

KOROR STATE GOVERNMENT

FINANCIAL STATEMENTS AND  
ADDITIONAL INFORMATION  
AND  
INDEPENDENT AUDITORS' REPORT

YEAR ENDED DECEMBER 31, 2006



November 23, 2010

*Robert J. Jovine LLC*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 23, 2010, 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 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.

Nevertheless, due to inadequacies in accounting records regarding lease receivables, fixed assets and prepaid expenses, the State is struggling to develop procedures to account for and correct current and prior audit findings to increase the reliability of its financial statements.

In an attempt to strengthen internal control policies, the State established a procurement section to ensure compliance with the procurement regulations in 2006. In addition, procedures have been implemented to preclude tampering with receipts and cash and to prevent the probability for potential malfeasance or fraud.

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.

At the outset, we will confine our discussion solely on what the audit engagement for the fiscal year has entailed respective to the financial status of the State. Certain assumptions can be made based on the number of findings decreasing from 29 in 2005 to 17 in 2006 that some form of internal control policies have been established in an effort to achieve better accountability and transparency while safeguarding and disbursing public funds.

### Overview of the Financial Statements

It is a vision of this administration that the State becomes a model organization for good governance to protect and serve the people of Koror with the principle spirit of our ancestors: A Oreo a ou rois er a rechad.

The mission of the State is "To serve and protect citizens of Koror State, the traditional and cultural community, and business agencies by providing accurate and timely information and by preserving assets and records of the government with greater accountability and transparency."

The State operates within the Republic of Palau and under its own Constitution.

### Introductory Section

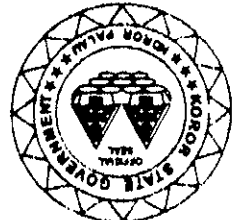
This section presents the Management's Discussion and Analysis (MD&A) of the Koror State Government's (the State) financial status and performance encompassing the fiscal year ended December 31, 2006. Please read in conjunction with the State's financial statements, which follows this section. Fiscal year 2005 comparative information has been included where appropriate for comparative purposes. The accounting firm of Deloitte & Touche was engaged to audit the State's financial statements in accordance with *Government Auditing Standards*.

## MANAGEMENT DISCUSSION AND ANALYSIS Year Ended December 31, 2006

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*Office of the Governor*



The State's financial transactions and subsequent statements are prepared in accordance with accounting principles generally accepted in the United States of America and standards mandated by the Governmental Accounting Standards Board, as applicable to governmental entities.

The State operates on an accrual basis wherein revenues are recognized when earned, not when received and expenses are recorded when incurred, not when paid. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met. Capital assets are recorded at historical cost or estimated historical cost and are depreciated using the straight-line method. Contributed capital assets are recorded at estimated fair market value at the date of donation. Further information is provided in the footnotes of the accompanying financial statements.

The financial statements of this report consist of the MD&A, the basic financial statements, and notes to the financial statements. The basic financial statements consist of the Governmental Funds Balance Sheet/Statement of Net Assets and the Statement of Governmental Fund Revenues, Expenditures and Changes in Fund Balance/Statement of Activities.

The State uses one governmental fund to report on its financial position and results of operations. The State presents a balance sheet and a statement of revenues, expenditures and changes in fund balances for its governmental fund.

A condensed Governmental Funds Balance Sheet/Statement of Net Assets as of September 30, 2006 follows with comparative information as of September 30, 2005:

**Governmental Funds Balance Sheet/Statements of Net Assets**

	2006		2005	
	General Fund	Net Assets	General Fund	Net Assets
Current and other assets	\$ 9,687,399	\$ 9,687,399	\$ 10,896,951	\$ 10,896,951
Capital assets	-	3,650,091	-	3,650,091
Total assets	\$ 9,687,399	\$ 13,337,490	\$ 10,896,951	\$ 14,547,042
Other liabilities	\$ 3,558,147	\$ 3,558,147	\$ 4,457,280	\$ 4,457,280
Total liabilities	3,558,147	3,558,117	4,457,280	4,457,280
Fund balances:				
Reserved for other assets	7,319,553		8,648,150	
Reserved for capital projects	1,786,987		132,743	
Unreserved	(2,977,288)		(2,341,222)	
Total liabilities and fund balances	\$ 9,687,399		\$ 10,896,951	
Net assets:				
Invested in capital assets	3,650,091		3,650,091	
Unrestricted	6,129,252		6,439,671	
Total net assets	\$ 9,779,343		\$ 10,089,762	

A condensed Statement of Governmental Fund Revenues, Expenditures and Changes in Fund Balance/Statement of Activities for the year ended September 30, 2006 follows with comparative information for the year ended September 30, 2005:

The new State administration has embarked on a mission to create more services as well as improve the level of current services to better meet the current demand from Koror residents and its clearly dedicated by the continuing growth in personnel and programs. It remains a challenge for the State to maintain its current revenues while seeking new sources to accommodate all of its programs and personnel costs.

There is insufficient National Government cash flow to disburse the State's share of block grants and fishing rights in a timely manner.

3. **National Government's Appropriation:**

It seems that the same is true for land lease revenues, but new opportunities for reclamation areas for commercial lease can create new revenues.

2. **Land Lease Revenue:**

During the recent global recession, the State has experienced a decline in the tourism industry causing a drop in our local revenues.

1. **Rock Island Diving Permits:**

The economic outlook of the State will improve as tourism opportunities and revenues increase. In fiscal year 2006, the State's main source of revenue is tourism (Rock Island diving permits), land leases and the National Government's appropriation (block grants and fishing rights fees).

**Economic Outlook**

At December 31, 2006 and 2005, 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.

**Capital Assets**

	2006		2005	
	General Fund	Net Assets	General Fund	Net Assets
Revenues:	\$ 2,622,694	\$ 2,622,694	\$ 3,500,560	\$ 3,500,560
Local revenues	867,625	867,625	852,625	852,625
Block grants	264,583	264,583	224,777	224,777
Fishing rights fees	7,104	7,104	15,789	15,789
Other				
Total revenues	3,762,006	3,762,006	4,593,751	4,593,751
Expenditures/expenses:	1,522,268	1,522,268	1,309,013	1,309,013
General government	897,414	897,414	632,889	632,889
Public works	897,414	897,414	632,889	632,889
Koror State projects	767,461	767,461	344,421	344,421
Law enforcement	504,963	504,963	439,484	439,484
Community and cultural affairs	380,319	380,319	236,854	236,854
Total expenditures/expenses	4,072,425	4,072,425	2,962,661	2,962,661
Excess of revenues (under) over expenditures	(310,419)	-	1,631,090	-
Change in net assets	-	(310,419)	-	1,631,090
Fund balance/net assets at beginning of year	6,439,671	10,089,762	4,808,581	8,458,672
Fund balance/net assets at end of year	\$ 6,129,252	\$ 9,779,343	\$ 6,439,671	\$ 10,089,762

Statements of Governmental Fund Revenues, Expenditures and Changes in Fund Balance/Statements of Activities

**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. The Management's Discussion and Analysis for the year ended December 31, 2005 is set forth in the report on the audit of the State's financial statements which is dated August 28, 2009. That Discussion and Analysis explains the major factors impacting the 2005 financial statements. If you have questions about the 2005 report, or need additional information, please contact the Koror State Government Department of Treasury, P.O. Box 116, Koror, Republic of Palau 96940, or email [finance@kororstate.org](mailto:finance@kororstate.org) or call 488-5005/8600.





KOROR STATE GOVERNMENT

Statement of Governmental Fund Revenues, Expenditures and  
Changes in Fund Balance/Statement of Activities  
Year Ended December 31, 2006

Statement of Activities	Adjustments (Note 2)	General Fund
\$ 2,622,694	-	\$ 2,622,694
867,625	-	867,625
264,583	-	264,583
7,104	-	7,104
<u>3,762,006</u>	<u>-</u>	<u>3,762,006</u>
Expenditures/expenses:		
Local revenues		
Block grants		
Fishing rights fees		
Other		
Total revenues		
897,414	-	897,414
Public works		
Koror State projects		
Law enforcement		
Community and cultural affairs		
Legislature		
232,231	-	232,231
Treasury		
217,354	-	217,354
Planning commission and public lands		
Traditional leaders		
156,146	-	156,146
Utility		
129,607	-	129,607
Social security and insurance		
110,631	-	110,631
Legal counsel		
113,143	-	113,143
Administration		
108,987	-	108,987
Pension fund		
88,827	-	88,827
Contingency		
45,851	-	45,851
Travel and transportation		
36,935	-	36,935
Prior year debt		
31,545	-	31,545
Others		
42,655	-	42,655
Total expenditures/expenses		
4,072,425	-	4,072,425
Excess of revenues over (under) expenditures Changes in net assets		
(310,419)	310,419	-
Fund balance/net assets: Beginning of the year		
6,439,671	-	6,439,671
End of the year		
\$ 6,129,252	\$ -	\$ 6,129,252
10,089,762	-	10,089,762
\$ 9,779,343	\$ -	\$ 9,779,343

See accompanying notes to financial statements.

KOROR STATE GOVERNMENT

Notes to Financial Statements  
December 31, 2006

(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 assets at December 31, 2006.
- 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:

Functions/Programs	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Net (Expense) Revenue and Changes in Net Assets
Governmental activities:					
General government	\$ 2,289,729	\$ -	\$ 867,625	\$ -	\$ (1,422,104)
Public safety	504,963	-	-	-	(504,963)
Public works	897,414	-	-	-	(897,414)
Culture and recreation	380,319	-	-	-	(380,319)
	\$ 4,072,425	\$ -	\$ 867,625	\$ -	\$ (3,204,800)
		\$ -			
		\$ -			

KOROR STATE GOVERNMENT

Notes to Financial Statements  
December 31, 2006

(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	\$ 6,129,252
Capital assets	3,650,091
Total net assets - governmental activities	<u>\$ 9,779,343</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, 2006

(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, 2006, the carrying amount of the primary government's total cash and cash equivalents was \$813,967 and the corresponding bank balance was \$806,920, which is maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2006, 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.

(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 appropriate for expenditures or (2) legally segregated for a specific future use. In the accompanying balance sheet, reserves for other assets 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 year 2006, the State implemented the following pronouncements:

- GASB 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 and unexpectedly.
- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation (an amendment to GASB Statement No. 34)*, which requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets.
- GASB Statement No. 47, *Accounting for Termination Benefits*, which establishes guidance for state and local governmental employers on accounting and financial reporting for termination of benefits.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefit Expenditures/Expense and Liabilities by Cost-Sharing Employers*, which clarifies the requirements of GASB Statement Nos. 27 and 45 for recognition of pension and other postemployment benefit expenditures/expense and liabilities by cost-sharing employers.

The implementation of these pronouncements did not have a material impact on the accompanying 2006 financial statements.

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments. The provisions of this Statement are effective for periods beginning after December 15, 2007. 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 July 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.

In September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*. GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. The statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. The provisions of this Statement are effective for periods beginning after December 15, 2006. 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, 2006

(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) Capital Assets

Capital asset activities for the year ended December 31, 2006, are as follows:

Balance at December 31, 2005	Additions	Deletions	Balance at December 31, 2006
\$ 3,650,091	\$ -	\$ -	\$ 3,650,091
General Capital Assets			

(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.

KOROR STATE GOVERNMENT

Notes to Financial Statements  
December 31, 2006

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

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 2006 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.

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) 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, 2006 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.



(7) Risk Management

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. The State has elected to purchase commercial insurance coverage from independent third parties for the risks of loss to which it is exposed. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years.

KOROR STATE GOVERNMENT  
REQUIRED SUPPLEMENTARY INFORMATION  
YEAR ENDED DECEMBER 31, 2006

KOROR STATE GOVERNMENT

Schedule of Revenues, Expenditures and Changes in Fund Balance  
Budget (GAAP Basis) and Actual - General Fund  
Year Ended December 31, 2006

Revenues:	Budgeted Amounts		Actual	Variance (Unfavorable)
	Original	Final		
Local revenues	\$ 3,954,525	\$ 3,973,105	\$ 2,622,694	\$ (1,350,411)
Block grants and capital projects grants	1,226,807	1,226,807	867,625	(359,182)
Fishing rights fees	160,000	160,000	264,583	104,583
Other	30,000	30,000	7,104	(22,896)
Total revenues	5,371,332	5,389,912	3,762,006	(1,627,906)
Expenditures:				
Public works	1,219,500	1,219,500	897,414	322,086
State programs and projects	1,114,000	1,515,727	767,461	748,266
Law enforcement	515,500	515,500	504,963	10,537
Community and cultural affairs	356,000	366,000	380,319	(14,319)
Legislature	253,750	253,750	232,231	21,519
Treasury	225,600	225,600	217,354	8,246
Planning commission and public lands	294,100	294,100	208,356	85,744
Traditional leaders	189,600	189,600	156,146	33,454
Utility	260,000	260,000	129,607	130,393
Social security and insurance	112,000	112,000	110,631	1,369
Legal counsel	105,300	105,300	113,143	(7,843)
Administration	117,800	117,800	108,987	8,813
Pension fund	92,000	92,000	88,827	3,173
Contingency	35,000	35,000	45,851	(10,851)
Travel and transportation	35,000	35,000	36,935	(1,935)
Prior year debt	50,000	50,000	31,545	18,455
Capital improvement projects	356,182	356,182	-	356,182
Others	40,000	40,000	42,655	(2,655)
Total expenditures	5,371,332	5,783,059	4,072,425	1,710,634
Excess of revenues over expenditures	-	(393,147)	(310,419)	82,728
Other changes in fund balance:				
Increase in reserve for continuing appropriations	-	393,147	-	(393,147)
Unreserved fund balance at beginning of year	-	-	6,439,671	6,439,671
Unreserved fund balance at end of year	\$ -	\$ -	\$ 6,129,252	\$ 6,129,252

See accompanying Independent Auditors' Report.

KOROR STATE GOVERNMENT

Notes to Required Supplementary Information - Budgetary Reporting  
December 31, 2006

(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; however, management has determined that no material encumbrances exist at year end.