

KOROR STATE GOVERNMENT

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEAR ENDED DECEMBER 31, 2004

INDEPENDENT AUDITORS' REPORT

Honorable Yositaka Adachi
Governor
Koror State Government:

We were engaged to audit the accompanying financial statements of the governmental activities and general fund of the Koror State Government (the State) as of and for the year ended December 31, 2004, which collectively comprise the State's basic financial statements. These financial statements are the responsibility of the State's management.

Because of inadequacies in the accounting records, detailed records regarding cash and cash equivalents, receivables, prepaid expenses and liabilities, and underlying supporting documentation evidencing the validity of revenues and expenditures/expenses, have not been maintained and certain supporting data were not made available during our audit. Additionally, we were unable to determine that receivables are stated at their net realizable value at December 31, 2004 and we are unable to assess the impact of this matter on the accompanying financial statements. Therefore, we were not able to satisfy ourselves about the amount at which cash and cash equivalents, receivables, prepaid expenses, liabilities, revenues and expenditures/expenses are recorded for the governmental activities and the general fund as of and for the year ended December 31, 2004.

Detailed property records were not made available for our audit concerning the underlying costs for capital assets or the bases supporting such costs. Therefore, we are not able to satisfy ourselves about the amounts at which capital assets and related accumulated depreciation are recorded for the governmental activities in the accompanying statement of net assets at December 31, 2004, and the amount of depreciation expense for the year then ended.

Because of the significance of the matters discussed in the second and third paragraphs above, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the respective financial statements of the governmental activities and the general fund.

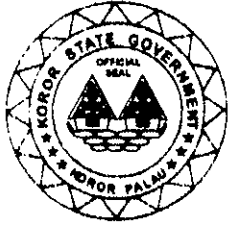
As discussed in Note 1, during the fiscal year ended December 31, 2004, the State adopted the provisions of Governmental Accounting Standards Board (GASB) Statements No. 34, *Basic Financial Statements - and Management Discussion and Analysis - for State and Local Governments*, GASB Statement No. 37, *Basic Financial Statements and Management Discussion and Analysis for State and Local Governments; Omnibus*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. The implementation of these standards changed the basic financial statement reporting model to include government-wide, full accrual statements and created a modified reporting of the fund perspective financial statements. Implementing these standards also required reporting of infrastructure assets and included the requirement for reporting a Management's Discussion and Analysis as required supplementary information. Beginning net asset and fund balances have been restated to account for the implementation of these accounting standards.

The Management's Discussion and Analysis on pages 3 through 5, as well as the Statement of Revenues, Expenditures and Changes in Fund Balance - Budget (GAAP Basis) and Actual - General Fund and notes thereto on pages 18 and 19, are not a required part of the basic financial statements but are supplementary information required by GASB. This supplementary information is the responsibility of the State's management. We did not audit and do not express an opinion on such information. However, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. As a result of these limited procedures, we believe that the Management's Discussion and Analysis is not in conformity with guidelines established by GASB because it is unknown whether it includes all required elements due to the matters discussed in the second and third paragraphs above.

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



Office of the Governor

Koror State Government

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MANAGEMENT'S DISCUSSION AND ANALYSIS Year Ended December 31, 2004

This section presents the Management's Discussion and Analysis (MD&A) of the Koror State Government's (the State) financial status and performance encompassing the fiscal year ended December 31, 2004. Please read it in conjunction with the State's financial statements, which follows this section. Fiscal year 2003 comparative information has been included where appropriate for comparative purposes.

Introductory Section

The nationally recognized accounting firm of Deloitte & Touche certified that the State's financial statements were audited in accordance with *Government Auditing Standards*.

This administration took office in January 10, 2006 and will not attempt to create additional documents to change the intentions of the previous administration. Therefore, the financial statements are reported based on the operations performance and the existing accounting practices.

Overview of the Financial Statements

At the outset, we will confine our discussion solely on what the audit for the fiscal year has entailed respective to the financial status of the State. Certain assumptions will have to be made based on the number of findings increasing from 2003 that some form of internal control policies may have been established in an effort to achieve better accountability and transparency while safeguarding and disbursing public funds.

Nevertheless, further findings clearly indicate that the probability for potential malfeasance or fraud during the year is much greater and indeed did occur which led to the concurrent termination of two key personnel within the Department of Treasury and the replacement of the Director.

Consequently, the audit reports do not provide sufficient assurance to safely and appropriately review, evaluate and forecast the future financial outlook of the State. There is a strong possibility of misstatement of revenues, overstatement of receivables and most significantly alarming mismanagement of cash collected through the State's Treasury.

Experience will recommend a major constitutional amendment that will not enable key individuals in the authority structure of the State to exercise their authority beyond their legal boundaries. Key legislation must be enacted to create opportunities for new trustworthy citizens of Koror to come on board and ensure that the interest of the people of Koror is best served.

The fear of seeing past practices resonating into the future still exists. Nevertheless, to prevent this from persisting is to ensure that internal control policies must be revamped and adhered to in order to achieve greater accountability and transparency while safeguarding the public funds for the citizens and residents of Koror.

The following condensed Statements of Net Assets highlights the aforementioned changes in condition with comparative information from prior year.

Statements of Net Assets				
	<u>2004</u>	<u>2003</u>	<u>\$</u> <u>Change</u>	<u>%</u> <u>Change</u>
Current and other assets	\$ 14,001,481	\$ 4,718,135	\$ 9,283,346	197%
Capital assets	<u>3,650,091</u>	<u>3,650,091</u>	-	0%
Total assets	\$ <u>17,651,572</u>	\$ <u>8,368,226</u>	\$ <u>9,283,346</u>	111%
Loans payable	\$ 140,254	\$ 297,408	\$ (157,154)	-53%
Other liabilities	<u>9,052,650</u>	<u>1,059,606</u>	<u>7,993,044</u>	754%
Total liabilities	<u>9,192,904</u>	<u>1,357,014</u>	<u>7,835,890</u>	577%
Net assets:				
Invested in capital assets	3,650,091	3,650,091	-	0%
Reserved for other assets	12,616,903	3,886,062	8,730,841	225%
Reserved for capital projects	132,342	132,342	-	0%
Unrestricted	<u>(7,940,668)</u>	<u>(657,283)</u>	<u>(7,283,385)</u>	1108%
Total net assets	<u>8,458,668</u>	<u>7,011,212</u>	<u>1,447,456</u>	21%
Total liabilities and net assets	\$ <u>17,651,572</u>	\$ <u>8,368,226</u>	\$ <u>9,283,346</u>	111%

A condensed year-to-year comparison of operating activity follows:

Statements of Activities				
	<u>2004</u>	<u>2003</u>	<u>\$</u> <u>Change</u>	<u>%</u> <u>Change</u>
Revenues:				
Local revenues	\$ 2,585,216	\$ 2,387,300	\$ 197,916	8%
Block grants	1,237,366	653,335	584,031	89%
Fishing rights fees	171,744	146,507	25,237	17%
Other	<u>73,145</u>	<u>466,308</u>	<u>(393,163)</u>	-84%
Total revenues	<u>4,067,471</u>	<u>3,653,450</u>	<u>414,021</u>	11%
Expenditures:				
Public works	605,613	601,019	4,594	1%
Law enforcement	407,331	362,047	45,284	13%
Koror State projects	358,689	238,649	120,040	50%
Community and cultural affairs	205,848	205,520	328	0%
Others	<u>1,339,942</u>	<u>1,661,237</u>	<u>(321,295)</u>	-19%
Total expenditures	<u>2,917,423</u>	<u>3,068,472</u>	<u>(151,049)</u>	-5%
Change in net assets	1,150,048	584,978	565,070	97%
Net assets at beginning of year	<u>7,308,620</u>	<u>6,426,234</u>	<u>882,386</u>	14%
Net assets at end of year	\$ <u>8,458,668</u>	\$ <u>7,011,212</u>	\$ <u>1,447,456</u>	21%

Capital Assets

At December 31, 2004 and 2003, the State had \$3,650,091 invested in capital assets. See note 4 to the financial statements for more information on the State's capital assets.

Long-Term Debt

On August 12, 2002, the State obtained a loan from the National Development Bank of Palau 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.

See note 6 to the financial statements for more information on the State's long-term debt.

Economic Outlook

The economic outlook of the State will improve as tourism opportunities increase and revenue amounts go up.

Contacting the State's Financial Management

This financial report is designed to provide a general overview of the State's finances and to demonstrate the State's accountability for the money it receives. If you have questions about the 2004 report, or need additional information, please contact the Koror State Government Department of Finance, P.O. Box 116, Koror, Republic of Palau 96940, or e-mail finance@kororstate.org or call 488-5005/8600.

KOROR STATE GOVERNMENT

Governmental Funds Balance Sheet/Statement of Net Assets
December 31, 2004

	General Fund	Adjustments (Note 2)	Statement of Net Assets
<u>ASSETS</u>			
Cash	\$ 886,102	\$ -	\$ 886,102
Receivables:			
Land lease	12,084,804	-	12,084,804
National Government block grants	498,476	-	498,476
Employees	129,707	-	129,707
Other	104,918	-	104,918
Prepaid expenses	297,474	-	297,474
Capital assets, net of accumulated depreciation	-	3,650,091	3,650,091
Total assets	\$ 14,001,481	\$ 3,650,091	\$ 17,651,572
<u>LIABILITIES</u>			
Accounts payable	\$ 317,585	\$ -	\$ 317,585
Accrued expenses	32,552	-	32,552
Deferred revenue	8,702,513	-	8,702,513
Loans payable	140,254	-	140,254
Total liabilities	9,192,904	-	9,192,904
Contingencies			
<u>FUND BALANCES/NET ASSETS</u>			
Fund balances:			
Reserved for other assets	12,616,903	(12,616,903)	-
Reserved for capital projects	132,342	(132,342)	-
Unreserved	(7,940,668)	7,940,668	-
Total fund balances	4,808,577	(4,808,577)	-
Total liabilities and fund balances	\$ 14,001,481		
Net assets:			
Invested in capital assets		3,650,091	3,650,091
Unrestricted		4,808,577	4,808,577
Total net assets		\$ 8,458,668	\$ 8,458,668

See accompanying notes to financial statements.

KOROR STATE GOVERNMENT

Statement of Governmental Fund Revenues, Expenditures and
Changes in Fund Balance/Statement of Activities
Year Ended December 31, 2004

	General Fund	Adjustments (Note 2)	Statement of Activities
Revenues:			
Local revenues	\$ 2,585,216	\$ -	\$ 2,585,216
Block grants	1,237,366	-	1,237,366
Fishing rights fees	171,744	-	171,744
Other	73,145	-	73,145
Total revenues	4,067,471	-	4,067,471
Expenditures/expenses:			
Public works	605,613	-	605,613
Law enforcement	407,331	-	407,331
Koror State projects	358,689	-	358,689
Planning commission and public lands	210,532	-	210,532
Community and cultural affairs	205,848	-	205,848
Legislature	161,802	-	161,802
Treasury	133,832	-	133,832
Pension fund	133,228	-	133,228
Traditional leaders	130,247	-	130,247
Legal counsel	120,361	-	120,361
Social security and insurance	96,137	-	96,137
Administration	91,224	-	91,224
Meriang Settlement	50,000	-	50,000
Contingency	25,261	-	25,261
Interest	22,684	-	22,684
Travel and transportation	21,626	-	21,626
Prior year debt	15,854	-	15,854
Capital improvement projects	13,140	-	13,140
Other	114,014	-	114,014
Total expenditures/expenses	2,917,423	-	2,917,423
Excess of revenues over (under) expenditures	1,150,048	(1,150,048)	-
Changes in net assets	-	1,150,048	1,150,048
Fund balance/net assets:			
Beginning of the year	3,658,529	-	7,308,620
End of the year	\$ 4,808,577	\$ -	\$ 8,458,668

See accompanying notes to financial statements.

KOROR STATE GOVERNMENT

Notes to Financial Statements
December 31, 2004

(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 accompanying basic 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.

Government-Wide Financial Statements

The Statement of Net Assets and the Statement of Activities report information on all nonfiduciary activities of the State.

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.

The Statement of Net Assets presents the State's nonfiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- Invested in capital assets consists of capital assets, net of accumulated depreciation plus construction or improvement of those assets.
- Restricted net assets result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through enabling legislation. The State has no restricted net asset at December 31, 2004.
- Unrestricted net assets consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated (for example, internally restricted), to indicate that management does not consider them to be available for general operations. They often have resources that are imposed by management, but can be removed or modified.

The degrees to which direct expenses of given functions or segments are offset by program revenues are described as follows:

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	<u>Net (Expense) Revenue and Changes In Net Assets Primary Government</u>
Governmental activities:					
General government	\$ 1,698,631	\$ -	\$ 1,237,366	\$ -	\$ (461,265)
Public safety	407,331	-	-	-	(407,331)
Public works	605,613	-	-	-	(605,613)
Culture and recreation	<u>205,848</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(205,848)</u>
	\$ 2,917,423	\$ -	\$ 1,237,366	\$ -	\$ (1,680,057)

KOROR STATE GOVERNMENT

Notes to Financial Statements
December 31, 2004

(2) Summary of Significant Accounting Policies, Continued

Government-Wide Financial Statements, Continued

Direct expenses are those that are clearly identifiable within a specific function. 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 do not meet the definition of program revenues.

Fund Financial Statements

The State uses one governmental fund to report on its financial position and results of operations. The operations of this fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures.

Separate financial statements are provided for governmental funds. The State presents a balance sheet and a statement of revenues, expenditures and changes in fund balances for its governmental fund. The ending fund balance on the balance sheet is then reconciled to the ending governmental net assets.

Adjustments required to reconcile total governmental fund balance to net assets of governmental activities in the Statement of Net Assets are as follows:

Total fund balance - governmental funds	\$ 4,808,577
Capital assets	<u>3,650,091</u>
Total net assets - governmental activities	\$ <u>8,458,668</u>

There are no adjustments required to reconcile net change in total governmental fund balance to change in net assets of governmental activities in the Statement of Activities as the State has not recorded depreciation.

Measurement Focus and Basis of Accounting

The government-wide financial statements are reported using the economic resources measurement 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 cash flows. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met.

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.

KOROR STATE GOVERNMENT

Notes to Financial Statements
December 31, 2004

(2) Summary of Significant Accounting Policies, Continued

Measurement Focus and Basis of Accounting, Continued

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

Unrestricted contributions and grants are recorded as revenue in the statement of revenues, expenditures, and changes in fund balances when received (in the case of contributions) or when approved by the grantor agency (in the case of grants).

Cash and Cash Equivalents

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.

For purposes of the balance sheet/statement of net assets, cash and cash equivalents is defined as cash on hand, and cash held in demand accounts. As of December 31, 2004, the carrying amount of the primary government's total cash and cash equivalents was \$886,102 and the corresponding bank balance was \$956,088, which is maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2004, bank deposits in the amount of \$100,000 were FDIC insured. The State does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

Receivables

In general, tax revenue is recognized on the government-wide statements, when assessed or levied and on the governmental fund financial statements to the extent that it is both measurable and available. 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. The allowance for doubtful accounts is stated at an amount that management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectability of these accounts and prior collection experience. The allowance is established through an allowance for doubtful accounts charged to bad debts expense.

Capital Assets

Capital assets are reported in the government-wide financial statements. Such assets, whether purchased or constructed, are recorded at historical cost or estimated historical cost. Contributed capital assets are recorded at estimated fair market value at the date of donation.

KOROR STATE GOVERNMENT

Notes to Financial Statements
December 31, 2004

(2) Summary of Significant Accounting Policies, Continued

Capital Assets, Continued

The State has not developed a capitalization policy. The costs of normal maintenance and repairs that do not add to the value of asset or materially extend assets lives are not capitalized. The State has not developed a depreciation policy. When capital assets are disposed, the cost and applicable accumulated depreciation are removed from the respective accounts, and the resulting gain or loss is recorded in the statement of activities.

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. No expenditure is reported for these amounts. No liability is recorded for nonvesting accumulating rights to receive sick pay benefits.

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.

Estimates

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

New Accounting Standards

During fiscal 2004, the State implemented the following new accounting standards issued by the GASB:

- 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 - Omnibus*, establishes new financial reporting standards for state and local governments. The requirements of this statement result in a significant change in the financial reporting model used by governments, including statement formats and changes in fund types. In addition to the traditional fund financial statements, governments are required to report government-wide financial statements, prepared using the accrual basis of accounting and the economic resources measurement focus. As a result, fund reclassifications and adjustments to the fund equities reported in the prior financial statements were required.

KOROR STATE GOVERNMENT

Notes to Financial Statements
December 31, 2004

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, amends certain note disclosures and adds additional note disclosure requirements related to GASB Statement Nos. 34 and 37.
- GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units (an amendment of GASB Statement No. 14)*, provides criteria for determining whether certain organizations should be reported as component units based on the nature and significance of their relationship with a primary government and to clarify reporting requirements for those organizations.
- GASB Statement No. 41, *Budgetary Comparison Schedules - Perspective Differences*, amends required supplemental information disclosure of adopted budget and actual amounts per GASB Statement No. 34. Should there be a perspective difference between these amounts and fund perspective revenues and expenditures, reconciliation is required.
- GASB Technical Bulletin No. 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets*, which clarifies guidance on derivative disclosures pending the results of the GASB's project on reporting and measurement of derivatives and hedging activities.
- Due to the implementation of GASB Statement Nos. 34 and 37, the beginning net assets of the governmental activities in the statement of net assets have been restated. The effect on fund balances of the governmental funds at December 31, 2003 could not be determined.

For fiscal year 2005, the State will be implementing GASB Statement No. 40, *Deposit and Investment Risk Disclosures* (an amendment of GASB Statement No. 3), which addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, GASB Statement No. 40 requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In November 2003, GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes standards for impairment of capital assets when its service utility has declined significantly or unexpectedly. The provisions of this Statement are effective for periods beginning after December 15, 2004. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

KOROR STATE GOVERNMENT

Notes to Financial Statements
December 31, 2004

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which establishes uniform reporting standards for other postemployment benefits and supersedes the interim guidance included in GASB Statement No. 26. The provisions of this Statement are effective for periods beginning after December 15, 2005. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.
- In May 2004, GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment to NCGA Statement 1*. GASB Statement No. 44 improves the understandability and usefulness of statistical section information and adds information from the new financial reporting model for state and local governments required by GASB Statement No. 34. The provisions of this Statement are effective for periods beginning after June 15, 2005. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.
- In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other post employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

(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.

(4) Fixed Assets

Capital asset activities for the year the year ended December 31, 200, are as follows:

	Balance at December 31, 2003	Additions	Deletions	Balance at December 31, 2004
General Fixed Assets	\$ <u>3,650,091</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>3,650,091</u>

KOROR STATE GOVERNMENT

Notes to Financial Statements
December 31, 2004

(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.

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.

KOROR STATE GOVERNMENT

Notes to Financial Statements
December 31, 2004

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

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) Loan 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.

Changes in the loan payable for the year ended December 31, 2004, are as follows:

	Balance January <u>1, 2003</u>	<u>Additions</u>	<u>Reductions</u>	Balance December <u>31, 2004</u>	Due Within <u>One Year</u>
Loan payable	\$ <u>297,408</u>	\$ <u>-</u>	\$ <u>(151,370)</u>	\$ <u>146,038</u>	\$ <u>146,038</u>

(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, 2004 could not be provided.

KOROR STATE GOVERNMENT

Notes to Financial Statements
December 31, 2004

(7) Contingencies, Continued

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.

KOROR STATE GOVERNMENT
REQUIRED SUPPLEMENTARY INFORMATION
YEAR ENDED DECEMBER 31, 2004

KOROR STATE GOVERNMENT

Statement of Revenues and Expenditures and Changes in Fund Balance
Budget (GAAP Basis) and Actual - General Fund
Year Ended December 31, 2004

	Budgeted Amounts		Actual	Variance
	Original	Final		Favorable (Unfavorable)
Revenues:				
Local revenues	\$ 2,404,100	\$ 2,404,100	\$ 2,585,216	\$ 181,116
Block grants and capital projects grants	1,237,366	1,237,366	1,237,366	-
Fishing rights fees	140,000	140,000	171,744	31,744
Other	45,000	45,000	73,145	28,145
Total revenues	3,826,466	3,826,466	4,067,471	241,005
Expenditures:				
Public works	616,625	616,625	605,613	11,012
Law enforcement	377,000	377,000	407,331	(30,331)
Koror State projects	497,500	497,500	358,689	138,811
Planning commission and public lands	235,600	235,600	210,532	25,068
Community and cultural affairs	237,000	237,000	205,848	31,152
Legislature	175,000	175,000	161,802	13,198
Treasury	140,000	140,000	133,832	6,168
Pension fund	205,000	205,000	133,228	71,772
Traditional leaders	145,500	145,500	130,247	15,253
Legal counsel	131,000	131,000	120,361	10,639
Social security and insurance	93,000	93,000	96,137	(3,137)
Administration	91,500	91,500	91,224	276
Meriang Settlement	100,000	100,000	50,000	50,000
Contingency	25,000	25,000	25,261	(261)
Interest	200,000	200,000	22,684	177,316
Travel and transportation	30,000	30,000	21,626	8,374
Prior year debt	50,000	50,000	15,854	34,146
Capital improvement projects	366,741	366,741	13,140	353,601
Other	110,000	110,000	114,014	(4,014)
Total expenditures	3,826,466	3,826,466	2,917,423	909,043
Excess of revenues over expenditures	-	-	1,150,048	1,150,048
Unreserved fund balance at beginning of year	-	-	7,308,620	7,308,620
Unreserved fund balance at end of year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,458,668</u>	<u>\$ 8,458,668</u>

See accompanying Independent Auditors' Report.

KOROR STATE GOVERNMENT

Notes to Required Supplementary Information - Budgetary Reporting
December 31, 2004

(1) Budgetary Information

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.