

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

**REPORT ON THE AUDIT OF
FINANCIAL STATEMENTS IN ACCORDANCE
WITH OMB CIRCULAR A-133**

YEAR ENDED SEPTEMBER 30, 2001

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2001

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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, 2001

INDEPENDENT AUDITORS' REPORT

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

We have audited 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, 2001, and for the year then ended. These general purpose financial statements are the responsibility of the management of the State of Chuuk. Our responsibility is to express an opinion on these general purpose financial statements based on our audit.

Except as discussed in the following paragraphs, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 general purpose financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Chuuk State has not assessed possible leases payable that should be accrued in the general fund as of September 30, 2001. We were unable to determine the amount of payables that should be so accrued through the use of alternative auditing procedures.

Property comprising the State of Chuuk's General Fixed Assets Account Group has not been inventoried as of September 30, 2001, 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 development authorities, which in our opinion, should be included to conform with accounting principles generally accepted in the United States of America. The development authorities would be reported as blended Component Units - Special Revenue Funds.

We were unable to perform audit procedures on the Chuuk Coconut Authority (CCA) or Chuuk Public Fisheries Corporation (CFC) as of September 30, 2001, as financial statements were not provided to us for inspection. The general purpose financial statements referred to above do not include CCA or CFC, Component Units – Proprietary Funds of the State of Chuuk, which in our opinion, should be included to conform with accounting principles generally accepted in the United States of America.

The State did not provide a schedule detailing continuing appropriations of the Compact Capital Project Fund as of September 30, 2001. We were unable to perform adequate alternative audit procedures with respect to continuing appropriations set forth in the accompanying general purpose financial statements.

We were unable to obtain audited financial statements supporting the State of Chuuk's investment in Chuuk Fresh Tuna (CFTI), in the Governmental Fund Type - Capital Projects Funds at September 30, 2001, 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 investee's earnings or losses. We were not able to satisfy ourselves as to the carrying value of this investment or the equity of its earnings or loss by other auditing procedures.

In our opinion, except for the effects on the general purpose financial statements of such adjustments, if any, as might have been determined to be necessary had we been able to 1) determine the amount of leases payable that should be accrued in the general fund; 2) determine balances that should be reported in the General Fund Fixed Assets Account Group; 3) determine the impact of the omission of the State's development authorities; 4) determine the balances of CCA and CFC that should be included; 5) determine the correct continuing appropriations of the Capital Projects Fund; and 6) examine evidence regarding the investment in CFTI, as discussed in the third through eighth paragraphs above, such general purpose financial statements, as set forth in Section II of the table of contents, with the exception of the General Fixed Assets Account Group, upon which we are unable to express an opinion because of the matters set forth in the fourth paragraph above, present fairly, in all material respects, the financial position of the State of Chuuk as of September 30, 2001, and the results of its operations and the cash flows of its proprietary fund types for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 17 to the general purpose financial statements, the State changed its method of accounting for nonexchange transactions to conform with Governmental Accounting Standards Board Statement No. 33 and has restated the 2000 general purpose financial statements to reflect the change.

Our audit was conducted for the purpose of forming an opinion on the general purpose financial statements taken as a whole. 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 management of the State of Chuuk, are presented for purposes of additional analysis and are not a required part of the general purpose financial statements of the State of Chuuk. Such additional information has been subjected to the auditing procedures applied in our audit of the general purpose financial statements and, except for the items described in the third and fifth through eighth paragraphs above, in our opinion, is fairly stated in all material respects when considered in relation to the general purpose financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 2002, on our consideration of the State of Chuuk's (primary Government only) internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.



December 17, 2002

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Combined Balance Sheet - All Fund Types, Account Groups and Discretely Presented Component Units
September 30, 2001
(With Comparative Totals as of September 30, 2000)

Assets	Governmental Fund Types			Account Groups		Totals Primary Government (Memorandum Only)	Discretely Presented Component Units	Totals Reporting Entity (Memorandum Only)	
	General	Special Revenue	Capital Projects	General Fixed Assets	General Long-Term Debt			2001	2000
Cash and equivalents (note 2)	\$ 73,675	\$ 8,079	\$ -	\$ -	\$ -	\$ 81,754	\$ 698,054	\$ 779,808	\$ 1,162,736
Investments (note 2)	-	-	8,695,774	-	-	8,695,774	-	8,695,774	18,280,329
Early Retirement Trust Fund (note 2)	4,062,348	-	-	-	-	4,062,348	-	4,062,348	3,238,260
Investments - other (note 9)	-	-	3,675,505	-	-	3,675,505	-	3,675,505	4,064,005
Receivables from other governments (note 3)	304,183	966,077	-	-	-	1,270,260	-	1,270,260	4,163,716
General receivables, net	455,095	189,066	-	-	-	644,161	662,262	1,306,423	1,261,196
Allowance for uncollectibles	(79,933)	(74,864)	-	-	-	(154,797)	-	(154,797)	(2,247,890)
Advances	415,483	-	-	-	-	415,483	-	415,483	531,113
Loans receivable, net of an allowance for doubtful accounts of \$1,157,613	-	-	-	-	-	-	1,313,246	1,313,246	1,037,642
Loans receivable, other (note 14)	2,817,718	-	-	-	-	2,817,718	-	2,817,718	1,795,680
Due from other funds (note 8)	-	4,021,494	764,824	-	-	4,786,318	-	4,786,318	7,316,801
Other assets	-	-	-	-	-	-	29,170	29,170	75,565
Fixed assets, net (note 4)	-	-	-	67,581,884	-	67,581,884	11,288,980	78,870,864	77,282,925
Amount to be provided for retirement of long-term debt	-	-	-	-	12,560,836	12,560,836	-	12,560,836	16,598,987
Total assets	\$ 8,048,569	\$ 5,109,852	\$ 13,136,103	\$ 67,581,884	\$ 12,560,836	\$ 106,437,244	\$ 13,991,712	\$ 120,428,956	\$ 134,561,065

See accompanying notes to financial statements.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Combined Balance Sheet - All Fund Types, Account Groups and Discretely Presented Component Units, Continued
September 30, 2001
(With Comparative Totals as of September 30, 2000)

<u>Liabilities and Fund Equity</u>	Governmental Fund Types			Account Groups		Totals Primary Government (Memorandum Only)	Discretely Presented Component Units	Totals Reporting Entity (Memorandum Only)	
	General	Special Revenue	Capital Projects	General Fixed Assets	General Long-Term Debt			2001	2000
	Liabilities:								
Accounts payable	\$ 5,578,942	\$ 2,500,480	\$ 3,623,821	\$ -	\$ -	\$ 11,703,243	\$ 1,046,413	\$ 12,749,656	\$ 9,203,202
Bank overdraft	925,438	-	-	-	-	925,438	-	925,438	-
Accrued payroll and annual leave	375,333	242,900	-	-	829,208	1,447,441	347,230	1,794,671	1,427,319
Due to other funds (note 8)	3,945,828	840,490	-	-	-	4,786,318	-	4,786,318	7,316,801
Payable to other governments	-	-	-	-	-	-	-	-	464,882
Notes payable (notes 5, 13 and 14)	4,296,754	-	329,179	-	5,128,335	9,754,268	3,456,478	13,210,746	14,057,396
Claims payable (note 11)	-	-	-	-	6,603,293	6,603,293	-	6,603,293	7,349,000
Deferred revenue	1,000	-	-	-	-	1,000	50,000	51,000	278,320
Total liabilities	15,123,295	3,583,870	3,953,000	-	12,560,836	35,221,001	4,900,121	40,121,122	40,096,920
Fund equity:									
Investment in general fixed assets (note 4)	-	-	-	67,581,884	-	67,581,884	-	67,581,884	67,581,884
Retained earnings (note 17)	-	-	-	-	-	-	9,091,591	9,091,591	9,736,587
Fund balances:									
Reserved for:									
Related assets (note 15)	6,449,400	-	3,675,505	-	-	10,124,905	-	10,124,905	8,248,463
Encumbrances	836,662	286,513	1,062,311	-	-	2,185,486	-	2,185,486	2,885,296
Continuing appropriations (note 6)	242,192	-	3,524,340	-	-	3,766,532	-	3,766,532	6,801,783
Unreserved	(14,602,980)	1,239,469	920,947	-	-	(12,442,564)	-	(12,442,564)	(789,868)
Total fund equity	(7,074,726)	1,525,982	9,183,103	67,581,884	-	71,216,243	9,091,591	80,307,834	94,464,145
Commitments and contingencies (notes 11, 16 and 18)									
Total liabilities and fund equity	\$ 8,048,569	\$ 5,109,852	\$ 13,136,103	\$ 67,581,884	\$ 12,560,836	\$ 106,437,244	\$ 13,991,712	\$ 120,428,956	\$ 134,561,065

See accompanying notes to financial statements.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Combined Statement of Revenues, Expenditures and Changes in Fund Balances (Deficit) -
All Governmental Fund Types
Year Ended September 30, 2001
(With comparative totals for the year ended September 30, 2000)

	Governmental Fund Types			Totals Reporting Entity (Memorandum Only)	
	General	Special Revenue	Capital Projects	2001	2000
Revenues:					
U.S. Compact of Free Association:					
Section 211(a)(2) - base grant	\$ 8,816,000	\$ -	\$ 6,144,000	\$ 14,960,000	\$ 14,960,000
Section 217 - inflation adjustment	4,936,960	-	3,440,640	8,377,600	8,078,400
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	-	671,888	-	671,888	512,892
Section 212 - base grant	-	250,000	-	250,000	385,000
FSM revenue sharing	4,319,588	-	-	4,319,588	5,006,452
Other federal contributions	-	1,086,816	-	1,086,816	963,856
State taxes and licenses	1,975,695	-	-	1,975,695	2,339,570
Other	1,671,913	983,049	-	2,654,962	4,242,882
Investment (loss) income (note 2)	(3,097,561)	-	-	(3,097,561)	3,560,287
Total revenues	18,622,595	7,132,640	9,584,640	35,339,875	44,190,226
Expenditures:					
General government	7,471,140	821,518	-	8,292,658	7,102,215
Education	5,628,809	2,598,003	-	8,226,812	7,416,338
Health services	2,876,567	3,198,691	-	6,075,258	4,475,648
Economic development	1,089,741	-	-	1,089,741	1,017,371
Public works and utilities	368,232	824,425	6,863,801	8,056,458	16,051,309
Public safety	1,291,923	176,479	-	1,468,402	1,068,192
Transportation	919,020	-	-	919,020	891,120
Community affairs	204,628	671,967	-	876,595	462,249
Boards and commissions	959,409	-	-	959,409	743,491
Special programs	-	-	-	-	1,267,926
Debt service - principal (note 5)	-	-	2,918,173	2,918,173	3,000,000
Debt service - interest	-	-	-	-	320,000
Acquisition of equipment	371,528	-	2,453,489	2,825,017	4,450,000
Loss on investment (note 9)	-	-	388,500	388,500	5,350,000
Other	5,262,739	46,098	-	5,308,837	6,416,001
Total expenditures	26,443,736	8,337,181	12,623,963	47,404,880	60,031,860
Excess (deficiency) of revenues over (under) expenditures	(7,821,141)	(1,204,541)	(3,039,323)	(12,065,005)	(15,841,634)
Other financing sources (uses):					
Chuuk recovery loan accrual (note 5)	(292,444)	-	-	(292,444)	(1,686,710)
Operating transfers in (note 7)	-	-	-	-	96,140
Operating transfers out (note 7)	(153,866)	(1,000,000)	-	(1,153,866)	(1,268,654)
Total other financing sources (uses), net	(446,310)	(1,000,000)	-	(1,446,310)	(2,859,224)
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(8,267,451)	(2,204,541)	(3,039,323)	(13,511,315)	(18,700,858)
Fund balances at beginning of year, as restated (note 17)	1,192,725	3,730,523	12,222,426	17,145,674	35,846,532
Fund (deficit) balances at end of year	\$ (7,074,726)	\$ 1,525,982	\$ 9,183,103	\$ 3,634,359	\$ 17,145,674

See accompanying notes to financial statements.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures and Changes in Fund Balance (Deficit)
Budget and Actual, Budgetary Basis - General Fund
Year Ended September 30, 2001
(With comparative totals for the year ended September 30, 2000)

	2001			2000		
	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)
Revenues:						
Compact of Free Association						
Section 211 and 217	\$ 13,752,960	\$ 13,752,960	\$ -	\$ 13,576,640	\$ 13,576,640	\$ -
Local revenue	18,159,763	4,869,635	(13,290,128)	11,900,163	12,045,332	145,169
Total revenues	<u>31,912,723</u>	<u>18,622,595</u>	<u>(13,290,128)</u>	<u>25,476,803</u>	<u>25,621,972</u>	<u>145,169</u>
Expenditures-budgetary basis:						
General government	6,580,431	7,349,332	(768,901)	6,630,745	6,879,226	(248,481)
Health services	2,713,614	2,861,689	(148,075)	2,796,169	2,764,552	31,617
Education	5,672,451	5,628,061	44,390	5,202,154	5,171,892	30,262
Economic development	1,087,162	1,087,277	(115)	908,214	1,023,256	(115,042)
Public safety	1,174,556	1,269,330	(94,774)	971,800	1,082,292	(110,492)
Transportation	917,775	915,065	2,710	905,050	894,084	10,966
Public works	414,101	368,243	45,858	336,234	327,358	8,876
Community affairs	202,519	203,604	(1,085)	170,200	188,952	(18,752)
Board and commissions	941,937	930,822	11,115	770,224	785,708	(15,484)
Special programs/legislative external appropriations	7,841,407	5,631,088	2,210,319	7,200,339	7,665,719	(465,380)
Early retirement	975,200	98,367	876,833	1,388,500	219,074	1,169,426
Total expenditures	<u>28,521,153</u>	<u>26,342,878</u>	<u>2,178,275</u>	<u>27,279,629</u>	<u>27,002,113</u>	<u>277,516</u>
Excess (deficiency) of revenues over (under) expenditures	3,391,570	(7,720,283)	(11,111,853)	(1,802,826)	(1,380,141)	422,685
Other financing sources (uses):						
Chuuk recovery loan accrual (note 5)	(635,680)	(292,444)	343,236	(500,000)	(1,686,710)	(1,186,710)
Operating transfers out (note 7)	(152,800)	(159,523)	(6,723)	(315,800)	(267,477)	48,323
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	2,603,090	(8,172,250)	(10,775,340)	(2,618,626)	(3,334,328)	(715,702)
Fund balance (deficit) at beginning of year as restated (note 17)	(4,195,287)	(4,195,287)	-	232,270	232,270	-
Other changes in deficit:						
Increase in reserve for related assets	-	(2,264,942)	(2,264,942)	(1,388,500)	(1,611,933)	(3,000,433)
Decrease in reserve for continuing appropriations	-	29,499	29,499	-	518,704	518,704
Deficit at end of year	<u>\$ (1,592,197)</u>	<u>\$ (14,602,980)</u>	<u>\$ (13,010,783)</u>	<u>\$ (3,774,856)</u>	<u>\$ (4,195,287)</u>	<u>\$ (3,197,431)</u>

See accompanying notes to financial statements

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Combined Statement of Revenues, Expenses and Changes in Fund Equity
All Discretely Presented Component Units - Proprietary Fund Type
Year Ended September 30, 2001
(With comparative totals for the year ended September 30, 2000)

	2001	2000
Operating revenues:		
Sales	\$ 3,302,118	\$ 2,951,167
Total operating revenues	3,302,118	2,951,167
Operating expenses:		
Fuel	2,246,736	2,067,529
Payroll and personnel	1,948,031	1,700,542
Depreciation	1,283,545	1,086,123
Bad debt	586,940	427,840
Rent	9,210	2,560
Other	112,369	51,109
Total operating expenses	6,186,831	5,335,703
Operating loss	(2,884,713)	(2,384,536)
Nonoperating revenues:		
Transfers in (note 7)	1,092,475	1,082,774
Federal contributions	622,760	710,950
Capital contributions	518,099	144,599
Other income	6,383	50,000
Total nonoperating revenues, net	2,239,717	1,988,323
Net loss	(644,996)	(396,213)
Retained earnings at beginning of year, as restated (note 17)	9,736,587	10,132,800
Retained earnings at end of year	\$ 9,091,591	\$ 9,736,587

See accompanying notes to financial statements

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Combined Statement of Cash Flows -
All Discretely Presented Component Units - Proprietary Fund Type
Year Ended September 30, 2001

Reconciliation of operating loss to net cash used for operating activities	
Operating loss	\$ (2,884,713)
Adjustments to reconcile operating loss to net cash used	
for operating activities:	
Depreciation	1,283,545
Allowance for bad debts	586,940
Increase in receivables	(592,228)
Increase in accounts payable	171,554
Increase in other liabilities	128,727
Total adjustments	<u>1,578,538</u>
Net cash used for operating activities:	<u>(1,306,175)</u>
Cash flows from noncapital financing activities	
Operating grants received	1,851,159
FSM contribution	73,994
Net cash provided by noncapital financing activities:	<u>1,925,153</u>
Cash flows from capital and related financing activities	
Acquisition of utility plant	(2,298,243)
Acquisition of building	(91,369)
Proceeds from notes payable	1,631,430
Net cash used for capital and related financing activities:	<u>(758,182)</u>
Net change in cash and equivalent:	(139,204)
Cash and equivalents at beginning of year	<u>837,258</u>
Cash and equivalents at end of year	<u>\$ 698,054</u>
See accompanying notes to financial statements	

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2001

(1) Summary of Significant Accounting Policies

The general purpose financial statements of the State of Chuuk (the State) have been prepared in conformity with accounting principles generally accepted in the United States of America (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

The general purpose financial statements of the State of Chuuk have been prepared in conformity with GAAP as applied to government units. GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting", requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The State of Chuuk has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

As required by GAAP, 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

Chuuk State Public Utility Corporation

Chuuk State Public Utility 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.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2001

(1) Summary of Significant Accounting Policies, Continued

2. Discretely Presented Component Units, Continued

Chuuk State Housing Authority

Chuuk State 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.

3. Omitted Component Units

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 would have been reported as a discretely presented component unit - proprietary fund.

Development Authorities

The accompanying general purpose financial statements do not include the State's 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 Public Fisheries Corporation

The Corporation was established to operate a fishing vessel received in the dissolution of the State's prior investment in a joint venture. The Corporation is governed by a five member Board of Directors who are determined pursuant to law. The Corporation would be reported as a discretely presented component unit – proprietary fund.

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.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2001

(1) Summary of Significant Accounting Policies, Continued

B. Fund Accounting and Basis of Presentation, Continued

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.

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 and decreases (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. 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.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2001

(1) Summary of Significant Accounting Policies, Continued

B. Fund Accounting and Basis of Presentation, Continued

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.

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 2001, 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 canceled. If an encumbrance is subsequently canceled, the funds revert to the applicable unreserved fund balance unless otherwise required by law.

Budgetary expenditures, which are on a basis other than GAAP, 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 GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2001

(1) Summary of Significant Accounting Policies, Continued

C. Budgetary Process, Continued

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.

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 in 2001 (primarily Chuuk State Housing Authority) consisted 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 \$75,000. 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.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2001

(1) Summary of Significant Accounting Policies, Continued

G. Interfund Transactions, Continued

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. The liability as of September 30, 2001 is \$829,208. No expenditure is reported for these amounts.

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. Investments

Investments are recorded at fair value. Investments in the equity of companies are carried at cost if less than twenty percent of the companies' total equity and market value cannot be determined, on the equity method if greater than twenty percent and less than fifty percent and on a consolidated basis if greater than fifty percent. (See Notes 2 and 9).

L. Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2001

(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 remaining balance being uncollateralized.

At September 30, 2001, the State had deposits as follows; in each situation, cost approximated fair value.

<u>General Fund</u>	
Restricted cash in early retirement trust fund	\$ 4,062,348
Cash on deposit with trustee and in checking and savings accounts with FDIC insured banks	<u>73,675</u>
	\$ <u>4,136,023</u>
<u>Special Revenue Funds</u>	
Cash in checking accounts with FDIC insured banks	\$ <u>8,079</u>
<u>Component Units</u>	
Cash in checking and savings accounts with FDIC insured banks	\$ <u>698,054</u>

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.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2001

(2) Cash and Equivalents and Investments, Continued

Investments, Continued

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 rated.
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.
 - 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, 2001, are summarized below:

Investments

Pooled investment debt and equity securities

\$ 8,695,774

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2001

(2) Cash and Equivalents and Investments, Continued

Investments, Continued

The State's investment income as of September 30, 2001, is summarized below:

Interest	\$ 521,678
Dividends	87,244
Realized gains	(915,221)
Unrealized gains	(2,467,316)
Management fees/other expenses	<u>(323,946)</u>
	\$ <u>(3,097,561)</u>

(3) Receivables From Other Governments

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 2001.

A summary of the general fixed assets accounted for in the General Fixed Assets Account Group as of September 30, 2001, 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>

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2001

(4) Fixed Assets, Continued

A summary of fixed assets accounted for in the component units-proprietary funds as of September 30, 2001, follows:

	<u>Estimated Useful Lives</u>	
General plant in service	3-7 years	\$ 299,916
Electric plant in service	3-20 years	14,358,391
Water and sewer in service	3-20 years	10,061,111
Buildings and improvements	3-20 years	406,110
Equipment and furniture	3-5 years	43,672
Vehicles	3-5 years	48,228
Other assets	3 years	<u>6,755</u>
		25,224,183
Less accumulated depreciation		<u>(13,962,203)</u>
		11,261,980
Construction in progress		<u>27,000</u>
		<u>\$ 11,288,980</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, 2001, 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

The State has yet to determine when or if repayments of this note will occur.

General Long-Term Debt Account Group

Medium-Term Note Program:

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.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2001

(5) Notes Payable, Continued

Medium-Term Note Program, Continued:

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, 2001, which included the final payment of \$2,918,173 against the debt.

Chuuk Recovery Loan:

During the fiscal year ended September 30, 1999, Chuuk State Government and the FSM National Government entered into a loan agreement whereby the FSM National Government agreed to loan the State of Chuuk the sum of \$5,000,000 dollars ("Chuuk Recovery Loan"). The primary purpose of this loan was to assist the State in satisfying amounts due to various vendors for payroll allotments and the principal portion of the State's tax liabilities to the FSM Revenue and Taxation and the FSM Social Security Administration.

The loan is to be repaid in quarterly allotments of \$416,667 including interest thereon beginning October 1, 1998. Interest is at 1% per annum. The total amount outstanding on this loan at September 30, 2001 was \$1,459,230. The State paid \$1,700,000 against this loan during fiscal year 1999 and \$500,000 in 2001, which was charged against the general fund.

Early Retirement Program:

During the fiscal year ended September 30, 1998, Chuuk State Government implemented an early retirement program for all eligible public service system employees. This program is funded through a loan from the Asian Development Bank through the FSM National Government. A total loan amount of \$5,300,000 is available to the State of Chuuk for this purpose. Under the terms of its loan agreement with the FSM National Government, the State shall pay the FSM National Government a service charge at the rate of (1%) per annum calculated based on the total loan balance outstanding from time to time.

Pursuant to the terms of the financing agreement between the State of Chuuk and the FSM National Government, the State is required to deposit into the Early Retirement Scheme Trust Account held in the name of the State within the FSM National Government's investment portfolio, 100% of the outstanding principal balance by September 30, 2001. Funds for the repayment of the loan are expected to be derived from annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The Chuuk State Legislature has authorized for appropriation from the general fund certain percentages of amounts borrowed under the loan in each fiscal year until the Early Retirement Scheme Trust Account is fully replenished in fiscal year 2001. The loan is to be repaid by the FSM National Government in semi-annual installments commencing February 1, 2008. The total amount outstanding on this loan at September 30, 2001 was \$5,128,335.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2001

(5) Notes Payable, Continued

Early Retirement Program, Continued:

The State was not able to provide a schedule of future interest expense attendant to the debt maturities.

(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. \$ 242,192

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. \$ 3,524,340

(7) Operating Transfers In/Out

Material General Fund, Special Revenue Fund and Component Units - Proprietary Funds transfers in/out for the year ended September 30, 2001, are as follows:

	<u>Transfers Out</u>	<u>Transfers In</u>
General Fund:		
Transfers out to Component Units:		
Chuuk State Housing Authority	\$ 92,475	\$ -
Chuuk Coconut Authority	<u>61,391</u>	<u>-</u>
Total General Fund	\$ <u>153,866</u>	\$ <u>-</u>
Special Revenue Funds:		
Transfers out to Component Units:		
Chuuk Public Utility Corporation	\$ <u>1,000,000</u>	\$ <u>-</u>
Total Special Revenue Funds	\$ <u>1,000,000</u>	\$ <u>-</u>
Transfers in to Component Units:		
Chuuk State Housing Authority	\$ -	\$ 92,475
Chuuk Coconut Authority	-	61,391
Chuuk Public Utility Corporation	<u>-</u>	<u>1,000,000</u>
Total transfers in to Component Units	<u>-</u>	<u>1,153,866</u>
	\$ <u>1,153,866</u>	\$ <u>1,153,866</u>

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2001

(8) Interfund Assets/Liabilities

The following summarizes due from/to other funds as of September 30, 2001:

<u>Fund</u>	<u>Receivable</u>	<u>Payable</u>
Special Revenue Funds:		
Chuuk Airport Authority	\$ 847,028	\$ -
Compact - Special Block Grant	2,533,715	-
Federal Grant Assistance Fund	-	251,162
Compact - Other Grants Fund	640,751	-
CFSM Grant Fund	-	589,328
Capital Projects Funds:		
Compact Capital Projects Fund	764,824	-
General Fund	<u>-</u>	<u>3,945,828</u>
	<u>\$ 4,786,318</u>	<u>\$ 4,786,318</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, 2001. The above investment is carried at cost since there is no method of ascertaining related value.

\$ 1,500,000

During fiscal year 1991, the State purchased \$250,000 of common stock in the Pacific Islands Development Bank (a 7.36% interest at September 30, 2001). The above investment is carried at cost since there is no method of ascertaining related 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, 2001. 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 should be deducted from the carrying value. However as audited financial information was not available for this purpose, the carrying value as of September 30, 2001 does not reflect such adjustments, if any.

1,202,005

During fiscal year 1993, the State purchased \$812,000 of common stock in the Bank of Guam, which represents a .007% interest as of September 30, 2001. This investment is carried at market value based on 70,000 shares at \$6.05 per share as determined by closing value on the Pacific Stock Exchange.

423,500

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2001

(9) Investments – Other, Continued

During fiscal year 1996, Chuuk State purchased \$300,000 of common stock in the FSM Development Bank (an interest of approximately 1% at September 30, 2001). The above investment is carried at cost since there is no method of ascertaining related value.

	<u>300,000</u>
Total other investments	\$ <u>3,675,505</u>

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.

During fiscal year 2001, it was determined that the State of Chuuk held, as an investment, 70,000 shares of bank stock. In prior years, the investment was carried at cost as there was no method of ascertaining the related market value. The stock is now listed on a national exchange and a market value has therefore been ascertained. The State recognized a loss on its carrying value of \$388,500 in the Compact Capital Fund in 2001 as a result of this change in valuation.

(10) Segment Data for Component Units - Proprietary Funds

The following represents key data extracted from the financial statements of the component units - proprietary funds presented by the State as of September 30, 2001, and for the year then ended:

	<u>Chuuk Public Utility Corporation</u>	<u>Chuuk State Housing Authority</u>
Total assets	\$ <u>12,188,918</u>	\$ <u>1,802,794</u>
Total fund equity	\$ <u>7,289,215</u>	\$ <u>1,802,376</u>
Net fixed assets	\$ <u>11,044,509</u>	\$ <u>244,471</u>
FY01 operating loss	\$ <u>(2,618,996)</u>	\$ <u>(265,717)</u>
FY01 net loss	\$ <u>(509,820)</u>	\$ <u>(135,176)</u>
FY01 operating revenues	\$ <u>3,191,846</u>	\$ <u>110,272</u>
FY01 operating transfers in	\$ <u>1,000,000</u>	\$ <u>92,475</u>

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, \$771,012 in cumulative questioned costs exist for fiscal years 1997 through 2001 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.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2001

(11) Commitments and Contingencies, Continued

Federal Programs, Continued

Additionally, Chuuk State wrote off approximately \$464,882 of payables due to the federal government as the amounts have been long outstanding and no communication from the affected agencies has occurred.

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, 2001, was \$2,861,545.

Pending Litigation and Other Matters

The State of Chuuk is a party to various legal proceedings. The State's Attorney General is of the opinion that a reasonable estimate of the amount of judgements against the State of Chuuk is approximately \$6.6 million. However, the State is currently negotiating with judgement creditors to arrive at settlement amounts favorable to both parties. Claims must be adjudicated and are not recognized as current liabilities of the State as they cannot be paid without an underlying appropriation from the State Legislature. Additionally, no appropriation currently exists to finance these judgements. The State's Attorney General asserts that these claims, although it is possible they will be resolved in an amount less than as adjudicated, represent valid liabilities of the State. Accordingly, the balance is recorded in the General Long-Term Debt Account Group.

(12) Fund Deficits

The following represents material fund deficits as of September 30, 2001. 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

\$ 137,144

(13) Notes Payable - Component Units-Proprietary Funds

Chuuk Public Utility Corporation, as of September 30, 2001, had the following notes payable:

Notes payable to a commercial bank, ninety-day terms, interest at prime plus 2.00% on a \$150,000 line of credit. The loan is collateralized by a Bank of the FSM deposit and security interest in fixed assets, accounts receivable and inventories.

\$ 130,000

Amount drawn on a note payable with an available total of \$549,743, facilitated by Federated States of Micronesia Development Bank (FSMDB), interest at 9%, due in monthly installments of \$11,412. The loan is collateralized by major machinery, equipment and assignment of income.

508,760

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2001

(13) Notes Payable – Component Units-Proprietary Funds, Continued

Amount drawn on a note payable with an available total of \$2,795,540 to the State of Chuuk, facilitated by an Asian Development Bank loan to the FSM, interest at 6.82%, due in semi-annual principal installments commencing August 1, 2007. The loan is ultimately collateralized by a Chuuk State pledge of Compact of Free Association revenues to the FSM National Government. The State of Chuuk has not imposed collateralization on the Corporation.

	<u>2,817,718</u>
	3,456,478
Less current maturities	<u>211,141</u>
Long-term portion of notes payable	\$ <u>3,245,337</u>

Notes payable mature as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>
2002	\$ 211,141	\$ 204,348
2003	102,623	226,489
2004	112,250	216,863
2005	122,779	206,333
2006	89,967	194,997
Thereafter	<u>2,817,718</u>	<u>2,919,891</u>
	\$ <u>3,456,478</u>	\$ <u>3,968,921</u>

(14) Loans Receivable - Related Parties

At September 30, 2001, the State had an outstanding loan of \$2,817,718 due from the Chuuk Public Utility Corporation, a component unit of the State. The loan to the Chuuk Public Utility Corporation is facilitated through a loan from the Asian Development Bank to the FSM National Government, which in turn lent the money to the State (see note 13).

(15) Fund Balances Reserved For Related Assets

Fund balance reserves for related assets are comprised of the following as of September 30, 2001:

	<u>General Fund</u>	<u>Capital Projects Funds</u>
Early Retirement Trust Fund	\$ 5,128,355	\$ -
Revenue share – 20%	480,411	-
Receivables	792,000	-
Other	<u>48,634</u>	<u>3,675,505</u>
	\$ <u>6,449,400</u>	\$ <u>3,675,505</u>

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2001

(16) Risk Management

Chuuk State Government does not purchase commercial insurance to cover its potential risks. Chuuk State Government is substantially self-insured for all risks. Management is of the opinion that no material losses have been sustained as a result of this practice.

(17) Adoption of New Accounting Principle

Effective October 1, 2000, Chuuk State Government adopted GASB Statement No. 33, "Accounting and Financial Reporting for Nonexchange Transactions." GASB No. 33 establishes uniform revenue recognition criteria and financial reporting standards regarding the timing of recognition of the results of nonexchange transactions involving cash and other financial and capital resources. The provisions of GASB No. 33 were applied to all periods presented.

Implementation of GASB No. 33 impacted the 2000 financial statements as follows:

General fund balance at September 30, 2000, as previously reported	\$ 562,347
Correction of unallocated revenue sharing receivables	<u>630,378</u>
General fund balance at September 30, 2000, as restated	\$ <u>1,192,725</u>

For component units, as a result of GASB 33, total fund equity has not been changed. However, contributed capital has been combined with retained earnings as follows:

2000 retained earnings, beginning of year, as previously report	\$ 1,078,627
Add contributed capital as adjusted for GASB 33 application	<u>9,054,173</u>
2000 retained earnings, beginning of year, as restated	\$ <u>10,132,800</u>

(18) Subsequent Event

Subsequent to September 30, 2001, the FSM National Government imposed a lien on State revenues to recover a dated tax liability. With interest and penalties, it is represented that the total liability exceeds \$3 million. The ultimate impact of this matter is uncertain, but may have a material impact on the accompanying general purpose financial statements.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Combining Schedule of Expenditures by Account-
All Governmental Fund Types
Year Ended September 30, 2001
(With comparative totals for the year ended September 30, 2000)

	Governmental Fund Types			Totals (Memorandum Only)	
	General	Special Revenue	Capital Projects	2001	2000
Expenditures:					
Personnel	\$ 16,849,581	\$ 1,592,006	\$ 169,695	\$ 18,611,282	\$ 17,018,727
Travel	1,146,098	117,814	61,990	1,325,902	1,386,324
Contractual services	885,216	673,702	2,697,625	4,256,543	8,646,521
POL	175,811	4,231	3,504	183,546	213,872
Other :					
Equipment	297,002	58,974	90,583	446,559	3,301,994
Medical supplies	19,982	313,094	5,775	338,851	417,789
Medical referral	300	-	-	300	108,498
Supplies and materials	328,022	283,625	98,916	710,563	987,848
Scholarships	151,441	-	-	151,441	145,030
Food	-	399,750	-	399,750	485,960
Books	2,256	-	-	2,256	3,949
All others	6,229,549	4,893,985	3,735,713	14,859,247	14,195,348
Debt service-principal	-	-	2,918,173	2,918,173	3,000,000
Debt service-interest	-	-	-	-	320,000
Fixed asset	358,478	-	2,453,489	2,811,967	4,450,000
Loss on investment	-	-	388,500	388,500	5,350,000
Total expenditures	<u>\$ 26,443,736</u>	<u>\$ 8,337,181</u>	<u>\$ 12,623,963</u>	<u>\$ 47,404,880</u>	<u>\$ 60,031,860</u>

See Accompanying Independent Auditors' Report.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

GENERAL FUND

Statement of Revenues, Expenditures by Function and Department and Changes in Fund Balance (Deficit)
Year Ended September 30, 2001

(With comparative totals for the year ended September 30, 2000)

	2001	2000
Revenues:		
U.S. Compact of Free Association:		
Section 211(a)(2) - base grant	\$ 8,816,000	\$ 8,816,000
Section 217 - inflation adjustment	4,936,960	4,760,640
FSM revenue sharing	4,494,871	4,376,074
Unallocated revenue sharing	(175,283)	630,378
State taxes and licenses:		
Cigarette tax	\$ 52,728	\$ 67,526
General sales tax	1,467,052	1,067,253
Alcohol	108,825	353,913
Hotel	143,879	135,454
Delinquent tax collections	2,408	19,686
License and fees	104,415	105,628
Other	96,388	590,110
	1,975,695	2,339,570
Other revenues:		
Hospital and utilities collections	18,271	47,042
Transportation collections	478,190	663,938
Leases	63,533	60,541
Miscellaneous	1,111,919	367,502
Investment (loss) income	(3,097,561)	1,139,023
	(3,097,561)	3,560,287
Total revenues	18,622,595	25,621,972
Expenditures by department:		
General government:		
Executive branch:		
Governor and staff	1,591,084	959,580
Attorney General	239,810	245,196
State Finance	415,693	118,193
ADP	67,409	47,905
Tax and revenue	303,525	293,257
Program and budget	185,804	142,650
Property and supply	109,467	97,007
Personnel	103,921	104,141
Planning	201,535	248,587
	3,218,248	2,256,516
Legislative internal operations:		
President and members	674,723	702,472
Speakers and members	1,903,423	2,043,633
Legislative committees	228,138	93,012
Legislative legal office	277,703	273,892
Legislative administration	203,000	173,944
Legislative budget office	137,003	163,246
Chief clerks	165,062	285,475
	3,589,052	3,735,674
Judicial operations	638,972	604,198
Office of the Public Auditor	24,868	20,029
	7,471,140	6,616,417
Education:		
Administration	405,306	207,616
Elementary	3,519,493	3,356,661
Secondary	1,550,553	1,430,817
Curriculum and instruction	153,457	164,899
	5,628,809	5,159,993
Health services:		
Hospital and dispensaries	2,500,416	2,408,266
Environmental health	136,460	104,956
Dental services	239,691	230,588
	2,876,567	2,743,810

See Accompanying Independent Auditors' Report.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

GENERAL FUND

Statement of Revenues, Expenditures by Function and Department and Changes in Fund Balance (Deficit), Continued
Year Ended September 30, 2001

(With comparative totals for the year ended September 30, 2000)

	2001	2000
Expenditures by department, continued:		
Economic development:		
Administration	\$ 122,443	\$ 202,536
Land management	51,903	44,449
Marine resources	397,421	375,605
Agriculture	383,038	288,252
Labor	37,747	33,031
Historic preservation	31,839	26,182
Business and trades	65,350	47,316
Total economic development	1,089,741	1,017,371
Public works:		
Operations and maintenance	368,232	327,369
Total public works	368,232	327,369
Public safety	1,291,923	1,060,062
Transportation:		
Administration	782,090	774,579
Airport	136,930	116,541
Total transportation	919,020	891,120
Community affairs:		
Division of public affairs	99,090	96,667
Division of youth affairs	20,501	21,775
Division of information and broadcast	85,037	69,070
Total community affairs	204,628	187,512
Boards and commissions:		
Investment board	5,803	26,433
Election commission	408,406	83,369
Education board	6,949	17,910
Recreation board	90,689	174,535
Land commission	148,104	128,682
Environmental Protection Agency	79,883	85,485
Facilities	37,278	52,091
Truk Scholarship Board	182,297	174,986
Total boards and commissions	959,409	743,491
Chuuk Early Retirement Program	98,367	219,074
Special programs	2,250,437	1,267,926
Legislative external appropriations	3,285,463	6,059,635
Total other	5,634,267	7,546,635
Total expenditures	26,443,736	26,293,780
Excess (deficiency) of revenues over (under) expenditures	(7,821,141)	(671,808)
Other financing sources (uses):		
Chuuk recovery loan accrual	(292,444)	(1,686,710)
Operating transfers out	(153,866)	(268,654)
(Deficiency) excess of revenues and other financing sources (under) over expenditures and other financing uses	(8,267,451)	(2,627,172)
Fund balance (deficit) at beginning of year	1,192,725	3,819,897
Fund balance (deficit) at end of year	\$ (7,074,726)	\$ 1,192,725

See Accompanying Independent Auditors' Report.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Special Revenue Funds
September 30, 2001

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, 2001, follows:

Chuuk Visitors' Bureau

This fund accounts for funds received by the Visitors' 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.

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
FEDERATED STATES OF MICRONESIA**

SPECIAL REVENUE FUNDS

Combining Balance Sheet

September 30, 2001

(With comparative totals as of September 30, 2000)

<u>ASSETS</u>	Chuuk Visitors Bureau	Chuuk Airport Authority	Federal Grant Assistance	CFSM Grant	Compact Other Grants	Compact Special Block Grant Section 221(b)	Totals	
							2001	2000
Cash and equivalents	\$ 8,079	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 8,079	\$ 11,230
Receivables:								
FSM National Governmen	-	-	346,922	619,155	-	-	966,077	2,921,195
General, net	-	-	189,066	-	-	-	189,066	12,802
Due from other funds:	-	847,028	-	-	640,751	2,533,715	4,021,494	7,316,801
Allowance for uncollectible	-	-	-	(74,864)	-	-	(74,864)	(2,167,957)
Total assets	\$ 8,079	\$ 847,028	\$ 535,988	\$ 544,291	\$ 640,751	\$ 2,533,715	\$ 5,109,852	\$ 8,094,071
 <u>LIABILITIES AND FUND BALANCES (DEFICIT)</u>								
Liabilities:								
Accounts payable	-	-	92,512	92,107	99,766	2,216,095	2,500,480	3,220,743
Accrued liabilities	-	50,586	192,314	-	-	-	242,900	35,062
Due to other funds	-	-	251,162	589,328	-	-	840,490	458,221
Payable to other government	-	-	-	-	-	-	-	372,202
Deferred revenue	-	-	-	-	-	-	-	277,320
Total liabilities	-	50,586	535,988	681,435	99,766	2,216,095	3,583,870	4,363,548
Fund balances (deficit)								
Reserved for encumbrance	-	185,547	33,382	-	21,626	45,958	286,513	325,104
Unreserved	8,079	610,895	(33,382)	(137,144)	519,359	271,662	1,239,469	3,405,419
Total fund balances (deficit)	8,079	796,442	-	(137,144)	540,985	317,620	1,525,982	3,730,523
Total liabilities and fund balances (deficit)	\$ 8,079	\$ 847,028	\$ 535,988	\$ 544,291	\$ 640,751	\$ 2,533,715	\$ 5,109,852	\$ 8,094,071

See Accompanying Independent Auditors' Report

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures by Function and Changes in Fund Balances (Deficit)
Year Ended September 30, 2001
(With comparative totals for the year ended September 30, 2000)

	Chuuk Visitors Bureau	Chuuk Airport Authority	Federal Grant Assistance	CFSM Grant	Compact Other Grants	Compact Special Block Grant Section 221(b)	Totals	
							2001	2000
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	-	-	-	-	671,888	-	671,888	512,892
Section 212-base grant	-	-	-	-	250,000	-	250,000	385,000
Federal contribution:	-	-	1,086,816	-	-	-	1,086,816	963,856
Other	44,613	366,757	-	571,679	-	-	983,049	3,103,859
Total revenues	44,613	366,757	1,086,816	571,679	2,332,775	2,730,000	7,132,640	9,106,494
Expenditures:								
General government	-	-	136,740	-	578,148	106,630	821,518	485,798
Education	-	-	739,276	-	-	1,858,727	2,598,003	2,256,345
Health services	-	-	-	-	497,892	2,700,799	3,198,691	1,731,838
Public works and utilities	-	632,135	192,290	-	-	-	824,425	3,289,126
Public safety	-	-	15,000	161,479	-	-	176,479	8,130
Community affairs	-	-	3,510	410,200	258,257	-	671,967	274,737
Other	46,098	-	-	-	-	-	46,098	137,292
Total expenditures	46,098	632,135	1,086,816	571,679	1,334,297	4,666,156	8,337,181	8,183,266
Excess (deficiency) of revenues over (under) expenditure	(1,485)	(265,378)	-	-	998,478	(1,936,156)	(1,204,541)	923,228
Other financing sources (uses)								
Operating transfers in	-	-	-	-	-	-	-	96,140
Operating transfers out	-	-	-	-	(1,000,000)	-	(1,000,000)	(1,000,000)
Total other financing sources (uses), net	-	-	-	-	(1,000,000)	-	(1,000,000)	(903,860)
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(1,485)	(265,378)	-	-	(1,522)	(1,936,156)	(2,204,541)	19,368
Fund balances (deficit) at beginning of year	9,564	1,061,820	-	(137,144)	542,507	2,253,776	3,730,523	3,711,155
Fund balances (deficit) at end of year	\$ 8,079	\$ 796,442	\$ -	\$ (137,144)	\$ 540,985	\$ 317,620	\$ 1,525,982	\$ 3,730,523

See Accompanying Independent Auditors' Report

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures by Account and Changes in Fund Balances (Deficit)
Year Ended September 30, 2001
(With comparative totals for the year ended September 30, 2000)

	Chuuk Visitors Bureau	Chuuk Airport Authority	Federal Grant Assistance	CFSM Grant	Compact Other Grants	Compact Special Block Grant Section 221(b)	Totals	
							2001	2000
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	-	-	-	-	671,888	-	671,888	512,892
Section 212-base grant	-	-	-	-	250,000	-	250,000	385,000
Federal contribution:	-	-	1,086,816	-	-	-	1,086,816	963,856
Other	44,613	366,757	-	571,679	-	-	983,049	3,103,859
Total revenues	44,613	366,757	1,086,816	571,679	2,332,775	2,730,000	7,132,640	9,106,494
Expenditures:								
Personnel	-	19,076	195,846	115	32,158	1,344,811	1,592,006	1,362,491
Travel	-	6,892	63,805	3,247	8,686	35,184	117,814	177,005
Contractual services:	-	-	167,115	-	353,152	153,435	673,702	3,469,395
POL	-	-	-	-	-	4,231	4,231	5,143
Other :								
Equipment	-	-	53,720	5,254	-	-	58,974	89,255
Medical supplies:	-	-	-	-	-	313,094	313,094	399,196
Supplies and materials:	-	7,500	229,423	-	-	46,702	283,625	141,171
Food	-	-	-	-	4,966	394,784	399,750	482,175
Books	-	-	-	-	-	-	-	369
All others	46,098	598,667	376,907	563,063	935,335	2,373,915	4,893,985	2,057,066
Total expenditures:	46,098	632,135	1,086,816	571,679	1,334,297	4,666,156	8,337,181	8,183,266
Excess (deficiency) of revenues over (under) expenditures	(1,485)	(265,378)	-	-	998,478	(1,936,156)	(1,204,541)	923,228
Other financing sources (uses)								
Operating transfers in	-	-	-	-	-	-	-	96,140
Operating transfers out	-	-	-	-	(1,000,000)	-	(1,000,000)	(1,000,000)
Total other financing sources (uses), net	-	-	-	-	(1,000,000)	-	(1,000,000)	(903,860)
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(1,485)	(265,378)	-	-	(1,522)	(1,936,156)	(2,204,541)	19,368
Fund balances (deficit) at beginning of year	9,564	1,061,820	-	(137,144)	542,507	2,253,776	3,730,523	3,711,155
Fund balances (deficit) at end of year	\$ 8,079	\$ 796,442	\$ -	\$ (137,144)	\$ 540,985	\$ 317,620	\$ 1,525,982	\$ 3,730,523

See Accompanying Independent Auditors' Report

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Combining Balance Sheet
Discretely Presented Component Units
September 30, 2001
(With Comparative Totals as of September 30, 2000)

	<u>Chuuk Public Utility Corporation</u>	<u>Chuuk State Housing Authority</u>	<u>Totals</u>	
			<u>2001</u>	<u>2000</u>
<u>Assets</u>				
Cash and equivalents	\$ 35,909	\$ 662,145	\$ 698,054	\$ 837,258
General receivables, net	641,422	20,840	662,262	618,016
Loans receivable, net	444,105	869,141	1,313,246	1,037,642
Fixed assets, net	11,044,509	244,471	11,288,980	9,701,041
Other assets	22,973	6,197	29,170	50,734
	<u>12,188,918</u>	<u>1,802,794</u>	<u>13,991,712</u>	<u>12,244,691</u>
Total assets	<u>\$ 12,188,918</u>	<u>\$ 1,802,794</u>	<u>\$ 13,991,712</u>	<u>\$ 12,244,691</u>
<u>Liabilities and Fund Equity</u>				
Liabilities:				
Accounts payable	\$ 1,045,995	\$ 418	\$ 1,046,413	\$ 567,756
Accrued payroll and annual leave	347,230	-	347,230	115,300
Deferred income	50,000	-	50,000	-
Notes payable	3,456,478	-	3,456,478	1,825,048
	<u>4,899,703</u>	<u>418</u>	<u>4,900,121</u>	<u>2,508,104</u>
Total liabilities	<u>4,899,703</u>	<u>418</u>	<u>4,900,121</u>	<u>2,508,104</u>
Fund equity:				
Retained earnings	<u>7,289,215</u>	<u>1,802,376</u>	<u>9,091,591</u>	<u>9,736,587</u>
Total liabilities and fund equity	<u>\$ 12,188,918</u>	<u>\$ 1,802,794</u>	<u>\$ 13,991,712</u>	<u>\$ 12,244,691</u>

See Accompanying Independent Auditors' Report.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Combining Statement of Revenues, Expenses and Changes in Fund Equity
Discretely Presented Component Unit:
Year Ended September 30, 2001
(With comparative totals for the year ended September 30, 2000)

	Chuuk Public Utility Corporation	Chuuk State Housing Authority	Totals	
			2001	2000
Operating revenues:				
Sales	\$ 3,191,846	\$ 110,272	\$ 3,302,118	\$ 2,951,167
Total operating revenues:	<u>3,191,846</u>	<u>110,272</u>	<u>3,302,118</u>	<u>2,951,167</u>
Operating expenses:				
Payroll and personnel	1,847,952	100,079	1,948,031	1,700,542
Fuel	2,246,736	-	2,246,736	2,067,529
Depreciation	1,260,004	23,541	1,283,545	1,086,123
Bad debt	456,150	130,790	586,940	427,840
Rent	-	9,210	9,210	2,560
Other	-	112,369	112,369	51,109
Total operating expenses:	<u>5,810,842</u>	<u>375,989</u>	<u>6,186,831</u>	<u>5,335,703</u>
Operating loss	<u>(2,618,996)</u>	<u>(265,717)</u>	<u>(2,884,713)</u>	<u>(2,384,536)</u>
Nonoperating revenues:				
Transfers in	1,000,000	92,475	1,092,475	1,082,774
Federal contributions	585,744	37,016	622,760	710,950
Contributions	518,099	-	518,099	144,599
Other income	5,333	1,050	6,383	50,000
Total nonoperating revenues, ne	<u>2,109,176</u>	<u>130,541</u>	<u>2,239,717</u>	<u>1,988,323</u>
Net loss	<u>(509,820)</u>	<u>(135,176)</u>	<u>(644,996)</u>	<u>(396,213)</u>
Retained earnings at beginning of yea	<u>7,799,035</u>	<u>1,937,552</u>	<u>9,736,587</u>	<u>10,132,800</u>
Retained earnings at end of yea	<u>\$ 7,289,215</u>	<u>\$ 1,802,376</u>	<u>\$ 9,091,591</u>	<u>\$ 9,736,587</u>

See Accompanying Independent Auditors' Report

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Combining Statement of Cash Flows -
Discretely Presented Component Units
Year Ended September 30, 2001

	<u>Chuuk Public Utility Corporation</u>	<u>Chuuk State Housing Authority</u>	<u>Totals</u>
Reconciliation of operating loss to net cash used for operating activities:			
Operating loss	\$ (2,618,996)	(265,717)	\$ (2,884,713)
Adjustments to reconcile operating loss to net cash used for operating activities			
Depreciation	1,260,004	23,541	1,283,545
Allowance for bad debts	456,150	130,790	586,940
Increase in receivables	(518,238)	(73,990)	(592,228)
Increase in accounts payable	171,554	-	171,554
(Decrease) increase in other liabilities and other asset:	133,205	(4,478)	128,727
Total adjustments:	<u>1,502,675</u>	<u>75,863</u>	<u>1,578,538</u>
Net cash used for operating activities:	<u>(1,116,321)</u>	<u>(189,854)</u>	<u>(1,306,175)</u>
Cash flows from noncapital financing activities:			
Operating grants received	1,720,618	130,541	1,851,159
FSM contribution	73,994	-	73,994
Net cash provided by noncapital financing activities:	<u>1,794,612</u>	<u>130,541</u>	<u>1,925,153</u>
Cash flows from capital and related financing activities:			
Acquisition of utility plan	(2,298,243)	-	(2,298,243)
Acquisition of building and equipment	-	(91,369)	(91,369)
Proceeds from notes payable	1,631,430	-	1,631,430
Net cash used for capital and related financing activities:	<u>(666,813)</u>	<u>(91,369)</u>	<u>(758,182)</u>
Net change in cash and equivalents:	11,478	(150,682)	(139,204)
Cash and equivalents at beginning of year	<u>24,431</u>	<u>812,827</u>	<u>837,258</u>
Cash and equivalents at end of year	\$ <u><u>35,909</u></u>	<u><u>662,145</u></u>	\$ <u><u>698,054</u></u>

See Accompanying Independent Auditors' Report



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL
CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

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

We have audited the general purpose financial statements of the State of Chuuk as of and for the year ended September 30, 2001, and have issued our report thereon dated December 17, 2002, which report was qualified due to 1) our inability to determine that accounts payable 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 development authorities; 4) the omission of the State's component units - Chuuk Coconut Authority and Chuuk Public Fisheries Corporation; 5) our inability to obtain audited financial statements from an investee of the State of Chuuk supporting investments recorded in the Governmental Fund Type - Capital Projects Fund; and 6) our inability to determine that continuing appropriations of the Capital Projects Fund were fairly stated. Except as discussed in the preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

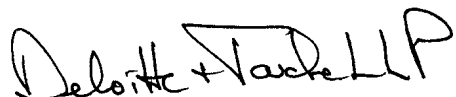
As part of obtaining reasonable assurance about whether the State of Chuuk's general purpose financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*, which are described in the accompanying Schedule of Findings and Questioned Costs (pages 62 through 86) in findings 01-01, 01-02 and 01-15.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State of Chuuk's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the State of Chuuk's ability to record, process, summarize and report financial data consistent with the assertions of management in the general purpose financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 01-06 through 01-23.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the 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 over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 01-15 and 01-19 to be material weaknesses.

This report is intended for the information of the management of the State of Chuuk, federal awarding agencies, pass-through entities, and the cognizant audit and other federal agencies and is not intended to be, and should not be, used by anyone other than those specified parties.

A handwritten signature in black ink that reads "Deloitte + Tatchell LLP". The signature is written in a cursive, somewhat stylized font.

December 17, 2002



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND INTERNAL CONTROL
OVER COMPLIANCE APPLICABLE TO EACH MAJOR FEDERAL AWARD PROGRAM
AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

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

Compliance

We have audited the compliance of the State of Chuuk with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2001. The State of Chuuk's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 62 through 86). Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of State of Chuuk's management. Our responsibility is to express an opinion on State of Chuuk's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the State of Chuuk's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the State of Chuuk's compliance with those requirements.

As described in items 01-01 through 01-06, 01-08 and 01-15 in the accompanying Schedule of Findings and Questioned Costs, the State of Chuuk did not comply with requirements regarding allowable costs/cost principles (CFDA #15.875), procurement and suspension and debarment (CFDA #84.256A) and equipment and real property management (all programs). Compliance with such requirements is necessary, in our opinion, for State of Chuuk to comply with requirements applicable to its federal programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the State of Chuuk, complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2001.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2001

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-133 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as the State's cognizant agency for Single Audit.

A. Programs Subject to Single Audit

Schedules of expenditures of federal awards are presented for each federal program related to the following agencies:

- U.S. Department of Education
- U.S. Department of the Interior
- 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 on the accrual method of accounting.

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."

C. Subgrantees

Certain program funds are passed through the State to subgrantee organizations. The Schedule of Expenditures of Federal Awards does not contain separate schedules disclosing how all the subgrantees outside of the State's control utilize these funds, with the exception of the Chuuk Utilities Corporation and the Chuuk State Housing Authority.

D. Indirect Cost Allocation

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

3. Component Units

The State of Chuuk's component units are to separately satisfy the requirements of OMB Circular A-133. The following presents information concerning component units which have satisfied their A-133 requirements.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2001

3. Component Units, Continued

Chuuk Public Utilities Corporation

The Chuuk Public Utilities Corporation, a component unit - proprietary fund, is the recipient of various pass-through funds from Chuuk State and direct grants from the U.S. Department of the Interior. No material instances of noncompliance or questioned costs were presented in its audit reports and are therefore not contained in the accompanying Schedule of Findings and Questioned Costs. The Chuuk Public Utilities Corporation's Schedule of Expenditures of Federal Awards is as follows:

<u>Grantor Agency/Program</u>	<u>CFDA#</u>	<u>Fiscal Year 2001 Expenditures</u>
U.S. Department of the Interior: Compact of Free Association	15.875	\$ 1,000,000
Trust Territory of the Pacific Islands	15.875	330,418
Operations and Maintenance Improvement Programs (OMIP) Grants	15.875	<u>255,326</u>
Total expenditures		\$ <u>1,585,744</u>

Compact of Free Association funds are received in a subrecipient capacity thru the State of Chuuk. All other grants are received in a direct capacity.

Chuuk State Housing Authority

The Chuuk State Housing Authority, a component unit - proprietary fund, is the recipient of various pass-through funds from Chuuk State and certain direct grants. The Chuuk State Housing Authority's Schedule of Expenditures of Federal Awards is as follows:

<u>Grantor Agency/Program</u>	<u>CFDA#</u>	<u>Fiscal Year 2001 Expenditures</u>
U.S. Department of the Interior: Compact of Free Association	15.875	\$ 92,475
U.S. Department of Housing and Urban Development: Section 8 Housing Program	14.156	<u>37,016</u>
Total expenditures		\$ <u>129,491</u>

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2001

3. Component Units, Continued

Chuuk State Housing Authority, Continued

Loan Funds:

As of September 30, 2001, some \$1.1 million of loans previously 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. The federal requirement attendant to these funds have expired and therefore, these funds now are only subject to State requirements.

Additionally, as of September 30, 2001, the Authority administered \$774,767 of loan 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.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Programs Selected For
Audit in Accordance with OMB Circular A-133
Year Ended September 30, 2001

<u>Grantor</u> <u>Program Title</u>	<u>CFDA No.</u>	<u>2001</u> <u>Fiscal Year</u> <u>Expenditures</u>
<u>U.S. Dept. of the Interior</u>		
Compact of Free Association:		
211(A) Capital Account	15.875	\$ 12,311,074
221(B) Special Block Grants	15.875	4,666,156
221(B) Compact Energy Grants	15.875	<u>1,578,149</u>
Total Major Programs Under CFDA # 15.875 excluding Compact Section 211 (A) Current Account expenditures		18,555,379
 <u>U.S. Department of Education</u>		
School Improvement Project	84.256A	<u>634,327</u>
Total U.S. Federal program expenditures selected excluding Compact Section 211 (A) Current Account expenditures		\$ <u>19,189,706</u>
Total U.S. Federal program expenditures excluding Compact Section 211 (A) Current Account expenditures		\$ <u>20,398,343</u>
% of total U.S. Federal expenditures covered by major programs excluding Compact Section 211 (A) Current Account expenditures		<u>94%</u>

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2001

Part I - Summary of Auditors' Results

1. The Independent Auditors' Report on the financial statements expressed a qualified opinion.
2. Reportable conditions in internal control over financial reporting were identified, some of which are considered to be material weaknesses.
3. Instances of noncompliance considered to be material to the financial statements were disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal award programs were identified, some of which are considered to be a material weaknesses.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. The State's major programs were:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
U.S. Department of the Interior - Compact of Free Association Capital Account	15.875
U.S. Department of Education - School Improvement Project	84.256A

8. A threshold of \$611,950 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
9. The State did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

Part II - Financial Statement Findings Section

<u>Reference Number</u>	<u>Findings</u>
01-07	Documentation Supporting Expenditures
01-09	Outstanding Collections and Reimbursable Grants
01-10	Travel Advances
01-11	Timely Submission of Accounts Payable Information to the Finance Office
01-12	Maintenance of Checks Signed but not Claimed
01-13	Maintenance of Accounts Payable Subsidiary Ledgers
01-14	Maintenance of Encumbrance Detailed Listings
01-16	Timelines of Investment Information
01-17	Appropriations in Excess of Estimated Revenues
01-18	Computer Systems Support
01-19	Leases Payable
01-20	Chuuk State Housing Authority (CSHA) – Accounting for Loans
01-21	Chuuk State Housing Authority (CSHA) – Collection of Loans Receivable
01-22	Chuuk State Housing Authority (CSHA) – FHMA Deed of Trust Agreement
01-23	Reconciliation of Personnel Action Forms and Payroll Rates Applied

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Part III - Federal Award Findings and Questioned Cost Section

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
01-01	School Improvement Plan Project – Procurement and Suspension and Debarment	\$ 150,597
01-02	Compact of Free Association – Compact Capital Funds – Allowable Costs/Cost Principles	\$ 150,000
01-03	Compact of Free Association Requirements	\$ 20,000
01-04	Compact of Free Association Requirements	\$ 20,000
01-05	Compact of Free Association Requirements	\$ -
01-06	Documentation Supporting Expenditures	\$ 12,500
01-08	Documentation Supporting Expenditures	\$ 16,400
01-15	Implementation of GAS 34	\$ -

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

U.S. Department of Education – School Improvement Plan Project – Procurement and Suspension and Debarment

<u>Item No.</u>	<u>CFDA No.</u>	<u>Criteria:</u>	<u>Questioned Costs</u>
01-01	84.256A	Competitive procurement should be performed in accordance with applicable federal guidelines.	\$ 150,597

Condition: No competitive procurement procedures appear to have been performed in the administration of the program during fiscal year 2001. Out of fifty items tested aggregating \$150,597 of non-payroll costs out of total program costs of \$634,327, no competitive procurement activities were noted.

Additionally, three instances were found where payments of phone bills were made without written justification indicating the relevance of the bills to the program. No phone logs appear to have been maintained. Therefore, in these instances, we were unable to determine the manner in which the program benefited from these expenditures.

Cause: Program officials were of the opinion that the State Procurement Office was performing this function whereas the State Procurement Office does not perform this function.

Effect: The effect of this condition is known questioned costs of \$150,597. Additionally, it appears that additional questioned costs could arise due to noncompliance with the stated criteria.

Prior Year Status: Noncompliance with the criteria was stated in the 2000 Chuuk State Single Audit report.

Recommendation: The State should ensure compliance with the stated criteria.

Auditee Response and Corrective Action Plan dated June 11, 2003: The State has taken corrective action. This condition was identified in the 2000 audit, which procedures were performed in the 2001 year. Therefore, corrective action did not occur until 2002. We believe this finding has been subsequently resolved.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

U.S. Department of the Interior– Compact of Free Association – Compact Capital Funds – Allowable Costs/Cost Principles

<u>Item No.</u>	<u>CFDA No.</u>	<u>Criteria:</u>	<u>Questioned Costs</u>
01-02	15.875	Costs charged to federal programs should be appropriately documented to substantiate the allowability of costs against the respective program.	\$ 150,000

Condition: A payment of \$150,000 in a wrongful shooting court judgement was made and was charged to Compact Capital account funds (reference numbers 101217901, 218801, 29280, and 1012188). The underlying funds were appropriated from Compact Capital funds by the Chuuk State Legislature and were allotted by the FSM National Government. However, the payment of litigation expenses does not appear to relate to the underlying requirements of Compact Capital account funds.

Cause: The cause of this condition appears to be that Compact Capital account funding was the only available source of cash at that time.

Effect: The effect of this condition is that questioned costs of \$150,000 exist.

Recommendation: The above matter should be reexamined by the Chuuk State Legislature and if appropriate, this item should be charged to the general fund.

Auditee Response and Corrective Action Plan dated June 11, 2003: To resolve the finding, legislation will be submitted to charge this amount to the general fund. We will work with the FSM National Government, which authorized the transfer amount per the allotment to us, to make the necessary corrective action.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Compact of Free Association Requirements

<u>Item No.</u>	<u>CFDA No.</u>	<u>Criteria:</u>	<u>Questioned Costs</u>
01-03	15.875	<p>Compliance with the terms of the Compact of Free Association requirements for Compact Capital Account funds should be present in support of all expenditures, if not otherwise self-evident.</p> <p><u>Condition:</u> We found payments of \$20,000 (APV # 101337701) for an easement that appears to have been made to assist a corporation in payment of its power bills. We were unable to determine the means used to establish conformity with the Compact of Free Association requirements.</p> <p><u>Cause:</u> The State did not utilize the services of its Attorney General to document the basis for the expenditure.</p> <p><u>Effect:</u> The effect of this condition is questioned costs of \$20,000.</p> <p><u>Recommendation:</u> The State should consult with the Attorney General to document the conformity of these expenditures with the Compact of Free Association requirements.</p> <p><u>Auditee Response and Corrective Action Plan dated June 11, 2003:</u> The Director of Treasury will request the State Attorney General to review this transaction to ensure its adequacy under the Compact Capital guidelines. This legal analysis will then be submitted to the National Government for its review and concurrence.</p>	\$ 20,000

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Compact of Free Association Requirements

<u>Item No.</u>	<u>CFDA No.</u>	<u>Criteria:</u>	<u>Questioned Costs</u>
01-04	15.875	<p>Compliance with the terms of the Compact of Free Association requirements for Compact Capital Account funds should be present in support of expenditures, if not otherwise self-evident.</p> <p><u>Condition:</u> The State paid \$20,000 in interest expense on a loan for acquisition of land and charged that interest expense to Compact Capital funding. The loan was not made. Therefore, the applicable interest expense does not appear to represent an eligible expense.</p> <p><u>Cause:</u> The cause of this condition is inadequate documentation to support the expenditure as applicable to Compact Capital Account funding.</p> <p><u>Effect:</u> The effect of this condition is questioned costs of \$20,000.</p> <p><u>Recommendation:</u> We recommend that this matter be referred to the State's Attorney General for review.</p> <p><u>Auditee Response and Corrective Action Plan dated June 11, 2003:</u> The FSM National Government, as grantor, will be requested to opine on this matter to advise on the appropriate method of resolving this finding. The Director of Treasury will so communicate and we trust that a response will be forthcoming to guide us in this matter.</p>	<p>\$ 20,000</p>

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Compact of Free Association Requirements (CFDA# 15.875)

Finding No. 01-05

Criteria: Compliance with the terms of the Compact of Free Association requirements for Compact Capital Account funds should be present in support of expenditures, if not otherwise self-evident.

Condition: Prior single audits of the State of Chuuk have raised the issue of the propriety of lease agreements as eligible charges against Compact Capital Account funding. This matter has not been resolved either by the State of Chuuk or the FSM National Government. In the current year, the State made various payments for leases in various municipalities. The leases did not appear to indicate the actual purpose served, the relationship to the Compact of Free Association funding and did not appear complete. The applicable amounts are as follows:

APV # 100243901 -	\$10,000
APV # 100242501	\$10,000
APV # 100242401	\$18,277
APV # 100254801	\$18,277

These costs are not questioned due to the absence of resolution of this issue by the State with the grantor agency (the FSM National Government).

Cause: The cause of this condition is inadequate documentation substantiating the relevancy of the leases to the Compact of Free Association and the non-resolution of the lease issue with the grantor agency.

Effect: The effect of this condition is potential noncompliance with Compact of Free Association terms and conditions.

Recommendation: The relevancy of the above leases should be documented and reviewed by the grantor agency for compliance with applicable terms and conditions of the Compact of Free Association.

Auditee Response and Corrective Action Plan dated June 11, 2003: This matter will be referred by the Director of Treasury to the State Attorney General to obtain the necessary review and documentation to determine whether these amounts are appropriately charged to the Compact Capital Account funding.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Documentation Supporting Expenditures

<u>Item No.</u>	<u>CFDA No.</u>	<u>Criteria:</u>	<u>Questioned Costs</u>
01-06	15.875	<p>Documentation should be on file in support of the relevance of the expenditure to the Compact of Free Association requirements.</p> <p><u>Condition:</u> A payment of \$12,500 (APV # 100209701) was made for telephone bills and charged against Health and Medical Compact funds. However, no detail of the bill was traceable to this fund.</p> <p><u>Cause:</u> The cause of this condition appears to be inadequate documentation in support of the charge.</p> <p><u>Effect:</u> The effect of this condition is that costs of \$12,500 has not been property documented.</p> <p><u>Recommendation:</u> The Government should review the subject transaction and ensure that an adequate trail exists in support of the relevancy of this expenditure to the funding source.</p> <p><u>Auditee Response and Corrective Action Plan dated June 11, 2003:</u> The Director of Treasury will instruct Finance and Accounting staff to have Health Services and Education enumerate and document each telephone bill to ensure that such is appropriately charged to the Compact source. Otherwise, these telephone expenses will be charged to their general fund account.</p>	\$ 12,500

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Documentation Supporting Expenditures

Finding No. 01-07

Criteria: Adequate documentation in support of expenditures should be on hand.

Condition: Payments are made on a quarterly basis to the Chuuk House, a facility based in Honolulu that assists in facilitating medical referrals in that area. However, the detail of the expenditures is not on file in support of the advances. Therefore, we were not able to ensure the relevance of the expenditures to the funding source or that all applicable funds were expended as of year end.

Cause: The cause of this condition is that the account is not being treated as an imprest fund.

Effect: The effect of this condition may be unsupported expenditures.

Recommendation: The Chuuk House should be established as an imprest fund and all underlying expenditure documentation should be ultimately filed in the Chuuk Finance Office.

Auditee Response and Corrective Action Plan dated June 11, 2003: The Director of Treasury will communicate with the Chuuk House and ensure that such account is established on an imprest account basis, with all original expenditure documents being housed in Chuuk State Finance.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Documentation Supporting Expenditures

<u>Item No.</u>	<u>CFDA No.</u>	<u>Criteria:</u>	<u>Questioned Costs</u>
01-08	15.875	Documentation should be on file to support the relevancy of payments to the underlying terms and conditions of the Compact of Free Association requirements.	\$ 16,400

Condition: Payments were made to cover funeral costs for ten individual services in the amount of \$16,400 (APV # 101232601). Funeral costs do not appear to be an eligible cost under the Health and Medical component of the Compact of Free Association.

Cause: Inadequate documentation exists with respect to ensuring the conformity of the underlying expenditure with grant requirements.

Effect: The effect of this condition is questioned costs in the amount of \$16,400.

Recommendation: This matter should be referred to the State Attorney General and the grantor agency for resolution.

Auditee Response and Corrective Action Plan dated June 11, 2003: The Director of Treasury will ask the State Attorney General for a legal opinion with respect to this matter. This is a legal issue and we will then request the FSM National Government to ratify that opinion. Depending on the outcome of the opinion, appropriate adjustment may have to be made to charge this amount to the general fund. If such is the case, appropriate legislation will be submitted to the Chuuk State Legislature.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Outstanding Collections of Reimbursable Grants

Finding No. 01-09

Criteria: Reimbursable grants should be collected in a timely manner.

Condition: As of September 30, 2001, financial records indicate that Chuuk is owed approximately \$742,000 that was not collected in fiscal year 2002. The breakdown is as follows:

Reimbursable Federal grants	\$166,000
Other reimbursable grants	\$189,000
Congress of the FSM grants	\$387,000

Cause: The cause of this condition appears to be the non-collection of the recorded receivables.

Effect: The effect of this condition is an increase in the reserve for related assets and the deficit as of September 30, 2001.

Recommendation: The above receivables should be analyzed and presented for collection. The collection attempts should be documented in writing. It appears that the majority of the above receivables are due from the FSM National Government.

Auditee Response and Corrective Action Plan dated June 11, 2003: The Director of Treasury will correspond with the FSM National Government and the FSM National Public Auditor to attempt to speed up the reimbursement process to the State. We believe that this finding is really directed at that entity. However, the State must document its collection attempts better. The Director of Treasury will instruct his staff to ensure that reminder notices will be sent bi-monthly documenting the status of outstanding collections.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Travel Advances

Finding No. 01-10

Criteria: Travel advances should be properly accounted for and collected in a timely manner.

Condition: The following conditions were apparent in the Chuuk State accounting records for the year ended September 30, 2001.

- a. It is not possible to differentiate between individuals on travel status, those who have returned from travel status but who failed to submit a travel voucher, and travelers who submitted a travel voucher or didn't travel and must repay Chuuk State.
- b. The detail travel advance subsidiary ledger has not been reconciled with the general ledger balance as of September 30, 2001.
- c. It is not possible to segregate encumbrances related to outstanding travel advances to determine the net impact on the deficit.

Cause: The cause of this condition is that necessary reconciliations are not performed on a recurring basis throughout the year.

Effect: We believe that the effect of the above conditions is not material to the general purpose financial statements. However, the possibility of a material misstatement occurring in the financial statements and remaining undetected appears to be a possibility as a result of this condition.

Recommendation: Chuuk State should reconcile the travel advance subsidiary to the general ledger on a monthly basis. The balances for travelers who actually owe the State should be segregated from the rest of travel advances to allow more effective monitoring. A separate general ledger account should be established for this purpose. Finally, travelers who fail to file timely travel vouchers should be informed of this requirement and if failure continues, payroll deductions should occur.

Auditee Response and Corrective Action Plan dated June 11, 2003: Based on the discussion that occurred during your audit process, we believe that we have already instituted processes correcting the noted deficiencies. We believe that you will be able to see these corrective actions in the conduct of your 2002 audit procedures.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Timely Submission of Accounts Payable Information to the Finance Office

Finding No. 01-11

Criteria: Departments should forward information relating to accounts payable to the Finance Office on a timely basis.

Condition: In September 2002, audit inquiries led to the discovery of a material amount of medical referral billings held at the Hospital and not provided Finance. The billings were both for fiscal year 2001 and 2002.

Cause: The cause of this condition is that the Hospital failed to provide necessary data to Finance.

Effect: The effect of this condition was a material understatement of accounts payable and related medical referral expenditures. This condition was corrected in the audit process.

Recommendation: Departments should be precluded from withholding financial data that should be transmitted to the Finance Office. The Chuuk Legislature should consider whether withholding such information represents a basis of civil or criminal violations.

Auditee Response and Corrective Action Plan dated June 11, 2003: The Director of Treasury has instructed his staff to periodically visit the Department in question and search for and obtain medical referral related accounting information. We believe that this finding has therefore been subsequently resolved.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Maintenance of Checks Signed but Not Claimed

Finding No. 01-12

Criteria: From time to time, checks will be prepared and unclaimed. Undistributed checks should be controlled and reconciled to the applicable general ledger control account. Additionally, the holder of the checks should not be the same as the person who maintains the general ledger control account.

Condition: The same person holds the undistributed checks and maintains the general ledger control account.

Cause: The cause of this condition is that the controls over undistributed checks have not been adequately addressed.

Effect: The effect of this condition is that controls surrounding undistributed checks are not adequate.

Recommendation: The incompatible duties of holding undistributed checks and controlling the applicable general ledger account should be segregated.

Auditee Response and Corrective Action Plan dated June 11, 2003: The Director of Treasury will separate the incompatible functions cited in your audit. The Treasury personnel will prepare the necessary reconciliations and Finance and Accounting personnel will reconcile such with the general ledger balance.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Maintenance of Accounts Payable Subsidiary Ledgers

Finding No. 01-13

Criteria: The accounts payable subsidiary ledger should be periodically reconciled with the general ledger control account, should be reviewed for possible erroneous items and should be periodically reconciled to underlying source payable information.

Condition: The accounts payable has not been periodically reconciled with the general ledger control account, has not been reviewed for possible erroneous items and has not been periodically reconciled to underlying source payable information.

Cause: The cause of this condition appears to be the absence of specific policies and procedures that would guide the reconciliation effort.

Effect: The effect of this condition is that material errors could exist and go undetected as related to accounts payable.

Recommendation: The State should initiate and implement policies and procedures that require the periodic reconciliation of the general ledger control account, require the periodic review for erroneous items require the periodic matching of accounts payable subsidiary ledger balances with underlying vendor statements.

Auditee Response and Corrective Action Plan dated June 11, 2003: We believe that to some degree, our problem is a system related one and we have not had the necessary technical support for the FOCUS system over the past several years. We, working through working with the auditors, have commenced our standard practice of reviewing detail accounts payable and removing erroneous balances. However, such is being removed from the general ledger and not from the subsidiary, due to the aforementioned problem. We will continue to seek assistance from the FSM National Government Secretary or Finance who is also responsible for our FOCUS system.

**CHUUK STATE GOVERNMENT
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Maintenance of Encumbrance Detailed Listings

Finding No. 01-14

Criteria: The detailed encumbrance subsidiary ledger should be periodically reconciled with the general ledger control account, reviewed for possible erroneous items and periodically reconciled to underlying source encumbrance documents.

Condition: The detailed encumbrance subsidiary ledger has not been periodically reconciled with the general ledger control account, has not been periodically reviewed for erroneous items and has not been periodically matched with underlying source encumbrance documents. However, this exercise was undertaken to some extent to satisfy audit requirements. We additionally noted that certain 2000 encumbrances were not carried forward in to the 2001 subsidiary ledger.

Cause: The cause of this condition is the procedures have not been implemented to require compliance with the criteria.

Effect: The effect of this condition is the possibility that material misstatements may exist and be undetected in the general purpose financial statements.

Recommendation: Policies and procedures should be implemented to ensure that compliance with the criteria occurs. If an encumbrance is not carried forward in to the succeeding year, the reasons therefore should be documented and the applicable encumbrance should be essentially cancelled.

Auditee Response and Corrective Action Plan dated June 11, 2003: Our response and corrective action plan parallels that of finding 13 as the same issues are involved. Since the process we went through in the 2001 audit, we have continued our review of encumbrance detail to ensure that incorrect balances are eliminated. However, the reconciliation process is being hampered due to the conditions specified above. Therefore, again, we must obtain programming assistance related to our FOCUS system from the National Government.

**CHUUK STATE GOVERNMENT
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Implementation of GAS 34

Finding No. 01-15

Criteria: The provisions of GAS 34 should be implemented in fiscal year 2003. The provisions include capitalization and depreciation of all long-lived assets, including infrastructure, MD & A requirements, significant footnote changes, among others.

Condition: The State has not made substantive progress in detailing an inventory of capital assets, inclusive of infrastructure, to allow for the financial presentation required by GAS 34.

Cause: The cause of this condition is that the State has yet to assign duties and responsibilities associated with compliance with GAS 34 requirements.

Effect: The effect of this condition is the potential inability of the State of Chuuk to conform to the GAS 34 presentation and disclosure requirements.

Prior Year Status: The absence of an inventory of capital assets, including noncompliance with equipment and real property management, was reported as a finding in prior year Single Audit reports.

Recommendation: The State should detail an action plan to allow for the timely implementation of GAS 34 requirements. If insufficient resources exist in the State to formulate and implement such a plan, the resources should be obtained through outside sources.

Auditee Response and Corrective Action Plan dated June 11, 2003: We have requested that this matter be directed by the FSM National Government since it affects all States equally. We are hopeful that the Secretary of Finance has opened communication to obtain necessary technical assistance from OIA or elsewhere. Therefore, we are aware of this problem, but inventorying and costing our infrastructure is an issue that we will require assistance on.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Timeliness of Investment Information

Finding No. 01-16

Criteria: Investment results should be obtained in a timely manner to allow for correct presentation in the general purpose financial statements.

Condition: Financial investment results for fiscal year 2001 were obtained in September, 2002.

Cause: The cause of this condition is the non-timely receipt of financial information from the FSM National Government.

Effect: The effect of this condition a delay in the determination of the State's financial position.

Recommendation: Financial information should be obtained in a timely manner. If such is not the case, the State should take whatever means necessary to allow for obtaining such information.

Auditee Response and Corrective Action Plan dated June 11, 2003: We concur and believe that this finding should be directed to the Secretary of Finance since the National Government bears responsibility for the accounting for investments through the FDA.

**CHUUK STATE GOVERNMENT
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Appropriations in Excess of Estimated Revenues

Finding No. 01-17

Criteria: Appropriations should not exceed estimated revenues and estimated revenues should be based on a balance reasonably related to actual revenues.

Condition: During fiscal year 2001, estimated revenues appear to have exceeded actual revenues by some \$13 million. Actual revenues were less than expenditures by approximately \$8.1 million.

Cause: The cause of this condition appears to be that estimated revenues did not correlate with actual revenues.

Effect: The effect of this condition is an approximate \$8.1 million increase in the deficit. We note that a portion of this condition may be attributable to the \$3.1 million investment loss experienced in 2001 (versus investment income of \$3.6 million in 2000). Additionally, appropriations were not made to cover the State's obligation under the Early Retirement Loan. As a result, the deficit in 2001 also increased by \$2,265,000 for this obligation.

Recommendation: The State should ensure that estimated revenues do not materially exceed actual revenues. The State should consider establishing an independent commission comprised of executive and legislative branch members and private citizen groups, such as the Chamber of Commerce, to establish the estimated revenue ceiling.

The State should also review its procedures for the issuance of allotments as no expenditures, even if appropriated, can be incurred without an allotment.

Auditee Response and Corrective Action Plan dated June 11, 2003: This matter has been broached with the Governor and the Legislature and is being considered. We are hopeful that through these discussions, a better method of tracking and estimating revenues will result.

**CHUUK STATE GOVERNMENT
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Computer Systems Support

Finding No. 01-18

Criteria: Computer systems utilized should be maintained in an appropriate manner.

Condition: The accounting systems utilized by the State of Chuuk appear to be supported by an adjunct of the National Government. State management has gone on record expressing assistance to resolve various technical matters that have resulted in account imbalances, subledger variances when compared with general ledger totals, and other matters of concern involving payroll and other accounting systems. No response to the State's requests has been forthcoming through the conclusion of our audit fieldwork.

Cause: The cause of this condition appears to be inadequate levels of assistance from the State's service provider.

Effect: The effect of this condition is the potential for material errors in the State's financial statements.

Recommendation: The State should ensure that it receives the required systems support. Otherwise, the State should explore an alternative provider.

Auditee Response and Corrective Action Plan dated June 11, 2003: The programming aspect of the FOCUS system is controlled by the National Government. We have requested assistance repeatedly from the Secretary of Finance to no avail. We therefore believe that this finding should be directed to the National Government.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Leases Payable

Finding No. 01-19

Criteria: Leases payable should be appropriately recorded in the financial statements.

Condition: The State is party to numerous leases. A summary of the lease terms and conditions has not been provided for inclusion in the general purpose financial statements, if required.

Cause: The documentation has not been provided Finance to allow consideration of required accounting adjustments and disclosures, if applicable.

Effect: The effect of this condition is a qualification of the State's general purpose financial statements.

Recommendation: The applicable lease information should be furnished Finance to allow for appropriate disclosure and accounting in the general purpose financial statements.

Auditee Response and Corrective Action Plan dated June 11, 2003: The Director of Treasury will communicate with the Director of Land Management to determine the issue. We understand that there has been a lot of turnover in the department and that could be hampering the State's ability to prepare an appropriate inventory of all leases. We cannot commit to a specific timetable for corrective action until we determine the root issue and therefore, we will ask that you again look at this matter in the 2002 audit.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Chuuk State Housing Authority (CSHA) – Accounting for Loans

Finding No. 01-20

Criteria: CSHA should possess an accounting system that accounts for its financial activities and its loans in a complete and timely manner.

Condition: The CSHA employs a manual system of accounting that is prone to error that does not account for its activities in a timely manner. Additionally, the system does not facilitate timely communication of transaction histories with borrowers

Cause: The CSHA has not made an investment in its accounting system.

Effect: The effect of this condition is untimely and inaccurate financial information is being produced.

Prior Year Status: The above condition was reported as a finding in the Single Audit of Chuuk State Government for the fiscal year ended September 30, 2000.

Recommendation: The CSHA should consider alternative accounting systems. Alternatives could be a stand-alone system, contracting out the maintenance of the loan subsidiary ledgers or some combination of the two.

Auditee Response and Corrective Action Plan: Previously, CSHA had purchased an accounting program (PeachTree) from a vendor and at the time contracted the vendor to conduct training for CSHA employees on the use of the program. Unfortunately, the contractor only conducted one training session and one of the employees is able to be familiar with the use and features of the program. I am confident that if enough training hours are provided we could be able to utilize the program.

I have already approach some individuals who could at least recommend and conduct trainings on a loan program in addition to the accounting program that is already installed. We hope that the date needed for FY '01 audit could be entered on such programs to make the next year easier.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Chuuk State Housing Authority (CSHA) – Collection of Loans Receivable

Finding No. 01-21

Criteria: CSHA management is charged with the responsibility of collecting loans receivable.

Condition: It is evident that more and more borrowers are discontinuing allotments and are not repaying their loans. However, the CSHA has not initiated foreclosure proceedings and has not otherwise aggressively utilized remedies set forth in the loan agreements to ensure collection.

Cause: The cause of this condition is unknown.

Effect: The effect of this condition is that inadequate cash flows result, which prevents the financing of additional loans.

Prior Year Status: The above condition was reported as a finding in the Single Audit of Chuuk State Government for the fiscal year ended September 30, 2000.

Recommendation: The CSHA management should aggressively take steps to ensure collection of loans and document those steps that it will take to achieve this end.

Auditee Response and Corrective Action Plan: CSHA management is mindful of the non-payment of loans. The Early Retirement Program has contributed to the high delinquent rate due to the fact that people are immigrating to the U.S. and its territories. At any rate, we are not neglecting this obligation but aggressively making collections and compile enough documents to be used as evidence in legal proceedings including foreclosures.

**CHUUK STATE GOVERNMENT
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Chuck State Housing Authority (CSHA) – FMHA Deed of Trust Agreement

Finding No. 01-22

Criteria: Loan guarantees are to be disclosed by the CSHA in its financial statements and depending on the condition of the underlying loans, provision for an allowance for doubtful loans should be made in the financial statements.

Condition: The CSHA management is not receiving adequate information under the FMHA Deed of Trust Agreement to make the necessary disclosure and adjustment in its financial statements, if required.

Cause: The cause of this condition is that the necessary information has not been requested or obtained from the FMHA office in Chuuk.

Effect: The effect of this condition is that inadequate provisions may be made in the CSHA financial statements.

Prior Year Status: The above condition was reported as a finding in the Single Audit of Chuuk State Government for the fiscal year ended September 30, 2000.

Recommendation: We recommend that the aforementioned information be obtained from the FMHA office on at least a semi-annual basis.

Auditee Response and Corrective Action Plan: CSHA management will take this recommendation that periodic information on loan guarantee is to be acquired from FMHA in order to reflect accurate adjustments on its financial statements.

**CHUUK STATE GOVERNMENT
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2001

Reconciliation of Personnel Action Forms and Payroll Rates Applied

Finding No. 01-23

Criteria: Pay rates recorded in the system should agree with rates specified on personnel action files.

Condition: As in the prior year, certain instances were noted where differences existed between the pay rates set up in the system and rates per the applicable personnel action form. We note however that the State made improvement with respect to this condition in fiscal year 2001 as the number of exceptions was substantially lower than in fiscal year 2000.

Cause: The cause of this condition appears to be the speed with which pay increments are formalized in revised personnel action forms.

Effect: There does not appear to be a material effect of the financial statements as a result of this condition.

Prior Year Status: This finding was present in the 2000 Single Audit Report.

Recommendation: The State should review the timeframe in which personnel action forms are updated and ensure that such forms coincide with system pay rates.

Auditee Response and Corrective Action Plan dated June 11, 2003: We agree that we have made much improvement in this area and believe that such is a coordination issue with the Personnel Office. PAF's are processed slowly; and we have not instituted a tracking system to determine and reach resolution concerning the differences noted in the audit process. However, based on your finding, it is evident that corrective action has been occurring and we will continue to make improvements in this area.

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Resolution of Prior Years' Findings and Questioned Costs
Year Ended September 30, 2001

For the year ended September 30, 2001, the following questioned costs were noted and prior questioned costs resolved:

	Questioned Costs Set Forth in Prior Audit Report <u>2000</u>	Questioned Costs Resolved in Fiscal Year <u>2001</u>	Questioned Costs at <u>September 30, 2001</u>
Unresolved Questioned Costs FY 97	\$ 16,125	\$ -	\$ 16,125
Unresolved Questioned Costs FY 98	54,882	-	54,882
Unresolved Questioned Costs FY 99	28,619	-	28,619
Unresolved Questioned Costs FY 00	301,889	-	301,889
Unresolved Questioned Costs FY 01	<u>-</u>	<u>-</u>	<u>369,497</u>
	\$ <u>401,515</u>	\$ <u>-</u>	\$ <u>771,012</u>