

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

**SCHEDULE OF CASH DRAWDOWNS AND
EXPENDITURES OF U.S. DEPARTMENT OF THE
INTERIOR PROGRAMS ADMINISTERED BY THE
STATE OF CHUUK AND INDEPENDENT
AUDITORS' REPORT**

QUARTER ENDED JUNE 30, 2009

INDEPENDENT AUDITORS' REPORT

Honorable Wesley Simina
Governor, State of Chuuk
Federated States of Micronesia

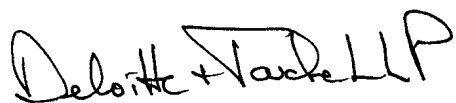
We have audited the accompanying schedule of cash drawdowns and expenditures of U.S. Department of the Interior programs administered by the State of Chuuk (the State) for the quarter ended June 30, 2009. This schedule is the responsibility of the State's management. Our responsibility is to express an opinion on this schedule based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The accompanying schedule of cash drawdowns and expenditures of U.S. Department of the Interior programs administered by the State is prepared on the modified accrual basis of accounting, as described in note 2, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the aforementioned schedule presents fairly, in all material respects, the cash drawdowns and expenditures of the U.S. Department of the Interior programs administered by the State for the quarter ended June 30, 2009, on the basis of accounting described in note 2.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 12, 2009, on our consideration of the State's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is 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.



August 12, 2009

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Schedule of Cash Drawdowns and Expenditures of
U.S. Department of the Interior Programs Administered by
the State of Chuuk
Quarter Ended June 30, 2009

Program	CFDA #	Cash Drawdowns	Expenditures
<u>U.S. DEPARTMENT OF THE INTERIOR</u>			
Compact Sector Grants Fund:			
Compact Sector Grants - Education	15.875	\$ 1,980,000	\$ 1,672,731
Compact Sector Grants - Health	15.875	3,545,678	2,116,573
Compact Sector Grants - Environment	15.875	22,000	78,858
Compact Sector Grants - Private	15.875	140,000	91,997
Compact Sector Grants - Capacity Building	15.875	120,000	98,293
Supplemental Education Grant	15.875	1,220,000	1,138,932
Total Compact Sector Grants Fund		<u>7,027,678</u>	<u>5,197,384</u>
U.S. DEPARTMENT OF THE INTERIOR TOTAL		<u>\$ 7,027,678</u>	<u>\$ 5,197,384</u>

Note: The above grants are received in a subrecipient capacity through the FSM National Government.

See accompanying notes to schedule of cash drawdowns and expenditures of U.S. federal programs administered by the State of Chuuk.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Schedule of Cash Drawdowns and Expenditures of
U.S. Department of the Interior Programs Administered by the State of Chuuk
Quarter Ended June 30, 2009

(1) Organization

The State of Chuuk (the State) is one of the four States of the Federated States of Micronesia. The schedule of cash drawdowns and expenditures of U.S. Department of the Interior programs administered by the State has been prepared as a result of certain special “high risk” conditions imposed on the State by the U.S. Department of the Interior on January 29, 2007.

(2) Summary of Significant Accounting Principles

Basis of Accounting

The schedule is prepared on the modified accrual basis of accounting. The State’s policy is to recognize cash drawdowns in the accompanying schedule when the requested receipt of cash is physically received in the State’s bank account. Expenditures are recognized when the obligation is incurred on the accrual basis of accounting.

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

Honorable Wesley Simina
Governor, State of Chuuk
Federated States of Micronesia

We have audited the schedule of cash drawdowns and expenditures of U.S. Department of the Interior programs administered by the State of Chuuk (the State) for the quarter ended June 30, 2009, and have issued our report thereon dated August 12, 2009, which report stated that the schedule was prepared on the modified accrual basis of accounting. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statement, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process or report financial data reliably in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as items 2009-01-C through 2009-04-C to be significant deficiencies in internal control over financial reporting.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

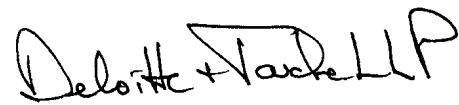
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiencies described above in items 2009-01-C, 2009-02-C, 2009-03-C and 2009-04-C to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's financial statement is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 2009-01-C through 2009-04-C.

The State's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the State's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management of the State, the Office of the Public Auditor of the Federated States of Micronesia, federal awarding agencies, pass-through entities and the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties.


August 12, 2009

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Quarter Ended June 30, 2009

Finding No.: 2009-01-C
 CFDA No.: 15.875
 Program Name: Compact Sector Grants
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$0

Criteria: In accordance with applicable allowable costs/cost principles, payroll expenditures should be supported by employee personnel action forms, supporting timesheets and other underlying documentation validating the expenditure. Furthermore, such should be kept on file and be available for examination.

Condition:

1. For 25 (or 32%) of 77 transactions tested, cancelled checks were not available for inspection.

<u>Fund</u>	<u>Employee #</u>	<u>Check #</u>	<u>Check Date</u>	<u>Check Amt</u>
15	42810	158464	04/24/09	\$ 363
15	608213	165969	06/30/09	63
15	602439	165924	06/30/09	137
13	73710	165845	06/30/09	48
13	58598	165846	06/30/09	545
12	601056	158402	04/24/09	131
12	28777	165816	06/30/09	103
11	32090	156581	04/08/09	319
11	605338	165449	06/30/09	117
11	66743	165642	06/30/09	1,471
11	600237	158349	04/24/09	-
11	617043	165795	06/30/09	33
11	621320	165667	06/30/09	512
10	23299	165382	06/30/09	37
10	28732	155867	04/08/09	35
10	45933	156002	04/08/09	-
10	26554	157440	04/24/09	107
10	43027	157298	04/24/09	294
10	68777	157574	04/24/09	173
10	56102	160212	05/22/09	59
10	32586	164704	06/30/09	193
10	606609	164869	06/30/09	45
10	609646	156435	04/08/09	45
10	42878	165383	06/30/09	100
				\$ <u>5,179</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended June 30, 2009

Finding No.: 2009-01-C, Continued
 CFDA No.: 15.875
 Program Name: Compact Sector Grants
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$0

Condition, Continued:

2. For 3 (or 3%) of 77 transactions tested, a difference exists between the pay rate in the AGLI table list and the accounting system.

<u>Fund</u>	<u>Employee #</u>	<u>AGLI Table</u>	<u>GL</u>	<u>Variance</u>
11	612683	\$3.40	2.00	\$ 1.40
11	621320	6.40	6.60	.20
10	49398	6.40	3.40	3.00

3. For 52 (or 68%) of 77 transactions tested, authorized allotment forms were not available for inspection.

Cause: The State currently has two employees assigned to payroll and it appears that assistance may have to be provided to assist in filing. Also, the above listed cancelled checks have yet to clear and such will be resolved in the year end audit.

Effect: The condition may result in potential noncompliance with applicable compliance requirements.

Recommendation: The State should consider whether periodic assistive can be provided to assist in payroll file maintenance.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. A temporary accounting clerk is now available in the payroll department to assist with filing allotment advices and other employee documents. The cancelled checks will be located for audit review during the fourth quarter. The differences in annual salary and corresponding group life premiums will be investigated and changed accordingly.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Quarter Ended June 30, 2009

Finding No.: 2009-02-C
CFDA No.: 15.875
Program Name: Compact Sector Grants
Requirement: Allowable Costs/Cost Principles
Questioned Costs: \$1,224

Criteria: In accordance with applicable allowable costs/cost principles, non-payroll expenditures should be supported by underlying documentation validating the expenditure. Furthermore, such should be kept on file and be available for examination.

Condition:

For 1 (or 1%) of 87 transactions tested, an import tax penalty was charged to the program and does not appear to represent an allowable cost.

<u>Invoice Date</u>	<u>Description</u>	<u>Ref 1</u>	<u>Amount</u>
5/13/09	FSM Division of Customs	24820	\$ <u>1,224</u>

Cause: The cause of the condition appears to be an oversight.

Effect: The effect of the condition is that general fund expenditures are understated by an immaterial amount.

Recommendation: The State should review the above and determine required corrective action.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The import tax penalty will be journal vouchered to the general fund to remove this questioned cost.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Quarter Ended June 30, 2009

Finding No.: 2009-03-C
CFDA No.: 15.875
Program Name: Compact Sector Grants
Requirement: Procurement/Special Related Requirements
Questioned Costs: \$4,800

Criteria: Procurement of goods and services should follow applicable federal procurement standards. Furthermore, applicable documentation should be kept on file and be available for examination.

Condition:

1. For 1 (or 1%) of 87 transactions tested, a "brand" name was included on the purchase requisition and no language was included providing for "a brand name or equivalent."

Transaction <u>Date</u>	Transaction <u>Amount</u>	<u>Oblig. #</u>
6/30/09	<u>\$4,800</u>	10440

2. For 8 (or 9%) of 87 transactions tested, the following contracts do not contain required provisions mandated by the amended Compact of Free Association fiscal procedures.

Transaction <u>Date</u>	<u>Oblig. #</u>
3/25/09	25773
3/31/09	24947
4/8/09	25076
4/13/09	22501
6/12/09	26177
6/5/09	24409
4/24/09	24331
5/25/09	25103

Cause: Controls over ensuring that underlying contracts contain required provisions do not appear to be effective. Additionally, the State appears to have accidentally forgot to include "or equivalent".

Effect: The condition may result in potential noncompliance with applicable compliance requirements and potential misstatements of expenditures may exist.

Recommendation: The State should ensure that contracts contain required provisions and that solicitation specify "or equivalent".

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The designation of a brand name on the purchase requisition was an oversight and does not reflect Chuuk State government procurement policy. The particular transaction in question pertained to a typewriter for which only one manufacturer's model was available on island and against normal procurement policy this brand was then designated on the requisition. In the future, the State will indicate the "or equivalent" designation to prevent repetition of this finding.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Quarter Ended June 30, 2009

Finding No.: 2009-04-C
CFDA No.: 15.875
Program Name: Compact Sector Grants
Requirement: Procurement/Special Related Requirements
Questioned Costs: \$0

Criteria: Expenditures represented by cash transfers should be recorded only when underlying support evidencing that actual disbursement has been made.

Condition: On December 26, 2008, a \$30,000 cash transfer was made to Chuuk House in Honolulu. This is essentially a bank transfer. The basis of the transfer were invoices evidencing the receipt of goods or services. The funds were charged to the program upon disbursement. We were able to determine that the funds were used timely to pay for applicable program expenses and, therefore, no questioned costs or matters of noncompliance are raised. However, from a control standpoint, this matter points to two potential areas of concern. The first is that the original payment is actually a bank transfer and is not an expense until underlying disbursements for eligible purposes are made. Therefore, Chuuk State Finance should record this item as either an advance or as an addition to the Honolulu cash account. The second is that Chuuk State Finance does not routinely obtain bank statements and detail of all underlying payment documentation related to the Chuuk House activities. Finance should reverse the advance or the cash account only upon receipt of appropriate documentation.

Cause: The cause of the condition is that Chuuk House employees are not providing underlying detailed documentation to Finance in a timely manner.

Effect: The above condition does not result in a material impact on the administration of this federal program although current processes could allow for such impact to occur.

Recommendation: We recommend that Finance record either a bank transfer or an advance when making payments to Chuuk House and the advance or cash account should be cleared only upon receipt of required authoritative documentation.

Auditee Response and Corrective Action: We agree with the finding and recommendation. All future Chuuk House Honolulu disbursements will be recorded as advances and documentation obtained to clear the advance account to expenditures.