because of inadequacies in the State's accounting records and internal control over financial reporting, we were unable to form an opinion regarding cash, time certificates of deposit, receivables, prepaid expenses, other assets, accounts payable, accrued expenses, deferred revenue, accrued vacation leave, loans payable, fund balance - reserved for capital projects, fund balance - reserved for other assets, fund balance - unreserved, revenues, expenditures and other financing uses. Additionally, management was unable to determine detail of receivables and establish an allowance for uncollectible receivables, and has reserved such receivables in fund balance as a reserve for other assets. We were unable to determine that receivables are stated at their net realizable value at December 31, 2003 and we are unable to assess the impact of this matter on the accompanying financial statements.

Because of the matters discussed in the preceding paragraphs, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the general purpose financial statements referred to in the first paragraph.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 28, 2009, on our consideration of the State'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 an 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 considered in assessing the results of our audit.

Deloitte & Touche LLC

August 28, 2009

KOROR STATE GOVERNMENT

Balance Sheet

December 31, 2003

(With comparative totals as of December 31, 2002)

	Governmental	Account Groups		Totals	
	Fund Types -	General	General	(Memorandum Only)	
	General	Fixed	Long-Term	2003	2002
	Fund	Assets	Debt		
<u>ASSETS</u>					
Cash	\$ 207,408	\$ -	\$ -	\$ 207,408	\$ 78,374
Time certificates of deposit	-	-	-	-	54,571
Receivables:					
Land lease	3,428,227	-	-	3,428,227	2,840,799
National Government		-	-		
block grants	624,665	-	-	624,665	738,656
Employees	105,213	-	-	105,213	70,731
Other	95,679	-	-	95,679	225,942
Prepaid expenses	256,943	-	-	256,943	208,405
Amount to be provided for					
retirement of General Long-		-	-		
Term Debt	-	-	297,408	297,408	678,026
Fixed assets	-	3,650,091	-	3,650,091	3,552,071
	<u>\$ 4,718,135</u>	<u>\$ 3,650,091</u>	<u>\$ 297,408</u>	<u>\$ 8,665,634</u>	<u>\$ 8,447,575</u>
<u>LIABILITIES AND FUND BALANCE</u>					
Liabilities:					
Accounts payable	\$ 391,040	\$ -	\$ -	\$ 391,040	\$ 258,234
Accrued expenses	43,901	-	-	43,901	200,000
Deferred revenue	624,665	-	-	624,665	738,656
Accrued vacation leave	-	-	-	-	33,581
Loans payable	-	-	297,408	297,408	444,445
	<u>1,059,606</u>	<u>-</u>	<u>297,408</u>	<u>1,357,014</u>	<u>1,674,916</u>
Contingencies					
Fund balance:					
Investment in General					
Fixed Assets	-	3,650,091	-	3,650,091	3,552,071
Reserved for other assets	3,886,062	-	-	3,886,062	3,345,877
Reserved for capital projects	132,342	-	-	132,342	182,779
Deficit	(359,875)	-	-	(359,875)	(308,068)
	<u>3,658,529</u>	<u>3,650,091</u>	<u>-</u>	<u>7,308,620</u>	<u>6,772,659</u>
	<u>\$ 4,718,135</u>	<u>\$ 3,650,091</u>	<u>\$ 297,408</u>	<u>\$ 8,665,634</u>	<u>\$ 8,447,575</u>

See accompanying notes to financial statements.

KOROR STATE GOVERNMENT

General Fund
Statement of Revenues and Expenditures and Changes in Fund Balance
Year Ended December 31, 2003
(With comparative totals for the year ended December 31, 2002)

	<u>2003</u>	<u>2002</u>
Revenues:		
Local revenues	\$ 2,387,300	\$ 2,772,894
Block grants	653,335	1,202,144
Fishing rights fees	146,507	138,421
Other	<u>466,308</u>	<u>402,708</u>
Total revenues	<u>3,653,450</u>	<u>4,516,167</u>
Expenditures:		
Public works	601,019	436,942
Law enforcement	362,047	312,437
Koror State projects	238,649	1,762,795
Planning commission and public lands	222,138	184,105
Community and cultural affairs	205,520	176,992
Meriang settlement	175,000	-
Pension fund	173,819	62,057
Legislature	171,302	164,670
Traditional leaders	159,755	152,615
Treasury	118,412	150,641
Legal counsel	116,660	97,487
Administration	104,205	123,668
Social security and insurance	96,809	88,806
Contingency	57,383	38,412
Prior year debt	38,605	9,722
Capital improvement projects	28,459	67,735
Travel and transportation	19,841	16,317
Bad debts	-	482,849
Others	<u>178,849</u>	<u>125,880</u>
Total expenditures	<u>3,068,472</u>	<u>4,454,130</u>
Excess of revenues over expenditures	<u>584,978</u>	<u>62,037</u>
Other financing sources (uses):		
Proceeds from loans payable	-	500,000
Contingencies	-	(3,955)
Payment of loans payable	<u>(147,037)</u>	<u>(55,555)</u>
Total other financing sources (uses)	<u>(147,037)</u>	<u>440,490</u>
Excess of revenues over expenditures and other financing sources (uses)	437,941	502,527
Fund balance at beginning of year	<u>3,220,588</u>	<u>2,718,061</u>
Fund balance at end of year	<u>\$ 3,658,529</u>	<u>\$ 3,220,588</u>

See accompanying notes to financial statements.

KOROR STATE GOVERNMENT

Statement of Revenues and Expenditures and Changes in Fund Balance
Budget (GAAP Basis) and Actual - General Fund
Year Ended December 31, 2003

	Budget	Actual	Variance Favorable (Unfavorable)
Revenues:			
Local revenues	\$ 2,816,100	\$ 2,387,300	\$ (428,800)
Block grants and capital projects grants	1,278,000	653,335	(624,665)
Fishing rights fees	-	146,507	146,507
Other	-	466,308	466,308
	4,094,100	3,653,450	(440,650)
Expenditures:			
Koror State projects	905,000	238,649	666,351
Public works	590,625	601,019	(10,394)
Administration	123,000	362,047	(239,047)
Law enforcement	305,000	222,138	82,862
Planning commission and public lands	214,000	205,520	8,480
Community and cultural affairs	232,000	171,302	60,698
Legislature	181,800	159,755	22,045
Traditional leaders	161,500	118,412	43,088
Treasury	157,000	104,205	52,795
Legal counsel	105,000	116,660	(11,660)
Social security and insurance	93,400	96,809	(3,409)
Capital improvement projects	427,375	28,459	398,916
Pension fund	183,400	173,819	9,581
Contingency	50,000	57,383	(7,383)
Travel and transportation	30,000	19,841	10,159
Prior year debt	-	38,605	(38,605)
Meriang settlement	-	175,000	(175,000)
Others	85,000	178,849	(93,849)
	3,844,100	3,068,472	775,628
Excess of revenues over expenditures	250,000	584,978	334,978
Other financing uses:			
Payment of loans payable	(250,000)	(147,037)	102,963
	(250,000)	(147,037)	102,963
Excess of revenues over expenditures and other financing uses	-	437,941	437,941
Unreserved fund balance at beginning of year	-	3,220,588	3,220,588
Unreserved fund balance at end of year	\$ -	\$ 3,658,529	\$ 3,658,529

See accompanying notes to financial statements.

KOROR STATE GOVERNMENT

Notes to Financial Statements
December 31, 2003

(1) Organization

The Koror State Government (the State) operates within the Republic of Palau and under its own Constitution.

(2) Summary of Significant Accounting Policies

The general purpose financial statements of the Koror State Government (the State) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates. The Governmental Accounting Standards Board is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the State's accounting policies are described below.

A. Fund Accounting

The State uses funds and account groups to report on its financial position and the results of its operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain State functions or activities.

A fund is a separate accounting entity with a self-balancing set of accounts. An account group, on the other hand, is a financial reporting device designed to provide accountability for certain assets and liabilities that are not recorded in the funds because they do not directly affect net expendable available financial resources. They are concerned only with the measurement of financial position and are not involved with measurement of results of operations.

The State's sole fund is the general fund, a governmental fund type, which is used to account for all activities of the State.

B. Basis of Presentation

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. Governmental funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

The modified accrual basis of accounting is used by all governmental fund types. Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., when they become both measurable and available). "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period.

KOROR STATE GOVERNMENT

Notes to Financial Statements
December 31, 2003

(2) Summary of Significant Accounting Policies, Continued

C. Budgetary Process

The State Constitution requires that the State Executive Administrator submit to the Legislature an annual budget for State operations. Upon passage by the Legislature and the House of Traditional Leaders, the budget becomes the State's financial plan for the applicable fiscal year.

Encumbrance accounting for budgetary control purposes is not followed by the State.

D. Cash and Time Certificates of Deposits

Cash includes amounts on hand and in demand deposits. Time certificates with maturity dates in excess of three months of the date acquired are separately classified in the State's balance sheet.

The State does not require collateralization of its deposits. Cash is maintained in FDIC insured banks, with \$100,000 being subject to such coverage as of December 31, 2003. These balances represent cash per the State's bank statements as of that date and do not include outstanding checks.

E. Receivables

Receivables of the State's Governmental Fund Type consist of Block Grants receivable from the Republic of Palau National Government, fishing rights fees receivable from the Republic of Palau National Government, and actual amounts expected to be collected for taxes, licenses, fees, permits and similar revenues.

F. Inventories

Inventories of materials and supplies are generally recorded as expenditures at the time of purchase.

G. Fixed Assets

The accounting and reporting treatment applied to the fixed assets associated with a fund are determined by its measurement focus. All governmental funds are accounted for on a spending or "financial flow" measurement focus. This means that only current assets and current liabilities are generally included on their balance sheets. Their reported fund balance (net current assets) is considered a measure of "available spending resources". Governmental fund operating statements present increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets. Accordingly, they are said to present a summary of sources and uses of "available resources" during a period.

Fixed assets used in governmental fund type operations (general fixed assets) are accounted for in the General Fixed Assets Account Group rather than in governmental funds.

KOROR STATE GOVERNMENT

Notes to Financial Statements
December 31, 2003

(2) Summary of Significant Accounting Policies, Continued

G. Fixed Assets, Continued

The State does not have records of general fixed assets prior to October 1, 1991. Depreciation on the General Fixed Asset Account Group is not recorded. The State does not capitalize land or most infrastructure costs or interest cost.

H. Compensated Absences

Vested or accumulated vacation leave that is expected to be liquidated with expendable available financial resources is reported as an expenditure and a fund liability of the governmental fund that will pay it. Amounts of vested or accumulated vacation leave that are not expected to be liquidated with expendable available financial resources are reported in the General Long-Term Debt Account Group. The liability as of December 31, 2003 is \$0. No expenditure is reported for these amounts. No liability is recorded for nonvesting accumulating rights to receive sick pay benefits.

I. Fund Balance Reserves and Designation

The State's fund balance reserves represent those portions of fund balance (1) not appropriable for expenditures or (2) legally segregated for a specific future use. In the accompanying balance sheet, reserves for related assets such as inventories are examples of the former. Reserves for capital project funding received from the Republic of Palau National Government to finance specific projects is an example of the latter.

J. Fishing Rights Fees

The State receives fishing rights fees from the Republic of Palau National Government.

K. Memorandum Only - Total Column

Total columns on the general purpose financial statements are captioned as "memorandum only" because they do not represent consolidated financial information and are presented only to facilitate financial analysis. The columns do not present information that reflects financial position or results of operations or cash flows in accordance with GAAP. Interfund eliminations have not been made in the aggregation of this data.

(3) Accounts Receivable - Republic of Palau National Government

The State receives block grants from the Republic of Palau National Government. As the State cannot predict when actual receipt of cash will occur, revenues are recognized on a cash basis. The grant receivable is offset by deferred revenue pending receipt of cash.

KOROR STATE GOVERNMENT

Notes to Financial Statements
December 31, 2003

(4) Fixed Assets

Changes to the General Fixed Assets Account Group during the year ended December 31, 2003, were as follows:

	Balance at December <u>31, 2002</u>	<u>Additions</u>	<u>Deletions</u>	Balance at December <u>31, 2003</u>
General Fixed Assets	\$ <u>3,552,072</u>	\$ <u>98,019</u>	\$ <u>-</u>	\$ <u>3,650,091</u>

(5) Republic of Palau Civil Service Pension Trust Fund

Under the terms and conditions of Republic of Palau Public Law (RPPL) 2-26, the State is to contribute to the Republic of Palau Civil Service Pension Trust Fund, a defined benefit, cost-sharing multi-employer pension plan established and administered by the Republic of Palau National Government.

From the plan's inception, October 1, 1987 to March 1, 1993, the State did not participate in the plan. In March 1993, the State began withholding and making current contributions to the Plan.

The State entered into a Memorandum of Understanding (MOU) with the Fund whereby employees will only receive credit for contributed years of service subsequent to March 1, 1993. Under the terms of this MOU, the employees must waive their rights in writing to receive benefits prior to March 1, 1993. In the event that such rights are not waived, the State is responsible for payment of balances in arrears, but is allowed to pursue employees for the employee's share. The estimated contribution in arrears is unknown.

The Fund provides retirement, security and other benefits to employees, and their spouses and dependents of the Republic of Palau, Republic of Palau State Governments and Republic of Palau agencies, funds and public corporations, which are paid monthly and are two percent of each member's average monthly salary. Normal benefits are the credited total service up to a maximum of thirty years total service. Generally, benefits vest after three years of credited service. Members who retire at or after age 60, or with 25 years of vesting service, are entitled to retirement benefits. RPPL 2-26 is the authority under which benefit provisions are established. Member contribution rates are established by RPPL 2-26 at six percent (6%) of total payroll and matched dollar for dollar by the employer.

Under the provisions of RPPL 2-26, the Fund's Board of Trustees adopted a Trust Fund Operation Plan which has the force and effect of law, and which sets forth the procedures for the administration and coverage of the Plan. Amendments to the Plan are subject to the requirements of Title 6 of the Palau National Code. The State's payroll for fiscal year 2003 was covered in total by the Fund's pension plan. The Fund utilizes the actuarial cost method termed "agreement cost method" with actuarial assumptions used to compute the pension benefit obligation as follows: (a) a rate of return of 8.5% per year on the investment of present and future assets, (b) a 3% increase in employee salaries until retirement, and (c) members are assumed to retire at their normal retirement date.

KOROR STATE GOVERNMENT

Notes to Financial Statements
December 31, 2003

(5) Republic of Palau Civil Service Pension Trust Fund, Continued

The pension benefit obligation, which is the actuarial present value of credited projected benefits, is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and any step-rate benefits, estimated to be payable in the future as a result of employment service to date. The measure is intended to assist users to evaluate the Fund's funding status on a going-concern basis, and evaluate progress made in accumulating adequate assets to pay benefits when due.

The Fund's October 1, 2005 actuarial valuation determined the unfunded pension benefit obligation as follows:

Participants in pay status	\$ 47,711,000
Active participants	33,893,000
Participants with vested deferred benefits	<u>1,565,000</u>
Total pension benefit obligation	83,169,000
Net assets available for benefits, at market value	<u>41,965,000</u>
Unfunded benefit obligation	<u>\$ 41,204,000</u>

The actuarial valuation did not provide a breakdown of actuarial present value of vested and non-vested accumulated plan benefits by sponsor or net assets available for benefits by sponsor.

(6) Loans Payable

On August 12, 2002, the State obtained a loan from the National Development Bank of Palau (NDBP) amounting to \$500,000 with interest at the rate of 12% per annum payable over thirty-six (36) months beginning September 30, 2002. The loan is collateralized by a parcel of land including all improvements. Proceeds of the loan were used for the construction of a building.

Principal payments for subsequent years ending December 31 and applicable interest due, are as follows:

<u>Year ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 172,613	\$ 26,673	\$ 199,286
2005	<u>124,795</u>	<u>5,784</u>	<u>130,579</u>
	<u>\$ 297,408</u>	<u>\$ 32,457</u>	<u>\$ 329,865</u>

KOROR STATE GOVERNMENT

Notes to Financial Statements
December 31, 2003

(7) Contingencies

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 work hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave at December 31, 2003 could not be provided.

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.