

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

**REPORT ON THE AUDIT OF GENERAL PURPOSE
FINANCIAL STATEMENTS IN ACCORDANCE
WITH OMB CIRCULAR A-128**

YEAR ENDED SEPTEMBER 30, 1996

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Year Ended September 30, 1996

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**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

**INDEPENDENT AUDITORS' REPORT,
GENERAL PURPOSE FINANCIAL STATEMENTS
AND ADDITIONAL INFORMATION**

YEAR ENDED SEPTEMBER 30, 1996

**INDEPENDENT AUDITORS' REPORT**

Honorable Ansito Walter
Governor, State of Chuuk
Federated States of Micronesia:

We were engaged to audit the accompanying general purpose financial statements of the State of Chuuk, as set forth in Section II of the foregoing Table of Contents, as of September 30, 1996, and for the year then ended. These general purpose financial statements are the responsibility of the State of Chuuk's management.

Because of inadequacies in the State of Chuuk's accounting records and internal control structure, we were unable to form an opinion regarding assets, liabilities, revenues and expenditures of the Governmental Fund Types as of and for the year ended September 30, 1996.

Property comprising the State of Chuuk's General Fixed Assets Account Group has not been inventoried as of September 30, 1996, nor have existing records been adequately assembled to permit the application of auditing procedures and verification of the detail of account balances. Accordingly, a statement of changes in general fixed assets has not been included within the accompanying general purpose financial statements.

As discussed in Note 1A, the accompanying general purpose financial statements do not include the State's eleven development authorities, which in our opinion, should be included to conform with generally accepted accounting principles. The development authorities would be reported as blended Component Units - Special Revenue Funds.

Because of inadequacies in the accounting records, we were unable to express an opinion on the financial statements of the Chuuk Coconut Authority (CCA) and the Chuuk State Public Utility Corporation (CSPUC) as of and for the year ended September 30, 1996. CCA and CSPUC are included within the Component Units-Proprietary Funds and represent 40% and 86% of the assets and operating revenues, respectively, of the Component Units-Proprietary Funds.

We were unable to perform audit procedures on the Chuuk Visitors Bureau's (CVB) financial statements as of September 30, 1996, as comprehensive financial statements were not provided to us for inspection. Account balances of CVB in the accompanying general purpose financial statements do not include amounts accounted for by CVB management. CVB is presented as a Governmental Fund Type - Special Revenue Fund in the accompanying general purpose financial statements.

We were unable to obtain audited financial statements supporting the State of Chuuk's investment in Western Pacific Tuna Group (WESTPAC), in the Governmental Fund Type - Capital Projects Funds at September 30, 1996, as described in Note 9 to the general purpose financial statements. The State of Chuuk has not adjusted this investment to reflect the equity in the investees' earnings or losses. We were not able to satisfy ourselves as to the carrying value of this investment or the equity in its earnings or losses by other auditing procedures.

The State has yet to determine whether Chuuk Organization for Community Action (COCA) should be accounted for as a Component Unit - Governmental Fund. Therefore COCA's financial statements are not included in the accompanying general purpose financial statements. The impact of this matter on the accompanying general purpose financial statements is not determinable.

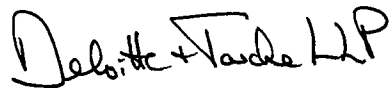
We were unable to obtain representation from the Chuuk State Attorney General regarding pending litigation and other legal matters outstanding as of September 30, 1996. Accordingly, no provision for any liability that may result from such matters, if any, has been made in the accompanying general purpose financial statements.

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

The accompanying general purpose financial statements have been prepared assuming that the State of Chuuk will continue as a going concern. The State of Chuuk's general fund has an unreserved fund deficit of \$17,123,887, a condition that raises substantial doubt about the ability of the State of Chuuk to meet its debts as they come due. The general purpose financial statements do not include any adjustment relating to the amounts and classification of liabilities that might be necessary if the State of Chuuk is not able to meet its debts as they come due.

The combining and individual fund financial statements and schedules listed in Section III of the foregoing Table of Contents, which are also the responsibility of the State of Chuuk's management, are presented for purposes of additional analysis and are not a required part of the general purpose financial statements of the State of Chuuk. The scope of our work was not sufficient to enable us to express, and we do not express, an opinion on this additional information.

In accordance with Government Auditing Standards, we have also issued a report dated April 23, 1997, on our consideration of the State of Chuuk's (primary Government only) internal control structure and a report dated April 23, 1997 on its compliance with laws and regulations.



April 23, 1997

CHUUK STATE GOVERNMENT

Combined Balance Sheet - All Fund Types, Account Groups and Discretely Presented Component Units
September 30, 1996
(With Comparative Totals as of September 30, 1995)

	Governmental Fund Types			Account Groups		Totals	Component	Totals	
	General	Special Revenue	Capital Projects	General	General	Primary	Units	Reporting	
				Fixed Assets	Long-Term Debt	Government (Memorandum Only)	Proprietary	Entity (Memorandum Only)	
								1996	1995
<u>Assets</u>									
Cash and equivalents (note 2)	\$ 765,220	\$ 516,032	\$ 574,462	\$ -	\$ -	\$ 1,855,714	\$ 986,759	\$ 2,842,473	\$ 5,351,914
Investments (note 2)	985,326	-	22,051,146	-	-	23,036,472	-	23,036,472	16,167,049
Investments - other (notes 9 and 17)	-	-	7,264,005	-	-	7,264,005	-	7,264,005	7,643,660
Receivables from other governments (note 3)	312,418	2,471,438	855,430	-	-	3,639,286	-	3,639,286	4,181,345
Receivables, federal agencies (note 3)	-	173,267	-	-	-	173,267	-	173,267	555,175
General receivables, net	25,938	134,952	-	-	-	160,890	747,216	908,106	84,656
Advances	93,663	137,073	208,861	-	-	439,597	-	439,597	538,535
Loans receivable, net of allowance for doubtful accounts of \$595,255	-	-	-	-	-	-	1,071,213	1,071,213	1,155,003
Loans receivable, other (note 14)	-	-	7,000,000	-	-	7,000,000	-	7,000,000	7,000,000
Due from other funds (note 8)	-	3,722,743	2,499,216	-	-	6,221,959	-	6,221,959	6,423,542
Inventories	-	-	-	-	-	-	20,493	20,493	72,785
Other assets	-	-	24,831	-	-	24,831	33,358	58,189	61,393
Fixed assets, net (note 4)	-	-	-	67,581,884	-	67,581,884	905,204	68,487,088	68,556,501
Dividends and interest receivable	174,968	-	-	-	-	174,968	-	174,968	112,898
Reserve for doubtful interfund receivable (note 16)	(173,267)	-	-	-	-	(173,267)	-	(173,267)	(577,105)
Amount to be provided for retirement of long-term debt	-	-	-	-	12,071,161	12,071,161	-	12,071,161	12,071,161
Allowance for uncollectibles	-	(2,278,052)	(855,430)	-	-	(3,133,482)	-	(3,133,482)	-
Due from primary government	-	-	-	-	-	-	-	-	277,240
Total assets	\$ 2,184,266	\$ 4,877,453	\$ 39,622,521	\$ 67,581,884	\$ 12,071,161	\$ 126,337,285	\$ 3,764,243	\$ 130,101,528	\$ 129,675,752

See accompanying notes to financial statements.

CHUUK STATE GOVERNMENT

Combined Balance Sheet - All Fund Types, Account Groups and Discretely Presented Component Units, Continued
September 30, 1996
(With Comparative Totals as of September 30, 1995)

	Governmental Fund Types			Account Groups		Totals	Component	Totals	
	General	Special Revenue	Capital Projects	General Fixed Assets	General Long-Term Debt	Primary Government (Memorandum Only)	Units Proprietary	Reporting Entity (Memorandum Only)	
								1996	1995
Liabilities and Fund Equity (Deficiency)									
Liabilities:									
Bank overdraft	\$ 2,351,110	\$ -	\$ -	\$ -	\$ -	\$ 2,351,110	\$ -	\$ 2,351,110	\$ 1,765,477
Accounts payable	8,873,672	1,905,522	1,797,752	-	-	12,576,946	65,587	12,642,533	13,475,093
Accrued payroll and annual leave	378,011	-	-	-	1,771,161	2,149,172	6,179	2,155,351	2,219,638
Due to other funds (note 8)	5,978,758	151,281	91,920	-	-	6,221,959	-	6,221,959	6,423,542
Payable to other governments	92,798	335,106	-	-	-	427,904	-	427,904	1,165,953
Notes payable (notes 5 and 13)	127,870	-	329,179	-	10,300,000	10,757,049	694,306	11,451,355	11,490,587
Deferred revenue	1,000	277,320	-	-	-	278,320	-	278,320	277,320
Total liabilities	17,803,219	2,669,229	2,218,851	-	12,071,161	34,762,460	766,072	35,528,532	36,817,610
Fund equity (deficiency):									
Investment in general fixed assets (note 4)	-	-	-	67,581,884	-	67,581,884	-	67,581,884	67,581,884
Contributed capital	-	-	-	-	-	-	2,238,106	2,238,106	2,020,266
Retained earnings	-	-	-	-	-	-	760,065	760,065	234,771
Fund balances (deficit):									
Reserved for:									
Related assets (note 15)	-	1,900	14,264,005	-	-	14,265,905	-	14,265,905	15,846,493
Encumbrances	629,625	1,388,131	2,692,176	-	-	4,709,932	-	4,709,932	5,916,140
Continuing appropriations (note 6)	875,309	-	19,763,410	-	-	20,638,719	-	20,638,719	17,696,014
Unreserved	(17,123,887)	818,193	684,079	-	-	(15,621,615)	-	(15,621,615)	(16,437,426)
Total fund equity (deficiency)	(15,618,953)	2,208,224	37,403,670	67,581,884	-	91,574,825	2,998,171	94,572,996	92,858,142
Commitments and contingencies (note 11)									
Total liabilities and fund equity (deficiency)	\$ 2,184,266	\$ 4,877,453	\$ 39,622,521	\$ 67,581,884	\$ 12,071,161	\$ 126,337,285	\$ 3,764,243	\$ 130,101,528	\$ 129,675,752

See accompanying notes to financial statements.

CHUUK STATE GOVERNMENT

Combined Statement of Revenues, Expenditures and Changes in Fund Balances (Deficit)-
All Governmental Fund Types
Year Ended September 30, 1996
(With comparative totals for the year ended September 30, 1995)

	Governmental Fund Types			Totals Reporting Entity (Memorandum Only)	
	General	Special Revenue	Capital Projects	1996	1995
Revenues:					
U.S. Compact of Free Association:					
Section 211(a)(2) - base grant	\$ 11,240,400	\$ -	\$ 7,833,600	\$ 19,074,000	\$ 19,074,000
Section 217 - inflation adjustment	5,395,367	-	3,760,128	9,155,495	8,774,040
Section 221(b) - base grant	-	2,730,000	-	2,730,000	2,730,000
Section 216(a)(2) - base grant	-	461,087	-	461,087	461,087
Section 214(c) - base grant	-	949,800	-	949,800	949,800
Section 217 - inflation adjustment	-	575,905	-	575,905	551,908
Section 212 - base grant	-	250,000	-	250,000	250,000
Section 216(a)(3) - FSM	-	900	-	900	405,560
U.S. Department of the Interior grants	-	-	119,371	119,371	61,927
FSM revenue sharing	1,667,168	-	-	1,667,168	2,376,027
Other federal contributions	-	1,213,278	-	1,213,278	2,572,578
State taxes and licenses	1,130,388	-	-	1,130,388	1,261,877
Other	1,116,813	134,353	-	1,251,166	1,601,044
Investment income (note 2)	2,054,416	-	-	2,054,416	1,436,393
Total revenues	22,604,552	6,315,323	11,713,099	40,632,974	42,506,241
Expenditures:					
General government	4,253,051	-	-	4,253,051	4,991,756
Education	7,843,113	2,955,422	-	10,798,535	12,741,135
Health services	3,014,690	1,026,326	-	4,041,016	5,393,311
Economic development	1,138,662	-	-	1,138,662	1,403,568
Public works and utilities	489,593	494,346	-	983,939	2,162,385
Public safety	828,807	1,421	-	830,228	865,651
Transportation	985,449	-	-	985,449	1,259,207
Community affairs	220,873	299,262	-	520,135	605,772
Boards and commissions	471,437	-	-	471,437	482,325
Capital projects	-	-	6,855,178	6,855,178	8,229,566
Debt service - interest	-	-	665,360	665,360	665,360
Other	5,132,958	83,568	-	5,216,526	2,710,464
Total expenditures	24,378,633	4,860,345	7,520,538	36,759,516	41,510,500
Excess (deficiency) of revenues over (under) expenditures	(1,774,081)	1,454,978	4,192,561	3,873,458	995,741
Other financing sources (uses):					
Operating transfers in (note 7)	-	142,946	-	142,946	198,240
Operating transfers out (note 7)	(386,332)	(1,033,612)	(1,250,000)	(2,669,944)	(1,199,594)
Other income	-	-	4,916	4,916	519,271
Loss on investment (note 17)	-	-	(379,656)	(379,656)	-
Total other financing sources (uses), net	(386,332)	(890,666)	(1,624,740)	(2,901,738)	(482,083)
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(2,160,413)	564,312	2,567,821	971,720	513,658
Fund balances (deficit) at beginning of year	(13,458,540)	1,643,912	34,835,849	23,021,221	22,507,563
Fund balances (deficit) at end of year	\$ (15,618,953)	\$ 2,208,224	\$ 37,403,670	\$ 23,992,941	\$ 23,021,221

See accompanying notes to financial statements.

CHUUK STATE GOVERNMENT

**Statement of Revenues, Expenditures and Changes in Deficit -
Budget and Actual, Budgetary Basis - General Fund
Year Ended September 30, 1996
(With comparative totals for the year ended September 30, 1995)**

	1996			1995		
	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)
Revenues:						
Compact of Free Association						
Section 211 and 217	\$ 16,410,984	\$ 16,635,767	\$ 224,783	\$ 16,186,176	\$ 16,410,984	\$ 224,808
Local Revenue	6,389,114	5,968,785	(420,329)	9,246,375	6,464,631	(2,781,744)
Total revenues	22,800,098	22,604,552	(195,546)	25,432,551	22,875,615	(2,556,936)
Expenditures-budgetary basis:						
General government	4,928,370	4,316,483	611,887	5,231,000	4,917,809	313,191
Health Services	3,080,300	2,990,568	89,732	3,209,498	3,662,705	(453,207)
Education	8,411,648	7,818,651	592,997	8,829,500	8,656,393	173,107
Economic development	1,165,250	1,132,607	32,643	1,228,500	1,179,102	49,398
Public safety	850,500	828,768	21,732	850,500	856,306	(5,806)
Transportation	997,100	984,730	12,370	1,236,241	1,227,236	9,005
Public works	489,500	490,115	(615)	508,400	505,500	2,900
Community affairs	228,500	223,286	5,214	279,500	238,868	40,632
Board and Commissions	531,850	612,583	(80,733)	477,648	496,724	(19,076)
Special programs	193,800	182,362	11,438	561,300	564,803	(3,503)
Legislative external appropriations	1,703,180	1,708,492	(5,312)	1,890,464	1,776,003	114,461
Uncollectible grants fund reserve	-	3,084,979	(3,084,979)	-	254,159	(254,159)
Total expenditures	22,579,998	24,373,624	(1,793,626)	24,302,551	24,335,608	(33,057)
Excess (deficiency) of revenues over (under) expenditures	220,100	(1,769,072)	(1,989,172)	1,130,000	(1,459,993)	(2,589,993)
Other financing sources (uses):						
Operating transfers out	(214,500)	(384,084)	(169,584)	(1,130,000)	(1,118,012)	11,988
Other income	-	-	-	-	437,611	437,611
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	5,600	(2,153,156)	(2,158,756)	-	(2,140,394)	(2,140,394)
Deficit at beginning of year	(15,606,061)	(15,606,061)	-	(12,601,087)	(12,601,087)	-
Other changes in deficit:						
(Increase) decrease in reserve for related assets	-	971,856	971,856	-	(866,229)	(866,229)
Decrease (increase) in reserve for continuing appropriations	-	(336,526)	(336,526)	-	1,649	1,649
Deficit at end of year	\$ (15,600,461)	\$ (17,123,887)	\$ (1,523,426)	\$ (12,601,087)	\$ (15,606,061)	\$ (3,004,974)

See accompanying notes to financial statements.

CHUUK STATE GOVERNMENT

Combined Statement of Revenues, Expenses and Changes in
Fund Equity - All Discretely Presented Component Units
Year Ended September 30, 1996
(With comparative totals for the year ended September 30, 1995)

	Totals	
	1996	1995
Operating revenues:		
Interest income	\$ 115,790	\$ 98,479
Sales	687,099	42,062
Total operating revenues	<u>802,889</u>	<u>140,541</u>
Operating expenses:		
Payroll and personnel	717,000	128,992
Fuel	1,159,487	-
Travel	23,440	27,289
Depreciation	23,963	22,806
Cost of sales	155,267	121,102
Bad debt	61,416	157,430
Rent	27,585	7,810
Other	921,266	50,956
Total operating expenses	<u>3,089,424</u>	<u>516,385</u>
Operating loss	<u>(2,286,535)</u>	<u>(375,844)</u>
Nonoperating revenues (expenses):		
Transfers in (note 7)	2,520,131	206,473
Payment to Coconut Development Authority	(4,956)	(5,000)
Federal contributions-HUD Section 8	36,856	38,306
Recovery of bad debt	39,951	38,360
Gain on sale of fixed assets	-	3,610
Interest expense	(3,474)	(37,796)
Other income	22,181	-
Total nonoperating revenues (expenses), net	<u>2,610,689</u>	<u>243,953</u>
Net earnings (loss)	324,154	(131,891)
Retained earnings at beginning of year	<u>435,911</u>	<u>366,662</u>
Retained earnings at end of year	<u>760,065</u>	<u>234,771</u>
Contributed capital at beginning of year	2,020,266	1,670,266
Contributions	<u>217,840</u>	<u>350,000</u>
Contributed capital at end of year	<u>2,238,106</u>	<u>2,020,266</u>
Total fund equity	<u>\$ 2,998,171</u>	<u>\$ 2,255,037</u>

See accompanying notes to financial statements.

CHUUK STATE GOVERNMENT

Combined Statement of Cash Flows -
All Discretely Presented Component Units
Year Ended September 30, 1996
(With comparative totals for the year ended September 30, 1995)

	Totals	
	1996	1995
Increase (Decrease) in Cash and Equivalents:		
Cash flows from operating activities:		
Cash received from customers	\$ 890,687	\$ 167,503
Cash payment to suppliers and employees	(3,517,571)	(563,210)
Net cash used for operating activities	(2,626,884)	(395,707)
Cash flows from noncapital financing activities:		
Chuuk State Legislature appropriations	2,520,131	206,473
Federal contributions	39,951	38,306
Copra subsidy	(4,956)	(5,000)
Net cash provided by noncapital financing activities	2,555,126	239,779
Cash flows from capital and related financing activities:		
Interest paid	(3,474)	(37,796)
Repayments of debt	(39,232)	(22,108)
Increase in contributed capital	217,840	350,000
Net cash provided by capital and related financing activities	175,134	290,096
Cash flows from investing activities:		
Decrease in loans receivable	83,790	4,148
Recovery of bad debts	36,856	38,360
Aquisition of fixed assets	(5,320)	(32,530)
Gain on sale of fixed assets	-	3,610
Net cash provided by investing activities	115,326	13,588
Increase in cash and equivalents	218,702	147,756
Cash and equivalents at beginning of year	768,057	419,161
Cash and equivalents at end of year	\$ 986,759	\$ 566,917
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	\$ (2,286,535)	\$ (375,844)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation	74,733	72,937
Other income	22,181	-
(Increase) in receivables	(424,588)	(155,323)
Decrease (increase) in inventories	52,292	(10,301)
(Increase) decrease in other assets	(13,704)	3,556
(Decrease) increase in accounts payable	(46,783)	65,694
(Decrease) increase in other liabilities	(4,480)	3,574
Total adjustments	(340,349)	(19,863)
Net cash used for operating activities	\$ (2,626,884)	\$ (395,707)

See accompanying notes to financial statements.

CHUUK STATE GOVERNMENT

Notes to Financial Statements September 30, 1996

(1) Summary of Significant Accounting Policies

The general purpose financial statements of the State of Chuuk (the State) have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing government accounting and financial reporting principles. The more significant of the State's accounting policies are described below.

A. Reporting Entity

As required by generally accepted accounting principles, the general purpose financial statements of the State of Chuuk present the government and its component units; entities for which the government is considered to be financially accountable. Blended component units, although legally separate entities, are, in substance, part of the governments' operations so data from these units are combined with data of the primary government. Discretely presented component units, on the other hand, are reported in a separate column in the general purpose financial statements to emphasize that they are legally separate from the government. Each blended and discretely presented component unit has a September 30 year end.

1. Blended Component Unit

Chuuk Visitors Bureau

The Chuuk Visitor's Bureau (the Bureau) is used to account for all funds received by the Bureau. The Bureau was created in fiscal year 1988 by Truk State Law No. 6-39. The primary purpose of the Bureau is to improve and develop Chuuk's tourism industry. The Bureau is governed by a nine member board. Five of the Bureau's board members are appointed by the Governor and the remaining four are appointed by the Speaker of the Chuuk State Legislature. The Bureau is reported as a special revenue fund.

2. Discretely Presented Component Units

(a) Chuuk Coconut Authority

Chuuk Coconut Authority (the Authority) was established in 1979 by Truk State Law 1-1-12. The purpose of the Authority is to manufacture, process, buy, collect, market, sell, export and deal with, in general, all products derived from the coconut tree. The affairs of the Authority are managed by a five-member board, consisting of members of Chuuk State Government. The Authority is reported as a discretely presented component unit - proprietary fund.

(b) Chuuk Housing Authority

Chuuk Housing Authority (the Authority) was established in fiscal year 1980 by Truk State Law 3-30. The purpose of the Authority is to monitor the U.S. Department of Housing and Urban Development Section 8 and CDBG housing renovation loan program. Additionally, the Authority monitors the GLF loan fund of the State of Chuuk which provides low cost housing loans to the general public. The affairs of the Authority are managed by a five-member board, consisting of representatives of Chuuk State Government. The Authority is reported as a discretely presented component unit - proprietary fund.

CHUUK STATE GOVERNMENT

Notes to Financial Statements
September 30, 1996

(1) Summary of Significant Accounting Policies, Continued

(c) Chuuk State Public Utilities Corporation

Chuuk State Public Utilities Corporation (the Corporation) was established in 1992 by Chuuk State Law 192-12. The purpose of the Corporation is to provide electrical services to the public through the operation and the maintenance of the State's electrical power system. The affairs of the Corporation are managed by a five-member board, consisting of members of the Chuuk State Government and the private sector. The Corporation is reported as a discretely presented Component Unit-Proprietary Fund. The Corporation was not included in the 1995 presentation and therefore, retained earnings (deficit) of the component units - proprietary funds at the beginning of the 1996 year is \$201,140 greater than as previously reported.

3. Omitted Component Units

Development Authorities

The accompanying general purpose financial statements do not include the State's eleven development authorities (component units). The majority of these entities do not present financial information concerning their operations, thus precluding presentation of financial statements for these funds. The development authorities would be reported as blended Component Units - Special Revenue Funds.

Chuuk Organization for Community Action

The State is currently reviewing this entity to determine whether it should be included as a component unit of the State.

B. Fund Accounting and Basis of Presentation

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

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

Funds are classified into two categories: governmental and proprietary. Each category, in turn, is divided into separate "fund types."

Governmental funds are used to account for all or most of government's general activities, including the collection and disbursement of earmarked monies (special revenue funds) and the acquisition or construction of general fixed assets (capital projects funds). The general fund is used to account for all activities of the general government not accounted for in some other fund.

CHUUK STATE GOVERNMENT

Notes to Financial Statements
September 30, 1996

(1) Summary of Significant Accounting Policies, Continued

B. Fund Accounting and Basis of Presentation, Continued

Proprietary funds are used to account for activities similar to those found in the private sector, where the determination of net income is necessary or useful to sound financial administration. Goods or services from such activities can be provided either to outside parties (enterprises funds) or to other departments or agencies primarily within the government (internal service funds).

There are two account groups. The General Fixed Assets Account Group is used to account for fixed assets not accounted for in proprietary funds. The General Long-Term Debt Account Group is used to account for general long-term debt and certain other long-term liabilities that are not specific liabilities of proprietary funds.

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

All proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included on the balance sheet. Fund equity (i.e., net total assets) is segregated into contributed capital and retained earnings components. Proprietary fund type operating statements present increases (e.g. revenues) and decreases (e.g., expenses) in net total assets.

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

Those revenues susceptible to accrual are FSM shared revenues for business gross receipts tax, import tax, income tax, leases and interest revenue. Fine and permit revenues are not susceptible to accrual because they are generally not measurable until received in cash.

The accrual basis of accounting is utilized by proprietary fund types. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

The State of Chuuk reports deferred revenue on its combined balance sheet. Deferred revenues arise when a potential revenue does not meet both the "measurable" and "available" criteria for recognition in the current period. Deferred revenues also arise when resources are received by the State of Chuuk before it has a legal claim to them, as when grant monies are received prior to the incurrence of qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met, or when the State of Chuuk has a legal claim to the resources, the liability for deferred revenue is removed from the combined balance sheet and revenue is recognized.

CHUUK STATE GOVERNMENT

Notes to Financial Statements September 30, 1996

(1) Summary of Significant Accounting Policies, Continued

C. Budgetary Process

Legislation requires the Governor to present a proposed budget to the Legislature at the beginning of each annual session. The Legislature enacts the budget through passage of specific departmental appropriations, the sum of which may not exceed estimated revenues. Before signing the Appropriations Act, the Governor may veto or reduce any specific appropriation, subject to legislative override. Once passed and signed, the budget becomes the State's financial plan for the ensuing fiscal year.

During fiscal year 1996, supplemental appropriations were made for both operating and capital purposes, to reflect revised financial priorities of Chuuk State Government.

Budgetary control is maintained at the departmental level. Budget revisions during the year, reflecting program changes or intradepartmental transfers of an administrative nature, may be effected with certain Executive and Legislative branch approval.

Encumbrance accounting is utilized for budgetary control purposes. Encumbrances outstanding at year-end are reported as reservations of fund balance and will be funded as expenditures in the ensuing year. Encumbrances remain reservations of fund balance until becoming expended or cancelled. If an encumbrance is subsequently cancelled, the funds revert to the applicable unreserved fund balance unless otherwise required by law.

Budgetary expenditures, which are on a basis other than generally accepted accounting principles, represent current charges against appropriations; current charges consist of all current year liquidated and unliquidated encumbrances. Budgetary expenditures are therefore determined by subtracting both current year liquidations of prior year encumbrances and unliquidated prior year encumbrances from the combined total of current year. When reviewed in relation to respective budgets, budgetary expenditures provide the principal means of evaluating current year operating performance and management stewardship. Amounts included on the Statement of Revenues, Expenditures and Changes in Deficit - Budget and Actual, Budgetary Basis - General Fund (which are presented on a non-GAAP budgetary basis) are reconciled to unreserved fund balance of the Combined Balance Sheet within the other changes in unreserved fund balance section of that statement.

Chuuk State does not establish budgets for the operations of its Special Revenue Funds. Accordingly, a budget to actual presentation for Special Revenue Funds is not required or presented.

Unencumbered appropriations normally lapse at the end of each fiscal year unless they are designated by the Legislature as representing continuing appropriations.

D. Cash and Equivalents

Cash and equivalents include amounts in demand deposits as well as short-term investments with a maturity date within three months of the date acquired by the State of Chuuk.

CHUUK STATE GOVERNMENT

Notes to Financial Statements
September 30, 1996

(1) Summary of Significant Accounting Policies, Continued

E. Receivables

Receivables in the State's governmental funds primarily consist of taxes and federal revenues. Since few governmental fund revenues are susceptible to accrual prior to receipt, most taxes, licenses, fees, permits and similar revenues are recognized primarily on a cash basis.

F. Loans Receivable

Loans receivable of the component units-proprietary funds consist of Community Development Block Grant (CDBG) loans and general loans extended to qualifying Federated States of Micronesia (FSM) citizens. CDBG loans are for the purpose of acquiring new homes and general loans are for the purpose of financing renovation, rehabilitation or extension of existing homes. In order to qualify for both types of loans, the citizen must own or acquire the land where the home will be located, the home or additions must be approved with regard to compliance with building codes, the applicant must fall within low-income eligibility parameters as established by the U.S. Department of Housing and Urban Development (HUD), and the applicant must exhibit the ability to repay the loans. Interest on both types of loans is charged at 4%. The loans are collateralized by land and improvements. The principal amounts of loans range between \$2,000 and \$25,000. Loan maturities range between 1 and 7 years.

G. Interfund Transactions

The State has three types of interfund transactions:

1. Operating appropriations/subsidies are accounted for as operating transfers in the funds involved.
2. Equity contributions are accounted for as equity transfers (additions to or deductions from beginning governmental fund balances or component unit contributed capital).
3. The majority of the State's financial operations are centrally administered, and this administration is facilitated by the use of a "pooled" cash account; for practical purposes, cash is primarily maintained in a single bank account which is considered to be an asset of the State's general fund.

As a result of this cash pooling practice, cash transactions normally include entries which adjust the relative balances of affected interfund asset/liability accounts; each fund's interfund balance therefore represents a net interest in the State's actual cash. Income derived from pooling of cash generally accrues to the general fund.

H. Compensated Absences

Vested or accumulated vacation leave that is liquidated with expendable available financial resources is reported as an expenditure of the general fund. Amounts of vested or accumulated vacation leave that are not expected to be liquidated with expendable available financial resources are reported in the general long-term debt account group. No expenditure is reported for these amounts.

CHUUK STATE GOVERNMENT

Notes to Financial Statements
September 30, 1996

(1) Summary of Significant Accounting Policies, Continued

I. Fund Balance Reserves and Designations

The State's fund balance reserves represent those portions of fund balance which are legally segregated for a specific future use. Reserves for encumbrances, contracts and continuing appropriations are examples of this legal segregation.

J. Totals - Memorandum Only

The "Totals - Memorandum Only" columns represents an aggregate of the individual combined financial statements. The totals column is presented for overview informational purposes and does not represent consolidated financial information.

K. Inventories

Inventories of supplies and raw materials of discretely presented component units-proprietary funds are carried at the lower of cost (first-in-first-out method) or market.

L. Reclassifications

Certain items in the 1995 general purpose financial statements have been reclassified to conform with the 1996 presentation.

M. Investments

Investments are generally carried at the lower of cost or market. (See Notes 2 and 9).

N. Estimates

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

(2) Cash and Equivalents and Investments

Cash and Equivalents

The State considers cash and equivalents to be cash on hand, cash in checking and savings accounts, cash on deposit with trustee, and unrestricted time certificates of deposit with initial maturities of less than ninety days.

Cash Deposits

All of the State's certificates of deposit and cash-in-bank accounts are held with FDIC insured banks. The State of Chuuk does not require collateralization of its bank accounts. Therefore \$300,000 is subject to FDIC insurance with the balance being uncollateralized.

At September 30, 1996, the State had deposits as follows; in each situation, cost approximated market value.

CHUUK STATE GOVERNMENT

Notes to Financial Statements
September 30, 1996

(2) Cash and Equivalents and Investments, Continued

Cash Deposits, Continued

General Fund

Cash in checking accounts and savings account with FDIC insured banks	\$ 1,285
Cash on deposit with trustee	<u>763,935</u>
	\$ <u>765,220</u>

Special Revenue Funds

Cash in checking accounts with FDIC insured banks	\$ 118,621
Cash on deposit with trustee	<u>397,411</u>
	\$ <u>516,032</u>

Capital Projects Funds

Cash on deposit with Trustee	\$ <u>574,462</u>
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Component Units

Cash in checking and savings accounts with FDIC insured banks	\$ <u>986,759</u>
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Investments

The State has appointed the Federated Development Authority (the Authority) as the agency to implement the overall development goals, policies and strategies of funds received and invested pursuant to the Compact of Free Association. The Federated States of Micronesia Secretary of Finance maintains the accounting system and records necessary to account for investment funds placed with the Authority on behalf of the State.

The Authority has selected investment managers who are given authority to buy and sell securities as follows:

- A. Investment managers may invest in stocks, bonds and cash equivalents. Minimum standards of quality for investments at the time of purchase shall be:
 1. Stocks - A "B" rating by a national rating service. Non-rated stocks such as banks or insurance companies must be equal in quality or higher.
 2. Bonds - Confined to issues rated "A" or higher by a national rating service, except in the case of U.S. Treasury or Agency Securities which are not stated.
 3. Cash and equivalents - The manager may engage in all normally accepted short-term investment practices including, but not limited to: U.S. Treasury and Agency securities, banker's acceptances, certificates of deposit, commercial paper and repurchase agreements using any of the foregoing as collateral. The following restrictions apply:
 - a. Commercial paper must be rated A-1/P-1 or higher by Standard & Poors Corporation and Moodys Investor Services.

CHUUK STATE GOVERNMENT

Notes to Financial Statements
September 30, 1996

(2) Cash and Equivalents and Investments, Continued

Investments, Continued

- b. Certificates of deposit must be from FDIC insured banks which must have assets in excess of two billion dollars. Deposits in smaller institutions are acceptable, but must not exceed the amount of the insurance unless collateralized by U.S. Treasury Securities at 102%.

- B. The equity portfolio shall be diversified among issues and industry classifications. No more than 25% of the equity portfolio may be invested in any single classification, as described by the Standard and Poors 500 Index, unless prior approval is received from the FSM Secretary of Finance.

- C. No investment may be made in a single corporate entity which exceeds 5% of the total assets of the fund at the time of purchase without prior approval by the FSM Secretary of Finance.

Statement No. 3 of the Governmental Accounting Standards Board requires government entities to categorize investments to give an indication of the level of risk assumed by the entity at year end. Category 1 includes investments that are insured or registered or for which securities are held by the State or its agent in the name of the State. Category 2 includes uninsured and unregistered investments for which securities are held by the broker's or dealer's trust department or agent in the name of the State. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer, or by its trust department or agent but not in the State's name. All of the State's investments are classified as Category 2 as all investments are held in the name of the Federated Development Authority.

Funds invested on behalf of the State as of September 30, 1996, are summarized below:

	<u>Carrying Amount</u>	<u>Market Value</u>
<u>Cash on Deposit with Trustee</u>		
Cash management fund	\$ <u>1,735,808</u>	\$ <u>1,735,808</u>
<u>Investments</u>		
Equity funds	\$ <u>23,036,472</u>	\$ <u>25,532,138</u>

Cash on deposit with Trustee as of September 30, 1996 is comprised of the following:

General fund	\$ 763,935
Compact other grants fund	316,460
Compact special block grant fund	80,951
Compact capital project fund	<u>574,462</u>
	\$ <u>1,735,808</u>

CHUUK STATE GOVERNMENT

Notes to Financial Statements September 30, 1996

(2) Cash and Equivalents and Investments, Continued

Investments, Continued

D. The State's investment income as of September 30, 1996, is summarized below:

Interest	\$ 1,338,703
Dividends	325,970
Realized gains	655,985
Management fees	(239,611)
Other expenses	<u>(26,631)</u>
	\$ <u>2,054,416</u>

(3) Receivables From Other Governments and Federal Agencies

Amounts due from other governments include those funds which are earned and have yet to be reimbursed by the FSM National Government for U.S. grants, U.S. Department of the Interior (DOI) grants, and those earned reimbursements resulting from Congress of the Federated States of Micronesia appropriations. Additionally, amounts due from the Office of Transition, Trust Territory Government (TTG), are for DOI Capital Projects.

Amounts due from federal agencies are those funds earned which are reimbursed directly from United States federal agencies.

(4) Fixed Assets

Chuuk State did not update the balances in the General Fixed Assets Account Group during fiscal year 1996.

A summary of the general fixed assets accounted for in the General Fixed Assets Account Group as of September 30, 1996, follows:

Roads	\$ 10,257,016
Port facilities	6,537,700
Airport facilities	24,506,300
Public utilities	22,961,621
Other	<u>3,319,247</u>
	\$ <u>67,581,884</u>

A summary of fixed assets accounted for in the component units-proprietary funds as of September 30, 1996, follows:

CHUUK STATE GOVERNMENT

Notes to Financial Statements
September 30, 1996

(4) Fixed Assets, Continued

	<u>Estimated Useful Lives</u>	
Housing units	25-50 years	\$ 271,964
Equipment	7-10 years	727,699
Building	20-30 years	301,649
Automobiles	3- 5 years	32,498
Office equipment	7-10 years	37,035
Other	5-10 years	<u>19,746</u>
		1,390,591
Less accumulated depreciation		<u>(485,387)</u>
		<u>\$ 905,204</u>

(5) Notes Payable

Capital Projects Fund

The State entered into a separate agreement with a contractor for payment of prior services performed. The agreement was not executed by the Attorney General's office and some amounts due are being renegotiated. Until a mutual settlement occurs, payment will not be made. The note is to be repaid from the State's Compact 211 (a)(2) Capital Projects Fund. As of September 30, 1996, the note is as follows:

Principal due in six monthly installments commencing on July 1, 1988, with interest payments due in monthly installments at 12% per annum. \$ 329,179

General Fund

The State signed a promissory note with the Federal Emergency Management Agency (FEMA) for the State's matching share of funds for the Typhoon Owen disaster as of September 30, 1991. The principal amount was originally estimated at \$2,500,000. The current principal amount is determined by calculating 25% of the FEMA grants less principal payments already made. The note is as follows:

Payable to FEMA, principal and interest due in 10 quarterly installments of \$233,234 maturing on April 1, 1995, at 7 1/8% per annum. \$ 127,870

The above debt is past due and is therefore reflected as a current liability.

CHUUK STATE GOVERNMENT

Notes to Financial Statements
September 30, 1996

(5) Notes Payable, Continued

General Long-Term Debt Account Group

During the year ended September 30, 1993, the State undertook a single issue of notes payable under the Medium-Term Note (MTN) program entered into by the FSM National Government on behalf of itself and the four FSM states.

On June 14, 1993, Chuuk State issued four (4) notes for \$10,300,000 to finance Chuuk State's equity investment in Western Pacific Tuna Group (WESTPAC), a fishing joint venture, and a loan to Bonjenva Holdings Ltd. The outstanding notes payable balance as of September 30, 1996, is comprised of several notes with varying interest rates and maturities as follows:

<u>Maturity</u>	<u>Interest Rate % P.A.</u>	<u>Principal Amount</u>
10/15/97	6.02	\$ 1,300,000
10/15/98	6.30	3,000,000
10/15/99	6.52	3,000,000
10/16/2000	6.75	<u>3,000,000</u>
Total		\$ <u>10,300,000</u>

Payments of principal and interest are entrusted to Bankers Trust, as Trustee. The FSM has pledged, as security for payments by the Trustee, a first priority lien on, and security interest in, all Compact of Free Association payments from the U.S. Government.

Upon receipt of the Compact payments, the Trustee is responsible for withdrawal of amounts necessary for payments of principal and interest. Various other restrictive covenants exist and are detailed in the Trust Agreement dated April 1, 1990, as amended by a Supplemental Trust Agreement dated March 15, 1994. Management is of the opinion that it has complied with such covenants through September 30, 1996.

(6) Continuing Appropriations

Continuing appropriations are summarized as follows:

General Fund

Each fiscal year, Chuuk State Legislature appropriates funds for various programs, municipal projects and other projects which are available until fully expended or until project completion.

\$ 875,309

Capital Projects

Each fiscal year, Chuuk State appropriates funds towards Capital Projects and Economic Development Projects. These funds are available until fully expended or project completion.

\$ 19,763,410

CHUUK STATE GOVERNMENT

Notes to Financial Statements
September 30, 1996

(7) Operating Transfers In/Out

Material General Fund, Special Revenue Fund, Capital Projects Fund and Component Units - Proprietary Funds transfers in/out for the year ended September 30, 1996, are as follows:

	<u>Transfer Out</u>	<u>Transfer In</u>
General Fund:		
Transfers out to Component Units:		
Chuuk Housing Authority	\$ 58,074	\$ -
Chuuk Coconut Authority	58,900	-
Chuuk State Development Authorities	1,867	
Chuuk Public Utilities Corporation	119,545	
Chuuk Organization for Community Action	<u>5,000</u>	<u>-</u>
Total transfers out to Component Units	<u>243,386</u>	<u>-</u>
Transfers out to Special Revenue Funds:		
Chuuk Visitors' Bureau	<u>142,946</u>	<u>-</u>
Total General Fund	<u>386,332</u>	<u>-</u>
Special Revenue Funds:		
Transfers out to Component Units:		
Chuuk Public Utilities Corporation	<u>1,033,612</u>	<u>-</u>
Total Special Revenue Funds	<u>1,033,612</u>	<u>-</u>
Capital Projects Funds:		
Transfers out to Component Units:		
Chuuk Public Utilities Corporation	<u>1,250,000</u>	<u>-</u>
Total Capital Projects Funds	<u>1,250,000</u>	<u>-</u>
Transfers in to Component Units:		
Chuuk Housing Authority	-	58,074
Chuuk Coconut Authority	-	58,900
Chuuk State Development Authorities	-	1,867
Chuuk Public Utilities Corporation	-	2,403,157
Chuuk Organization for Community Action	<u>-</u>	<u>5,000</u>
Total transfers in Component Units	<u>-</u>	<u>2,526,998</u>
Transfers in Special Revenue Funds:		
Chuuk Visitors' Bureau	<u>-</u>	<u>142,946</u>
	<u>\$ 2,669,944</u>	<u>\$ 2,669,944</u>

CHUUK STATE GOVERNMENT

Notes to Financial Statements September 30, 1996

(8) Interfund Assets/Liabilities

The following summarizes due from/to other funds as of September 30, 1996:

<u>Fund</u>	<u>Receivable Amount</u>	<u>Payable Amount</u>
Special Revenue Funds:		
Chuuk Airport Authority	\$ 662,597	\$ -
Compact - Special Block Grant	1,735,301	-
Federal Grant Assistance Fund	839,582	-
Compact - Other Grants Fund	485,263	-
Other Grant Assistance Fund	-	831
CFSM Grant Fund	-	150,450
Capital Projects Funds:		
TTG Capital Projects Fund	-	91,920
Compact Capital Projects Fund	2,497,716	-
CFSM State Project Fund	1,500	-
General Fund	<u>-</u>	<u>5,978,758</u>
	<u>\$ 6,221,959</u>	<u>\$ 6,221,959</u>

(9) Investments - Other

During fiscal year 1993, the State purchased \$1,000,000 of common stock in the Bank of the Federated States of Micronesia. The State purchased \$250,000 of common stock in fiscal year 1990 and fiscal year 1989. This represents an interest of 16.08% as of September 30, 1996. The above investment is carried at cost since there is no method of ascertaining related market value.

\$1,500,000

During fiscal year 1991, the State purchased \$250,000 of common stock in the Pacific Islands Regional Development Bank (a 7.36% interest at September 30, 1996). The above investment is carried at cost since there is no method of ascertaining related market value.

250,000

During fiscal year 1996, the State purchased \$125,000 of common stock in a joint venture with the National Fisheries Corporation for a longline base. The State also purchased \$875,000, \$130,000 and \$370,000 of common stock in fiscal years 1994, 1993 and 1991, respectively in the same joint venture. This represents an interest of 50% as of September 30, 1996. Under the equity method of accounting, which has been adopted for Chuuk's investment in Chuuk Fresh Tuna, Incorporated (CFTI), Chuuk State's share of earnings and losses incurred by the entity have been deducted from the carrying value.

1,202,005

During fiscal year 1993, the State purchased \$812,000 of common stock in the Bank of Guam, which represents a .7% interest as of September 30, 1996. The above investment is carried at cost since there is no method of ascertaining related market value.

812,000

CHUUK STATE GOVERNMENT

Notes to Financial Statements
September 30, 1996

(9) Investments - Other, Continued

During fiscal year 1995, the State invested \$3,160,000 for a 40% interest in Western Pacific Tuna Group (WESTPAC), a fishing joint venture. During fiscal year 1995, Chuuk State invested \$40,000 for a 45% interest in Western Pacific Operating Group (WESTOP). The above investments are carried at cost as there is no method of ascertaining related market value. 3,200,000

During fiscal year 1996, Chuuk State purchased \$300,000 of common stock in the FSM Development Bank (a less than 1.1% interest at September 30, 1996). The above investment is carried at cost since there is no method of ascertaining related market value. 300,000

Total other investments \$ 7,264,005

Since the investments are considered unavailable to finance expenditures of the ensuing fiscal year, the investments are restricted in the reserve for related assets component of fund balance. Therefore, even though the State has been unable to obtain financial statements from WESTPAC for its interest in the partnership, there is no impact on appropriable fund balance reserves due to the aforementioned related asset designation.

(10) Segment Data for Component Units-Proprietary Funds

The following represents key data extracted from the financial statements of material component units - proprietary funds of the State as of September 30, 1996, and for the year then ended:

	<u>Chuuk Public Utility Corporation</u>	<u>Chuuk Coconut Authority</u>	<u>Chuuk Housing Authority</u>
Total assets	\$ <u>649,503</u>	\$ <u>844,088</u>	\$ <u>2,270,652</u>
Total fund equity	\$ <u>649,503</u>	\$ <u>145,860</u>	\$ <u>2,202,808</u>
Net fixed assets	\$ <u>-</u>	\$ <u>739,233</u>	\$ <u>165,971</u>
FY96 operating loss	\$ <u>1,954,794</u>	\$ <u>206,378</u>	\$ <u>125,363</u>
FY96 net (loss) earnings	\$ <u>448,363</u>	\$ <u>(150,253)</u>	\$ <u>26,044</u>
FY96 operating revenues	\$ <u>661,898</u>	\$ <u>25,201</u>	\$ <u>115,790</u>
FY96 operating transfers in	\$ <u>2,403,157</u>	\$ <u>58,900</u>	\$ <u>58,074</u>

CHUUK STATE GOVERNMENT

Notes to Financial Statements September 30, 1996

(11) Commitments and Contingencies

Federal Programs

The State participates in a number of U.S. federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Currently, \$8,876,238 in cumulative questioned costs exist for the operation of fiscal years 1984-1996 grants.

If the grantor agencies ultimately disallow these costs or a portion thereof, the General Fund will bear responsibility for reimbursing the affected agencies. Accordingly, no provision for any liability that may result from this matter has been recorded in the accompanying general purpose financial statements. Pursuant to Title I, Section 105 of United States Public Law 99-239 the Government of the Federated States of Micronesia (FSM) is no longer liable for debts to U.S. federal agencies arising prior to the date of the implementation of the Compact of Free Association. This matter has not yet been officially resolved with the U.S. Government.

Sick Leave

It is the policy of the State to record the cost of sick leave when leave is actually taken and a liability is actually incurred. The accumulated estimated amount of unused sick leave at September 30, 1996, was \$3,846,934.

Compact of Free Association - Medical Referrals

During fiscal year 1989, the State reversed a previously recorded liability for unpaid medical referral billings amounting to \$2,937,704. The Compact of Free Association contains an authorization to pay for this debt. An appropriation has not been enacted by the U.S. Congress. Management is of the opinion that the Compact of Free Association clearly states the United States Government is responsible for this debt.

Committed Compact Funding

Under Chuuk State Law No. 193-16, which amended State Law No. 193-06, the Legislature has appropriated future cash flows of the Compact of Free Association. The amounts will be used by the State to repay current and future borrowings under the Medium-Term Note program (Refer Note 5).

The future appropriations have been made for Chuuk State's investment in Western Pacific Tuna Group (WESTPAC), a fishing joint venture. Appropriations totalling \$14,813,000 have been committed up to and including fiscal year 2001. These funds have been appropriated from Compact Section 211 (a) Capital Account Funds for this purpose.

CHUUK STATE GOVERNMENT

Notes to Financial Statements
September 30, 1996

(11) Commitments and Contingencies, Continued

Loan to Western Pacific Tuna Group (WESTPAC)

During the year ended September 30, 1995, the State financed an equity investment in WESTPAC. (See Notes 9 and 14). WESTPAC has received an additional \$3,000,000 loan from the FSM Development Bank for which Chuuk State is the guarantor.

(12) Fund Deficits

The following represents material fund deficits as of September 30, 1996. If operation of these funds cannot cover prior losses, the State's General Fund may have to absorb these amounts or a portion thereof:

Special Revenue Funds:	
CFSM Grant Fund	\$ <u>137,144</u>
Capital Projects Funds:	
TTG Capital Projects Fund	\$ <u>95,061</u>

(13) Notes Payable - Component Units-Proprietary Funds

The Chuuk Housing Authority, as of September 30, 1996, had the following note payable:

Payable to bank, principal and interest of \$1,634, due in monthly installments, at 10% per annum, collateralized by L043-A02 in Nepung, Chuuk.	\$ <u>22,054</u>
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Chuuk Coconut Processing Authority, as of September 30, 1996, had the following note payable:

Payable to FSM Development Bank, after an initial grace period of 18 months which was extended to 24 months, principal and interest are due in monthly installments of \$3,221 until December, 1995 then monthly installments of \$6,442 maturing in 2006 at 5% per annum, collateralized by 15.442 hectares of land, buildings, and soap making equipment. The outstanding balance at September 30, 1996, represents drawdowns to date on a credit facility with the Bank.	\$ <u>672,252</u>
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Future minimum payments on the above notes payable for subsequent years ending September 30, are as follows:

<u>Years ending September 30,</u>	<u>Amount</u>
1997	\$ 66,777
1998	47,011
1999	49,416
2000	51,944
2001	54,602
Thereafter	<u>424,556</u>
	\$ <u>694,306</u>

CHUUK STATE GOVERNMENT

Notes to Financial Statements September 30, 1996

(14) Loans Receivable - Related Party

As of September 30, 1996, Chuuk State has outstanding loans receivable from Bonjenvall Holdings Limited (BJL) of \$7,000,000 which was recorded in the Compact capital projects fund. The loan matures in fiscal year 2011, with interest being accrued semiannually at an interest rate of 7% per annum. The first payment on the loan is due on October 16, 1996. However, an amortization schedule has yet to be formulated.

Collateral for the loan is in the form of a second preferred mortgage over three fishing vessels purchased by WESTPAC, through the loan proceeds. The above loans receivable are being fully reserved for as a related asset within the Compact capital improvement projects fund balance.

(15) Fund Balances Reserved For Related Assets

Fund balance reserves for related assets are comprised of the following as of September 30, 1996:

	<u>Special Revenue Fund</u>	<u>Capital Projects Funds</u>
Receivables	\$ 1,900	\$ -
Loans	-	7,000,000
Investments - other	<u>-</u>	<u>7,264,005</u>
	<u>\$ 1,900</u>	<u>\$ 14,264,005</u>

(16) Reserve For Doubtful Interfund Receivable

The State General Fund advanced funds to certain Special Revenue Funds in anticipation of receiving additional funding from grantor agencies. This funding has yet to materialize. The State has accordingly recognized a bad debt expense related to these advances in the General Fund and has recorded a reserve for doubtful interfund receivable. This reserve is not netted against the interfund receivables/payables in the accompanying combined balance sheet in order for the related interfund accounts to balance (See Note 8).

(17) Loss on Equity Investment

Chuuk State Government holds a 50% investment in Chuuk Fresh Tuna, Inc. (CFTI). The Company is managed by National Fisheries Corporation, a component unit of the FSM National Government, which holds the remaining equity investment. Condensed financial information for CFTI is as follows:

	<u>1996</u>	<u>1995</u>
Balance sheet:		
Current assets	\$ 250,645	\$ 592,462
Property, plant and equipment	<u>6,901,268</u>	<u>7,282,889</u>
	<u>\$ 7,151,913</u>	<u>\$ 7,875,351</u>

CHUUK STATE GOVERNMENT

Notes to Financial Statements
September 30, 1996

(17) Loss on Equity Investment, Continued

Current liabilities	\$ 1,083,792	\$ 852,431
Long-term debt	3,564,111	3,759,599
Stockholders' equity	<u>2,504,010</u>	<u>3,263,321</u>
	\$ <u>7,151,913</u>	\$ <u>7,875,351</u>
Sales	\$ 1,377,544	\$ 3,117,870
Cost of sales	(735,108)	(2,030,937)
Operating expenses	(1,241,150)	(1,181,423)
Interest expenses, net	<u>(160,597)</u>	<u>(108,524)</u>
Net loss	\$ <u>(759,311)</u>	\$ <u>(203,014)</u>

All debt is due to the FSM Development Bank, a component unit of the FSM National Government.

CHUUK STATE GOVERNMENT

Combining Schedule of Expenditures by Account-
All Governmental Fund Types
Year Ended September 30, 1996
(With comparative totals for the year ended September 30, 1995)

	Governmental Fund Types			Totals (Memorandum Only)	
	General	Special Revenue	Capital Projects	1996	1995
Expenditures:					
Personnel	\$ 18,989,353	\$ 1,877,065	\$ 94,961	\$ 20,961,379	\$ 22,054,816
Travel	269,739	392,685	300,569	962,993	967,011
Contractual services	296,548	582,445	2,100,584	2,979,577	4,303,606
POL	90,120	406,640	27,346	524,106	2,016,485
Other :					
Equipment	85,170	89,830	1,572,090	1,747,090	2,162,518
Medical supplies	-	302,440	-	302,440	737,168
Medical referral	-	-	-	-	370,087
Supplies and materials	211,257	141,034	817,207	1,169,498	1,897,522
Scholarships	78,505	900	-	79,405	603,535
Official allowance	-	-	-	-	158,777
Food	72,310	746,950	-	819,260	892,171
Books	(8,403)	-	-	(8,403)	17,830
All others	3,717,907	25,482	-	3,743,389	2,492,231
Debt service-principal	-	-	-	-	127,870
Debt service-interest	-	-	665,360	665,360	665,360
Miscellaneous	576,127	294,874	1,942,421	2,813,422	2,043,513
Total expenditures	\$ 24,378,633	\$ 4,860,345	\$ 7,520,538	\$ 36,759,516	\$ 41,510,500

See Accompanying Independent Auditors' Report.

**CHUUK STATE GOVERNMENT
GENERAL FUND**

Statement of Revenues, Expenditures by Function and Department and Changes in Deficit
Year Ended September 30, 1996
(With comparative totals for the year ended September 30, 1995)

	1996	1995
Revenues:		
U.S. Compact of Free Association:		
Section 211(a)(2) - base grant	\$ 11,240,400	\$ 11,240,400
Section 217 - inflation adjustment	5,395,367	5,170,584
FSM revenue sharing	1,667,168	2,376,027
State taxes and licenses:		
Cigarette tax	\$ 55,923	\$ 56,192
General sales tax	779,830	801,909
Alcohol	113,872	152,118
Hotel	129,565	134,017
Delinquent tax collections	16,384	2,928
License and fees	18,551	18,378
Other	16,263	96,335
	1,130,388	1,261,877
Other revenues:		
Hospital and utilities collections	66,880	252,974
Transportation collections	606,489	863,862
Leases	40,128	165,092
Miscellaneous	403,316	108,406
Investment income	-	-
	2,054,416	1,390,334
	22,604,552	22,875,615
Expenditures by department:		
General government:		
Executive branch:		
Governor and staff	377,649	416,082
Attorney General	203,915	248,439
State Finance	241,800	244,227
ADP	96,938	77,344
Tax and revenue	79,243	100,667
Program and budget	126,454	145,144
Property and supply	149,451	159,989
Personnel	96,968	109,771
Planning	131,995	157,978
	1,504,413	1,659,641
Legislative internal operations:		
President and members	353,453	509,461
Speakers and members	925,024	1,339,859
Legislative committees	115,498	58,217
Legislative legal office	289,429	260,374
Legislative administration	178,700	214,048
Legislative budget office	83,240	96,856
Chief clerk	251,982	276,818
	2,197,326	2,755,633
Judicial operations	551,312	576,482
	4,253,051	4,991,756
Education:		
Administration	323,420	383,541
Elementary	4,994,970	4,811,767
Secondary	1,812,767	1,705,785
Nutrition	448,584	1,520,810
Curriculum and instruction	263,372	322,316
	7,843,113	8,744,219
Health services:		
Hospital and dispensaries	2,617,233	2,777,478
Environmental health	122,940	142,832
Dental services	264,635	281,749
Medical supplies	9,882	151,883
Medical referrals	-	371,487
	3,014,690	3,725,429

See Accompanying Independent Auditors' Report.

**CHUUK STATE GOVERNMENT
GENERAL FUND**

Statement of Revenues, Expenditures by Function and Department and Changes in Deficit, Continued
Year Ended September 30, 1996
(With comparative totals for the year ended September 30, 1995)

	1996	1995
Expenditures by department, continued:		
Economic development:		
Administration	\$ 116,479	\$ 124,495
Land management	67,089	64,783
Marine resources	489,209	497,978
Agriculture	336,477	341,376
Labor	36,456	47,914
Historic preservation	24,341	24,974
Business and trades	68,611	74,752
	1,138,662	1,176,272
Public works:		
Operations and maintenance	489,593	545,889
	489,593	545,889
Public safety		
	828,807	855,711
Transportation:		
Administration	506,109	748,280
Micro Vessels	348,491	365,023
Airport	130,849	145,904
	985,449	1,259,207
Community affairs:		
Division of public affairs	103,297	103,092
Division of youth affairs	18,161	35,573
Division of information and broadcast	99,415	94,976
	220,873	233,641
Boards and commissions:		
Investment board	4,789	5,795
Election commission	176,975	76,539
Education board	20,438	20,663
Recreation board	16,162	53,898
Land commission	180,060	201,354
General election	(10,562)	39,785
Environmental Protection Agency	83,575	84,291
	471,437	482,325
Medical referrals	-	6,767
Special programs	382,751	515,780
Legislative external appropriations	1,664,032	2,128,697
Uncollectible grants fund	3,086,175	-
	5,132,958	2,651,244
Total expenditures	24,378,633	24,665,693
Deficiency of revenues under expenditures	(1,774,081)	(1,790,078)
Other financing sources (uses):		
Operating transfers out	(386,332)	(1,140,405)
Other income	-	437,611
	(386,332)	(702,794)
Deficiency of revenues and other financing sources under expenditures and other financing uses	(2,160,413)	(2,492,872)
Deficit at beginning of year	(13,458,540)	(10,965,668)
Deficit at end of year	\$ (15,618,953)	\$ (13,458,540)

See Accompanying Independent Auditors' Report.

CHUUK STATE GOVERNMENT

Special Revenue Funds September 30, 1996

Specific revenues that are legally restricted to expenditures for particular purposes are accounted for in the Special Revenue Funds. A brief discussion of the State's Special Revenue Funds as of September 30, 1996, follows:

Chuuk Visitors' Bureau

This fund accounts for funds received by the Visitor's Bureau, to improve and develop Chuuk's tourism industry.

Chuuk Airport Authority

This fund accounts for funds received by the Airport Authority for the maintenance of Chuuk Airport.

Federal Grant Assistance Fund

This fund accounts for all activities of United States special federal assistance grants utilized by the State to finance general governmental operations. Federal grants are administered by the Federated States of Micronesia National Government with the State as the subrecipient.

Other Grant Assistance Fund

This fund accounts for all grants received directly from non-U.S. sources.

CFSM Grant Fund

This fund accounts for activities received from FSM congressional appropriations utilized by the State to finance general governmental operations.

Compact Other Grants Fund:

Compact Section 212 - Special Development Assistance Fund

This grant is restricted for special development assistance and is granted under the Compact of Free Association with the United States.

Compact 214(c) - Energy Grant Fund

This fund accounts for funds, granted under the Compact of Free Association with the United States, specifically restricted for energy programs.

Compact 216 (a)(2) Health and Medical Fund

This fund accounts for funds granted under the Compact of Free Association with the United States, specifically restricted for health and medical programs including referrals to hospital and treatment centers.

Compact Section 216(a)(3)

This fund accounts for funds granted under the Compact of Free Association with the United States to the FSM National Government which are subgranted to the State and are specifically restricted for educational scholarships at U.S. and Micronesian higher education institutions.

Compact 221 (b) Special Block Grant Fund

This fund accounts for funds granted under the Compact of Free Association with the United States, specifically restricted for health and education.

See Accompanying Independent Auditors' Report.

**CHUUK STATE GOVERNMENT
SPECIAL REVENUE FUNDS**

Combining Balance Sheet
September 30, 1996
(With comparative totals as of September 30, 1995)

ASSETS	Chuuk Visitors' Bureau	Chuuk Airport Authority	Federal Grant Assistance	Other Grant Assistance	CFSM Grant	Compact Other Grants	Compact Special Block Grant Section 221(b)	Totals	
								1996	1995
Cash and equivalents	\$ -	\$ -	\$ 118,621	\$ -	\$ -	\$ 316,460	\$ 80,951	\$ 516,032	\$ 411,028
Receivables:									
FSM National Gov't	-	-	2,269,681	21,928	74,864	16,798	88,167	2,471,438	3,278,853
Federal agencies, direct	-	-	173,267	-	-	-	-	173,267	555,175
General, net	133,052	-	1,900	-	-	-	-	134,952	39,969
Advances	-	-	102,234	831	13,306	11,093	9,609	137,073	151,759
Due from other funds	-	662,597	839,582	-	-	485,263	1,735,301	3,722,743	2,501,328
Allowance for uncollectibles	-	-	(2,093,093)	(21,928)	(74,864)	-	(88,167)	(2,278,052)	-
Total assets	\$ 133,052	\$ 662,597	\$ 1,412,192	\$ 831	\$ 13,306	\$ 829,614	\$ 1,825,861	\$ 4,877,453	\$ 6,938,112
LIABILITIES AND FUND BALANCES (DEFICIT)									
Liabilities:									
Bank overdraft	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 47,963
Accounts payable	-	-	799,766	-	-	412,339	693,417	1,905,522	2,563,944
Payable to other governments	-	-	335,106	-	-	-	-	335,106	1,073,155
Due to other funds	-	-	-	831	150,450	-	-	151,281	1,331,818
Accrued payroll	-	-	-	-	-	-	-	-	-
Deferred revenue	-	-	277,320	-	-	-	-	277,320	277,320
Total liabilities	-	-	1,412,192	831	150,450	412,339	693,417	2,669,229	5,294,200
Fund balances (deficit):									
Reserved for related assets	-	-	1,900	-	-	-	-	1,900	75,343
Reserved for encumbrances	-	-	915,965	935	16,573	302,673	151,985	1,388,131	1,717,018
Unreserved	133,052	662,597	(917,865)	(935)	(153,717)	114,602	980,459	818,193	(148,449)
Total fund balances (deficit)	133,052	662,597	-	-	(137,144)	417,275	1,132,444	2,208,224	1,643,912
Total liabilities and fund balances (deficit)	\$ 133,052	\$ 662,597	\$ 1,412,192	\$ 831	\$ 13,306	\$ 829,614	\$ 1,825,861	\$ 4,877,453	\$ 6,938,112

See Accompanying Independent Auditors' Report.

**CHUUK STATE GOVERNMENT
SPECIAL REVENUE FUNDS**

Combining Statement of Revenues, Expenditures by Function and Changes in Fund Balances (Deficit)
Year Ended September 30, 1996
(With comparative totals for the year ended September 30, 1995)

	Chuuk Visitors' Bureau	Chuuk Airport Authority	Federal Grant Assistance	Other Grant Assistance	CFSM Grant	Compact Other Grants	Compact Special Block Grant Section 221(b)	Totals	
								1996	1995
Revenues:									
U.S. Compact of Free Association:									
Section 221(b)-base grant	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 2,730,000	\$ 2,730,000	\$ 2,730,000
Section 216(a)2-base grant	-	-	-	-	-	461,087	-	461,087	461,087
Section 214(c)-base grant	-	-	-	-	-	949,800	-	949,800	949,800
Section 217-inflation adjustment	-	-	-	-	-	575,905	-	575,905	551,908
Section 212-base grant	-	-	-	-	-	250,000	-	250,000	250,000
Section 216(a)(3)-FSM	-	-	-	-	-	900	-	900	405,560
Federal contributions	-	-	1,213,278	-	-	-	-	1,213,278	2,572,488
Other	-	132,932	-	-	1,421	-	-	134,353	210,710
Total revenues	-	132,932	1,213,278	-	1,421	2,237,692	2,730,000	6,315,323	8,131,553
Expenditures:									
Education	-	-	960,739	-	-	900	1,993,783	2,955,422	3,996,916
Health services	-	-	88,410	-	-	437,167	500,749	1,026,326	1,667,882
Economic development	-	-	-	-	-	-	-	-	227,296
Public works and utilities	-	-	48,744	-	-	445,602	-	494,346	1,616,496
Public safety	-	-	-	-	1,421	-	-	1,421	9,940
Community affairs	-	-	31,817	-	-	267,445	-	299,262	372,131
Other	-	-	83,568	-	-	-	-	83,568	59,220
Total expenditures	-	-	1,213,278	-	1,421	1,151,114	2,494,532	4,860,345	7,949,881
Excess of revenues over expenditures	-	132,932	-	-	-	1,086,578	235,468	1,454,978	181,672
Other financing sources (uses):									
Operating transfers in	142,946	-	-	-	-	-	-	142,946	198,240
Operating transfers out	-	-	-	-	-	(1,033,612)	-	(1,033,612)	-
Total other financing sources (uses), net	142,946	-	-	-	-	(1,033,612)	-	(890,666)	198,240
Excess of revenues and other financing sources over expenditures and other financing uses	142,946	132,932	-	-	-	52,966	235,468	564,312	379,912
Fund balances (deficit) at beginning of year	(9,894)	529,665	-	-	(137,144)	364,309	896,976	1,643,912	1,264,000
Fund balances (deficit) at end of year	\$ 133,052	\$ 662,597	\$ -	\$ -	\$ (137,144)	\$ 417,275	\$ 1,132,444	\$ 2,208,224	\$ 1,643,912

See Accompanying Independent Auditors' Report.

**CHUUK STATE GOVERNMENT
SPECIAL REVENUE FUNDS**

**Combining Statement of Revenues, Expenditures by Account and Changes in Fund Balances (Deficit)
Year Ended September 30, 1996
(With comparative totals for the year ended September 30, 1995)**

	Chuuk Visitors' Bureau	Chuuk Airport Authority	Federal Grant Assistance	Other Grant Assistance	CFSM Grant	Compact Other Grants	Compact Special Block Grant Section 221(b)	Totals	
								1996	1995
Revenues:									
U.S. Compact of Free Association:									
Section 221(b)-base grant	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 2,730,000	\$ 2,730,000	\$ 2,730,000
Section 216(a)2-base grant	-	-	-	-	-	461,087	-	461,087	461,087
Section 214(c)-base grant	-	-	-	-	-	949,800	-	949,800	949,800
Section 217-inflation adjustment	-	-	-	-	-	575,905	-	575,905	551,908
Section 212-base grant	-	-	-	-	-	250,000	-	250,000	250,000
Section 216(a)(3)-FSM	-	-	-	-	-	900	-	900	405,560
Federal contributions	-	-	1,213,278	-	-	-	-	1,213,278	2,572,488
Other	-	132,932	-	-	1,421	-	-	134,353	210,710
Total revenues	-	132,932	1,213,278	-	1,421	2,237,692	2,730,000	6,315,323	8,131,553
Expenditures:									
Personnel	-	-	457,072	-	-	-	1,419,993	1,877,065	2,112,882
Travel	-	-	119,195	-	1,421	211,278	60,791	392,685	418,336
Contractual services	-	-	242,900	-	-	280,434	59,111	582,445	968,129
POL	-	-	5,028	-	-	401,339	273	406,640	1,544,291
Other :									
Equipment	-	-	39,357	-	-	49,998	475	89,830	366,915
Medical supplies	-	-	3,905	-	-	67,450	231,085	302,440	585,285
Supplies and materials	-	-	103,487	-	-	-	37,547	141,034	410,803
Scholarships	-	-	-	-	-	900	-	900	403,560
Food	-	-	-	-	-	87,175	659,775	746,950	663,754
Books	-	-	-	-	-	-	-	-	12,128
All others	-	-	-	-	-	-	25,482	25,482	132,258
Miscellaneous	-	-	242,334	-	-	52,540	-	294,874	331,540
Total expenditures	-	-	1,213,278	-	1,421	1,151,114	2,494,532	4,860,345	7,949,881
Excess of revenues over expenditures	-	132,932	-	-	-	1,086,578	235,468	1,454,978	181,672
Other financing sources (uses):									
Operating transfers in	142,946	-	-	-	-	-	-	142,946	198,240
Operating transfers out	-	-	-	-	-	(1,033,612)	-	(1,033,612)	-
Total other financing sources (uses), net	142,946	-	-	-	-	(1,033,612)	-	(890,666)	198,240
Excess of revenues and other financing sources over expenditures and other financing uses	142,946	132,932	-	-	-	52,966	235,468	564,312	379,912
Fund balances (deficit) at beginning of year	(9,894)	529,665	-	-	(137,144)	364,309	896,976	1,643,912	1,264,000
Fund balances (deficit) at end of year	\$ 133,052	\$ 662,597	\$ -	\$ -	\$ (137,144)	\$ 417,275	\$ 1,132,444	\$ 2,208,224	\$ 1,643,912

See Accompanying Independent Auditors' Report.

CHUUK STATE GOVERNMENT

Capital Projects Funds
September 30, 1996

The acquisition and construction of major capital facilities, other than those financed by proprietary funds are accounted for in the Capital Projects Funds. A brief discussion of the State's Capital Projects Funds as of September 30, 1996, follows:

TTG Capital Projects Fund

This fund accounts for various capital projects received under grant awards from the U.S. Department of the Interior, Office of Transition (formerly the Trust Territory Government).

CFSM State Projects Fund

This fund accounts for the various capital projects funded by the Congress of the Federated States of Micronesia.

Compact 211 (a) (2) Capital Projects Fund

This fund accounts for various capital projects funded by the Compact of Free Association with the United States, Title Two, Article I, Section 211.

See Accompanying Independent Auditors' Report.

**CHUUK STATE GOVERNMENT
CAPITAL PROJECTS FUNDS**

Combining Balance Sheet
September 30, 1996
(With comparative totals as of September 30, 1995)

<u>Assets</u>	TTG Capital Projects	CFSM State Projects	Compact 211(a)(2) Capital Projects	Totals	
				1996	1995
Cash and equivalents	\$ -	\$ -	\$ 574,462	\$ 574,462	\$ 3,107,658
Investments	-	-	22,051,146	22,051,146	15,051,146
Investments - other	-	-	7,264,005	7,264,005	7,643,660
Receivable from:					
Dept. of the Interior grants - TTG	762,349	93,081	-	855,430	642,978
FSM National Government	-	-	-	-	93,081
Prepaid expenses	-	-	24,831	24,831	24,831
Advances	11,841	-	197,020	208,861	167,475
Loans receivable, other	-	-	7,000,000	7,000,000	7,000,000
Due from other funds	-	1,500	2,497,716	2,499,216	-
Allowance for uncollectibles	(762,349)	(93,081)	-	(855,430)	3,922,214
Total assets	\$ 11,841	\$ 1,500	\$ 39,609,180	\$ 39,622,521	\$ 37,653,043
 <u>Liabilities and Fund Balances (Deficit)</u>					
Liabilities:					
Notes payable	\$ -	\$ -	\$ 329,179	\$ 329,179	\$ 329,179
Accounts payable	14,982	1,500	1,781,270	1,797,752	1,660,912
Due to other funds	91,920	-	-	91,920	827,103
Total liabilities	106,902	1,500	2,110,449	2,218,851	2,817,194
Fund balances (deficit):					
Reserved for:					
Related assets	-	-	14,264,005	14,264,005	14,799,294
Encumbrances	13,313	-	2,678,863	2,692,176	3,562,240
Continuing appropriations	-	-	19,763,410	19,763,410	17,157,231
Unreserved	(108,374)	-	792,453	684,079	(682,916)
Total fund balances (deficit)	(95,061)	-	37,498,731	37,403,670	34,835,849
Total liabilities and fund balances (deficit)	\$ 11,841	\$ 1,500	\$ 39,609,180	\$ 39,622,521	\$ 37,653,043

See Accompanying Independent Auditors' Report.

**CHUUK STATE GOVERNMENT
CAPITAL PROJECTS FUNDS**

Combining Statement of Revenues, Expenditures by Function And Changes in Fund Balances (Deficit)
Year Ended September 30, 1996
(With comparative totals for the year ended September 30, 1995)

	TTG Capital Projects	CFSM State Projects	Compact 211(a)(2) Capital Projects	Totals	
				1996	1995
Revenues:					
U.S. Compact of Free Association:					
Section 211 (a)(2) - base grant	\$ -	\$ -	\$ 7,833,600	\$ 7,833,600	\$ 7,833,600
Section 217 - inflation adjustment	-	-	3,760,128	3,760,128	3,603,456
U.S. Department of the Interior grants	119,371	-	-	119,371	61,927
Other federal contributions	-	-	-	-	90
Total revenues	119,371	-	11,593,728	11,713,099	11,499,073
Expenditures:					
Capital projects	119,371	-	6,735,807	6,855,178	8,229,566
Debt service-interest	-	-	665,360	665,360	665,360
Total expenditures	119,371	-	7,401,167	7,520,538	8,894,926
Excess of revenues over expenditures	-	-	4,192,561	4,192,561	2,604,147
Other financing sources (uses):					
Operating transfers out	-	-	(1,250,000)	(1,250,000)	(59,189)
Other income	-	-	4,916	4,916	81,660
Loss on investment	-	-	(379,656)	(379,656)	-
Excess of revenues and other financing sources over expenditures and other financing uses	-	-	2,567,821	2,567,821	2,626,618
Fund balances (deficit) at beginning of year	(95,061)	-	34,930,910	34,835,849	32,209,231
Fund balances (deficit) at end of year	\$ (95,061)	\$ -	\$ 37,498,731	\$ 37,403,670	\$ 34,835,849

See Accompanying Independent Auditors' Report.

**CHUUK STATE GOVERNMENT
CAPITAL PROJECTS FUNDS**

Combining Statement of Revenues, Expenditures by Account And Changes in Fund Balances (Deficit)
Year Ended September 30, 1996
(With comparative totals for the year ended September 30, 1995)

	TTG Capital Projects	CFSM State Projects	Compact 211(a)(2) Capital Projects	Totals	
				1996	1995
Revenues:					
U.S. Compact of Free Association:					
Section 211 (a)(2) - base grant	\$ -	\$ -	\$ 7,833,600	\$ 7,833,600	\$ 7,833,600
Section 217 - inflation adjustment	-	-	3,760,128	3,760,128	3,603,456
U.S. Department of the Interior grants	119,371	-	-	119,371	61,927
Other federal contributions	-	-	-	-	90
Total revenues	119,371	-	11,593,728	11,713,099	11,499,073
Expenditures:					
Personnel	714	-	94,247	94,961	166,093
Travel	118,657	-	181,912	300,569	159,754
Contractual services	-	-	2,100,584	2,100,584	2,778,003
POL	-	-	27,346	27,346	12,294
Other:					
Equipment	-	-	1,572,090	1,572,090	1,645,257
Supplies and materials	-	-	817,207	817,207	1,060,183
All others	-	-	-	-	2,046,627
Food	-	-	-	-	1,000
Debt service-interest	-	-	665,360	665,360	665,360
Miscellaneous	-	-	1,942,421	1,942,421	360,355
Total expenditures	119,371	-	7,401,167	7,520,538	8,894,926
Excess of revenues over expenditures	-	-	4,192,561	4,192,561	2,604,147
Other financing sources (uses) :					
Operating transfers out	-	-	(1,250,000)	(1,250,000)	(59,189)
Other income	-	-	4,916	4,916	81,660
Loss on investment	-	-	(379,656)	(379,656)	-
Excess of revenues and other financing sources over expenditures and other financing uses	-	-	2,567,821	2,567,821	2,626,618
Fund balances (deficit) at beginning of year	(95,061)	-	34,930,910	34,835,849	32,209,231
Fund balances (deficit) at end of year	\$ (95,061)	\$ -	\$ 37,498,731	\$ 37,403,670	\$ 34,835,849

See Accompanying Independent Auditors' Report.

CHUUK STATE GOVERNMENT

Component Units-Proprietary Funds
September 30, 1996

Component units - proprietary funds are legally separate organizations for which the elected officials of the State of Chuuk are financially accountable. Proprietary funds are used to account for a government's ongoing organizations and activities that are similar to those often found in the private sector. All assets, liabilities, equities, revenues, expenses and transfers relating to the government's business and quasi - business activities - where net income and capital maintenance are measured - are accounted for through proprietary funds. The generally accepted accounting principles here are generally those applicable to similar businesses in the private sector; the measurement focus is on determination of net income, financial position and cash flows. A brief discussion of the State's Component Units-Proprietary Funds as of September 30, 1996, follows:

Chuuk Housing Authority

The Chuuk Housing Authority receives rental subsidies from the U.S. Department of Housing and Urban Development to operate Section 8 housing renovation and income programs.

Chuuk Coconut Authority

The Chuuk Coconut Authority manufactures soap and soap by-products for resale.

Chuuk Public Utilities Corporation

The Chuuk Public Utilities Corporation provides electrical services to the public through the operation and maintenance of the State's electric power system.

See Accompanying Independent Auditors' Report.

**CHUUK STATE GOVERNMENT
COMPONENT UNITS-PROPRIETARY FUNDS**

Combining Balance Sheet
September 30, 1996
(With comparative totals as of September 30, 1995)

<u>ASSETS</u>	Chuuk Housing Authority	Chuuk Coconut Authority	Chuuk Public Utility Corporation	<u>Totals (Memorandum Only)</u>	
				1996	1995
Cash and equivalents	\$ 834,874	\$ 2,382	\$ 149,503	\$ 986,759	\$ 566,917
General receivables, net of allowance for doubtful accounts for \$33,564	175,000	72,216	500,000	747,216	280,889
Loans receivables, net of allowance for doubtful accounts of \$595,255	1,071,213	-	-	1,071,213	1,155,003
Inventories	-	20,493	-	20,493	72,785
Other assets	23,594	9,764	-	33,358	61,393
Fixed assets, net	165,971	739,233	-	905,204	974,617
Total assets	\$ 2,270,652	\$ 844,088	\$ 649,503	\$ 3,764,243	\$ 3,111,604
 <u>Liabilities and Fund Equity</u>					
Liabilities:					
Accounts payable	\$ 45,790	\$ 19,797	\$ -	\$ 65,587	\$ 112,370
Accrued payroll and others	-	6,179	-	6,179	10,659
Notes payable	22,054	672,252	-	694,306	733,538
Total liabilities	67,844	698,228	-	766,072	856,567
Fund equity:					
Contributed capital	1,785,271	452,835	-	2,238,106	2,020,266
Retained earnings (deficit)	417,537	(306,975)	649,503	760,065	234,771
Total fund equity	2,202,808	145,860	649,503	2,998,171	2,255,037
Total liabilities and fund equity	\$ 2,270,652	\$ 844,088	\$ 649,503	\$ 3,764,243	\$ 3,111,604

See Accompanying Independent Auditors' Report.

**CHUUK STATE GOVERNMENT
COMPONENT UNITS-PROPRIETARY FUNDS**

Combining Statement of Revenues, Expenses and Changes in Fund Equity
Year Ended September 30, 1996
(With comparative totals for the year ended September 30, 1995)

	Chuuk Housing Authority	Chuuk Coconut Authority	Chuuk Public Utility Corporation	Totals (Memorandum Only)	
				1996	1995
Operating revenues:					
Interest income	\$ 115,790	\$ -	\$ -	\$ 115,790	\$ 98,479
Sales	-	25,201	661,898	687,099	42,062
Total operating revenues	115,790	25,201	661,898	802,889	140,541
Operating expenses:					
Payroll and personnel	59,717	29,654	627,629	717,000	128,992
Fuel	-	-	1,159,487	1,159,487	-
Travel	14,195	496	8,749	23,440	27,289
Depreciation	19,238	4,725	-	23,963	22,806
Cost of sales	-	155,267	-	155,267	121,102
Bad debt	49,688	11,728	-	61,416	157,430
Rent	1,285	-	26,300	27,585	7,810
Other	97,030	29,709	794,527	921,266	50,956
Total operating expenses	241,153	231,579	2,616,692	3,089,424	516,385
Operating loss	(125,363)	(206,378)	(1,954,794)	(2,286,535)	(375,844)
Nonoperating revenues (expenses) :					
Transfers in	58,074	58,900	2,403,157	2,520,131	206,473
Payment to Coconut Development Authority	-	(4,956)	-	(4,956)	(5,000)
Federal contributions-HUD Section 8	36,856	-	-	36,856	38,306
Recovery of bad debt	39,951	-	-	39,951	38,360
Gain on sale of fixed assets	-	-	-	-	3,610
Interest expense	(3,474)	-	-	(3,474)	(37,796)
Other income	20,000	2,181	-	22,181	-
Total nonoperating revenues (expenses), net	151,407	56,125	2,403,157	2,610,689	243,953
Net earnings (loss)	26,044	(150,253)	448,363	324,154	(131,891)
Retained earnings (deficit) at beginning of year	391,493	(156,722)	201,140	435,911	366,662
Retained earnings (deficit) at end of year	417,537	(306,975)	649,503	760,065	234,771
Contributed capital at beginning of year	1,567,431	452,835	-	2,020,266	1,670,266
Contributions	217,840	-	-	217,840	350,000
Contributed capital at end of year	1,785,271	452,835	-	2,238,106	2,020,266
Total fund equity	\$ 2,202,808	\$ 145,860	\$ 649,503	\$ 2,998,171	\$ 2,255,037

See Accompanying Independent Auditors' Report.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

**INDEPENDENT AUDITORS' REPORTS ON COMPLIANCE
WITH LAWS AND REGULATIONS**

YEAR ENDED SEPTEMBER 30, 1996



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE BASED ON THE
ENGAGEMENT TO AUDIT THE GENERAL PURPOSE FINANCIAL STATEMENTS**

Honorable Ansito Walter
Governor, State of Chuuk
Federated States of Micronesia:

We were engaged to audit the general purpose financial statements of the State of Chuuk as of and for the year ended September 30, 1996. Our report, dated April 23, 1997, stated that the scope of our work was not sufficient to enable us to express, and we did not express an opinion on the general purpose financial statements due to; 1) our inability to determine that the assets, liabilities, revenues and expenditures of the Governmental Fund Types were fairly stated; 2) our inability to form an opinion on the General Fixed Assets Account Group; 3) the omission of the State's eleven development authorities; 4) our inability to express an opinion on the Chuuk Coconut Authority, the Chuuk State Public Utility Corporation and the Chuuk Visitors Bureau; 5) our inability to obtain audited financial statements from investees of the State of Chuuk supporting investments recorded in the Governmental Fund Type - Capital Projects Fund; 6) the noninclusion of a potential Component Unit-Governmental Fund, and; 7) our inability to obtain representation from the Chuuk State Attorney General, regarding pending litigation and other legal matters.

Generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States, require that an audit be planned and performed in order to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement.

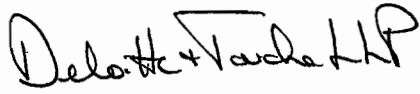
Compliance with laws, regulations, contracts, and grants applicable to the State of Chuuk is the responsibility of Chuuk State management. We performed tests of Chuuk State's compliance with certain provisions of laws, regulations, contracts, and grants. However, our objective was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed one material instance of noncompliance, detailed in the accompanying Schedule of Findings and Questioned Costs (pages 73 through 84) in Federal Finding Number 3, that is required to be reported herein under Government Auditing Standards, the ultimate resolution of which cannot presently be determined. Accordingly, no provision for any liability that may result upon resolution has been made to the federal financial assistance programs to which they relate.

We also noted certain immaterial instances of noncompliance that we have reported to the management of the State of Chuuk, which are described in the accompanying Schedule of Findings and Questioned Costs in Federal Findings 1, 2 and 4 and Local Findings 1 through 6.

We also noted matters involving compliance with laws and regulations related to federal financial assistance which we reported to the State of Chuuk's management in our reports dated April 23, 1997 on compliance related to federal financial assistance programs.

This report is intended for the information of the management of the State of Chuuk and the cognizant audit and other federal agencies. However, this report is a matter of public record and its distribution is not limited.

A handwritten signature in black ink, appearing to read "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

April 23, 1997



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH
SPECIFIC REQUIREMENTS APPLICABLE TO MAJOR FEDERAL
FINANCIAL ASSISTANCE PROGRAMS**

Honorable Ansito Walter
Governor, State of Chuuk
Federated States of Micronesia:

We were engaged to audit the general purpose financial statements of the State of Chuuk as of and for the year ended September 30, 1996. Our report, dated April 23, 1997, stated that the scope of our work was not sufficient to enable us to express, and we did not express an opinion on the general purpose financial statements due to; 1) our inability to determine that the assets, liabilities, revenues and expenditures of the Governmental Fund Types were fairly stated; 2) our inability to form an opinion on the General Fixed Assets Account Group; 3) the omission of the State's eleven development authorities; 4) our inability to express an opinion on the Chuuk Coconut Authority, the Chuuk State Public Utility Corporation and the Chuuk Visitors Bureau; 5) our inability to obtain audited financial statements from investees of the State of Chuuk supporting investments recorded in the Governmental Fund Type - Capital Projects Fund; 6) the noninclusion of a potential Component Unit-Governmental Fund, and; 7) our inability to obtain representation from the Chuuk State Attorney General, regarding pending litigation and other legal matters

We were also engaged to audit the State of Chuuk's compliance with the requirements governing special tests and provisions related to the Compact of Free Association that are applicable to its one major federal financial assistance program, which is identified in the accompanying Schedule of Federal Financial Assistance (pages 55 through 69), for the year ended September 30, 1996. The management of the State of Chuuk is responsible for Chuuk State's compliance with those requirements.

As described in the accompanying Schedule of Findings and Questioned Costs (pages 73 through 84) in Federal finding number 3, the results of our procedures disclosed a material instance of noncompliance with the requirements referred to above. In our opinion, the State of Chuuk's adherence to the recommendations made in that finding is necessary for the State of Chuuk to comply with the requirements applicable to the major programs of the State of Chuuk.

The results of our procedures disclosed one immaterial instance of noncompliance with the requirements referred to above, which is described in the accompanying Schedule of Findings and Questioned Costs in Federal finding number 4.

Because of the matter described in the third paragraph above, the scope of our audit work was not sufficient to enable us to express, and we do not express, an opinion on the State of Chuuk's compliance with the requirements governing special tests and provisions related to the Compact of Free Association that are applicable to its one major federal financial assistance program for the year ended September 30, 1996.

This report is intended for the information of the management of the State of Chuuk and the cognizant audit and other federal agencies. However, this report is a matter of public record and its distribution is not limited.

Delo: He & Tache LLP

April 23, 1997



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE
WITH THE GENERAL REQUIREMENTS APPLICABLE TO
FEDERAL FINANCIAL ASSISTANCE**

Honorable Ansito Walter
Governor, State of Chuuk
Federated States of Micronesia:

We were engaged to audit the general purpose financial statements of the State of Chuuk as of and for the year ended September 30, 1996. Our report, dated April 23, 1997, stated that the scope of our work was not sufficient to enable us to express, and we did not express an opinion on the general purpose financial statements due to; 1) our inability to determine that the assets, liabilities, revenues and expenditures of the Governmental Fund Types were fairly stated; 2) our inability to form an opinion on the General Fixed Assets Account Group; 3) the omission of the State's eleven development authorities; 4) our inability to express an opinion on the Chuuk Coconut Authority, the Chuuk State Public Utility Corporation and the Chuuk Visitors Bureau; 5) our inability to obtain audited financial statements from investees of the State of Chuuk supporting investments recorded in the Governmental Fund Type - Capital Projects Fund; 6) the noninclusion of a potential Component Unit-Governmental Fund, and; 7) our inability to obtain representation from the Chuuk State Attorney General, regarding pending litigation and other legal matters. We have also performed auditing procedures on the State of Chuuk's compliance applicable to requirements of major federal financial assistance programs and issued our report thereon dated April 23, 1997, which stated that the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on compliance applicable to requirements of major federal financial assistance programs.

We have applied procedures to test the State of Chuuk's compliance with the following requirements applicable to its federal financial assistance programs, which are identified in the Schedule of Federal Financial Assistance (pages 55 through 69), for the year ended September 30, 1996: cash management, federal financial reports, allowable costs/cost principles, Drug-Free Workplace Act, and administrative requirements.

The requirements of political activity, Davis-Bacon Act, civil rights and relocation assistance and real property acquisition are not applicable to the federal financial assistance programs of the State of Chuuk, which are identified in the Schedule of Federal Financial Assistance.

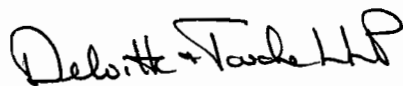
Our procedures were limited to the applicable procedures described in the Office of Management and Budget's Compliance Supplement for Single Audits of State and Local Governments. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on Chuuk State's compliance with the requirements listed in the preceding paragraph. Accordingly, we do not express such an opinion.

Material instances of noncompliance consist of failures to follow the general requirements that caused us to conclude that the misstatements resulting from those failures are material to the Schedule of Federal Financial Assistance or the general purpose financial statements. As described in the accompanying Schedule of Findings and Questioned Costs (pages 73 through 84) in Federal finding number 3, the results of our tests of compliance disclosed one material instance of noncompliance.

Except as described above, the results of our procedures to determine compliance indicate that, with respect to the items tested, Chuuk State complied, in all material respects, with the requirements listed in the second paragraph of this report. Because of the significance of the item noted in the preceding paragraph, the scope of our audit work was not sufficient to enable us to express, and we do not express, any assurance as to the items not tested. However, the results of our procedures also disclosed immaterial instances of noncompliance with those requirements, which are described in the accompanying Schedule of Findings and Questioned Costs in Federal Findings 1, 2 and 4.

We also noted matters involving compliance with laws and regulations related to our audit of the general purpose financial statements and with requirements related to major and nonmajor federal financial assistance programs that we reported to the State of Chuuk's management in our report dated April 23, 1997.

This report is intended for the information of the management of the State of Chuuk and the cognizant audit and other federal agencies. However, this report is a matter of public record and its distribution is not limited.

A handwritten signature in black ink, appearing to read "Deloitte Touche LLP". The signature is written in a cursive, flowing style.

April 23, 1997



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE
WITH REQUIREMENTS APPLICABLE TO NONMAJOR
FEDERAL FINANCIAL ASSISTANCE PROGRAM TRANSACTIONS**

Honorable Ansito Walter
Governor, State of Chuuk
Federated States of Micronesia:

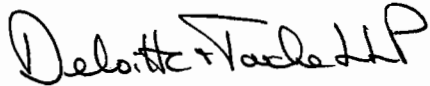
We were engaged to audit the general purpose financial statements of the State of Chuuk as of and for the year ended September 30, 1996. Our report, dated April 23, 1997, stated that the scope of our work was not sufficient to enable us to express, and we did not express an opinion on the general purpose financial statements due to; 1) our inability to determine that the assets, liabilities, revenues and expenditures of the Governmental Fund Types were fairly stated; 2) our inability to form an opinion on the General Fixed Assets Account Group; 3) the omission of the State's eleven development authorities; 4) our inability to express an opinion on the Chuuk Coconut Authority, the Chuuk State Public Utility Corporation and the Chuuk Visitors Bureau; 5) our inability to obtain audited financial statements from investees of the State of Chuuk supporting investments recorded in the Governmental Fund Type - Capital Projects Fund; 6) the noninclusion of a potential Component Unit-Governmental Fund, and; 7) our inability to obtain representation from the Chuuk State Attorney General, regarding pending litigation and other legal matters. We were also engaged to audit Chuuk State's compliance applicable to requirements of major federal financial assistance programs and to apply procedures to test compliance with general requirements applicable to federal financial assistance programs and have issued our reports thereon dated April 23, 1997, which stated that the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on Chuuk State's compliance with specific requirements applicable to major federal financial assistance programs or any assurance as to items not tested regarding compliance with general requirements.

Office of Management and Budget (OMB) Circular A-128, "Audits of State and Local Governments", requires that in connection with performing an audit of the general purpose financial statements, consideration be given to the control structure used to administer federal financial assistance programs, and assessment of control risk be made, and we selected certain transactions applicable to certain nonmajor federal financial assistance programs for the year ended September 30, 1996.

OMB Circular A-128 requires that auditing procedures be performed to test compliance with the requirements governing types of services allowed or unallowed; eligibility; and reporting that are applicable to those transactions. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on Chuuk State's compliance with these requirements. Accordingly, we do not express such an opinion.

With respect to the items tested, the results of those procedures disclosed no material instances of noncompliance with the requirements listed in the preceding paragraph. With respect to items not tested, there is more than a relatively low risk that Chuuk State may have violated applicable laws and regulations based on the extent of noncompliance noted with respect to the items tested.

This report is intended for the information of the management of the State of Chuuk and the cognizant audit and other federal agencies. However, this report is a matter of public record and its distribution is not limited.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, flowing style.

April 23, 1997



**INDEPENDENT AUDITORS' REPORT ON THE INTERNAL CONTROL STRUCTURE
USED IN ADMINISTERING FEDERAL FINANCIAL ASSISTANCE**

Honorable Ansito Walter
Governor, State of Chuuk
Federated States of Micronesia:

We were engaged to audit the general purpose financial statements of the State of Chuuk as of and for the year ended September 30, 1996. Our report, dated April 23, 1997, stated that the scope of our work was not sufficient to enable us to express, and we did not express an opinion on the general purpose financial statements due to; 1) our inability to determine that the assets, liabilities, revenues and expenditures of the Governmental Fund Types were fairly stated; 2) our inability to form an opinion on the General Fixed Assets Account Group; 3) the omission of the State's eleven development authorities; 4) our inability to express an opinion on the Chuuk Coconut Authority, the Chuuk State Public Utility Corporation and the Chuuk Visitors Bureau; 5) our inability to obtain audited financial statements from investees of the State of Chuuk supporting investments recorded in the Governmental Fund Type - Capital Projects Fund; 6) the noninclusion of a potential Component Unit-Governmental Fund, and; 7) our inability to obtain representation from the Chuuk State Attorney General, regarding pending litigation and other legal matters. We were also engaged to audit Chuuk State's compliance with requirements applicable to major federal financial assistance programs and have issued our report thereon dated April 23, 1997, which stated that the scope of our work was not sufficient to express, and we did not express, an opinion on compliance with requirements applicable to major federal financial assistance programs.

Generally accepted accounting standards; Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Circular A-128, "Audits of State and Local Governments", require that audits be planned and performed to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement and about whether Chuuk State complied with laws and regulations, noncompliance with which would be material to a major federal financial assistance program.

In planning our audits for the year ended September 30, 1996, generally accepted auditing standards and Government Auditing Standards require that auditors consider the State of Chuuk's internal control structure and assess control risk in order to determine auditing procedures necessary to express opinions on the State of Chuuk's general purpose financial statements and on its compliance with requirements applicable to major programs, and to report on the internal control structure in accordance with OMB Circular A-128. This report addresses our consideration of internal control structure policies and procedures relevant to compliance with requirements applicable to federal financial assistance programs. We have addressed internal control structure policies and procedures relevant to our audit of the general purpose financial statements in a separate report dated April 23, 1997.

The management of the State of Chuuk is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of general purpose financial statements in accordance with generally accepted accounting principles, and that federal financial assistance programs are managed in compliance with applicable laws and regulations. Because of inherent limitations in any internal control structure, errors, irregularities, or instances of noncompliance may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures used in administering federal financial assistance programs in the following categories:

Controls Used in Administering Federal Programs

General Requirements

- Cash management
- Federal financial reports
- Allowable costs/cost principles
- Drug-Free Workplace Act
- Administrative requirements

Specific Requirements

- Compact of Free Association
- Types of services allowed or unallowed
- Eligibility
- Reporting

Claims for Advances and Reimbursements

Accounting Controls

- Revenue and receipt cycle
- Purchases and disbursement cycle
- Payroll and personnel cycle
- External financial reporting
- Cash and equivalents
- Receivables
- Fixed assets
- Payables and accrued liabilities

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and determined whether they have been placed in operation, and we assessed control risk.

During the year ended September 30, 1996, Chuuk State expended 89% of its total federal financial assistance under one major federal financial assistance program.

We performed tests of controls, as required by OMB Circular A-128, to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that we considered relevant to preventing or detecting material noncompliance with specific requirements, general requirements, and requirements governing claims for advances and reimbursements that are applicable to Chuuk State's one major federal financial assistance program, which is identified in the accompanying Schedule of Federal Financial Assistance (pages 55 through 69). Our procedures were less in scope than would be necessary to render an opinion on these internal control structure policies and procedures. Accordingly, we do not express such an opinion.

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

We noted certain matters, which are presented in the accompanying Schedule of Findings and Questioned Costs (pages 73 through 84), in Federal Findings 1 through 4, involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants.

Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the State of Chuuk's ability to administer federal financial assistance programs in accordance with applicable laws and regulations.

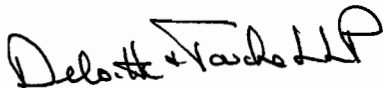
A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that noncompliance with laws and regulations that would be material to a federal financial assistance program may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure policies and procedures used in administering federal financial assistance would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we consider the matter set forth in Federal Finding number 3, involving the internal control structure and its operation, to be a material weakness, as defined above. This condition was considered in determining the nature, timing and extent of the procedures to be performed in our engagement to audit Chuuk State's compliance with requirements applicable to its major federal financial assistance programs for the year ended September 30, 1996, and this report does not affect our report thereon dated April 23, 1997.

Because of the foregoing condition, noncompliance with laws and regulations governing federal financial assistance may occur and not be detected.

We also noted other matters involving the internal control structure and its operation based on our engagement to audit the general purpose financial statements that we reported to management of the State of Chuuk, in a report dated April 23, 1997.

This report is intended for the information of the management of the State of Chuuk and the cognizant audit and other federal agencies. However, this report is a matter of public record and its distribution is not limited.



April 23, 1997

**INDEPENDENT AUDITORS' REPORT ON THE SUPPLEMENTARY
SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE**

Honorable Ansito Walter
Governor, State of Chuuk
Federated States of Micronesia:

We were engaged to audit the general purpose financial statements of the State of Chuuk as of and for the year ended September 30, 1996. Our report, dated April 23, 1997, stated that the scope of our work was not sufficient to enable us to express, and we did not express an opinion on the general purpose financial statements due to; 1) our inability to determine that the assets, liabilities, revenues and expenditures of the Governmental Fund Types were fairly stated; 2) our inability to form an opinion on the General Fixed Assets Account Group; 3) the omission of the State's eleven development authorities; 4) our inability to express an opinion on the Chuuk Coconut Authority, the Chuuk State Public Utility Corporation and the Chuuk Visitors Bureau; 5) our inability to obtain audited financial statements from investees of the State of Chuuk supporting investments recorded in the Governmental Fund Type - Capital Projects Fund; 6) the noninclusion of a potential Component Unit-Governmental Fund, and; 7) our inability to obtain representation from the Chuuk State Attorney General, regarding pending litigation and other legal matters. These general purpose financial statements are the responsibility of the Chuuk State government.

Generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States, require that an audit be planned and performed to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

The system of financial accounting and reporting in operation for Chuuk State for the year ended September 30, 1996, was inadequate, as discussed in our Report on the Internal Control Structure based on the Engagement to Audit the General Purpose Financial Statements, dated April 23, 1997.

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

The accompanying Schedule of Federal Financial Assistance (pages 55 through 69) for the year ended September 30, 1996, which is also the responsibility of the management of the State of Chuuk, is presented for purposes of additional analysis and is not a required part of the general purpose financial statements. The scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the information that is in that schedule.

This report is intended for the information of the management of the State of Chuuk and the cognizant audit and other federal agencies. However, this report is a matter of public record and its distribution is not limited.

Deloitte + Touche LLP

April 23, 1997

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance
FSM Federal Assistance Fund
Year Ended September 30, 1996

(The following grants are received in a subrecipient capacity through the FSM National Government)

Grantor Account Title	Chuuk Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
<u>U.S. Department of Agriculture</u>			
FY95 Forestry Project	7719	10.664	\$ 3,132
			<u>\$ 3,132</u>
<u>U.S. Department of Education</u>			
PREL "Umbrella" Project	3803	84.256	\$ 1,500
FY95 PREL "Umbrella" Project	3804	84.256	179,081
Vocational Education Program	3805	84.994	8,077
FY96 School Improvement Project	3808	84.994	155,568
FY95 Special Education Program	7729	84.027	227,015
FY94 Special Education Program	7743	84.027	95,110
			<u>666,351</u>
Total U.S. Department of Education			<u>\$ 666,351</u>
<u>U.S. Department of Health and Human Services</u>			
FY95 Family Planning	7365	93.217	\$ 836
FY94 Substance Abuse Prevention & Treatment	7378	93.959	20,081
FY94 Diabetes Program	7384	93.988	3,569
FY94 Sapt/Siis Municipal	7385	93.959	2,939
FY95 State System Dev. Ini.	7388	93.110	7,852
FY96 Family Planning	7438	93.217	5,627
FY95 Aids Prevention	7441	93.940	2,327
FY95 MCH Program	7445	93.994	14,657
FY95 Tuberculosis & Aids	7448	93.116	3,670
FY93 MCH Program	7454	93.994	404
FY94 MCH Program	7489	93.994	10,831
FY94 Immunization Program	7494	93.268	9,896
			<u>82,689</u>
Total U.S. Department of Health and Human Services			<u>\$ 82,689</u>

See accompanying notes to schedule of federal financial assistance.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued
FSM Federal Assistance Fund, Continued
Year Ended September 30, 1996

(The following grants are received in a subrecipient capacity through the FSM National Government)

<u>Grantor Account Title</u>	<u>Chuuk Org. #</u>	<u>CFDA I.D. #</u>	<u>1995 Fiscal Year Expenditures</u>
<u>U.S. Department of the Interior</u>			
FY94 Historic Preservation	7326	15.904	\$ 1,907
Road & Health Dispensary Repair	7893	15.875	26,778
Department of Education O & M	7894	15.875	43,391
Public Utilities Corporation	7316	15.875	<u>439</u>
Total U.S. Department of the Interior			<u>\$ 72,515</u>
<u>U.S. Department of Labor</u>			
FY94 JTPA Administration	3440	17.250	\$ 27,269
FY94 JTPA Adult Program	3441	17.250	63,654
FY94 JTPA Youth Program	3442	17.250	72,870
FY94 JTPA Technical Assistance	3446	17.250	<u>15,601</u>
Total U.S. Department of Labor			<u>\$ 179,394</u>
<u>Federal Emergency Management Agency</u>			
Typhoon Owen Public Assistance	3820	83.516	\$ 67,289
FEMA PeaceSat Project	3825	83.516	2,703
Hazard Mitigation Broadcast	3854	83.516	9,526
Hazard Mitigation Management Cost	3856	83.516	<u>4,047</u>
Total Federal Emergency Management Agency			<u>\$ 83,565</u>
<u>U.S. Environmental Protection Agency</u>			
House Sewer Connection	1580	66.418	<u>\$ 48,305</u>
<u>Other Grants</u>			
School V & D Programs	3802	N/A	\$ 1,840
FY95 School Visions	3806	N/A	6,658
PREL V.E.I.P. Year 4	3807	84.994	63,105
Family Food Nutrition Program	3959	UNICEF	<u>5,724</u>
Total Other U.S. Grants			<u>\$ 77,327</u>
Total Federal Financial Assistance Fund			<u>\$ 1,213,278</u>

See accompanying notes to schedule of federal financial assistance.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued
TTPI Capital Projects Fund
Year Ended September 30, 1996

(The following grants are received in a subrecipient capacity through the FSM National Government)

<u>Grantor Account Title</u>	<u>Chuuk Org. #</u>	<u>CFDA I.D. #</u>	<u>1996 Fiscal Year Expenditures</u>
Weno Dock Rehabilitation	6662	15.875	\$ <u>119,371</u>
Total TTPI Capital Projects Fund			\$ <u><u>119,371</u></u>

See accompanying notes to schedule of federal financial assistance.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued
CFSM Special Revenue Fund
Year Ended September 30, 1996

(The following grants are received in a subrecipient capacity through the FSM National Government)

Grantor Account Title	Chuuk Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
Chuuk Joint Law Enforcement	9437	N/A	\$ <u>1,421</u>
Total CFSM Special Revenue Fund			\$ <u><u>1,421</u></u>

See accompanying notes to schedule of federal financial assistance.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued
Compact of Free Association Capital Projects Fund
Section 211 (A)(2)
Year Ended September 30, 1996

Grantor Account Title	Chuuk Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
<u>Section 211 (A)(2)</u>			
Tolensom Fishing Market	5001	15.875	\$ 9,610
Weno Fishing Project Supply	5002	15.875	44,118
Chuuk State Public Utility	5003	15.875	500,000
Weno Water System Dev.	5004	15.875	2,280
MS Nama II Suppl.	5005	15.875	134,535
MS Nama II Suppl.	5006	15.875	7,421
Onou Housing Project Supple.	5007	15.875	38,000
Moch Credit Union	5008	15.875	8,000
Tonoas Farming Project	5009	15.875	1,001
Road Paving Repair	5011	15.875	77,939
Paata Fishing Project	5013	15.875	12,950
Wonei Fishing Project	5014	15.875	22,020
Paata Housing Revolving Loan Fund	5016	15.875	78,279
Paata Farming Project	5017	15.875	2,177
V6AK Radio & TV Complex	5022	15.875	8,894
Fono Sewing Project	5023	15.875	4,993
Losap Sewing Project	5026	15.875	20,000
Mechitiw Fishing Project	5027	15.875	19,943
Uman Fishing Market	5029	15.875	30,795
Chuuk State Rad. & Tel. Brod.	6027	15.875	1,542
Wonei Sapitiw Water Catchment	6030	15.875	167
Lukunoch Ice Maket	6037	15.875	999
Siis Municipal Office Complex	6042	15.875	40,000
Polle (Tonoas) Youth Center	6043	15.875	1,090
Tonoas Power Generator	6050	15.875	12,734
Tonoas Lease Claim	6051	15.875	2,267
Restoration Program	6141	15.875	5,391
Onoun Fishing Cooperative	6142	15.875	10
Pattiw Junior High School	6145	15.875	9,594
Sewer System FY88	6150	15.875	36,325
Road Improvement	6151	15.875	5,000
Magur Coop. Association	6160	15.875	1,152
Moch School Project	6161	15.875	571
Typhoon Owen Dis. Rel. Fund	6175	15.875	15,254
Udot Water Project	6199	15.875	203
Etiamar Dock Repair	6207	15.875	2,130
Tunuk Fishing Development Project	6215	15.875	1,050
Weno Primary Road	6218	15.875	16,924
Iras Fishing Proj.	6230	15.875	943
Piis/Paneu Community Hall	6239	15.875	406
Tol Road Upgrade	6254	15.875	25,764
Eor Basketball/Water	6256	15.875	2,995
Nama Fishing Proj.	6270	15.875	4,837
Install New Aircon	6275	15.875	16,982
Pollap Piggery Project	6276	15.875	6,652
Preliminary Engineering Design	6284	15.875	15,605
CIP Administration	6292	15.875	1,594
Parem Fishing Project	6303	15.875	538
Subtotal			<u>1,251,674</u>

See accompanying notes to schedule of federal financial assistance.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued
Compact of Free Association Capital Projects Fund
Section 211 (A)(2), Continued
Year Ended September 30, 1996

Grantor Account Title	Chuuk Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
Balance forwarded			\$ 1,251,674
Kuttu Fishing Project	6314	15.875	6,475
Unanu Housing Proj.	6352	15.875	9
Parem Shoreline	6358	15.875	740
Fefan Pub. Road Upgrade	6375	15.875	8,842
Fefan Municipal Office Complex	6376	15.875	45,000
Fefan Pub. Road Upgrade	6377	15.875	27,626
Fefan Pub. Road Upgrade	6378	15.875	17,720
Iras Water Catchment	6402	15.875	794
Typhoon Owen Disaster	6404	15.875	13,694
Road (Tunnuk-Sapuk)	6405	15.875	5,000
Extension of Health Services	6406	15.875	10,590
Water Project	6408	15.875	1,699
Project Admin. Cost	6426	15.875	3,274
Fefan Fishing Project	6435	15.875	500
Chuuk Air Terminal Expansion	6436	15.875	10,000
Sefin Seawall	6456	15.875	2,523
Fefan Fishing Project	6487	15.875	607
Dublon Fisheries Complex	6490	15.875	9,051
Ufo (Fefan) Water System	6496	15.875	549
Romalum Seawall Supple.	6498	15.875	500
Polle Marketing Project	6506	15.875	11,287
Pollap Multi-purpose Center	6545	15.875	4,613
Weno Village Sewing Project	6549	15.875	700
Piherarh Fishing Project	6558	15.875	189
Polle-Nethon Dispensary	6562	15.875	8,785
Polle-Manaio Dispensary	6563	15.875	3,993
Polle Municipal Office	6564	15.875	20,000
Neirenom Dock-Polle	6575	15.875	47
Uman Fisheries Development	6581	15.875	7,586
Romanum Seawall	6606	15.875	4,211
Satawan Fisheries Development	6607	15.875	1,007
Sangkumi Artisanal Fish	6611	15.875	5,918
Airport Terminal Parking	6619	15.875	1,888
Water System Improvement Div.	6622	15.875	5,000
Tol Municipal Road Improvement	6668	15.875	4,400
Tuna Longline Fishing	6678	15.875	112
Micro Vessels Dry Docking	6684	15.875	22,995
Onongoch Fishing Market	6687	15.875	3,000
Fongon Agriculture Project	6696	15.875	1,580
Anom Water Improvement Project-Fefan	6830	15.875	847
Uman Road & Dock Major Upgrade	6833	15.875	7,285
Udot Road and Dock Supple.	6839	15.875	2,080
Ruo Fish Project Supple.	6841	15.875	1,400
Houk School Cookhouse	6852	15.875	165
Houk Runway & Cap. Equipment	6853	15.875	24,554
Pollap Dispensary Project	6858	15.875	835
Satawan Sub Power & Facilities	6870	15.875	45,600
Subtotal			1,606,944

See accompanying notes to schedule of federal financial assistance.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued
Compact of Free Association Capital Projects Fund
Section 211 (A)(2), Continued
Year Ended September 30, 1996

Grantor Account Title	Chuuk Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
Balance forwarded			\$ 1,606,944
Namoluk Runway Construction	6874	15.875	5,678
Pollap Community Center	6884	15.875	5,000
Tonoas Garment Man.	6892	15.875	3,449
Tonoas Garment Man.	6893	15.875	15,673
Tonoas Fishing Project	6895	15.875	255
Tol Dispensary Site Lease	6906	15.875	10,000
Uman Sopou Dock Repair	6908	15.875	1,000
Onoun Housing Project	6922	15.875	957
Nukanap (Parem) C.C.R.	6925	15.875	2,544
Neauo Shoreline Project	6933	15.875	347
Eot Municipal Office & School Supplies	6940	15.875	5,673
Chuuk Tuna Cannery	6943	15.875	(7,924)
Polle Community Water	6959	15.875	730
Kukku Fefan School Exp.	6965	15.875	2,160
Nomwin Fishing Development Project	6969	15.875	1,829
Nomwin Fishing Development Project	6971	15.875	8,130
Sapuk Public Building Renovation	6976	15.875	10,000
Sefin Mud Retention Wall	6979	15.875	981
Fefan Fishing Project	6984	15.875	400
Fefan Market Project	6985	15.875	64,960
Paata Coop.	6995	15.875	247
Onoun Housing Project	6998	15.875	391
Electricity & Solar Power Generator	6999	15.875	2,209
Chuuk Tuna Cannery	8504	15.875	133,692
Sewer System Rehabilitation	8505	15.875	118,136
Chuuk US/EDA Water Upgrade	8506	15.875	129,782
Public Safety Facilities Renovation	8508	15.875	895
Chuuk Hospital Renovation	8510	15.875	33,945
Water Reservoir Rehab.	8512	15.875	824
Kuttu Local Market	8516	15.875	5,000
Romalum Water Co. Sp.	8518	15.875	24,003
Fongen Meeting Hall	8519	15.875	227
Oneop S. Wl. Rd. & Com.	8527	15.875	10,036
Piherarh Housing Project	8533	15.875	9,752
Polle Public Building Con.	8539	15.875	15,182
Polle Water Project	8540	15.875	480
Chuuk Agriculture Development	8541	15.875	1,000
Chuuk Hono. PA. Housing	8546	15.875	4,526
Nema Court and Municipal	8548	15.875	18,962
Unanu Marketing Out	9556	15.875	750
Pafeng J.H.S. Con.	8557	15.875	177,469
Makur Solar Light System	8563	15.875	33,992
Romalum Market Supplies	8571	15.875	1,556
Romalum Market Supplies	8573	15.875	1,205
Romalum Market Supplies	8574	15.875	4
Moch Land Reclaim	8575	15.875	3,266
Subtotal			<u>2,466,317</u>

See accompanying notes to schedule of federal financial assistance.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued
Compact of Free Association Capital Projects Fund
Section 211 (A)(2), Continued
Year Ended September 30, 1996

Grantor Account Title	Chuuk Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
Balance forwarded			\$ 2,466,317
Fanapanges Public Building	8576	15.875	3,964
Romalum Market Sup.	8579	15.875	715
Nepukos Sewing Project	8582	15.875	606
Weno Road Supplies and Equipment	8591	15.875	54,100
Fefan School Rep. Sup.	8594	15.875	372
Fono Typhoon Shelter	8595	15.875	1,794
INS/ACT/COV	8601	15.875	2,777
Fefan SSNP Sewing	8606	15.875	166
Mechitiw Water Project	8607	15.875	906
Piararh Housing	8608	15.875	13,865
Pisemwar P. Building & Water	8609	15.875	776
Lukunor Runway Project	8610	15.875	11,151
Satowan Dock Upgrade	8613	15.875	66,116
Satowan Road Repair Survey	8614	15.875	143
Polle Chukuram Fish	8616	15.875	7,200
Udot Water Project Sup.	8617	15.875	9,897
Fefan Meseiku Market	8622	15.875	2,700
Iras Auto Repair Shop	8624	15.875	3,844
Houk Reefer Plant.	8632	15.875	374
Unanu Housing Project Sup.	8633	15.875	8
Fefan Nukan Market	8636	15.875	1,500
Fefan Soppo Market	8637	15.875	4,250
Fefan FSN Fishing Project	8638	15.875	3,662
Fefan FSN Fishing Project	8639	15.875	929
Udot Village Meeting Hall	8641	15.875	4,500
Magur Housing Project Supp.	8643	15.875	1,194
Nepukos School Anx. Sup.	8644	15.875	14,676
Nepukos School Anx. Sup.	8645	15.875	25,000
Weno Building Supp.	8648	15.875	9,500
Kuttu Office Complex	8654	15.875	5,756
Kuttu Power Generator Acquisition	8656	15.875	4,177
Eot Housing Project Sup.	8657	15.875	2,000
Penta Water Supply System	8658	15.875	1,524
Piies Paneu Meeting Hall	8659	15.875	225
Kuttu Land Lease	8663	15.875	4,800
Nemwan (Weno) Water Project	8664	15.875	9,938
Penia (Weno) Water Project	8665	15.875	7,640
Fefan Rock Crushing Plant	8668	15.875	17,280
Polle Neirenom Fishing Project	8670	15.875	3,700
Polle Malaio Fishing Project	8671	15.875	16,743
Uman Sannuk Water Project	8680	15.875	300
Niare (Paata) Water Project	8681	15.875	1,275
Sapota (Paata) Water Project	8683	15.875	700
Onoun Road/Runway Maintenance	8686	15.875	18,855
Siis Dock Repair	6888	15.875	8,700
Weno Computer Network	8690	15.875	1,983
Subtotal			<u>2,818,598</u>

See accompanying notes to schedule of federal financial assistance.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued
Compact of Free Association Capital Projects Fund
Section 211 (A)(2), Continued
Year Ended September 30, 1996

Grantor Account Title	Chuuk Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
Balance forwarded			\$ 2,818,598
Onoun Fishing Project	8693	15.875	2,649
Lukunoch Ice Machine	8696	15.875	2,000
Tamatam Fishing Project	8702	15.875	12,888
Lukunoch Housing Revolving Fund	8703	15.875	45,000
Tonoas Livestock Project	8707	15.875	4,837
Oneop Drydocking-IKK	8708	15.875	3,650
Fono Municipal Office	8710	15.875	14,624
Newotes (Nepukos) Public Bl. Su.	8713	15.875	100
Sapota (Paata) Water Project	8716	15.875	789
Fefan Municipal Government Debts	8720	15.875	11,500
Lukunoch Copra Warehouse	8723	15.875	12,966
Sapuk Nukenap Fishing/Supple.	8726	15.875	2,185
Tamatam Solar System	8729	15.875	4,674
Losap (Weno) Civic Center	8730	15.875	10,000
Road Paving Supplemental	8732	15.875	145,096
Paata Water Project Supplemental	8735	15.875	1,314
Micro Vessels Drydocking	8740	15.875	309,827
Purchase of Medical Equipment	8742	15.875	11,225
Dept. of Agriculture Facilities Reconstruction	8743	15.875	29,287
Fefan Road Supplemental	8745	15.875	23,551
Ta Runway Repair & Land Surv. Sup.	8747	15.875	11,308
Ta Dock Improvement/Expansion Sup.	8748	15.875	5,000
Satuni Pwene Economic Project	8750	15.875	10,789
Romalum Housing Project	8754	15.875	55,670
Peniesene (Weno) Access Road	8759	15.875	3,012
Losap Furniture Making Project	8765	15.875	1,500
Murilo Fishing Project	8767	15.875	15,000
Soputiw Farming Project	8770	15.875	10,116
Paata Fishing Project	8772	15.875	4,676
Paata/Etiemar/Nukaf Dispensary	8774	15.875	542
Paata Seawall	8777	15.875	5,000
Paata Water Project	8778	15.875	11,246
Paata Baseball Field Claim	8779	15.875	1,500
Paata Baseball Field Claim	8780	15.875	4,000
Wonei Community Centers	8782	15.875	600
Nomwin Housing Project	8788	15.875	26,097
Neauo (Weno) Water Project	8789	15.875	510
Paata Community Centers Sup.	8790	15.875	658
Tol Public Road Renovation & Beauty	8793	15.875	13,170
Tol Fishing and Trans.	8794	15.875	42,000
V6AK Radio/TV Complex	8796	15.875	25,000
Oneop Seawall and Road Project Supp.	8797	15.875	35,000
Miss Nama	8798	15.875	126,419
Miss Nama	8799	15.875	111,656
Miss Nama	8800	15.875	122,194
Subtotal			<u>4,109,423</u>

See accompanying notes to schedule of federal financial assistance.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued
Compact of Free Association Capital Projects Fund
Section 211 (A)(2), Continued
Year Ended September 30, 1996

Grantor Account Title	Chuuk Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
Balance forwarded			\$ 4,109,423
Pollap Dispensary Project	8802	15.875	4,000
Pattiw Dispensary Site Purchase	8804	15.875	4,500
Weno Secondary Road Repair	8805	15.875	112,839
Saramen Chuuk Academy School	8806	15.875	45,889
Piherarh Ice Making Machine	8807	15.875	2,500
Etten Tonoas Water Project	8808	15.875	3,367
Miss Nama	8809	15.875	84,032
Wonip (Tol) Seawall Project	8810	15.875	3,841
Faro (Tol) Seawall Project	8811	15.875	6,218
Wonip Dispensary Project Completion	8812	15.875	944
Amwachang (Tol) Seawall Construction	8814	15.875	6,388
Fanapanges Housing Supp.	8815	15.875	21,992
Fuun Metaw Drydocking	8816	15.875	8,360
Polle Youth Centers	8819	15.875	30,000
Tonoas Junior High School Lease	8820	15.875	101,000
U. Mortlocks Public Building Nama	8821	15.875	31,465
Pentecost Academy School	8822	15.875	400
Weno Sefin Water Dev. System	8823	15.875	9,955
Weno Water Development & Upgrade	8824	15.875	39,000
Etten Water Project Suppl.	8827	15.875	190
Ettal Longline Vessel	8828	15.875	41,250
Tonoas Road Upgrade Suppl.	8829	15.875	51,667
Tonoas Power Distribution	8830	15.875	7,133
Mwanukun Uman Road Repair	8832	15.875	24,221
Tol Public Building Project	8833	15.875	22,627
Romalum Fishing Project	8835	15.875	18,025
Wichap Office Building Site Purchase	8836	15.875	37,475
Lukunor Dock Engineering	8838	15.875	40,000
Iras Project (Loan)	8840	15.875	21,498
Tonoas Public Facility Repair	8843	15.875	106,865
Iras Meeting Hall Renovation	8844	15.875	4,033
Wonei Marketing Project	8846	15.875	9,825
Lease Payment (Ufo) Fefan	8847	15.875	4,000
Fefan Dispensary	8849	15.875	16,986
Fefan School Site Lease & Claim	8850	15.875	25,000
Kuttu Dock Project	8861	15.875	14,993
Kuttu Municipal Complex Building	8863	15.875	30,000
Imwapek (Wichao) Public Meeting Hall	8864	15.875	10,175
Romalum Dock Project	8865	15.875	24,310
Romalum Outright Land Purchase	8866	15.875	10,000
Moch Passenger Boat Acquisition	8867	15.875	50,225
Tamatam Municipal Office Construction	8868	15.875	7,705
Upper Mortlocks Water	8869	15.875	10,000
Piis-Emwar Office Construction	8870	15.875	10,000
Berea Christian School Facilities	8873	15.875	71,205
Wonip (Tol) School Water Tank	8874	15.875	3,000
Subtotal			<u>5,298,521</u>

See accompanying notes to schedule of federal financial assistance.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued
Compact of Free Association Capital Projects Fund
Section 211 (A)(2), Continued
Year Ended September 30, 1996

Grantor Account Title	Chuuk Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
Balance forwarded			\$ 5,298,521
West Fefan School Repair	8875	15.875	32,367
Weno Court/Jail Complex	8876	15.875	26,175
Wichap School Annex Site	8878	15.875	5,000
Onnongoch Damage Claims	8879	15.875	6,551
Nukan (Fefan) Water Project	8882	15.875	3,770
Romanum Jail Site Lease	8884	15.875	2,500
Uman Water Development Project	8885	15.875	22,206
Uman Jail Site Lease	8886	15.875	9,000
Fono Fishing Project	8887	15.875	27,730
Acquisition of Project for Oneop	8888	15.875	22,500
Losap Solar Lighting System	8889	15.875	10,000
Losap Water Catchment Tank	8890	15.875	36,000
Tolensom Farming Project	8891	15.875	5,000
Mizpah School Construction	8892	15.875	22,012
Weno Youth Beautification	8893	15.875	18,599
Teolensom Fishing Project	8894	15.875	141,562
Fananu Fishing Project	8895	15.875	29,634
Sefin Piggery Project	8896	15.875	4,766
Kuttu Road Seawall	8897	15.875	14,487
Tonoas Fishing Project	8898	15.875	104,501
Kuttu Road & Seawall Project	8899	15.875	3,362
St. Cecilia Toilet Repair	8900	15.875	900
Tol Community Cenetrs	8901	15.875	18,230
Satowan Ice Machine	8902	15.875	264
Fono Solar Lighting System	8903	15.875	29,398
Fefan Water System	8904	15.875	24,900
Fefan Public Building	8905	15.875	6,893
Eor (Weno) Public Building Repair	8907	15.875	3,410
Nepukos (Weno) School Site Lease	8908	15.875	10,000
Nukanap (Weno) Seawall Supp.	8909	15.875	9,804
Weno Water Catchments	8912	15.875	8,412
Fefan Road Major Upgrade	8913	15.875	54,280
Weno Public Building Repair	8914	15.875	8,847
Uman Sapota/Nukanap Sea Wall	8915	15.875	6,204
Sub-State Satowan Staff	8916	15.875	7,620
Uman Water Project	8917	15.875	22,000
Losap Fishing Project	8918	15.875	28,000
Losap Sewing Project	8920	15.875	20,001
Pollap Fishing Market Revolving	8921	15.875	17,000
Nomwin Housing Supp.	8924	15.875	53,101
Pollap Community Center	8925	15.875	18,436
Romalum Road Repair	8927	15.875	3,000
Ruo Dispensary Project	8929	15.875	13,319
N. Namon Public Building Rep. & Sup.	8931	15.875	50,347
Losap Office Complex	8934	15.875	33,388
Fefan Housing Project	8936	15.875	20,000
Subtotal			<u>6,313,997</u>

See accompanying notes to schedule of federal financial assistance.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued
Compact of Free Association Capital Projects Fund
Section 211 (A)(2), Continued
Year Ended September 30, 1996

Grantor Account Title	Chuuk Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
Balance forwarded			\$ 6,313,997
Kukku Fefan Water Project	8937	15.875	11,875
Udot Economic Development Loan Fund	8938	15.875	45,000
Romanum Fishing Project	8941	15.875	25,000
Udot Ice Plant	8942	15.875	7,553
Udot Ice Plant	8943	15.875	441
Udot Ice Plant Regional	8946	15.875	41,000
Epinup Fishing Project	8947	15.875	34,803
M/S Nama Repair/Maintenance	8948	15.875	5,000
Weno Sewing Project	8950	15.875	20,918
Weno, Sefin Fishing Project	8951	15.875	4,999
Tol CIP Related Claim	8952	15.875	12,000
Weno Housing Loan Fund	8955	15.875	100,000
Moch Transportation Services	8956	15.875	32,750
Tol School Site Lease	8957	15.875	30,000
Eot Housing Project	8958	15.875	53,000
Pattiw Junior High School Construction	8959	15.875	30,870
Murilo Revolving Fund	8961	15.875	10,000
Outstanding CIP Rel. Obl. Fefan	8962	15.875	47,550
Nama Passenger Vessel	8963	15.875	32,000
Romalum Dock Project	8964	15.875	26,441
Weno Sefin Piggery Project	8966	15.875	5,000
Acquisition of Property for Oneop	8968	15.875	23,500
Magur Housing Project	8970	15.875	16,019
Sotuni Pwene Fishing Project	8972	15.875	10,000
Power Generation and Distribution	8973	15.875	750,000
Fefan Agriculture Project	8975	15.875	15,369
Wonei Community Center	8976	15.875	27,372
Paata Housing Supplement	8977	15.875	60,000
Wonei Farming Project	8978	15.875	10,331
Fefan Handicraft Markets	8979	15.875	49,601
Fefan Housing Authority	8981	15.875	45,318
Fono Sewing Project	8982	15.875	6,000
Fono Admin Cost 1.5% Project	8984	15.875	885
Fono Admin Cost 1.5% Project	8990	15.875	415
Tonoas Fishing Project	8997	15.875	70,800
Kuchu-Uman School Site Lease	8998	15.875	10,000
Payment of MTN	N/A	15.875	665,360
Total Compact of Free Association Capital Projects Fund-Section 211(A)(2)			<u>\$ 8,651,167</u>

See accompanying notes to schedule of federal financial assistance.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued
Compact of Free Association Capital Projects Fund
Section 211 (A)(2), Continued
Year Ended September 30, 1996

For general-purpose financial statement presentation, total expenditures are reconciled as follows:

Audited expenditures per the general-purpose financial statements	\$ 7,401,167
Operating transfer out to Chuuk Public Utilities Corporation	<u>1,250,000</u>
Expenditures per page 62	<u><u>\$ 8,651,167</u></u>

Note: These funds are made available by Title Two, Article I, Section 211 of the Compact of Free Association.

These funds are disbursed through the Office of Territorial and International Affairs (OTIA), U.S. Department of the Interior and bear CFDA #15.875. The National Government of the FSM receives all grant awards on behalf of the FSM and reallocs such to the component States.

See accompanying notes to schedule of federal financial assistance.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued
Compact of Free Association-Other Grants Fund
Year Ended September 30, 1996

(The following grants are received in a subrecipient capacity through the FSM National Government)

Grantor Account Title	Chuuk Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
Section 212			
-Civic Action Team	2182	15.875	\$ 259,168
-Chuuk Airport	2186	15.875	44,264
-Transportation/Admin.	2189	15.875	8,277
			<u>311,709</u>
Section 214-Energy			
-Energy	2780	15.875	262,743
-Trans. Admin. Fuel	2783	15.875	138,595
-Chuuk Public Utility Corporation	2784	15.875	1,033,612
			<u>1,434,950</u>
Section 216(a)(2)			
-Health & Medical	2901	15.875	437,167
Section 216(a)(3)			
-Post Secondary Education	2613	15.875	900
Total Compact of Free Association-Other Grants Fund			<u>\$ 2,184,726</u>

For general purpose financial statement presentation, total expenditures are reconciled as follows:

Audited expenditures per the general purpose financial statements	\$ 1,151,114
Operating transfer out to Chuuk Public Utilities Corporation	<u>1,033,612</u>
	<u>\$ 2,184,726</u>

These funds are disbursed through the Office of Territorial and International Affairs (OTIA), U.S. Department of the Interior and bear CFDA No. 15.875. The FSM National Government receives all grant awards on behalf of the FSM and reallocates such to the component States.

See accompanying notes to schedule of federal financial assistance.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued
Compact of Free Association
Special Block Grant Fund - Section 221(B)
Year Ended September 30, 1996

Grantor Account Title	Chuuk Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
Communicable Diseases	2004	15.875	\$ 120,634
Mental Health	2005	15.875	42,364
Medical Referral	2120	15.875	106,272
Medical Supplies	2123	15.875	231,479
Food Services	2128	15.875	679,774
Elementary Education	2129	15.875	862,309
VRS-SBG	2135	15.875	49,714
PREL Conference	2136	15.875	10
Secondary Education	2142	15.875	113,021
Education Program	2145	15.875	681
Education Special Services	2148	15.875	288,274
Total Compact of Free Association Block Grant Fund-Section 221(b)			\$ 2,494,532

These funds are disbursed through the Office of Territorial and International Affairs (OTIA), U.S. Department of the Interior and bear CFDA No. 15.875. The FSM National Government receives all grant awards on behalf of the FSM and reallocates such to the component States.

See accompanying notes to schedule of federal financial assistance.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Federal Financial Assistance
Year Ended September 30, 1996

(1) Scope of Review

The State of Chuuk is one of the four States of the Federated States of Micronesia. All significant operations of the State are included in the scope of the OMB Circular A-128 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as the State's cognizant agency for the Single Audit.

Programs Subject to Single Audit

Expenditures by grantor are presented for each federal program related to the following agencies:

- U.S. Department of Agriculture
- U.S. Department of Education
- U.S. Department of Health and Human Services
- U.S. Department of the Interior
- U.S. Department of Labor
- U.S. Environmental Protection Agency
- U.S. Federal Emergency Management Agency

(2) Summary of Significant Accounting Policies

A. Basis of Accounting

For purposes of this report, certain accounting procedures were followed which help illustrate the expenditures of the individual programs. All expenses and capital outlays are reported as expenditures.

B. Reporting Entity

The State of Chuuk, for purposes of the general purpose financial statements, includes all of the funds of the primary government as defined by Governmental Accounting Standards Board (GASB) Statement 14, "The Financial Reporting Entity." However, the State is currently reviewing whether the Chuuk Organization for Community Action should be included as a component unit. This entity currently separately satisfies its Single Audit requirements.

C. Subgrantees

Certain program funds are passed through the State to subgrantee organizations. The Schedule of Federal Financial Assistance does not disclose how the subgrantee outside of the State's control utilizes these funds (See Note 3).

D. Indirect Cost Allocation

The State does not receive any indirect cost allocation and does not charge indirect costs against federal programs.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Federal Financial Assistance
Year Ended September 30, 1996

(3) Component Units

Chuuk Housing Authority

The Chuuk Housing Authority, a Component Unit-Proprietary Fund, receives federal funding and separately satisfies its OMB Circular A-128 audit requirements. The audit report of the Chuuk Housing Authority did not report questioned costs or material noncompliance during the year ended September 30, 1996. Chuuk Housing Authority's audit report, dated April 14, 1997, included the following Schedule of Federal Financial Assistance:

<u>Grant Title</u>	<u>Grantor Agency</u>	<u>CFDA No.</u>	<u>1996 Expenditures</u>
Section 8 Housing Assistance Program	HUD	14.156	\$ <u>36,856</u>

This funding was received in a direct capacity.

Loan Funds:

As of September 30, 1996, \$1,014,556 of loans made out of U.S. federal financial assistance, CFDA #14.219, were outstanding. The assistance provided by the U.S. Department of Housing and Urban Development was made to the State of Chuuk and passed through to the Authority.

Additionally, as of September 30, 1996, the Authority administered a loan program consisting of funds provided by the U.S. Department of the Interior, CFDA #15.875, which funds were received by the State of Chuuk and were passed through to the Authority. As of September 30, 1996, \$651,912 of loans were outstanding under this program.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Programs Selected for Audit
in Accordance with OMB Circular A-128
Year Ended September 30, 1996

The following list specifies programs selected for detailed compliance testing in accordance with applicable OMB Circular A-128 requirements.

U.S. Department of the Interior, CFDA #15.875

Compact of Free Association Capital Projects Fund, Title Two, Article I, Section 211 (a) (2)	\$ 8,651,167
Compact of Free Association, Section 214 Energy Grant	1,434,950
Compact of Free Association, Section 216 (a)(2) Health and Medical Grant	437,167
Compact of Free Association Block Grant, Title Two, Article I, Section 221 (b)	<u>2,494,532</u>
 Total CFDA #15.875	 <u>13,017,816</u>
 Total Programs Selected for Audit	 \$ <u>13,017,816</u>
 Total Federal Program Assistance Expenditures (excluding \$16,635,767 of Compact of Free Association Section 211a Current Account and related funds)	 <u>\$ 14,648,852</u>
 Percentage of Program Assistance Expenditures Tested	 <u>89%</u>

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 1996

Federal Findings

Drug-Free Workplace Act

<u>Item No.</u>	<u>CFDA No.</u>	<u>Criteria:</u>	<u>Questioned Costs</u>
1.	All	<p>Per the Office of Management and Budget Compliance Supplement, grantees are required to provide employees a drug-free workplace. In order to satisfy the above requirement, the following procedures must be performed:</p> <p>a) Publishing a policy statement notifying employees that the unlawful manufacture, distribution, dispensing, possession or use of a controlled substance is prohibited in the grantee's workplace and specifying the actions that will be taken against employees for violation of such prohibition;</p> <p>b) Establishing an ongoing drug-free awareness program to inform employees about:</p> <ul style="list-style-type: none">• The dangers of drug abuse in the workplace;• The grantee's policy of maintaining a drug-free workplace;• Any available drug counseling, rehabilitation, and employee assistance programs, and,• The penalties that may be imposed upon employees for drug abuse violations occurring in the workplace; <p>c) Making it a requirement that each employee to be engaged in the performance of the grant be given a copy of the statement required by paragraph (a);</p> <p>d) Notifying the employee in the statement required by paragraph (a) that, as a condition of employment under the grant, the employee will:</p> <ul style="list-style-type: none">• Abide by the terms of the statement; and• Notify the employer in writing of any criminal drug statute conviction for a violation occurring in the workplace no later than five calendar days after such conviction; <p>e) Notifying the agency in writing within ten calendar days after receiving notice under subparagraph (d) (2) from an employee or otherwise receiving actual notice of such conviction;</p>	

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1996

Federal Findings, Continued

Federal Finding No. 1 - Drug-Free Workplace Act, Continued

<u>Item No.</u>	<u>CFDA No.</u>	<u>Criteria, Continued:</u>	<u>Questioned Costs</u>
		<p>f) Taking one of the following actions, within 30 calendar days of receiving notice under subparagraph (d) (2), with respect to any employee who is so convicted:</p> <ul style="list-style-type: none">• Taking appropriate personnel action against such an employee, up to and including termination; or• Requiring such employees to participate satisfactorily in a drug abuse assistance or rehabilitation program approved for such purposes by a Federal, State, or local health, law enforcement, or other appropriate agency.	
		<p><u>Condition:</u> Per our inquiries, we noted the State of Chuuk has not complied with the above required procedures.</p>	
		<p><u>Cause:</u> Chuuk State has been waiting for the FSM National Government to take a lead on this finding as it also relates to the FSM in general.</p>	
		<p><u>Effect:</u> The effect is noncompliance with the Drug-Free Workplace Act.</p>	
		<p><u>Recommendation:</u> We recommend that in addition to issuing a policy statement in compliance with the Drug-Free Workplace Act, procedures be implemented to document that employees engaged in the performance of federal grants are aware of the policy statement.</p>	
		<p><u>Prior Year Status:</u> Noncompliance with the Drug-Free Workplace Act was reported as a finding in the Single Audits of the Chuuk State Government for fiscal years 1991 through 1996.</p>	
		<p><u>Auditee Response and Corrective Action Plan:</u> The State will maximize its efforts to ensure that it effectuates the auditors recommendations to comply with the Drug-Free Workplace Act.</p>	

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1996

Federal Findings, Continued

Administrative Requirements - Equipment Management

<u>Item No.</u>	<u>CFDA No.</u>	<u>Criteria:</u>	<u>Questioned Costs</u>
2.	All	<p>The Common Rule for Uniform Administrative Requirements for Federal Grants, Section 33 (d) (2) requires that a physical inventory of property acquired with federal funds be performed at least every two years and that the inventory be reconciled to property records.</p> <p><u>Condition:</u> A physical inventory of property has not been performed in over two years.</p> <p><u>Cause:</u> The cause of this condition is unknown.</p> <p><u>Effect:</u> The effect is noncompliance with the Administrative Requirements over federal grants.</p> <p><u>Recommendation:</u> We recommend that a physical inventory of property be taken and the results reconciled to the property records at least once every two years.</p> <p><u>Auditee Response and Corrective Action Plan:</u> Management concurs with this finding. The Director will attempt to resolve this finding through the collective efforts of all the departments of Chuuk State.</p>	

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1996

Federal Findings, Continued

Cash and Investments

<u>Item No.</u>	<u>CFDA No.</u>	<u>Criteria:</u>	<u>Questioned Costs</u>
3.	All	<p>Reconciliation of bank accounts is a key control in any accounting system.</p> <p><u>Condition:</u> Bank accounts were not reconciled as of September 30, 1996. As of September 30, 1996, the general fund unreconciled checking account balance reflected an approximate \$2.3 million bank overdraft. The general fund checking account has not been reconciled since January, 1996.</p> <p><u>Cause:</u> The cause appears to be due to the State not following prescribed control procedures.</p> <p><u>Effect:</u> A possibility of misappropriation of funds could go undetected. Additionally, an uncertainty exists as to whether all transactions have been recorded. Because of this uncertainty, we are unable to determine whether compliance with grant terms and conditions has occurred.</p> <p><u>Recommendation:</u> We recommend that all checking accounts be reconciled on a monthly basis.</p> <p><u>Auditee Response and Corrective Action Plan:</u> Management concurs with this finding. This finding will be discussed with the State Reconciliation Division and the Director will implement the auditors recommendations in fiscal year 1997.</p>	

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1996

Federal Findings, Continued

4. **Previous Years' Findings**

Criteria: Findings from prior audit reports should be resolved.

Condition: The following findings from previous years' Single Audit Reports remain unresolved.

<u>Finding No.</u>	<u>Page No.</u>	<u>Description</u>
<u>FISCAL YEAR 1994</u>		
<u>Federal Findings</u>		
8	97	Eligibility Documentation
<u>FISCAL YEAR 1993</u>		
<u>Federal Findings</u>		
1	89	Reimbursement in excess of expenditures (CFDA # 84.003)
2	90	Reimbursement in excess of expenditures (CFDA # 10.560)
<u>FISCAL YEAR 1992</u>		
<u>Federal Findings</u>		
2	88	Subrecipient Audits - JTPA
<u>FISCAL YEAR 1991</u>		
<u>Federal Findings</u>		
5	95	Training Programs for JTPA
8	103	Job Placement Requirement - JTPA
9	104	Course and Instructor Evaluations - JTPA
11	107	Matching - Chapter I

Cause: The cause of this condition is unknown.

Effect: Lack of timely resolution of audit findings hinders the effectiveness of the Chuuk State's administrative controls over federal financial assistance.

Recommendation: Administrative control findings from previous Single Audit Reports should be satisfactorily resolved in a timely manner.

Auditee Response and Corrective Action Plan: Management concurs with the auditors recommendations and will maximize its efforts in resolving the findings. No specific time frame can be given but resolution of some findings can be expected in fiscal year 1997.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1996

Local Findings

Bidding Procedures

1. **Criteria:** Per Chuuk State law, bidding procedures should be performed on all contracts over \$20,000 and all personal property purchases over \$50,000.

Condition: State management has been unable to provide bidding documents for items meeting the criteria within a reasonable period of time.

Cause: The cause of this condition is unknown.

Effect: Possible noncompliance with local and federal regulations could be the result of this finding.

Recommendation: We recommend that documentation pertaining to bidding procedures be made readily available for review.

Prior Year Status: The above condition was cited as a finding in the Chuuk State Government Single Audit for the fiscal year 1995.

Auditee Response and Corrective Action Plan: Management concurs with the finding. Resolution has been implemented in fiscal year 1997. We will ensure that bidding documents for applicable purchases are documented with the APVs.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1996

Local Findings, Continued

Use of Compact Capital Funds

2. Criteria: Compact Capital expenditures should be in compliance with the uses outlined in the Compact Agreement between the FSM and the United States.

Condition: We are unable to determine if expenditures for dry docking of State vessels is an allowable use of Compact CIP funds.

Cause: The cause of this condition is unknown.

Effect: Possible noncompliance with allowable use of Compact funds could be the result of this finding.

Recommendation: We recommend that the State resolve this finding through the FSM and the Chuuk Attorney General's office.

Prior Year Status: The above condition was cited as a finding in the Chuuk State Government Single Audit for the fiscal year 1995.

Auditee Response and Corrective Action Plan: Management concurs with this finding and will attempt to resolve such through the State Attorney General's office.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1996

Local Findings, Continued

Use of Compact Capital Funds

3. Criteria: Compact Capital expenditures should be in compliance with the uses outlined in the Compact Agreement between the FSM and the United States.

Condition: We are unable to determine if expenditures for land leases and claims are an allowable use of Compact CIP funds.

Cause: The cause of this condition is unknown.

Effect: Possible noncompliance with allowable use of Compact funds could be the result of this finding.

Prior Year Status: The above condition was cited as a finding in the Chuuk State Government Single Audit for the fiscal year 1995.

Recommendation: We recommend that the State resolve this finding through the FSM and the Chuuk Attorney General's office.

Auditee Response and Corrective Action Plan: Management concurs with this finding and will attempt to resolve such through the State Attorney General's office.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1996

Local Findings, Continued

Use of Compact Capital Funds

4. Criteria: Compact Capital expenditures should be in compliance with the uses outlined in the Compact Agreement between the FSM and the United States.

Condition: We are unable to determine if expenditures for repairs and maintenance is an allowable use of Compact CIP funds.

Cause: The cause of this condition is unknown.

Effect: Possible noncompliance with allowable use of Compact funds could be the result of this finding.

Prior Year Status: The above condition was cited as a finding in the Chuuk State Government Single Audit for the fiscal year 1995.

Recommendation: We recommend that the State resolve this finding through the FSM and the Chuuk Attorney General's office.

Auditee Response and Corrective Action Plan: Management concurs with this finding and will attempt to resolve such through the State Attorney General's office.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1996

Local Findings, Continued

Use of Compact Current Account Funds

5. **Criteria:** The Financial Management Act mandates that all expenditures of public funds be properly accounted for.

Condition: No accounting for the annual appropriations of Compact Current Account funds to the municipalities exists at this time.

Cause: The cause of this condition is unknown.

Effect: Possible noncompliance with the Financial Management Act could be the result of this condition.

Prior Year Status: The above condition was cited as a finding in the Chuuk State Government Single Audit for the fiscal year 1995.

Recommendation: We recommend that the State attempt to resolve this finding by implementing a formal program to train the treasurers of the municipal governments and development authorities on how to operate a simple accounting system to account for municipal expenditures.

Auditee Response and Corrective Action Plan: Management concurs with this finding and will attempt to resolve such through the State Attorney General's office.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1996

Local Findings, Continued

Unresolved Prior Years' Findings

6. **Criteria:** Findings from prior audit reports should be resolved.

Condition: The following findings from previous years' Single Audit Reports remain unresolved.

<u>Finding No.</u>	<u>Page No.</u>	<u>Description</u>
<u>FISCAL YEAR 1993</u>		
<u>Local Findings</u>		
1	91	Use of Compact Capital Funds
2	92	Municipalities
3	93	Use of Compact Capital Funds
<u>FISCAL YEAR 1991</u>		
<u>Local Findings</u>		
1	87	Residual Inventory
2	92	Acquisition of Fixed Assets
5	96	Improper Classification of Expenditures
6	99	Code of Federal Regulations
7	100	Scholarship Application
<u>FISCAL YEAR 1990</u>		
<u>Local Findings</u>		
<u>Accounting</u>		
1	80	Fixed Assets
2	80	Compliance
<u>Administrative</u>		
1	81	Expenditures/Disbursements
2	81	Expenditures/Disbursements
5	82	Budget

Cause: The cause of this condition is unknown.

Effect: Lack of timely resolution of audit findings hinders the effectiveness of the Chuuk State's administrative controls over federal financial assistance.

Recommendation: Administrative control findings from previous Single Audit Reports should be satisfactorily resolved in a timely manner.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1996

Local Findings, Continued

Unresolved Prior Years' Findings, Continued

Auditee Response and Corrective Action Plan: Management concurs with the auditors recommendations and will maximize its efforts in resolving the findings. No specific time frame can be given but resolution of some findings can be expected in fiscal year 1997.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Resolution of Prior Years' Questioned Costs
Year Ended September 30, 1996

The following questioned costs from prior years audit reports have not been resolved:

Unresolved 1984 questioned costs	\$ 221,836
Unresolved 1985 questioned costs	193,164
Unresolved 1986 questioned costs	685,713
Unresolved 1987 questioned costs	833,896
Unresolved 1988 questioned costs	4,350,427
Unresolved 1989 questioned costs	779,850
Unresolved 1990 questioned costs	1,337,063
Unresolved 1991 questioned costs	167,352
Unresolved 1992 questioned costs	39,367
Unresolved 1994 questioned costs	208,439
Unresolved 1995 questioned costs	<u>59,131</u>
Total unresolved questioned costs for prior years	 8,876,238
Fiscal year 1996 questioned costs	 <u>-</u>
Total unresolved questioned costs	 \$ <u><u>8,876,238</u></u>

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

**INDEPENDENT AUDITORS' REPORT
ON THE INTERNAL CONTROL STRUCTURE**

YEAR ENDED SEPTEMBER 30, 1996



**INDEPENDENT AUDITORS' REPORT ON THE INTERNAL
CONTROL STRUCTURE BASED ON THE ENGAGEMENT TO AUDIT
OF THE GENERAL PURPOSE FINANCIAL STATEMENTS**

Honorable Ansito Walter
Governor, State of Chuuk
Federated States of Micronesia:

We were engaged to audit the general purpose financial statements of the State of Chuuk as of and for the year ended September 30, 1996. Our report, dated April 23, 1997, stated that the scope of our work was not sufficient to enable us to express, and we did not express an opinion on the general purpose financial statements due to; 1) our inability to determine that the assets, liabilities, revenues and expenditures of the Governmental Fund Types were fairly stated; 2) our inability to form an opinion on the General Fixed Assets Account Group; 3) the omission of the State's eleven development authorities; 4) our inability to express an opinion on the Chuuk Coconut Authority, the Chuuk State Public Utility Corporation and the Chuuk Visitors Bureau; 5) our inability to obtain audited financial statements from investees of the State of Chuuk supporting investments recorded in the Governmental Fund Type - Capital Projects Fund; 6) the noninclusion of a potential Component Unit-Governmental Fund, and; 7) our inability to obtain representation from the Chuuk State Attorney General, regarding pending litigation and other legal matters.

General accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States, require that audits be planned and performed to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement.

The management of the State of Chuuk, is responsible for establishing and maintaining the internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of general purpose financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning the audit of the general purpose financial statements of the State of Chuuk for the year ended September 30, 1996, generally accepted auditing standards and Government Auditing Standards require that auditors obtain an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

We noted certain matters, which are presented in the accompanying Schedule of Internal Control Findings (pages 89 through 101) in Findings 1 through 13, involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants.

Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect Chuuk State's ability to record, process, summarize, and report financial data consistent with the assertions of management in the general purpose financial statements.

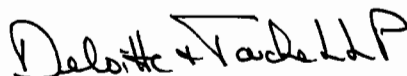
A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we consider Findings 3, 5, 6 and 10 involving the internal control structure and its operation to be material weaknesses as defined above. These conditions were considered in determining that the system of financial accounting and reporting in operation for Chuuk State for the year ended September 30, 1996, was inadequate.

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

We also noted other matters involving the internal control structure and its operation used to administer federal financial assistance programs which we reported to the management of the State of Chuuk in a report dated April 23, 1997.

This report is intended for the information of the management of the State of Chuuk and the cognizant audit and other federal agencies. However, this report is a matter of public record and its distribution is not limited.



April 23, 1997

CHUUK STATE GOVERNMENT

Schedule of Internal Control Findings Year Ended September 30, 1996

Prior Year Internal Control Findings

Finding No. 1

Criteria: Findings from the Report on Internal Control for prior years should be adequately resolved by Chuuk State management.

Condition: The following findings from the Report on Internal Controls for prior years, were not resolved during the year ending September 30, 1996:

<u>Finding No.</u>	<u>Heading</u>	<u>Page No.</u>
Fiscal Year 1990		
1	Payroll account reconciliations	94
19	Filing of contracts	104
21	Segregation of duties - payroll	105
33	Nonintegration of budgeted revenues	112
35	Fire alarms in EDP	114
Fiscal Year 1991		
5	Receiving reports	124
13	Personnel policies	132
16	Segregation of duties, Revenues Division	135
17	Filing system - tax returns	136
21	Insurance coverage - EDP	140
	Chuuk Visitor's Bureau:	
23	Subsidiary ledger	142
24	Accounting system	143
Fiscal Year 1994		
7	Payroll	114
8	Payroll	115

Cause: The cause of this condition is unknown.

Effect: The non-resolution of these prior year findings will continue to hinder the effective maintenance of the State's accounting records.

Recommendation: Chuuk State management should take action to resolve these prior year audit findings.

Auditee Response and Corrective Action Plan: Management concurs with the auditors recommendation and will maximize its efforts in resolving the findings. No specific time frame can be given but resolution of some findings can be expected in fiscal year 1997.

CHUUK STATE GOVERNMENT

Schedule of Internal Control Findings, Continued
Year Ended September 30, 1996

Revenue/Receipts

Finding No. 2

Criteria: Deposits of cash receipts should be made in a timely manner.

Condition: On one occasion, cash receipts were not deposited until four days after receipt.

Cause: The cause of this condition is unknown.

Effect: A possible misuse or loss of State funds could be the result of this finding.

Recommendation: Cash receipts should be deposited to the bank in a timely manner.

Prior Year Status: This condition was reported as a finding in the Chuuk State Government Single Audit for the fiscal year 1995.

Auditee Response and Corrective Action Plan: Management concurs with this finding. The Director will implement the auditors recommendations in fiscal year 1997.

CHUUK STATE GOVERNMENT

Schedule of Internal Control Findings, Continued
Year Ended September 30, 1996

Cash and Investments

Finding No. 3

Criteria: Reconciliation of bank accounts is a key detective control in any accounting system.

Condition: Bank accounts were not reconciled as of September 30, 1996.

Cause: The cause appears to be due to the State not following the prescribed control procedures.

Effect: A possibility of misappropriation of funds could go undetected.

Recommendation: We recommend that all checking accounts be reconciled on a monthly basis.

Auditee Response and Corrective Action Plan: Management concurs with this finding. This finding will be discussed with the State Reconciliation Division and the Director will implement the auditors recommendations in fiscal year 1997.

CHUUK STATE GOVERNMENT

Schedule of Internal Control Findings, Continued
Year Ended September 30, 1996

Cash Disbursements

Finding No. 4

Criteria: All disbursement transactions should be posted on a timely basis.

Condition: The following cash disbursement has not been properly posted and updated:

<u>Fund #</u>	<u>APV #</u>	<u>Amount</u>
600000	961220	\$65,807

Cause: The cause of this condition is unknown.

Effect: A lack of controls exist over the disbursement transaction cycle. This condition may lead to a misuse of State funds.

Recommendation: Disbursement transactions should be processed in a timely manner.

Auditee Response and Corrective Action Plan: Management concurs with this finding. The Director will discuss this finding with the division responsible for the transaction in question and ensure that the auditors recommendations are implemented in fiscal year 1997.

CHUUK STATE GOVERNMENT

Schedule of Internal Control Findings, Continued
Year Ended September 30, 1996

Invoices and Cash Receipts

Finding No. 5

Criteria: An adequate system of internal controls provides preventive and detective controls over errors and irregularities.

Condition: During the course of our audit, the following problems were noted:

1. Some invoices were never input into the system.
2. Some invoices were input twice.
3. Some cash receipts were never input into the system.
4. Some cash receipts were input twice.

Cause: The cause of this deficiency was the lack of an organized system of processing invoices and receipts.

Effect: As a result of these problems, the possibility of the State producing accurate, timely and reliable data is minimized.

Recommendation: It is recommended that the State establish an adequate filing system, particularly for invoices not matched to APV's, and that all invoices and cash receipts are restrictively stamped "processed" and "input" once they have been entered into the system.

Auditee Response and Corrective Action Plan: Management concurs with this finding. The Director will discuss this finding with the division responsible for the transactions in question and ensure that the auditors recommendations are implemented in fiscal year 1997.

CHUUK STATE GOVERNMENT

Schedule of Internal Control Findings, Continued Year Ended September 30, 1996

Reconciliation

Finding No. 6

Criteria: An adequate system of internal control requires that general ledger control balances be supported by a detailed subsidiary ledger.

Condition: Balances per the State's subsidiary ledger records do not agree with those per suppliers' statements and/or confirmation.

Cause: No reconciliation procedures exist to effectuate reconciliation between the general ledger and the subsidiary ledger.

Effect: Two effects result from this condition. The first is that individual vendor balances are not accurately stated and thus payments made may be incorrect. The second is that the total payable balance may be materially misstated.

Recommendation: In order to prevent such discrepancies, we recommend that monthly reconciliations between the subsidiary ledger, general ledger and suppliers' invoices be performed.

Auditee Response and Corrective Action Plan: Management concurs with this finding. The Director will implement the auditors recommendations in fiscal year 1997.

CHUUK STATE GOVERNMENT

Schedule of Internal Control Findings, Continued Year Ended September 30, 1996

Payroll

Finding No. 7

Criteria: Sufficient documentation should exist to support employee deductions and current employee pay rates.

Condition: Employee personnel files were not updated by personnel action forms or authorized deduction forms. In addition, the personnel files had no systematic filing arrangement.

Cause: The payroll department has no formal policy with respect to required documentation or systematic procedures for filing payroll documents.

Effect: Sufficient, competent evidential matter does not exist to support employee deductions and instances were noted where employee pay increases were not implemented until weeks after the official date.

Recommendation: A complete analysis of the payroll processing and filing cycle should be initiated, reviewed and documented to ensure the timely recording and proper documentation of changes.

Auditee Response and Corrective Action Plan: Management concurs with this finding. The Director will discuss this finding with the State Payroll Division and ensure that the auditors recommendations are implemented in fiscal year 1997.

CHUUK STATE GOVERNMENT

Schedule of Internal Control Findings, Continued
Year Ended September 30, 1996

Payroll

Finding No. 8

Criteria: Payroll payments should be made based on a rates set forth in related personnel action forms.

Condition: Of 132 payroll transactions tested, 28 occasions arose where the pay rate per the payroll register deviated from the pay rate documented in the personnel action file.

Cause: The payroll department has no formal policy with respect to required documentation or systematic procedures for filing payroll documents.

Effect: The effect of this condition is that payroll payments may be incorrect.

Recommendation: We recommend that a complete review of personnel files be performed to ensure that pay rates per the system are in accordance with authorized pay rates per personnel action forms.

Auditee Response and Corrective Action Plan: Management concurs with this finding. The Director will discuss this finding with the State Payroll Division and ensure that the auditors recommendations are implemented in fiscal year 1997.

CHUUK STATE GOVERNMENT

Schedule of Internal Control Findings, Continued Year Ended September 30, 1996

Payroll

Finding No. 9

Criteria: An adequate system of internal control provides that access to personnel files is limited to avoid misplacement or misuse of files.

Condition: Personnel files could not be located.

Cause: Access to personnel files is not controlled.

Effect: The effect of the above condition is the lack of control over personnel files.

Recommendation: Access to files should be limited to authorized individuals. File disposition should be monitored by the person in charge of the payroll department.

Auditee Response and Corrective Action Plan: Management concurs with this finding. The Director will discuss this finding with the State Payroll Division and ensure that the auditors recommendations are implemented in fiscal year 1997.

CHUUK STATE GOVERNMENT

Schedule of Internal Control Findings, Continued Year Ended September 30, 1996

Purchases, Payables and Disbursements

Finding No. 10

Criteria: Effective internal control over encumbrances requires periodic review to determine the validity of aged balances.

Condition: Approximately \$335,762 in fiscal year 1996 and prior encumbrances were listed as outstanding at September 30, 1996. It does not appear that these encumbrances were adjusted when paid or were otherwise determined to be invalid.

Cause: Although we noted that certain aged balances were adjusted, it does not appear that there are established procedures to ensure that a periodic review of aged encumbrances is performed on a regular basis.

Effect: The reserve for encumbrances appears to be materially misstated.

Recommendation: We recommend that periodic reviews of encumbrances be performed to determine the validity of long outstanding encumbrances. If this review determines the presence of invalid encumbrances, we recommend that they be adjusted, so the balance of the reserve for encumbrances reflects only valid encumbrances.

Auditee Response and Corrective Action Plan: Management concurs with this finding. The Director will implement the auditors recommendations in fiscal year 1997.

CHUUK STATE GOVERNMENT

Schedule of Internal Control Findings, Continued
Year Ended September 30, 1996

Electronic Data Processing

Finding No. 11

Criteria: An adequate system of internal control requires adequate insurance coverage for equipment and data.

Condition: There is no insurance coverage on the EDP equipment or data.

Cause: The State of Chuuk self-insures its assets. Therefore, insurance coverage on the EDP equipment has not been explored.

Effect: Should the EDP equipment and data be destroyed, the State will be subject to a significant loss of equipment and data. The loss of data would require significant time and expense to recreate.

Recommendation: We recommend that adequate insurance coverage be considered for EDP equipment and financial data.

Auditee Response and Corrective Action Plan: Management concurs with this finding. The Director will attempt to implement the auditors recommendations in fiscal year 1997.

CHUUK STATE GOVERNMENT

Schedule of Internal Control Findings, Continued
Year Ended September 30, 1996

Travel Advances

Finding No. 12

Criteria: Travel authorizations should be adequately encumbered.

Condition: Approximately 31% of travel authorizations tested were unencumbered.

Cause: The cause of this condition is unknown.

Effect: A possible misuse of State funds could result from this condition.

Recommendation: We recommend that measures be taken to ensure that travel advances are properly encumbered prior to disbursement of funds.

Auditee Response and Corrective Action Plan: Management concurs with this finding. The Director will discuss this finding with the State Travel Division and ensure that the auditors recommendations are implemented in fiscal year 1997.

CHUUK STATE GOVERNMENT

Schedule of Internal Control Findings, Continued Year Ended September 30, 1996

Municipalities

Finding No. 13

Criteria: Entities receiving funds should adequately account for those funds.

Condition: Municipalities do not appear to have formal accounting systems.

Cause: No program has been established to train the treasurers of the municipal governments and development authorities.

Effect: It is possible that unauthorized or unrecorded cash disbursements could occur without being detected, budgeted spending authority could be exceeded, and there is presently no control at the State level to ensure that funds are expended in accordance with State laws and regulations at the municipal level.

Recommendation: We recommend that a formal program be implemented to train the treasurers of the municipal governments and development authorities how to operate a simple accounting system. This training should cover establishing a disbursement journal, a cash receipts journal, retention of invoices and other evidential matter to support expenditures, preparation of monthly bank reconciliations, Chuuk State procurement standards and policies, and how to create quarterly financial reports for submission to the Finance department.

Auditee Response and Corrective Action Plan: Management concurs with this finding. The auditors recommendations have been implemented for certain municipal transactions in fiscal year 1997. The Director will discuss this finding with the appropriate State and municipal officials and attempt to resolve the finding in fiscal year 1997.