

**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, 2002

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA
YEAR ENDED SEPTEMBER 30, 2002**

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FEDERATED STATES OF MICRONESIA**

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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, 2002

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 Chuuk State Government (the State), as set forth in Section II of the foregoing table of contents, as of September 30, 2002, and for the year then ended. These general purpose financial statements are the responsibility of the management of the State. 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.

The accompanying general purpose financial statements do not include the State's development authorities, Governmental Fund Type – Special Revenue Funds, the Chuuk Coconut Authority, a Component Unit – Proprietary Fund, the Chuuk Public Utility Corporation, a Component Unit – Proprietary Fund, the Chuuk State Housing Authority, a Component Unit – Proprietary Fund, and the Chuuk Public Fisheries Corporation, a Component Unit – Proprietary Fund, which in our opinion, should be included to conform with accounting principles generally accepted in the United States of America. The entities comprising these material omitted funds were not able to produce financial statements and the effect on the general purpose financial statements is unknown.

The State has excluded its obligations for land leases from General Fund liabilities and its obligations for land acquisitions from the General Long-Term Debt Account Group. In our opinion, accounting principles generally accepted in the United States of America require that such obligations be included in the combined balance sheet. The effects of those departures on the general purpose financial statements are not determinable.

Because of the inadequacies in the accounting records, we were unable to determine that fixed assets and fund equity of the General Fixed Assets Account Group were fairly stated as of September 30, 2002. Accordingly, a statement of changes in general fixed assets has not been included within the accompanying general purpose financial statements.

Because of inadequacies in the accounting records, we were unable to determine that the reserve for continuing appropriations of the Governmental Fund Type – Capital Projects Fund was fairly stated as of September 30, 2002.

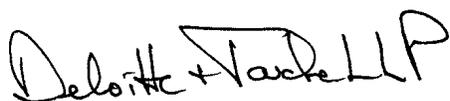
Because of inadequacies in the accounting records, we were unable to determine that advances of the Governmental Fund Type – General Fund and interfund receivables/payables of the Governmental Fund Types were fairly stated as of September 30, 2002.

We were unable to obtain audited financial statements supporting the State's investment in Chuuk Fresh Tuna, Incorporated, recorded in the Governmental Fund Type - Capital Projects Funds at September 30, 2002, as described in note 9 to the general purpose financial statements. The State 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: 1) obligations for land leases and land acquisitions been included in liabilities of the Governmental Fund Type – General Fund and the General Long-Term Debt Account Group; 2) the propriety of fixed assets and fund equity of the General Fixed Assets Account Group been determinable; 3) the propriety of the reserve for continuing appropriations of the Governmental Fund Type – Capital Projects Fund been determinable; 4) the propriety of advances of the Governmental Fund Type – General Fund and interfund receivables/payables of the Governmental Fund Types been determinable; 5) we been able to obtain sufficient evidence regarding the investment in, and equity in the earnings of, Chuuk Fresh Tuna, Incorporated, as discussed in the fourth through eighth paragraphs above; and, 6) except for the effects of the omission of the State's development authorities, the Chuuk Coconut Authority, the Chuuk Public Utility Corporation, the Chuuk State Housing Authority, and the Chuuk Public Fisheries Corporation, as discussed in the third paragraph 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 matter set forth in the fifth paragraph, present fairly, in all material respects, the financial position of the Chuuk State Government as of September 30, 2002, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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 Chuuk State Government, are presented for purposes of additional analysis and are not a required part of the general purpose financial statements of the State. Such additional information has been subjected to the auditing procedures applied in our audit of the general purpose financial statements and, except for the effect of the matters described in the fourth through eight paragraphs above, and the omissions discussed in the third paragraph, 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 November 1, 2004, on our consideration of the State of Chuuk's (primary Government only) internal control over financial reporting and our tests of its compliance and other matters. The purpose of that report is to describe the scope of our testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.



November 1, 2004

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Combined Balance Sheet - All Fund Types and Account Groups
September 30, 2002
(With Comparative Totals as of September 30, 2001)

<u>Assets</u>	Governmental Fund Types			Account Groups		Total Primary Government (Memorandum Only)	Totals Reporting Entity (Memorandum Only)	
	General	Special Revenue	Capital Projects	General Fixed Assets	General Long-Term Debt		2002	2001
Cash and cash equivalents	\$ 802,793	\$ -	\$ -	\$ -	\$ -	\$ 802,793	\$ 802,793	\$ 779,808
Restricted cash	4,150,440	-	-	-	-	4,150,440	4,150,440	-
Investments	-	-	14,107,730	-	-	14,107,730	14,107,730	8,695,774
Early Retirement Trust Fund	-	-	-	-	-	-	-	4,062,348
Investments - other	-	-	3,675,505	-	-	3,675,505	3,675,505	3,675,505
Receivables from other governments	-	766,561	-	-	-	766,561	766,561	1,270,260
General receivables, net	687,107	41,959	-	-	-	729,066	729,066	1,151,626
Advances	553,470	-	-	-	-	553,470	553,470	415,483
Loans receivable	-	-	-	-	-	-	-	1,313,246
Loans receivable, other	2,817,713	-	-	-	-	2,817,713	2,817,713	2,817,718
Due from other funds	753,885	4,763,377	1,695,063	-	-	7,212,325	7,212,325	4,786,318
Other assets	-	-	-	-	-	-	-	29,170
Fixed assets, net	-	-	-	67,581,884	-	67,581,884	67,581,884	78,870,864
Amount to be provided for retirement of long-term debt	-	-	-	-	12,410,836	12,410,836	12,410,836	12,560,836
 Total assets	 <u>\$ 9,765,408</u>	 <u>\$ 5,571,897</u>	 <u>\$ 19,478,298</u>	 <u>\$ 67,581,884</u>	 <u>\$ 12,410,836</u>	 <u>\$ 114,808,323</u>	 <u>\$ 114,808,323</u>	 <u>\$ 120,428,956</u>

See accompanying notes to financial statements.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Combined Balance Sheet - All Fund Types and Account Groups, Continued
September 30, 2002
(With Comparative Totals as of September 30, 2001)

	Governmental Fund Types			Account Groups		Total Primary Government (Memorandum Only)	Totals Reporting Entity (Memorandum Only)	
	General	Special Revenue	Capital Projects	General Fixed Assets	General Long-Term Debt		2002	2001
Liabilities and Fund Equity (Deficiency)								
Liabilities:								
Bank overdraft	\$ 2,961,513	\$ -	\$ -	\$ -	\$ -	\$ 2,961,513	\$ 2,961,513	\$ 925,438
Accounts payable	6,501,219	2,374,422	3,950,898	-	-	12,826,539	12,826,539	12,749,656
Accrued payroll and annual leave	-	4,293	-	-	829,208	833,501	833,501	1,794,671
Due to other funds	6,457,542	753,885	-	-	-	7,211,427	7,211,427	4,786,318
Payable to other governments	33,386	-	-	-	-	33,386	33,386	-
Notes payable	4,296,754	-	329,179	-	5,128,335	9,754,268	9,754,268	13,210,746
Claims payable	-	-	-	-	6,453,293	6,453,293	6,453,293	6,603,293
Deferred revenue	1,000	-	-	-	-	1,000	1,000	51,000
Total liabilities	20,251,414	3,132,600	4,280,077	-	12,410,836	40,074,927	40,074,927	40,121,122
Commitments and contingencies								
Fund equity (deficiency):								
Investment in general fixed assets	-	-	-	67,581,884	-	67,581,884	67,581,884	67,581,884
Retained earnings	-	-	-	-	-	-	-	9,091,591
Fund balances (deficit):								
Reserved for:								
Related assets	7,142,899	-	3,675,505	-	-	10,818,404	10,818,404	10,124,905
Encumbrances	370,970	187,637	1,093,393	-	-	1,652,000	1,652,000	2,185,486
Continuing appropriations	108,766	-	10,429,323	-	-	10,538,089	10,538,089	3,766,532
Unreserved	(18,108,641)	2,251,660	-	-	-	(15,856,981)	(15,856,981)	(12,442,564)
Total fund equity (deficiency)	(10,486,006)	2,439,297	15,198,221	67,581,884	-	74,733,396	74,733,396	80,307,834
Total liabilities and fund equity (deficiency)	\$ 9,765,408	\$ 5,571,897	\$ 19,478,298	\$ 67,581,884	\$ 12,410,836	\$ 114,808,323	\$ 114,808,323	\$ 120,428,956

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, 2002
(With comparative totals for the year ended September 30, 2001)

	Governmental Fund Types			Totals Reporting Entity (Memorandum Only)	
	General	Special Revenue	Capital Projects	2002	2001
Revenues:					
U.S. Compact of Free Association:					
Section 211(a)(2) - base grant	\$ 11,093,467	\$ 2,730,000	\$ 7,731,200	\$ 21,554,667	\$ 14,960,000
Section 217 - inflation adjustment	6,434,210	-	4,484,096	10,918,306	8,377,600
Section 221(b) - base grant	-	-	-	-	2,730,000
Section 216(a)(2) - base grant	-	461,087	-	461,087	461,087
Section 214(c) - base grant	-	1,400,638	-	1,400,638	949,800
Section 217 - inflation adjustment	-	-	-	-	671,888
Section 212 - base grant	-	368,667	-	368,667	250,000
FSM revenue sharing	2,878,990	-	-	2,878,990	4,319,588
Federal contributions	-	1,307,128	-	1,307,128	1,086,816
State taxes and licenses	1,477,823	-	-	1,477,823	1,975,695
Other	740,273	554,190	-	1,294,463	2,654,962
Net decrease in the fair value of investments	(1,165,534)	-	-	(1,165,534)	(3,097,561)
Total revenues	<u>21,459,229</u>	<u>6,821,710</u>	<u>12,215,296</u>	<u>40,496,235</u>	<u>35,339,875</u>
Expenditures:					
Education	5,615,743	2,681,188	-	8,296,931	8,226,812
Public works and utilities	427,505	118,071	6,200,178	6,745,754	8,056,458
General government	5,859,889	442,676	-	6,302,565	8,292,658
Legislative appropriations	4,456,709	-	-	4,456,709	2,913,935
Health services	2,954,681	1,221,425	-	4,176,106	6,075,258
Public safety	1,288,278	71,269	-	1,359,547	1,468,402
Economic development	1,079,251	-	-	1,079,251	1,089,741
Interest and penalties on tax lien	943,555	-	-	943,555	-
Boards and commissions	837,410	-	-	837,410	959,409
Transportation	761,646	-	-	761,646	919,020
Special programs	429,977	-	-	429,977	2,250,437
Community affairs	247,232	-	-	247,232	876,595
Early retirement program	60,303	-	-	60,303	98,367
Debt service - principal	-	-	-	-	2,918,173
Acquisition of equipment	-	-	-	-	2,825,017
Loss on investment	-	-	-	-	388,500
Chuuk recovery loan	-	-	-	-	292,444
Other	-	543,766	-	543,766	46,098
Total expenditures	<u>24,962,179</u>	<u>5,078,395</u>	<u>6,200,178</u>	<u>36,240,752</u>	<u>47,697,324</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(3,502,950)</u>	<u>1,743,315</u>	<u>6,015,118</u>	<u>4,255,483</u>	<u>(12,357,449)</u>
Other financing sources (uses):					
Operating transfers in	300,000	-	-	300,000	-
Operating transfers out	(208,330)	(830,000)	-	(1,038,330)	(1,153,866)
Total other financing sources (uses), net	<u>91,670</u>	<u>(830,000)</u>	<u>-</u>	<u>(738,330)</u>	<u>(1,153,866)</u>
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	<u>(3,411,280)</u>	<u>913,315</u>	<u>6,015,118</u>	<u>3,517,153</u>	<u>(13,511,315)</u>
Fund balances (deficit) at beginning of year	<u>(7,074,726)</u>	<u>1,525,982</u>	<u>9,183,103</u>	<u>3,634,359</u>	<u>17,145,674</u>
Fund balances (deficit) at end of year	<u>\$ (10,486,006)</u>	<u>\$ 2,439,297</u>	<u>\$ 15,198,221</u>	<u>\$ 7,151,512</u>	<u>\$ 3,634,359</u>

See accompanying notes to financial statements.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures and Changes in Deficit -
Budget and Actual, Budgetary Basis - General Fund
Year Ended September 30, 2002

(With comparative totals for the year ended September 30, 2001)

	2002			2001		
	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)
Revenues:						
Compact of Free Association						
Section 211 and 217	\$ 17,310,216	\$ 17,527,677	\$ 217,461	\$ 13,752,960	\$ 13,752,960	\$ -
Local revenue	9,315,960	5,097,086	(4,218,874)	18,159,763	7,967,196	(10,192,567)
Net decrease in fair value of investments	-	(1,165,534)	(1,165,534)	-	(3,097,561)	(3,097,561)
Total revenues	<u>26,626,176</u>	<u>21,459,229</u>	<u>(5,166,947)</u>	<u>31,912,723</u>	<u>18,622,595</u>	<u>(13,290,128)</u>
Expenditures-budgetary basis:						
General government	5,945,267	5,627,052	318,215	6,580,431	7,349,332	(768,901)
Health services	3,101,158	2,937,293	163,865	2,713,614	2,861,689	(148,075)
Education	5,823,400	5,601,528	221,872	5,672,451	5,628,061	44,390
Economic development	1,076,150	1,072,394	3,756	1,087,162	1,087,277	(115)
Public safety	1,247,658	1,286,185	(38,527)	1,174,556	1,269,330	(94,774)
Transportation	763,704	759,951	3,753	917,775	915,065	2,710
Public works and utilities	409,652	427,505	(17,853)	414,101	368,243	45,858
Community affairs	258,213	239,764	18,449	202,519	203,604	(1,085)
Board and commissions	812,724	811,350	1,374	941,937	930,822	11,115
Acquisition of equipment	-	-	-	-	371,528	(371,528)
Interest and penalties on tax lien	-	943,555	(943,555)	-	-	-
Special programs	422,132	444,636	(22,504)	-	2,177,796	(2,177,796)
Legislative appropriations	4,197,914	4,127,547	70,367	7,841,407	3,081,764	4,759,643
Early retirement	-	60,303	(60,303)	975,200	98,367	876,833
Chuuk recovery loan accrual	-	-	-	635,680	292,444	343,236
Total expenditures	<u>24,057,972</u>	<u>24,339,063</u>	<u>(281,091)</u>	<u>29,156,833</u>	<u>26,635,322</u>	<u>2,521,511</u>
Excess (deficiency) of revenues over (under) expenditures	<u>2,568,204</u>	<u>(2,879,834)</u>	<u>(5,448,038)</u>	<u>2,755,890</u>	<u>(8,012,727)</u>	<u>(10,768,617)</u>
Other financing sources (uses):						
Operating transfers in	-	300,000	300,000	-	-	-
Operating transfers out	(197,600)	(200,938)	(3,338)	(152,800)	(159,523)	(6,723)
Total other financing sources (uses), net	<u>(197,600)</u>	<u>99,062</u>	<u>296,662</u>	<u>(152,800)</u>	<u>(159,523)</u>	<u>(6,723)</u>
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	<u>2,370,604</u>	<u>(2,780,772)</u>	<u>(5,151,376)</u>	<u>2,603,090</u>	<u>(8,172,250)</u>	<u>(10,775,340)</u>
Deficit at beginning of year	(14,602,980)	(14,602,980)	-	(4,195,287)	(4,195,287)	-
Other changes in deficit:						
Increase in reserve for related assets	-	(693,499)	(693,499)	-	(2,264,942)	(2,264,942)
Decrease in reserve for continuing appropriations	-	(31,390)	(31,390)	-	29,499	29,499
Deficit at end of year	<u>\$ (12,232,376)</u>	<u>\$ (18,108,641)</u>	<u>\$ (5,876,265)</u>	<u>\$ (1,592,197)</u>	<u>\$ (14,602,980)</u>	<u>\$ (13,010,783)</u>

See accompanying notes to financial statements

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(1) Summary of Significant Accounting Policies

The general purpose financial statements of the Chuuk State Government (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 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 Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The State 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 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 government's 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 Visitor's 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 the State'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 State Legislature. The Bureau is reported as a special revenue fund.

2. Omitted Component Units

Development Authorities

The accompanying general purpose financial statements do not include the State's development authorities, Governmental Fund Types - Special Revenue Funds. The majority of these entities do not present financial information concerning their operations, thus precluding presentation of financial statements for these funds.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

2. Omitted Component Units, Continued

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 the Chuuk State Government.

Chuuk State Public Utility Corporation

Chuuk State Public Utility Corporation (the Corporation), a Component Unit – Proprietary Fund, 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.

Chuuk Public Fisheries Corporation

The Corporation, a Component Unit – Proprietary Fund, 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.

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 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 the Chuuk State Government.

B. Fund Accounting and Basis of Presentation

The State 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 State functions or activities.

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

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(1) Summary of Significant Accounting Policies, Continued

B. Fund Accounting and Basis of Presentation, Continued

In the accompanying general purpose financial statements, the State's funds are classified into one category: governmental fund. In turn, the governmental fund is divided into separate "fund types."

Governmental funds are used to account for all or most of a 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 other funds.

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

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current 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. The State considers all revenues available if they are collected within 60 days after year end.

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.

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.

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.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(1) Summary of Significant Accounting Policies, Continued

C. Budgetary Process, Continued

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 the 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 fund deficit section of that statement.

The 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 Cash Equivalents

Cash and cash 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.

Restricted cash includes \$3,701,240 held in a joint fund with the FSM National Government to repay certain Early Retirement Program debt. Additionally, cash accounts of \$449,200 are held by the FSM National Government to liquidate certain payroll related and Compact Capital liabilities.

E. Receivables

Receivables primarily consist of taxes and federal revenues and are stated net of estimated allowances for uncollectible accounts.

F. 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).

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(1) Summary of Significant Accounting Policies, Continued

F. Interfund Transactions, Continued

3. The majority of the State's financial operations are centrally administered, and this administration is facilitated by the use of a "pooled" cash account; for practical purposes, cash is primarily maintained in a single bank account which is considered to be an asset of the State's general fund.

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

G. Compensated Absences

Vested or accumulated vacation leave that is expected to be liquidated with expendable available financial resources is reported as an expenditure and a fund liability. 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, 2002 is \$829,208. No expenditure is reported for these amounts. No liability is recorded for nonvesting accumulating rights to receive sick pay benefits.

H. 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.

I. 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.

J. Investments

Investments are carried at fair value. Fair value is the amount at which an investment could be exchanged in a current transaction between willing parties. 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.

K. Estimates

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

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(1) Summary of Significant Accounting Policies, Continued

L. New Accounting Standards

In fiscal year 2003, the State will implement GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments* as subsequently amended by Statement No. 37, *Basic Financial Statements – and Management’s Discussion and Analysis – For State and Local Governments: Omnibus* and Statement No. 38, *Certain Financial Statement Note Disclosures*. For fiscal year 2004, the State will be implementing GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units* and GASB Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3)*. For fiscal year 2005, the State will be implementing GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. The State has not evaluated the financial statement impact of the implementation of GASB Statement Nos. 34, 37, 38, 39, 40 and 42.

(2) Cash and Cash Equivalents and Investments

Cash and Cash Equivalents

The State considers cash and cash 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 does not require collateralization of its bank accounts. Therefore \$300,000 is subject to FDIC insurance with the remaining balance being uncollateralized.

Investments

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

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

- A. Investment managers may invest in stocks, bonds and cash equivalents. Minimum standards of quality for investments at the time of purchase shall be:
1. Stocks - A "B" rating by a national rating service. Non-rated stocks such as banks or insurance companies must be equal in quality or higher.
 2. Bonds - Confined to issues rated "A" or higher by a national rating service, except in the case of U.S. Treasury or Agency Securities which are not rated.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(2) Cash and Cash Equivalents and Investments, Continued

Investments, Continued

3. Cash and cash 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 Moody's 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.

GASB Statement No. 3 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, 2002, are summarized below:

<u>Investments</u>	
Pooled investment debt and equity securities	\$ <u>14,107,730</u>

The State's investment loss as of September 30, 2002, is summarized below:

Interest	\$ 597,952
Dividends	87,254
Realized losses, net	(1,061,701)
Unrealized losses, net	(291,181)
Management fees/other expenses	<u>(141,758)</u>
	(809,434)
Unrealized losses on Early Retirement Trust account	(419,107)
Other	<u>63,007</u>
	\$ <u>1,165,534</u>

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(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

The State did not update the balances in the General Fixed Assets Account Group during fiscal year 2002.

A summary of general fixed assets accounted for in the General Fixed Assets Account Group as of September 30, 2002, 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>

(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, 2002, 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

Chuuk Recovery Loan:

During the fiscal year ended September 30, 1999, the State and the FSM National Government entered into a loan agreement whereby the FSM National Government agreed to loan the State 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. As of September 30, 2002, the balance outstanding under the loan is \$1,479,041, which includes related interest payable. The loan is delinquent and is classified as a current liability of the General Fund.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(5) Notes Payable, Continued

General Long-Term Debt Account Group, Continued

Early Retirement Program:

During the fiscal year ended September 30, 1998, the State 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 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 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, 2002. 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 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, 2002 was \$5,128,335.

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

Continuing appropriations are summarized as follows:

General Fund

Each fiscal year, the State Legislature appropriates funds for various programs, municipal projects and other projects which are available until fully expended or until project completion. \$ 108,766

Capital Projects

Each fiscal year, the State Legislature appropriates funds towards Capital Projects and Economic Development Projects. These funds are available until fully expended or project completion. \$ 10,429,323

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(7) Operating Transfers In/Out

Operating transfers in/out for the year ended September 30, 2002, are as follows:

	<u>Transfers Out</u>	<u>Transfers In</u>
General Fund:		
From General Fund to:		
Chuuk State Housing Authority (CSHA)	\$ 100,983	\$ -
Chuuk Coconut Authority (CCA)	107,347	-
To General Fund from:		
Chuuk Fisheries Corporation (CFC)	-	300,000
	<u>\$ 208,330</u>	<u>\$ 300,000</u>
Special Revenue Funds:		
From Compact Other Grants Fund to:		
Chuuk Public Utility Corporation	\$ <u>830,000</u>	\$ <u>-</u>

The \$300,000 transfer in resulted from insurance proceeds stemming from the loss of the sole CFC fishing vessel.

Neither CSHA, CCA or CPUC are presented in the accompanying general purpose financial statements and therefore, operating transfers in and out on a combined basis will not balance.

(8) Interfund Assets/Liabilities

The following summarizes due from/to other funds as of September 30, 2002:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Federal Grant Assistance	\$ 360,667
	CFMSM Grant	393,218
Chuuk Airport Authority	General	875,997
Compact – Other Grants		1,300,862
Compact – Special Block Grant		2,586,518
Compact Capital Projects		<u>1,695,063</u>
		<u>\$ 7,212,325</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 1989 and fiscal year 1990. This represents an equity interest of 16.08% as of September 30, 2002. 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% equity interest at September 30, 2002). The above investment is carried at cost since there is no method of ascertaining related value.

250,000

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(9) Investments – Other, Continued

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 equity interest of 50% as of September 30, 2002. Under the equity method of accounting, which has been adopted for the State's investment in Chuuk Fresh Tuna, Incorporated (CFTI), the 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, 2002 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% equity interest as of September 30, 2002. 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

During fiscal year 1996, the State purchased \$300,000 of common stock in the FSM Development Bank (an equity interest of approximately 1% at September 30, 2002). The above investment is carried at cost since there is no method of ascertaining related value. 300,000

Total other investments \$ 3,675,505

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.

(10) Commitments and Contingencies

Federal Programs

The State participates in a number of U.S. federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Currently, \$794,096 in cumulative questioned costs exist for fiscal years 1997 through 2002 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.

Additionally, the 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.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(10) Commitments and Contingencies, Continued

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, 2002, was \$3,432,113.

Pending Litigation and Other Matters

The State 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 is approximately \$6.45 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 as claims payable in the General Long-Term Debt Account Group. Additionally, the State's Attorney General indicates that pending cases and other claims against the State exist at September 30, 2002 in the amount of approximately \$5.4 million. Due to an inability to predict the ultimate outcome of these matters, no provision for these liabilities has been made in the accompanying financial statements.

(11) Fund Deficits

The following represents material fund deficits as of September 30, 2002. If operation of these funds cannot cover prior losses, the State's General Fund may have to absorb these amounts or a portion thereof:

General Fund	\$ <u>10,486,006</u>
Special Revenue Funds:	
CFSM Grant Fund	\$ <u>143,305</u>

(12) Loans Receivable - Related Parties

At September 30, 2002, the State had an outstanding loan of \$2,817,713 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.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(13) Fund Balances Reserved For Related Assets

Fund balance reserves for related assets are comprised of the following as of September 30, 2002:

	General <u>Fund</u>	Capital Projects <u>Funds</u>
Early Retirement Trust Fund	\$ 5,128,355	\$ -
Revenue share – 20%	1,284,925	-
Receivables	670,527	-
Investments – other	-	3,675,505
Other	<u>59,092</u>	<u>-</u>
	\$ <u>7,142,899</u>	\$ <u>3,675,505</u>

(14) Risk Management

The State does not purchase commercial insurance to cover its potential risks and 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.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Combining Schedule of Expenditures by Account-
All Governmental Fund Types
Year Ended September 30, 2002
(With comparative totals for the year ended September 30, 2001)

	Governmental Fund Types			Totals (Memorandum Only)	
	General	Special Revenue	Capital Projects	2002	2001
Expenditures:					
Personnel	\$ 17,735,315	\$ 1,796,233	\$ 170,101	\$ 19,701,649	\$ 18,611,282
Travel	355,515	103,599	7,051	466,165	1,325,902
Contractual services	2,240,299	1,013,224	4,274,427	7,527,950	4,256,543
POL	-	-	-	-	183,546
Equipment	-	-	-	-	446,559
Medical supplies	-	-	-	-	338,851
Medical referral	-	-	-	-	300
Supplies and materials	-	-	-	-	710,563
Scholarships	-	-	-	-	151,441
Food	-	-	-	-	399,750
Books	-	-	-	-	2,256
All others	3,447,537	2,097,253	1,592,663	7,137,453	14,859,247
Debt service-principal	-	-	-	-	2,918,173
Debt service-interest	-	-	-	-	-
Fixed assets	239,958	68,086	155,936	463,980	2,811,967
Loss on investment	-	-	-	-	388,500
Interest and penalties on tax lien	943,555	-	-	943,555	-
Total expenditures	<u>\$ 24,962,179</u>	<u>\$ 5,078,395</u>	<u>\$ 6,200,178</u>	<u>\$ 36,240,752</u>	<u>\$ 47,404,880</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, 2002

(With comparative totals for the year ended September 30, 2001)

	2002	2001
Revenues:		
U.S. Compact of Free Association:		
Section 211(a)(2) - base grant	\$ 11,093,467	\$ 8,816,000
Section 217 - inflation adjustment	6,434,210	4,936,960
FSM revenue sharing	2,878,990	4,494,871
Unallocated revenue sharing	-	(175,283)
State taxes and licenses:		
Cigarette tax	\$ 41,357	\$ 52,728
General sales tax	1,148,109	1,467,052
Alcohol	6,277	108,825
Hotel	139,170	143,879
Delinquent tax collections	4,223	2,408
License and fees	49,693	104,415
Other	88,994	96,388
Other revenues:		
Hospital and utilities collections	1,215	18,271
Transportation collections	462,072	478,190
Leases	86,125	63,533
Miscellaneous	190,861	740,273
Net decrease in the fair value of investments	(1,165,534)	1,111,919
Total revenues	21,459,229	18,622,595
Expenditures by department:		
General government:		
Executive branch:		
Governor and staff	557,827	1,591,084
Attorney General	242,529	239,810
State Finance	483,119	415,693
ADP	54,219	67,409
Tax and revenue	340,814	303,525
Program and budget	198,379	185,804
Property and supply	115,354	109,467
Personnel	105,642	103,921
Planning	183,614	201,535
Total executive branch	2,281,497	3,218,248
Legislative internal operations:		
President and members	571,082	674,723
Speakers and members	1,573,616	1,903,423
Legislative committees	160,956	228,138
Legislative legal office	288,125	277,703
Legislative administration	131,350	203,000
Legislative budget office	108,023	137,003
Chief clerks	144,324	165,062
Total legislative internal operations	2,977,476	3,589,052
Judicial operations	585,740	638,972
Office of the Public Auditor	15,176	24,868
Total general government	5,859,889	7,471,140
Education:		
Administration	224,854	405,306
Elementary	3,676,739	3,519,493
Secondary	1,569,579	1,550,553
Curriculum and instruction	144,571	153,457
Total education	5,615,743	5,628,809
Health services:		
Hospital and dispensaries	2,527,997	2,500,416
Environmental health	156,318	136,460
Dental services	270,366	239,691
Total health services	2,954,681	2,876,567

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, 2002

(With comparative totals for the year ended September 30, 2001)

	2002	2001
Expenditures by department, continued:		
Economic development:		
Administration	\$ 87,729	\$ 122,443
Land management	54,371	51,903
Marine resources	431,793	397,421
Agriculture	363,007	383,038
Labor	39,222	37,747
Historic preservation	29,849	31,839
Business and trades	<u>73,280</u>	<u>65,350</u>
Total economic development	<u>1,079,251</u>	<u>1,089,741</u>
Public works and utilities:		
Operations and maintenance	<u>427,505</u>	<u>368,232</u>
Total public works and utilities	<u>427,505</u>	<u>368,232</u>
Public safety	<u>1,288,278</u>	<u>1,291,923</u>
Transportation:		
Administration	613,091	782,090
Airport	<u>148,555</u>	<u>136,930</u>
Total transportation	<u>761,646</u>	<u>919,020</u>
Community affairs:		
Division of public affairs	115,785	99,090
Division of youth affairs	23,722	20,501
Division of information and broadcast	<u>107,725</u>	<u>85,037</u>
Total community affairs	<u>247,232</u>	<u>204,628</u>
Boards and commissions:		
Investment board	-	5,803
Election commission	118,625	408,406
Education board	2,250	6,949
Recreation board	236,717	90,689
Land commission	168,831	148,104
Environmental Protection Agency	72,482	79,883
Facilities	40,000	37,278
Truk Scholarship Board	<u>198,505</u>	<u>182,297</u>
Total boards and commissions	<u>837,410</u>	<u>959,409</u>
Other:		
Early Retirement Program	60,303	98,367
Special programs	429,977	2,250,437
Legislative appropriations	4,456,709	3,285,463
Interest and penalties on tax lien	943,555	-
Chuuk recovery loan	<u>-</u>	<u>292,444</u>
Total other	<u>5,890,544</u>	<u>5,926,711</u>
Total expenditures	<u>24,962,179</u>	<u>26,736,180</u>
Excess (deficiency) of revenues over (under) expenditures	(3,502,950)	(8,113,585)
Other financing sources (uses):		
Operating transfers in	300,000	-
Operating transfers out	<u>(208,330)</u>	<u>(153,866)</u>
Total other financing sources (uses)	<u>91,670</u>	<u>(153,866)</u>
(Deficiency) excess of revenues and other financing sources (under) over expenditures and other financing uses	(3,411,280)	(8,267,451)
(Deficit) fund balance at beginning of year	<u>(7,074,726)</u>	<u>1,192,725</u>
Deficit at end of year	<u>\$ (10,486,006)</u>	<u>\$ (7,074,726)</u>

See Accompanying Independent Auditors' Report.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Special Revenue Funds
September 30, 2002

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, 2002, 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 Special Block Grant Section 221 (b) 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, 2002

(With comparative totals as of September 30, 2001)

<u>ASSETS</u>	Chuuk Visitors' Bureau	Chuuk Airport Authority	Federal Grant Assistance	CFSM Grant	Compact Other Grants	Compact Special Block Grant Section 221(b)	<u>Totals</u>	
							2002	2001
Cash and cash equivalents	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 8,079
Receivables:								
FSM National Government/U.S. Direct Grants	-	-	470,923	295,638	-	-	766,561	891,213
General, net	-	-	41,959	-	-	-	41,959	189,066
Due from other funds	-	875,997	-	-	1,300,862	2,586,518	4,763,377	4,021,494
 Total assets	 \$ -	 \$ 875,997	 \$ 512,882	 \$ 295,638	 \$ 1,300,862	 \$ 2,586,518	 \$ 5,571,897	 \$ 5,109,852
 <u>LIABILITIES AND FUND BALANCES (DEFICIT)</u>								
Liabilities:								
Accounts payable	\$ -	\$ -	\$ 226,369	\$ 45,725	\$ 93,795	\$ 2,008,533	\$ 2,374,422	\$ 2,500,480
Accrued liabilities	-	4,293	-	-	-	-	4,293	242,900
Due to other funds	-	-	360,667	393,218	-	-	753,885	840,490
 Total liabilities	 -	 4,293	 587,036	 438,943	 93,795	 2,008,533	 3,132,600	 3,583,870
Fund balances (deficit):								
Reserved for encumbrances	-	185,547	583	-	1,507	-	187,637	286,513
Unreserved	-	686,157	(74,737)	(143,305)	1,205,560	577,985	2,251,660	1,239,469
 Total fund balances (deficit)	 -	 871,704	 (74,154)	 (143,305)	 1,207,067	 577,985	 2,439,297	 1,525,982
 Total liabilities and fund balances (deficit)	 \$ -	 \$ 875,997	 \$ 512,882	 \$ 295,638	 \$ 1,300,862	 \$ 2,586,518	 \$ 5,571,897	 \$ 5,109,852

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, 2002

(With comparative totals for the year ended September 30, 2001)

	Chuuk Visitors' Bureau	Chuuk Airport Authority	Federal Grant Assistance	CFSM Grant	Compact Other Grants	Compact Special Block Grant Section 221(b)	Totals	
							2002	2001
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	-	-	-	-	1,400,638	-	1,400,638	949,800
Section 217-inflation adjustment	-	-	-	-	-	-	-	671,888
Section 212-base grant	-	-	-	-	368,667	-	368,667	250,000
Federal contributions	-	-	1,307,128	-	-	-	1,307,128	1,086,816
Other	-	76,087	-	478,103	-	-	554,190	983,049
Total revenues	-	76,087	1,307,128	478,103	2,230,392	2,730,000	6,821,710	7,132,640
Expenditures:								
General government	-	-	-	-	341,117	101,559	442,676	821,518
Education	-	-	974,476	-	-	1,706,712	2,681,188	2,598,003
Health services	-	-	265,112	-	393,193	563,120	1,221,425	3,198,691
Public works and utilities	-	825	19,002	-	-	98,244	118,071	824,425
Public safety	-	-	-	71,269	-	-	71,269	176,479
Community affairs	-	-	-	-	-	-	-	671,967
Other	8,079	-	122,692	412,995	-	-	543,766	46,098
Total expenditures	8,079	825	1,381,282	484,264	734,310	2,469,635	5,078,395	8,337,181
Excess (deficiency) of revenues over (under) expenditures	(8,079)	75,262	(74,154)	(6,161)	1,496,082	260,365	1,743,315	(1,204,541)
Other financing uses:								
Operating transfers out	-	-	-	-	(830,000)	-	(830,000)	(1,000,000)
Total other financing uses	-	-	-	-	(830,000)	-	(830,000)	(1,000,000)
Excess (deficiency) of revenues and over (under) expenditures and other financing uses	(8,079)	75,262	(74,154)	(6,161)	666,082	260,365	913,315	(2,204,541)
Fund balances (deficit) at beginning of year	8,079	796,442	-	(137,144)	540,985	317,620	1,525,982	3,730,523
Fund balances (deficit) at end of year	\$ -	\$ 871,704	\$ (74,154)	\$ (143,305)	\$ 1,207,067	\$ 577,985	\$ 2,439,297	\$ 1,525,982

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, 2002

(With comparative totals for the year ended September 30, 2001)

	Chuuk Visitors' Bureau	Chuuk Airport Authority	Federal Grant Assistance	CFSM Grant	Compact Other Grants	Compact Special Block Grant Section 221(b)	Totals	
							2002	2001
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	-	-	-	-	1,400,638	-	1,400,638	949,800
Section 217-inflation adjustment	-	-	-	-	-	-	-	671,888
Section 212-base grant	-	-	-	-	368,667	-	368,667	250,000
Federal contributions	-	-	1,307,128	-	-	-	1,307,128	1,086,816
Other	-	76,087	-	478,103	-	-	554,190	983,049
Total revenues	-	76,087	1,307,128	478,103	2,230,392	2,730,000	6,821,710	7,132,640
Expenditures:								
Personnel	-	825	450,025	41,685	19,556	1,284,142	1,796,233	1,592,006
Travel	-	-	97,128	-	1,510	4,961	103,599	117,814
Contractual services	-	-	211,999	409,834	347,353	44,038	1,013,224	673,702
POL	-	-	-	-	-	-	-	4,231
Equipment	-	-	-	-	-	-	-	58,974
Medical supplies	-	-	-	-	-	-	-	313,094
Supplies and materials	-	-	-	-	-	-	-	283,625
Food	-	-	-	-	-	-	-	399,750
Fixed Asset	-	-	66,402	-	-	1,684	68,086	-
All others	8,079	-	555,728	32,745	365,891	1,134,810	2,097,253	4,893,985
Total expenditures	8,079	825	1,381,282	484,264	734,310	2,469,635	5,078,395	8,337,181
Excess (deficiency) of revenues over (under) expenditures	(8,079)	75,262	(74,154)	(6,161)	1,496,082	260,365	1,743,315	(1,204,541)
Other financing uses:								
Operating transfers out	-	-	-	-	(830,000)	-	(830,000)	(1,000,000)
Total other financing uses	-	-	-	-	(830,000)	-	(830,000)	(1,000,000)
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(8,079)	75,262	(74,154)	(6,161)	666,082	260,365	913,315	(2,204,541)
Fund balances (deficit) at beginning of year	8,079	796,442	-	(137,144)	540,985	317,620	1,525,982	3,730,523
Fund balances (deficit) at end of year	\$ -	\$ 871,704	\$ (74,154)	\$ (143,305)	\$ 1,207,067	\$ 577,985	\$ 2,439,297	\$ 1,525,982

See Accompanying Independent Auditors' Report.

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS
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 Chuuk State Government (the State) as of and for the year ended September 30, 2002, and have issued our report thereon dated November 1, 2004, which report was qualified due to 1) obligations for land leases and land acquisitions being excluded from the General Fund and the General Long-Term Debt Account Group; 2) our inability to determine the propriety of fixed assets and fund equity of the General Fixed Assets Account Group; 3) our inability to determine the propriety of the reserve for continuing appropriations of the Capital Projects Fund; 4) our inability to determine the propriety of advances of the General Fund and interfund receivables/payables of the Governmental Fund Types; 5) our inability to obtain sufficient evidence regarding the State's investment in Chuuk Fresh Tuna, Incorporated; and 6) the omission of the State's development authorities from the Governmental Fund Type – Special Revenue Funds, and the Chuuk Coconut Authority, the Chuuk Public Utility Corporation, the Chuuk State Housing Authority, and the Chuuk Public Fisheries Corporation. 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.

Internal Control Over Financial Reporting

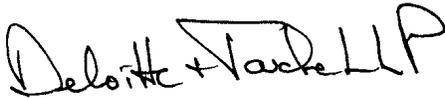
In planning and performing our audit, we considered the State's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide an opinion on the internal control over financial 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 02-05 through 02-22 and 02-25 and 02-26.

A material weakness is a reportable 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 caused by error or fraud in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control 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 02-07, 02-10, 02-13, 02-18 and 02-22 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State'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 general purpose 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* and are described in the accompanying Schedule of Findings and Questioned Costs (pages 43 through 59) as items 02-10 and 02-17.

This report is intended for the information and use of the management of the State, 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 + Touche LLP". The signature is written in a cursive, stylized font.

November 1, 2004

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 Chuuk State Government (the State) 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, 2002. The State's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 43 through 59). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the State's management. Our responsibility is to express an opinion on the State'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'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's compliance with those requirements.

As described in items 02-01 through 02-04, 02-10, 02-17, 02-23 and 02-24 in the accompanying Schedule of Findings and Questioned Costs, the State did not comply with requirements regarding allowable costs/cost principles (CFDA #15.875), procurement and suspension and debarment (CFDA #84.256A), equipment and real property management (all programs), special tests and requirements governing the Compact of Free Association Scholarship Program (CFDA #15.875) and monitoring of subrecipients (CFDA #15.875). Compliance with such requirements is necessary, in our opinion, for the State to comply with the requirements applicable to its federal programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the State, 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, 2002.

Internal Control Over Compliance

The management of the State is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the State's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance 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 compliance that, in our judgment, could adversely affect the State's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 02-01 through 02-04, 02-10, 02-17, 02-23, and 02-24.

A material weakness is a reportable 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 noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program 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 compliance 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 02-10 and 02-17 to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the general purpose financial statements of the State of Chuuk as of and for the year ended September 30, 2002, and have issued our report thereon dated November 1, 2004, which report was qualified due to: 1) obligations for land leases and land acquisitions being excluded from the General Fund and the General Long-Term Debt Account Group; 2) our inability to determine the propriety of fixed assets and fund equity of the General Fixed Assets Account Group; 3) our inability to determine the propriety of the reserve for continuing appropriations of the Capital Projects Fund; 4) our inability to determine the propriety of advances of the General Fund and interfund receivables/payables of the Governmental Fund Types; 5) our inability to obtain sufficient evidence regarding the State's investment in Chuuk Fresh Tuna, Incorporated; and 6) the omission of the State's development authorities from the Governmental Fund Type – Special Revenue Funds, and the Chuuk Coconut Authority, the Chuuk Public Utility Corporation, the Chuuk State Housing Authority, and the Chuuk Public Fisheries Corporation. Our audit was performed for the purpose of forming an opinion on the general purpose financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards (pages 32 through 41) is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the general purpose financial statements. This schedule is the responsibility of the management of the State. Such information has been subjected to the auditing procedures applied in our audit of the general purpose financial statements and, in our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had the propriety of accounts payable and related expenditures of the Governmental Fund Type been determinable, is fairly stated, in all material respects when considered in relation to the general purpose financial statements taken as a whole.

This report is intended for the information and use of the State, 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.

Deloitte + Touche LLP

November 1, 2004

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards
Federal Grant Assistance Fund
Year Ended September 30, 2002

Grantor Account Title	Org./Cost Center #	CFDA I.D. #	Expenditures
<u>Direct Grants:</u>			
<u>U.S. Department of Education</u>			
School Improvement Project	FG3001	84.256A	\$ (1,160)
School Improvement Project	FG3002	84.256A	(16,750)
School Improvement Project	FG3003	84.256A	641,199
School Improvement Project	FG3004	84.256A	77,328
BECLEPS (EDUCATION)6-01-21	FG4001	84.290	152,070
96 School Improvement Project	TX4010	84.256A	1,349
Total U.S. Department of Education			854,036
<u>Received in a Pass through Capacity From:</u>			
<u>Pacific Resources for Education and Learning (PREL)</u>			
Vocational Education Improvement Project	3870	84.994	3,792
Vocational Education Improvement Project	3872	84.994	430
Vocational Education Improvement Project	3873	84.994	116,218
Total Pacific Resources for Education and Learning (CFDA #84.994)			120,440
<u>FSM National Government:</u>			
<u>Federal Emergency Management Agency</u>			
Typhoon Yuri Public Assistance	TX2800	83.516	10,529
El Nino Drought/Public Assistance	TX8500	83.516	8,473
Total CFDA #83.516			19,002
<u>U.S. Department of the Interior - Office of Insular Affairs</u>			
Water Quality Monitoring	TH9513	15.875	2,346
Total Office of Insular Affairs (CFDA #15.875)			2,346
<u>U.S. Department of Health and Human Services</u>			
AIDS Prevention	TV0230	93.940	11,406
Immunization	TV0240	93.268	55,227
MCH Programs/6-01-21	TV1203	93.994	72,694
Tuberculosis Control Prog	TV2721	93.116	10,592
Substance Abuse (6-01-21)	TV2802	93.954	115,193
Total Department of Health and Human Services			265,112
<u>U.S. Department of Agriculture</u>			
Urban and Community Forestry	TE1201	10.664	35,947
Forestry Stewardship Program	TE1202	10.664	9,465
Total CFDA #10.664			45,412
Total Federal Financial Assistance Fund			\$ 1,306,348
Reconciliation to the general purpose financial statements:			FY 2002
			Expenditures
Federal Grant Assistance Fund, a Governmental Fund Type - Special Revenue Fund			\$ 1,381,282
Unlocated difference			(74,934)
			\$ 1,306,348

See accompanying notes to schedule of expenditures of federal awards.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
CFSM Grant Fund
Year Ended September 30, 2002

Grantor Account Title	Chuuk Org. #	CFDA I.D. #	Expenditures
C-FSM JOINT LAW ENFORCEMENT	C9437	N/A	\$ 29,438
JOINT LAW ENFORCEMENT	101234	N/A	41,831
COMPACT SCHOLARSHIP 12-12	252688	N/A	(A) 405,834
COMPACT SCHOLARSHIP	252680	N/A	(A) 1,000
Total CFSM Special Revenue Fund			\$ <u>478,103</u>

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

Reconciliation to the general purpose financial statements:

CFSM Grant Fund, a Governmental Fund Type - Special Revenue Fund	\$ 484,264
Unlocated difference	<u>(6,161)</u>
	<u>\$ 478,103</u>

(A) These funds are subgranted from the FSM National Government and represent Compact Scholarship Funds, CFDA #15.875. During the year ended September 30, 2002, the State received \$410,200 of such Scholarship funds from the FSM National Government in a subrecipient capacity.

See accompanying notes to schedule of expenditures of federal awards.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association Capital Projects Fund
Section 211 (A)(2)
Year Ended September 30, 2002

Grantor Account Title	Org./Cost Center #	CFDA I.D. #	Expenditures
<u>Section 211 (A)(2)</u>			
MOEN DUBLON H2O IMPROVEMENT	6136	15.875	\$ 10,000
STATE CIP IMPL/COURT	6224	15.875	23,000
POLLE SOCIAL PROJECT	6434	15.875	2,000
POLLE FISHING PROJECT	6494	15.875	1,500
EPIN ANNUK DOCK POLLE	6571	15.875	809
NECHAP-TONOAS DOCK PROJECT	6605	15.875	2,454
UPGRADE WENO SEC. RD.	6824	15.875	1,250
UDOT ROAD & DOCK SUPPLEMENT	C0257	15.875	2,747
UNKNOWN	C0259	15.875	3,500
POLLE COMMUNITY WATER/6-81M	C0385	15.875	1,134
CHUUK US/EDA WATER UPGRADE	C0434	15.875	5,000
TOL PUB. RD. RENOV. & BEAUTY	C0744	15.875	1,050
MIZPAH SCHOOL CONSTRUCTION	C0839	15.875	5,365
EPINUP FISHING PROJECT	C0902	15.875	197
UNKNOWN	C1071	15.875	11,403
ROAD REPAVEMENT AND PAVEMENT	C1073	15.875	83,866
WICHAP WENO WATER PROJ 3-95-17	C1078	15.875	414
HS DORMS RENOVATION 4-97-10	C1099	15.875	4,896
ROMALUM SEAWALL/3-95-17(R)	C1119	15.875	4,854
POLLE MTNG.HALLS/V.OFF./95(M)	C1142	15.875	411
WICHAP WENO FISHING PROJ./94M	C1580	15.875	189
WICHAP WENO OFFICE BLDG SUPPLE	C1693	15.875	1,600
NAMOLUK PASSENGER OR CARGO VES	C1709	15.875	1,832
GOVT. LAND PURCHASE/4-99-01	C1711	15.875	(5,000)
UMAN FARMING PROJ/4-98-32M	C1738	15.875	12,781
TOLENSOM BOAT &ELECT.REP.SHOP	C1765	15.875	4,979
CHUUK STATE ROAD PAVING SUPPLE	C1783	15.875	7,939
WICHAP EL NINO WATER CATCHMENT	C1800	15.875	4,120
WICHAP WATER CATCHMENT/96M	C1830	15.875	101
UNUNNO FEFAN DOCK REPAIR/98	C1839	15.875	3,941
CHUUK AIRPORT RUNWAY REPAIR/99	C1851	15.875	16,000
POLLE ICE PLANT PROJ./4-97-10M	C1853	15.875	1,911
CHUUK AIRPORT REPAIR/MAKUR/99M	C1906	15.875	8,000
CHUUK AIRPORT REPAIR/KUTTU/96M	C1907	15.875	(86,000)
WENO SCHL.FACIL.SUBSIDY/98R	C1919	15.875	3,260
KUTTU POWER GEN./DIST./4-97-10	C1927	15.875	7,891
CHUUK AIRPORT REPAIR/PAREM/97M	C1965	15.875	1,436
CHUUK AIRPORT REPAIR/P. PANEU	C1966	15.875	(10,000)
CHUUK AIRPORT REPAIR/FONOTON	C1974	15.875	38,870
CHUUK AIRPORT REPAIR/FONOTON	C1975	15.875	(38,870)
HALL ISLANDS MARKET CENTER	C1994	15.875	8,970
CHUUK AIRPORT REP/FANANU/93M	C2034	15.875	10,000
AIRPORT REPAIR/ROMALUM/498-32M	C2045	15.875	27,799
AIRPORT REPAIR(WENO)4-99-01M	C2048	15.875	3,988
CHUUK AIRPORT REPAIR/TONOAS/90	C2065	15.875	(27,799)
CHUUK AIRPORT REPAIR/KUTTU/91M	C2075	15.875	80,576
MID.MORTLOCKS FISHING/498-29KL	C2093	15.875	30,000
NAMUSOFO FISHING PROJ/599-15R	C2166	15.875	1,785
Subtotal			276,149

See accompanying notes to schedule of expenditures of federal awards.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association Capital Projects Fund
Section 211 (A)(2), Continued
Year Ended September 30, 2002

Grantor Account Title	Org./Cost Center #	CFDA I.D. #	Expenditures
Balance forwarded			276,149
LEKINIOCH PASSEN.&CARGO VESSEL	C2183	15.875	3,441
LOSAP DOCK TRANSP.&MOBILIZ/00M	C2204	15.875	2,750
LOSAP FISHING PROJ/5-99-15M	C2234	15.875	15,950
WENO HOUSING REV.FUNDS/5-99-15	C2244	15.875	17,500
UMAN DAMAGE CLAIM & OTHER REL.	C2252	15.875	1,942
FANAPANGES HOUSING REVOL/99M	C2269	15.875	16,500
WENO FISHING PROJ/4-98-32M	C2283	15.875	2,950
TONOAS FISHING PROJECT/5-00-28	C2358	15.875	786
LEKINIOCH GYMNASIUM CON.	C2410	15.875	13,000
LEKINIOCH GYMNASIUM CONSTRUCT.	C2411	15.875	9,600
LEKINIOCH GYMNASIUM CONSTRUCT.	C2412	15.875	8,273
POLLE CHUKURAM FARMING	C2434	15.875	9,998
POLLE MUN. OFFICE	C2435	15.875	7,506
SAPOU(POLLE) ROAD & SEAWALL	C2437	15.875	4,000
POLLE FISHING PROJECT	C2438	15.875	9,981
FEFAN ROAD UPGRADE/5-00-28	C2445	15.875	6,276
SN REGIONAL FISHING/5-99-15	C2448	15.875	3,938
UPPER MORTLOCKS FARMING	C2451	15.875	6,410
MAKUR COOPERATIVE BUILDING6-81	C2486	15.875	10,000
ENIN(TONOAS) WATER PROJECT	C2491	15.875	3,947
NEWEN(TONOAS)DOCK REPAIR PROJ.	C2493	15.875	8,726
MAKUR COOPERATIVE BUILDING	C2502	15.875	12,290
NOMUISOFO FIBERGLASS SHOP	C2536	15.875	1,473
MANAIO POLLE MEETING HALL	C2544	15.875	663
NETHON POLLE MEETING HALL	C2545	15.875	495
NUKANAP UMAN SEAWALL R	C2556	15.875	2,940
NOMWIN COMMUNITY CENTER M	C2564	15.875	3,000
PIISEMWAR SEWING PROJECT/M	C2576	15.875	14,900
LEPOLIECH NEMA SCHL.SITE LEASE	C2578	15.875	2,800
ROMANUM FISHING PROJECT	C2581	15.875	2,153
FEFEN CIP RELATED DAMAGE CLAIM	C2598	15.875	25,550
ROMALUM FISHING PROJECT	C2608	15.875	9,217
PATTIW REGION SEW. PROJ/ED	C2623	15.875	494
UNUNO(FEFAN)DISPENSARY PROJ./M	C2625	15.875	10,000
UMAN NAUT MEETING HALL SUPP./M	C2630	15.875	3,985
NAMOLUK GOV.VESSEL SUP. PAY./M	C2632	15.875	50,639
FANAPANGES LAND PURCHASE	C2635	15.875	5,000
CHUUK ROAD MAINTENANCE FUND	C2637	15.875	130,262
NAMOLUK MUN VESSEL SUPPLE PMT	C2638	15.875	50,348
DEPT. AGRI. BROODING PIGERRY/S	C2645	15.875	2,645
URBAN FORESTRY DEVELOP.PROJ/S	C2646	15.875	47,284
SANNUK UMAN PIGGERY/M	C2650	15.875	200
SANNUK UMAN MARKET/M	C2651	15.875	2,386
MURILO SCHOOL BUILDING/M	C2655	15.875	15,422
MOCHON UMAN FISHING/M	C2656	15.875	651
ONOUN ROAD MAINTENANCE/M	C2658	15.875	19,976
POLOWAT MUNICIPAL OFFICE/R	C2661	15.875	48,776
Subtotal			<u>903,172</u>

See accompanying notes to schedule of expenditures of federal awards.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association Capital Projects Fund
Section 211 (A)(2), Continued
Year Ended September 30, 2002

Grantor Account Title	Org./Cost Center #	CFDA I.D. #	Expenditures
Balance forwarded			903,172
LEKINIOCH FARMING PROJECT/M	C2662	15.875	17,781
NEPONONONG ROAD UPGRADE/M	C2668	15.875	4,000
FEFAN SCHOOL IMPROVE/5-00-28/M	C2674	15.875	38,543
SAPOU LANDSLIDE WALL/M	C2680	15.875	3,645
CHUUK LAND ACQUISITION(S)	C2689	15.875	581,785
WENO JR.HIGH SCHL.RELOC/6-01-6	C2691	15.875	150,000
CHUUK LEGIS.COMPLEX RELOCATION	C2692	15.875	357,740
CHUUK STATE LAND ACQUI/6-01-06	C2693	15.875	2,064,415
CHUUK GOV'T.OFFICES REPAIR	C2694	15.875	76,092
CHUUK CIP RELATED CLAIM SETTL.	C2695	15.875	299,900
CHUUK STATE WENO ROAD MATCHING	C2696	15.875	230,044
LOSAP SCHL.SOLAR/6-01-06R/AK	C2698	15.875	40,000
CHUUK DCO DEEPWELL PROJECT	C2699	15.875	86,959
NAMA ELEM.SCHL.REPAIR/6-01-06R	C2700	15.875	31,005
MID.MORTLOCKS JHS TOILET SYS/R	C2701	15.875	70,970
POLLAP REEFER PLANT/6-01-06M	C2702	15.875	25,000
FONOTON SCHL. PROJ/6-01-06M	C2703	15.875	4,794
FONOTON FISHING PROJ./6-01-06M	C2704	15.875	23,993
NW REGION FISHING/6-01-06R/ML	C2706	15.875	12,879
NW COMMUNITY MARKETING ASSOC.	C2707	15.875	9,047
NW COMMUNIC.EQUIP/6-01-06R/ML	C2708	15.875	7,145
NW-WEITO CLRMS.RENOV/6-01-06R	C2709	15.875	14,999
NW-ONOUN CULTURAL CENTER/02/R	C2710	15.875	11,894
TOLENSOM SEWING/6-01-06R/WW	C2711	15.875	8,999
TOLENSOM FISHING/6-01-06R/WW	C2712	15.875	24,990
TOLENSOM FARMING/6-01-06R/WW	C2713	15.875	10,000
TOLENSOM ROAD REPAIR & BEAUTI.	C2714	15.875	9,984
PPO SEWING PROJ./6-01-06R/KN	C2715	15.875	3,150
PPO DOCK REPAIR./6-01-06R/KN	C2716	15.875	3,875
PPO REGIONAL FISHING/6-01-06R	C2717	15.875	20,554
PPO COMMUNITY HALL/6-01-06R/KN	C2718	15.875	17,989
PPO SCHL.RENOV.&FENCING/02R/KN	C2719	15.875	6,297
SAPORE REGIONAL SEAWALL/02R/SH	C2720	15.875	6,000
TSIS FARMING PROJ/6-01-06R/SH	C2721	15.875	5,000
UFO FISHING PROJ/6-01-06R/SH	C2722	15.875	4,988
SAPETA FEFAN FISHING/6-01-06R/	C2723	15.875	4,988
SAFETA FEFAN FARMING/6-01-06R	C2724	15.875	5,000
PAREM FISHING/6-01-06R/SH	C2725	15.875	5,000
UFO FEFAN FARMING PROJ/6-01-06	C2726	15.875	5,001
PAREM FARMING PROJ/6-01-06R/SH	C2727	15.875	4,762
SIIS REGIONAL SEAWALL/6-01-06R	C2728	15.875	5,000
TSIS FISHING PROJ/6-01-06R/SH	C2729	15.875	5,000
FONOMO UDOT DOCK REPAIR/601-06	C2730	15.875	10,000
UDOT PUBLIC ROAD SYS/6-01-06M	C2731	15.875	20,000
UDOT WATER SYSTEM/6-01-06M	C2732	15.875	12,500
UDOTLANDSLIDE/EROSION/6-01-06M	C2734	15.875	13,674
POLLAP SEAWALL PROJ./6-01-06M	C2735	15.875	11,250
Subtotal			<u>5,289,803</u>

See accompanying notes to schedule of expenditures of federal awards.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association Capital Projects Fund
Section 211 (A)(2), Continued
Year Ended September 30, 2002

Grantor Account Title	Org./Cost Center #	CFDA I.D. #	Expenditures
Balance forwarded			5,289,803
TOLENSOM SCHL.RENOV/6-01-15R	C2736	15.875	5,500
UFO FEFAN SEAWALL/6-01-06M	C2737	15.875	2,254
FEFAN ROAD UPGRADE/6-01-06M	C2738	15.875	5,700
UFO WATER CATCHMENT/6-01-06M	C2739	15.875	3,906
LOSAP FISHING PROJ/6-01-06M	C2740	15.875	67,620
MAKUR CLRM. TRAINING/6-01-06M	C2741	15.875	5,270
MAKUR DISPENSARY PROJ/6-01-06M	C2742	15.875	38,998
WENO REGIONAL FISHING/6-01-06R	C2743	15.875	7,499
NN DISPENSARY REPAIR/6-01-06R	C2744	15.875	4,905
PENIESENE 2NDARY ROAD/6-01-06R	C2745	15.875	25,422
SELETIW YOUTH CENTER/601-15RB	C2746	15.875	23,600
LM PUBLIC TOILET FACIL/6-01-06R	C2747	15.875	3,582
TONOAS POWER DISTRIB/6-01-06R	C2748	15.875	16,834
TONOAS ROAD MAINTEN./6-0106R	C2749	15.875	9,908
SN FISHING PROJ/6-01-06R/JS	C2750	15.875	29,224
UMAN REGIONAL SOLAR LINGTING/R	C2753	15.875	27,000
CHUUK TOURISM PROMOTION/601-06	C2754	15.875	38,445
SN FISHING PROJ/6-01-15R/WM	C2757	15.875	10,989
PAATA FISHING PROJ./6-01-06M	C2759	15.875	69,660
PAATA SOCIAL/DEEPWELL/6-01-06M	C2760	15.875	3,539
ONEISOMW YOUTH CENTER/601-06M	C2761	15.875	2,492
ONEISOMW LAND ACQUISITION/M	C2762	15.875	25,000
ONEISOMW WATER DEV./6-01-06M	C2763	15.875	7,999
ONEISOMW EDUC.INFRA.DEV/02M	C2764	15.875	17,786
ONEISOMW ROAD IMPROV/6-01-06M	C2765	15.875	11,000
ONEISOMW SEAWALL PROJ/6-01-06M	C2766	15.875	39,990
CHUUK STATE HEALTH CARE PLAN	C2768	15.875	39,090
ONEOP LAND PURCHASE/6-01-06/M	C2776	15.875	197,924
FANANU FISHING SUPPLIES	C2793	15.875	59,950
SIIS FISHING PROJECT	C2799	15.875	94,368
WENO TUNNUK WATER PROJECT	C2813	15.875	786
PURCH. OF MED. EQUIPMENT	C8742	15.875	14,135
Total Compact of Free Association Capital Projects Fund-Section 211 (A)(2)			\$ <u>6,200,178</u>

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

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

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continue
Compact of Free Association-Other Grants Fund
Year Ended September 30, 2002

Grantor Account Title	Chuuk Org. #	CFDA I.D. #	Expenditures
COMPACT ENERGY GRANT - GOVERNMENT UTILITY	CT2783	15.875	\$ 341,117 (B)
COMPACT ENERGY GRANT - CHUUK PUBLIC UTILITY CORP.	272783	15.875	<u>830,000 (A)</u>
Total Section 214 (c) Energy Grants			1,171,117
MEDICAL AND HEALTH 216(A)(2)	HM6091	15.875	<u>393,193</u>
Total Compact of Free Association - Other Grants Fund			<u><u>\$ 1,564,310</u></u>

These funds are disbursed through the Office of Insular Affairs (OIA U.S. Department of the Interior and bear CFDA #15.875. The National Government of the FSM receives all grant awards on behalf of the FSM and reallocates such to the component States

- (A) These funds were transferred to the Chuuk Public Utility Corporation, component unit of the State, who is to separately satisfy its Single Audit requirements.
- (B) These funds were used to pay the State's power bills and those payments were made to the Chuuk Public Utilities Corporation, a component unit of the State

Reconciliation to the general purpose financial statement:

Compact Other Grants Fund - a Governmental Fund Type - Special Revenue Fund

Expenditures	\$ 734,310
Transfer out	<u>830,000</u>
	<u><u>\$ 1,564,310</u></u>

See accompanying notes to schedule of expenditures of federal awards.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association
Special Block Grant Fund - Section 221(B)
Year Ended September 30, 2002

Grantor Account Title	Cost Center #	CFDA I.D. #	Expenditures
GOVERNOR'S OFFICE SBG	152151	15.875	\$ 86,987
FUEL FOR LEADERSHIP CONFERENCE	282815	15.875	14,572
CHUUK AIRPORT	CA2815	15.875	9,836
HEALTH CARE PLAN	152099	15.875	14,480
DEFICIT REDUCTION (MED. DEBTS)	TI8122	15.875	122,988
VOCATIONAL REHABILITATION 22B	TI8207	15.875	17,287
HEALTH SERV./DOCTORS PROF.FEES	T18121	15.875	6,739
MENTAL HEALTH SBG 221B	TI8116	15.875	66,894
HEALTH SERV.COMMUNICABLE DISEA	TI8121	15.875	149,084
MEDICAL SUPPLY 221B SBG	HM6092	15.875	185,646
PUBLIC WORKS ADMIN.	OM2815	15.875	72,812
CHUUK AIRPORT	CA2815	15.875	15,597
FOOD SERVICES (NUTRITION)	TI8205	15.875	454,787
EDUCATION SPECIAL SERV 221B	TI8208	15.875	73,295
ELEMENTARY EDUCATION SBG 221B	TI8206	15.875	790,552
ASSIST JR. HIGH SCHOOL	152153	15.875	280,455
SECONDARY EDUCATION/SBG	T18202	15.875	(1)
SECONDARY EDUCATION 221B SBG	TI8202	15.875	<u>107,625</u>
Total Compact of Free Association Block Grant Fund-Section 221(b)			<u>\$ 2,469,635</u>

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

Compact of Free Association Section 211(a)(2)
Base Grant and Section 217 Inflation Adjustment
Year Ended September 30, 2003

CURRENT ACCOUNT AND INFLATION ADJUSTMENT \$ 17,527,677

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

See accompanying notes to schedule of expenditures of federal awards.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2002

1. Scope of Audit

The State 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 Agriculture
- U.S. Department of Education
- U.S. Department of the Interior
- U.S. Federal Emergency Management Agency
- U.S. Department of Health and Human Services

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, 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.

D. Indirect Cost Allocation

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

E. Single Audit Excluded Funding

For purposes of the Single Audit, Compact Section 211(a) Current Account Funding and Compact Section 215 Current Account Funding have been excluded from the dollar threshold used to distinguish between Type A and Type B programs. The requirement to exclude such funding was recommended by the U.S. Department of the Interior, Office of the Inspector General (OIG). The OIG took this position since there are no compliance requirements imposed on the abovementioned funds.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2002

3. Component Units

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

Chuuk Public Utilities Corporation

The Chuuk Public Utilities Corporation, (CPUC), 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. The CPUC has yet to satisfy its 2002 reporting responsibilities under the Single Audit Act.

Chuuk State Housing Authority

The Chuuk State Housing Authority (CSHA), a component unit - proprietary fund, is the recipient of various pass-through funds from Chuuk State and certain direct grants. The CSHA has yet to satisfy its 2002 reporting responsibilities under the Single Audit Act.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Programs Selected For
Audit in Accordance with OMB Circular A-133
Year Ended September 30, 2002

<u>Grantor</u> <u>Program Title</u>	<u>CFDA No.</u>	<u>2002</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	\$ 6,200,178
Scholarship Grants	15.875	406,834
Compact Energy Program Funds – Section 214(c)	15.875	<u>1,171,117</u>
Total Major Programs Under CFDA # 15.875 excluding Compact Section 211 (A) Current Account expenditures		<u>7,778,129</u>
 <u>U.S. Department of Education</u>		
School Improvement Project	84.256A	<u>701,966</u>
 <u>U.S. Department of Health Services</u>		
Substance Abuse	93.954	<u>115,193</u>
Total U.S. Federal program expenditures selected excluding Compact Section 211 (A) Current Account expenditures		\$ <u>8,595,288</u>
Total U.S. Federal program expenditures excluding Compact Section 211 (A) Current Account expenditures		\$ <u>12,018,574</u>
% of total U.S. Federal expenditures covered by major programs excluding Compact Section 211 (A) Current Account expenditures		<u>71%</u>

Note: Total U.S. Federal program expenditures exclude Compact Section 211(A) Current Account expenditures as no compliance requirements pertain to those funds and inclusion of that amount in the base would exclude other U.S. federal program funds from Single Audit coverage.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2002

Part I - Summary of Auditors' Results

1. The Independent Auditors' Report on the general purpose 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 material to the general purpose 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 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
U.S. Department of the Interior - Compact of Free Association Scholarship Program	15.875
U.S. Department of the Interior – Compact of Free Association, Energy Programs	15.875
U.S. Department of Health and Human Services – Substance Abuse	93.954

8. A threshold of \$300,000 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>	
02-05	Adequacy of Documentation	\$ -
02-06	Current Systems Configuration	\$ -
02-07	Interfund Reconciliations	\$ -
02-08	Lack of Timely Deposits and Numerical Sequence of Receipts	\$ -
02-09	Reconciliation of Personnel Action Forms to Underlying Pay Rates	\$ -
02-10	Component Unit Financial Statements	\$ -
02-11	Maintenance of Financial Records	\$ -
02-12	Contract Workers	\$ -

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2002

Part II - Financial Statement Findings Section, Continued

<u>Reference Number</u>	<u>Findings</u>	
02-13	Timely Reconciliations of Subsidiary Ledgers to General Ledgers	\$ -
02-14	Documentation of Supporting Expenditures	\$ -
02-15	Outstanding Collections of Reimbursable Grants	\$ -
02-16	Maintenance of Checks Signed But Not Claimed	\$ -
02-17	Implementation of GASB Statement No. 34	\$ -
02-18	Leases Payable	\$ -
02-19	Appropriation in Excess of Actual Revenues	\$ -
02-20	Returned Checks from Payees	\$ -
02-21	Payroll Timesheets	\$ -
02-22	Acquisition of Land	\$ -
02-25	Cash Reconciliation	\$ -
02-26	Cash Reconciliation	\$ -

Part III - Federal Award Findings and Questioned Cost Section

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
02-01	Adequacy of Documentation	\$ 67,416
02-02	Competitive Procurement Actions	\$ 23,709
02-03	Conformance with Grant Terms and Conditions	\$ 15,713
02-04	Adequacy of Documentation (CFDA #15.875)	\$ 30,583
02-10	Component Unit Financial Statements	\$ -
02-17	Implementation of GAS 34/Fixed Asset Compliance	\$ -
02-23	Competitive Procurement	\$ 16,651
02-24	Scholarship Procedures	\$ -

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding 02-01 – Adequacy of Documentation

Criteria: Documents should exist in support of recorded disbursements.

Condition: The disbursement packages supporting the following expenditures could not be located.

Special Block Grants (CFDA #15.875):

<u>Check #</u>	
59432	\$24,229
2008269	10,004
2010825	10,000
54081	9,900
55740	<u>4,425</u>
	<u>\$58,558</u>

Federal Program Direct Grants (CFDA #84.256A):

<u>Check #</u>	
4700	\$ 2,581
4700	2,800
4700	1,677
4067	<u>1,800</u>
	<u>\$ 8,858</u>

Cause: The cause of this condition is an inability of the State to locate the underlying disbursement package.

Effect: The effect of this condition is that questioned costs in the amount of \$67,416 are reported.

Recommendation: The underlying disbursement documents should be located and provided to substantiate the recorded expenditures.

Auditee Response and Corrective Action Plan: During and immediately after the period, the Finance office was renovated, which caused major disruption to our procedures. Files were physically removed from the office and due to absence of space, were kept in non-air conditioned areas. As a result, it was quite difficult to locate certain documentation. We will continue to look for these documents and when found, we will provide them to the auditors.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding 02-02 – Competitive Procurement Actions

Criteria: The State should comply and document its compliance with federal program competitive procurement activities. While the State has imposed by statute a legal requirement to engage in competitive procurement activities for expenditures greater than \$10,000, the State does not enforce this requirement and we saw essentially no evidence of its use.

Condition: We could not locate any evidence of competitive procurement activities in connection with the following transactions:

<u>Check #</u>	
4026	\$ 6,000 (CFDA #84.256A)
4632	5,000 (CFDA #84.256A)
4696	2,436 (CFDA #84.256A)
4697	3,700 (CFDA #84.256A)
58687	4,275 (CFDA #10.664)
3970	<u>2,298</u> (CFDA #84.256A)
	\$ <u>23,709</u>

Cause: The cause of this condition appears to be the State's failure to document its compliance with federally mandated competitive procurement activities.

Effect: The effect of this condition is that questioned costs of \$23,709 are present in this report.

Prior Year Status: This condition was previously reported in the 2001 Single Audit Report.

Recommendation: The State must follow applicable competitive procurement procedures. Given that the State has not adopted procurement procedures that are at least in conformance with federal requirements, the State must comply with federal requirements. The State does not enforce competitive procurement requirements when using its local funds.

Auditee Response and Corrective Action Plan: The amended Compact of Free Association requires competitive procurement for all related expenditures and therefore, a system is now in place to ensure compliance with federal requirements. The amended Compact commenced in fiscal year 2004.

Finding 02-03 – Conformance with Grant Terms and Conditions

Criteria: Expenditures and contracts should be incurred and executed in accordance with grant terms and conditions.

Condition: We could not determine the manner in which a contract paid under the following check numbers was either competitively procured or executed in accordance with the grant terms, conditions and budget:

<u>Check #</u>	
4043	\$12,113 (CFDA #10.664)
4217	700 (CFDA #10.664)
4339	1,000 (CFDA #10.664)
4350	<u>1,900</u> (CFDA #10.664)
	\$ <u>15,713</u>

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding 02-03 – Conformance with Grant Terms and Conditions, Continued

Cause: The cause of this condition is that the State has not linked this contract to its approved budget and has not provided evidence of competitive procurement in the selection process.

Effect: The effect of this condition is questioned costs in the amount of \$15,713.

Recommendation: The State should document competitive procurement procedures associated with the transaction and should document the manner that the transaction relates to the approved budget.

Auditee Response and Corrective Action Plan: The amended Compact of Free Association requires competitive procurement for all related expenditures and therefore, a system is now in place to ensure compliance with federal requirements. The amended Compact commenced in fiscal year 2004.

Finding Number 02-04 – Adequacy of Documentation (CFDA 15.875)

Criteria: Payments should be supported by adequate documentation.

Condition: The following disbursements were not supported by invoices or receiving reports, evidencing the receipt of goods paid for:

<u>Check #</u>	
61892	\$15,653
55323	<u>14,930</u>
	<u>\$30,583</u>

Cause: The cause of this condition is an inability to locate the underlying requested information.

Effect: The effect of this condition is questioned costs in the amount of \$30,583.

Recommendation: The invoices and receiving reports should be located to substantiate the abovementioned disbursements.

Auditee Response and Corrective Action Plan: During and immediately after the period, the Finance office was renovated, which caused major disruption to our procedures. Files were physically removed from the office and due to absence of space, were kept in non-air conditioned areas. As a result, it was quite difficult to locate certain documentation. We will continue to look for these documents and when found, we will provide them to the auditors.

Finding 02-05 – Adequacy of Documentation

Criteria: Documentation in support of disbursements should be on file and available for review.

Condition: The following General Fund disbursement packages could not be located:

<u>Check or Package #</u>	
49493	\$100,000
49492	80,000
49490	80,000
50353	50,000
57989	40,000

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding 02-05 – Adequacy of Documentation, Continued

Condition, Continued:

53909	34,056
53912	34,056
2012641	30,000
58901	22,087

Additionally, per check number 56942, \$31,938 was expended to purchase tickets to the South Pacific Games, yet no indication of the receipt or the use of these tickets was on file.

Per disbursement package number 2010298, a \$28,000 payment was made to a Guam vendor based on a public law, without a supporting contract or purchase order or any evidence of the performance by the contractor.

Vehicles were apparently purchased with check number 49461 in the amount of \$32,864, yet there was no evidence on file of the receipt of the vehicle.

Cause: The cause of this condition is inadequate or unlocatable evidence contained in disbursement files.

Effect: The effect of this condition is that the above transactions cannot be substantiated.

Recommendation: Documentation supporting the above transactions should be obtained and reviewed to ensure that such were correctly recorded in the financial statements.

Auditee Response and Corrective Action Plan: The amended Compact of Free Association requires competitive procurement for all related expenditures and therefore, a system is now in place to ensure compliance with federal requirements. The amended Compact commenced in fiscal year 2004.

Finding 02-06 – Current Systems Configuration

Criteria: The Finance computer system should be configured in a manner to allow as many personnel as possible to utilize the system.

Condition: The current system configuration allows only five users at a time. This translates into a very slow and unresponsive system and minimizes the amount of work that can be accomplished in one workday.

Cause: The cause of this condition is that the systems configuration is inadequate and necessary resources have yet to be committed to this task.

Effect: The effect of this condition is that the Chuuk Finance system is not configured in an optimum manner.

Recommendation: The State should seek the assistance of the FSM National Government to reconfigure the existing system to allow more users to access the system simultaneously.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding 02-06 – Current Systems Configuration, Continued

Auditee Response and Corrective Action Plan: The State of Chuuk has requested assistance from the FSM National Government to provide the resource necessary to correcting this matter and we believe that this matter should be resolved in November 2004.

Finding 02-07 – Interfund reconciliations

Criteria: Interfund balances should reconcile monthly.

Condition: Interfund balances at September 30, 2002 are out of balance by in excess of \$80,000. It appears that the imbalance may have been caused by inappropriate recording of payroll expenditures and related deductions.

Cause: The cause of this condition has not been established, but it appears to relate to improper payroll system maintenance.

Effect: The effect of this condition is that the interfund balances are out of balance by \$80,000 as of September 30, 2002 and the effect on the financial statements is unknown.

Recommendation: Technical assistance should be sought from the FSM National Government to reconcile these accounts and to ensure that payroll related expenditures are appropriately recorded.

Auditee Response and Corrective Action Plan: We have obtained additional assistance from the FSM National Government to further investigate this matter and we believe that this matter should be substantially resolved in November 2004.

Finding 02-08 – Lack of Timely Deposits and Numerical Sequence of Receipts

Criteria: Cash should be deposited to the bank, intact, on a daily basis. Cash receipts should be used in numerical sequence and any breaks in the sequence should be documented and the original receipt retained.

Condition: At September 30, 2002, fourteen cash receipts from the State Revenue Office were not timely deposited. We also could not ensure that receipts were used in numerical sequence throughout the year.

Cause: The cause of this condition appears to be the lack of timely deposits, intact, on a daily basis and a lack of control over monitoring cash receipts.

Effect: The effect of this condition is that the State exposes itself to a higher potential for fraud or defalcations as a result of non-timely deposits and the absence of documentation of cash receipt sequences.

Recommendation: All cash collected should be deposited intact on a daily basis and the numerical integrity of cash receipts should be maintained and monitored.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding 02-08 – Lack of timely Deposits and Numerical Sequence of Receipts, Continued

Auditee Response and Corrective Action Plan: The Director of the Department has issued a memo to the Treasurer's office indicating that all receipts must be issued sequentially and any unused receipts will be kept on file to document the propriety of cash receipt sequences.

Finding 02-09 – Reconciliation of Personnel Action Forms to underlying Pay Rates

Criteria: Personnel Action Forms (PAF's) should agree with wage rates paid.

Condition: In four of twenty-five samples tested, we could not reconcile the PAF to the underlying rate paid.

Cause: The cause of this condition is that the reconciliation between the PAF and the rate paid was not made.

Effect: The effect of this condition is that it is not possible to ensure that the correct wage rate is paid.

Prior Year Status: This finding was reported in the 2001 Single Audit but it appears that improvements have been made as the noted error rate in the current year is less than that of prior years.

Recommendation: PAF's should reconcile with underlying wage rates paid.

Auditee Response and Corrective Action Plan: As the finding indicates, we believe that improvements have been made and the frequency of errors is decreasing. The errors are attributable to the slowness of the receipt of amended personnel action forms from Personnel. We will continue to work with that entity to speed up the process. We do not believe that any untoward acts are occurring with respect to this matter, rather, that such is a timing difference.

Finding 02-10 – Component Unit Financial Statements

Criteria: The State should obtain component unit financial statements for presentation in the general-purpose financial statements.

Condition: The State did not obtain financial statements from the Chuuk Fisheries Corporation (CFC), the Chuuk Public Utility Corporation (CPUC), the Chuuk Coconut Authority (CCA) or the Chuuk Housing Authority (CHA). Neither CFC, CPUC, CCA or CHA were able to present financial statements or cause an audit of their financial statements to be made.

Cause: The cause of this condition is that the underlying financial statement records in CPUC, CCA or CHA has not enabled the audit to proceed. No financial statements have been provided for the Chuuk Fisheries Corporation, although that entity may have ceased operations.

Effect: The effect of this condition is an incomplete financial statement presentation and a qualification on the Chuuk State 2002 financial statements. Additionally, both CPUC and CHA received federal funding and these entities are in noncompliance with Single Audit requirements. CPUC received, per review of Chuuk State records, \$830,000 in subsidies and \$341,117 in State utility payments under CFDA #15.875, Compact of Free Association Energy Grants. The composition of federal funding received by CHA is not determinable.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding 02-10 – Component Unit Financial Statements, Continued

Recommendation: The State should ensure that all component units are able to produce timely, accurate financial statements and that audits of such financial statements occur in accordance with State, National Government and federal laws and regulations.

Auditee Response and Corrective Action Plan: We have contacted the respective component units and will work with them to ensure that they are able to produce financial information for inclusion in subsequent audits. We have also communicated this problem to the Legislature so that resources may be allocated to correct these matters.

Finding 02-11 – Maintenance of Financial Records

Criteria: The State is responsible for its financial statements and should therefore approve all transactions that are to be entered into its financial systems.

Condition: During fiscal year 2002, the State entered in to a Memorandum of Understanding (MOU) with the FSM National Government (FSMNG). As part of the MOU, the FSMNG assumed responsibility for liquidating State payrolls and related allotments. All related transactions were not processed through the State's financial systems. During the audit process, in order to ensure that all transactions were recorded in the State's systems, entries were made by the FSMNG. Unfortunately, the entries were incorrect and it took substantial efforts to effectuate correction.

Cause: The State did not exercise sufficient monitoring over this process.

Effect: The effect of this condition was a substantial delay in the completion of the 2002 audit.

Recommendation: The State should ensure that all transactions are processed in to its systems, that such transactions are reconciled and that the State has evidence to substantiate the propriety of these transactions.

Auditee Response and Corrective Action Plan: We concur with the finding and will not allow unsupervised access to our records by another entity.

Finding 02-12 – Contract Workers

Criteria: State law appears to prohibit the hiring of full time employees under contract status.

Condition: It appears that various individuals were hired as full time employees under a contract status.

Cause: The cause of this condition is that employees were hired under contract status.

Effect: The effect of this condition may be noncompliance with State appropriation laws.

Recommendation: State management should document the number of contract workers employed during the year and assess the related compliance with local laws.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding 02-12 – Contract Workers, Continued

Auditee Response and Corrective Action Plan: We will continue to discuss this matter with the Chuuk Legislature to resolve this matter.

Finding 02-13 – Timely Reconciliations of Subsidiary Ledgers to General Ledgers

Criteria: Timely reconciliations of cash, travel advances, accounts payable, continuing appropriations (Compact Capital Project Fund) and encumbrances should be made on a monthly basis.

Condition: Timely reconciliations of the above accounts are not made. Reconciliations of these accounts occurred only after a substantial amount of time after September 30, 2002.

Cause: The cause of this condition is that substantial numbers of transactions, such as cash receipts, are not entered in to the accounting systems on an ongoing basis. As a result, the transactions are entered only after year end and then reconciliations commence. For accounts payable and encumbrances, there is no systematic process that requires documentation of monthly cut-offs and reconciliations.

Effect: The effect of this condition is that the internally produced financial statements can contain material errors that are not corrected until substantially after the fiscal year end.

Recommendation: All transactions should be entered daily and monthly reconciliations should occur.

Auditee Response and Corrective Action Plan: We are attempting to obtain resources to obtain one additional position, which would be filled by a trained general ledger accountant. We believe that the addition of this resource will provide us the ability to ensure that timely reconciliations occur.

Finding No. 02-14 – Documentation Supporting Expenditures

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.

Prior Year Status: This matter was addressed in the 2001 Single Audit Report.

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: We are working with the Chuuk house to work out a system to ensure that the authoritative documentation will be available for audit purposes, on site, in Chuuk.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding No. 02-15 – Outstanding Collections of Reimbursable Grants

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

Condition: As of September 30, 2002, financial records indicate that Chuuk is owed approximately \$670,527 that was not collected subsequent to fiscal year 2002. The breakdown is as follows:

Reimbursable Federal grants	\$374,889
Congress of the FSM grants	\$295,638

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, 2002.

Prior Year Status: This matter was addressed in the 2001 Single Audit Report.

Recommendation: The above receivables should be analyzed and presented for collection. The collection attempts should be documented in writing.

Auditee Response and Corrective Action Plan: We will continue to pursue collection of these balances and will request that the FSM National Government pursue reconciliation with our records.

Finding No. 02-16 – Maintenance of Checks Signed but Not Claimed

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.

Prior Year Status: This matter was addressed in the 2001 Single Audit Report.

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

Auditee Response and Corrective Action Plan: This matter will be resolved within Finance. The reconciliation division will reconcile this account on a quarterly basis commencing with December 31, 2004.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding No. 02-17 – Implementation of GASB Statement No. 34

Criteria: The provisions of GASB 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 GASB 34.

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

Effect: The effect of this condition is the potential inability of the State of Chuuk to conform to the GASB 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 GASB 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: We have been requesting assistance from the FSM National Government with respect to fixed assets to prepare for GASB 34 and believe that such will be implemented in fiscal year 2003.

Finding No. 02-18 – Leases Payable

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.

Prior Year Status: This matter was addressed in the 2001 Single Audit Report.

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: Due to a fire at the Land Management building, we expect that this matter will take time to resolve. The Finance Office will work with Land Management to develop a plan of action.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding No. 02-19 – Appropriation in Excess of Actual Revenues

Criteria: Estimated revenues used in the appropriation process should be continually monitored to ensure that such represent achievable targets.

Condition: Estimated fiscal year 2002 revenues exceeded actual revenues by \$3.991 million.

Cause: The cause of this condition appears to be that local revenue estimates were not realized.

Effect: The effect of this condition is an increase in the State's deficit during fiscal year 2002.

Recommendation: The State should explore methods of achieving better revenue estimates and should prepare contingency plans to enact in the event that revenue estimates are not realized.

Auditee Response and Corrective Action Plan: Since this time, the Administration has adopted a stringent policy of limiting allotments since the Legislature's revenue estimates have tended to remain aggressive. We have therefore determined that the Executive Branch will have to limit expenditures through the allotment process. This process commenced during fiscal year 2004.

Finding No. 02-20 – Returned Checks from Payees

Criteria: Returned checks should be reconciled with the general ledger on a monthly basis and should be separately inventoried to ensure their physical existence.

Condition: As of September 30, 2002, the general ledger account reflected a balance of \$102,000. It is not possible to determine the composition of this account.

Cause: The cause of this condition is that when checks are redeposited, it does not appear that such is annotated on the deposit slip. There is no separate inventory of returned checks at the end of each month and there does not appear to be accounting control exercised over returned checks.

Effect: The effect of this condition is an inability to determine what the correct balance of this account should be. No qualification of the Independent Auditors' Report results from this condition as various provisions for doubtful accounts have been recorded against the general ledger balance.

Recommendation: Returned checks should be inventoried at the end of each month and reconciled to the general ledger control account. All redeposits of returned checks should be separately annotated on the deposit slip.

Auditee Response and Corrective Action Plan: This matter stems from Treasury and the reconciliation division will be tasked with visiting Treasury at each month end to obtain a listing of such returned checks on hand and to aid in the reconciliation of this general ledger control account on a monthly basis.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding No. 02-21 – Payroll timesheets

Criteria: Payrolls should be supported by timesheets.

Condition: In twenty of twenty-five payroll transactions tested, the underlying timesheet could not be located.

Cause: The cause of this condition appears to be the inability to locate underlying timesheets.

Effect: The effect of this condition is that Chuuk State policy could not be supported.

Recommendation: The State should ensure that all underlying support for payroll payments be retained.

Auditee Response and Corrective Action Plan: During and immediately after the period, the Finance office was renovated, which caused major disruption to our procedures. Files were physically removed from the office and due to absence of space, were kept in non-air conditioned areas. As a result, it was quite difficult to locate certain documentation. We will continue to look for these documents and when found, we will provide them to the auditors.

Finding No. 02-22 – Acquisition of Land

Criteria: If agreements to acquire land are entered in to, a funding source should be designated and the amounts due in the future should be recorded in the financial statements.

Condition: The State entered into various land purchase agreements. The agreements call for significant future payments, which amounts have not been recorded on the books. Additionally, the State has not designated a funding source for these payments.

Cause: The cause of this condition is that the State has not recorded these liabilities on its books.

Effect: The effect of this condition is a qualification of the fiscal year 2002 audit report.

Recommendation: We recommend that the State determine and record the liability arising from the matter set forth in the condition and determine the manner in which this liability will be settled.

Auditee Response and Corrective Action Plan: This matter has been referred to the State Attorney General for resolution.

Finding No. 02-23 – Competitive Procurement – Substance Abuse (CFDA #93.954)

Criteria: Conflicts between Federal and local procurement rules should be resolved.

Condition: The State of Chuuk has a legal requirement for competitive procurement only when the amount exceeds \$10,000. The State does not enforce this requirement for local or federal funds and therefore does not appear to exercise competitive procurement activities as anticipated in the Common Rule.

**CHUUK STATE GOVERNMENT
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding No. 02-23 – Competitive Procurement – Substance Abuse (CFDA #93.954), Continued

Condition, Continued:

In nine of nine instances tested aggregating \$14,760 of \$38,505 of nonpayroll program expenditures, no indication of competitive procurement was found. Two of the items are for fuel. These were bulk payments for in excess of 2,000 gallons and there was no description of the use of the funds or the manner in which the program benefited.

<u>Check No.</u>	<u>Amount</u>
201078501	\$ 2,200
201169501	1,250
201254601	1,800
201338601	2,500
201338602	1,000
200826301	2,000
200865301	1,000
201115501	1,860
201289501	<u>1,150</u>
	\$ <u>14,760</u>

Additionally, we located one payment for telephone services. The payment was made for delinquent charges and was not supported by a detailed phone billing, which precluded us from determining whether long distance calls were program related.

<u>Check No.</u>	<u>Amount</u>
200826301	\$ <u>1,891</u>
	\$ <u>16,651</u>

Cause: The cause of the condition appears to be an absence of competitive procurement activities and inadequate documentation in support of the above procurements.

Effect: The effect of this condition is questioned costs of \$16,651.

Recommendation: The FSM National Government, as grantee, should review the above and determine the manner in which the federal program benefited from these payments.

Chuuk State Finance should not process phone bills without detailed statements supporting the amounts. A phone log should be established at the program office and each call should be logged and the business purpose stated.

Since the State does not utilize competitive procurement procedures as required by State law, the State should utilize Federal procurement procedures.

Auditee Response and Corrective Action Plan: The amended Compact of Free Association requires competitive procurement for all related expenditures and therefore, a system is now in place to ensure compliance with federal requirements. The amended Compact commenced in fiscal year 2004.

**CHUUK STATE GOVERNMENT
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding No. 02-24 – Scholarship Procedures – Compact of Free Association (CFDA #15.875)

Criteria: Applicable guidelines established by the FSM National Government require that scholarship payments be made jointly to the recipient and the applicable College or University.

Condition: Of 26 scholarship awards tested aggregating \$178,500 out of \$406,834 in total scholarship awards for the audit year, 70% of disbursements were made solely to the awardee and were not made jointly with the college or university.

Cause: The cause of this condition is noncompliance with established rules and regulations. No questioned costs result as scholarship files indicate that the students were enrolled and met eligibility criteria.

Effect: The effect of this condition is that noncompliance with established procedures results.

Recommendation: The State should comply with the grantor requirement and scholarship payments should be made jointly to the recipient and the applicable college or university.

Auditee Response and Corrective Action Plan: This matter will be resolved as immediately, no checks to scholarship recipients will be allowed. Rather, all of such checks will be issued jointly with the College or University.

Finding No. 02-25 – Cash

Criteria: Cash transactions posted in the bank accounts but not recorded in the general ledger should be investigated promptly to minimize potential loss. Such investigation should be documented in writing; any written correspondence with the banks should also be maintained.

Condition: We noted reconciling items in various bank accounts that are denoted as bank errors. However, these items appear to be aged. In addition, no written correspondence was provided for our review to substantiate follow-up of these items. These errors include:

<u>Account</u>	<u>Description</u>	<u>Total Amount</u>	<u>Date Range</u>
CIP Acct	Checks posted by bank but not in system	\$ 23,196	November 2000
CIP Acct	Items misposted by bank	\$ 5,672	Jan 01 thru May 02
CIP Acct	Duplicate items posted by bank	\$ 6,150	December 2001
General Acct	Unidentified withdrawal	\$ 52,468	Nov 01 thru Sept 02
Payroll Acct	Duplicate items posted by bank	\$ 4,744	Oct 99 thru Sept 02
Payroll Acct	Deposit not posted by bank	\$ 42,061	December 2000
Payroll Acct	Checks posted by bank but not in system	\$ 5,823	Dec 97 thru Sept 02

Cause: The cause of this condition appears to be that preparation and review of bank reconciliations is not performed timely. This caused the errors to be discovered on an untimely manner and, as a result, become more difficult to correct. Also, it appears that these errors are not aggregated and reported in writing to the bank's higher management.

Effect: The effect of this condition is that, if remaining unresolved, these reconciling items will need to be written off the books as an expense of the State.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding No. 02-25 – Cash, Continued

Recommendation: We recommend that the State ensure timely preparation and review of bank reconciliations is performed, and any bank errors are promptly brought to bank management’s attention. We also recommend that a paper trail be maintained to substantiate State efforts to resolve these errors.

Auditee Response and Corrective Action Plan: We believe that we have followed up on these matters, but such communication has been oral. We will commence writing the banks to obtain resolution of these matters and if such are not resolved locally, we will address higher level management of the Banks.

Finding No. 02-26 – Cash

Criteria: Deposits made in bank accounts should be properly identified and recorded in the proper general ledger accounts. In addition, deposits should be made timely (within one to two business days) to minimize potential loss.

Condition: We noted unidentified deposits (deposits made in the bank accounts not recorded in the general ledger) as follows:

<u>Account</u>	<u>Amount</u>	<u>Date</u>
CIP Savings	\$28,056	May 01
CIP	\$13,370	Feb 01 thru July 02
Federal grant	\$36,000	May 02
General acct	\$80,369	Dec 01 thru June 02
ER	\$5,000	May 03
Payroll	\$5,082	March 01 thru March 02

Furthermore, we noted the following deposits that were not made timely:

<u>Account</u>	<u>Amount</u>	<u>Date Posted in G/L</u>	<u>Date Deposited in Bank</u>
General Fund	\$32,369	September 30, 2002	October 22, 2002
ER	\$5,000	May 3, 2002	After September 30, 2002

Cause: The cause of this condition appears to be the lack of communication between the treasury section, reconciliation accountants, and the banks.

Effect: The effect of this condition is that these unidentified deposits are not properly recorded in the State’s general ledger.

Recommendation: We recommend that the State ensure timely preparation and review of bank reconciliations is performed and any differences between bank records and general ledger balances are promptly followed up.

Auditee Response and Corrective Action Plan: We believe that we have followed up on these matters, but such communication has been oral. We will commence writing the banks to obtain resolution of these matters and if such are not resolved locally, we will address higher level management of the Banks.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Resolution of Prior Years' Findings and Questioned Costs
Year Ended September 30, 2002

For the year ended September 30, 2002, the following questioned costs were noted and prior questioned costs resolved:

	Questioned Costs Set Forth in Prior Audit Report <u>2001</u>	Questioned Costs Resolved for Fiscal Year <u>2002</u>	Questioned Costs at <u>September 30, 2002</u>
Unresolved Questioned Costs FY 97	\$ 16,125	\$ 16,125 (1)	\$ -
Unresolved Questioned Costs FY 98	54,882	54,882 (1)	-
Unresolved Questioned Costs FY 99	28,619	-	28,619
Unresolved Questioned Costs FY 00	301,889	59,981 (1)	241,908
Unresolved Questioned Costs FY 01	369,497	-	369,497
Unresolved Questioned Costs FY 02	<u>-</u>	<u>-</u>	<u>154,072</u>
	\$ <u>771,012</u>	\$ <u>130,988</u>	\$ <u>794,096</u>

(1) These costs were resolved by written communication from the affected grantor agency.