

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEAR ENDED SEPTEMBER 30, 2003

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2003

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Chuuk (the State), as of and for the year ended September 30, 2003, which collectively comprise the basic financial statements of the State's primary government as set forth in Section II of the foregoing table of contents. These financial statements are the responsibility of the management of the State. Our responsibility is to express an opinion on the respective 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 respective financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Our audit of the respective financial statements referred to above includes only the primary government of the State, which consists of all funds, organizations, institutions, agencies, departments, and offices that comprise the State's legal entity and did not include the financial activities of the Chuuk Public Utility Corporation (CPUC) and the Chuuk State Housing Corporation (CSHC). The financial activities of CPUC and CSHC are included in the State's basic financial statements as discretely presented component units and represent the entire assets, net assets, and revenues of the State's aggregate discretely presented component units. Accounting principles generally accepted in the United States of America require that the financial data for the State's legally separate component units be reported with the financial data of the State's primary government. These entities were not able to produce audited financial statements and the effect on the respective financial statements is unknown.

As discussed in Note 2 to the financial statements, the Compact Capital Projects Fund reports its investment in Chuuk Fresh Tuna, Inc., a 50%-owned corporation, at cost. In our opinion, the investment should be adjusted to reflect the Compact Capital Projects Fund's equity in the losses of that corporation to conform with accounting principles generally accepted in the United States of America, which would decrease the investment, decrease fund balance, and change the expenditures of the Compact Capital Projects Fund. Due to the lack of audited financial statements of Chuuk Fresh Tuna, Inc., the amount by which this departure would affect investments, fund balance, and expenditures of the Compact Capital Projects Fund is not reasonably determinable.

As discussed in Note 8 to the financial statements, management has not recorded a liability for land leases payable in the General Fund and, accordingly, has not recorded an expenditure for the current period change in that liability. Accounting principles generally accepted in the United States of America require that liabilities incurred attributable to services already rendered and that are not contingent upon a specific event that is outside of the control of the State be accrued as liabilities and expenditures, which would increase the liabilities, increase fund deficit, and change the expenditures of the General Fund. The amount by which this departure would affect the liabilities, fund deficit, and expenditures of the General Fund is not reasonably determinable.

Because of inadequacies in the accounting records over financial reporting, we were unable to form an opinion regarding the amount at which receivables due from the FSM National Government and reserve for continuing appropriations are recorded in the Compact Capital Projects Fund. Furthermore, the amount at which receivables due from the FSM National Government are recorded enters into the determination of expenditures of the Compact Capital Projects Fund for the year ended September 30, 2003.

Because of inadequacies in the accounting records over financial reporting, we were unable to form an opinion regarding the amount at which accounts payable and reserve for encumbrances are recorded in the General Fund, the Compact Capital Projects Fund, and the aggregate remaining fund information. Furthermore, the amount at which accounts payable are recorded enters into the determination of expenditures of the General Fund, the Compact Capital Projects Fund, and the aggregate remaining fund information for the year ended September 30, 2003.

Because of the absence of significant accounting records concerning the underlying costs for capital assets or the bases supporting such costs, it was not practicable to extend our auditing procedures to enable us to form an opinion on the State's capital assets.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had obligations for land leases payable been included in liabilities of the General Fund, the value of the investment of the Compact Capital Projects Fund in Chuuk Fresh Tuna, Inc. been adjusted, accounting records concerning the receivable due from the FSM National Government and the reserve for continuing appropriations of the Compact Capital Projects Fund been adequate, accounting records concerning accounts payable and reserve for encumbrances of the General Fund, the Compact Capital Projects Fund, and the aggregate remaining fund information been adequate, and had the underlying costs for the State's capital assets been supported, as discussed in the fourth through eighth paragraphs above, such financial statements, as set forth in Section II of the foregoing table of contents, present fairly, in all material respects, the respective financial position of the governmental activities, the General Fund, the Compact Capital Projects Fund, and the aggregate remaining fund information of the State's primary government as of September 30, 2003, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

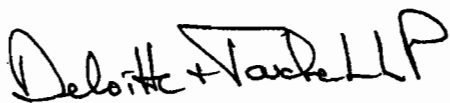
Furthermore, in our opinion, because the financial statements of the Chuuk Public Utility Corporation and the Chuuk State Housing Corporation have not been audited, as discussed in the third paragraph above, the basic financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the reporting entity of the State as of September 30, 2003, and the changes in its financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, during the year ended September 30, 2003 the State adopted the provisions of the Governmental Accounting Standards Board (GASB) Statements No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, GASB Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments; Omnibus*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. The implementation of these standards changed the basic financial statement reporting model to include government-wide, full accrual statements and created a modified reporting of the fund perspective financial statements. Implementing these standards also required reporting of infrastructure assets, changed the method of reporting cash flows from the indirect method to the direct method, and included the requirement for reporting a Management's Discussion and Analysis as required supplementary information. Beginning net asset and fund balances have been restated to account for the implementation of these accounting standards.

The Management's Discussion and Analysis, on pages 4 through 9, as well as the Schedule of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund and notes thereto, on pages 37 and 38, are not a required part of the basic financial statements but are supplementary information required by GASB. This supplementary information is the responsibility of the management of the State. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Our audit was conducted for the purpose of forming an opinion on the State's respective financial statements that collectively comprise the State's basic financial statements. The combining and individual fund financial statements, as set forth in Section IV of the foregoing table of contents, which are also the responsibility of the management of the State, are presented for purposes of additional analysis and are not a required part of the basic financial statements of the State. Such additional information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, except for the effects of the matters discussed in the fourth through seventh paragraphs above, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 31, 2006, on our consideration of the State's (Primary Government only) internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



May 31, 2006

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2003

This section of Chuuk State's financial report presents our Management's Discussion and Analysis (MD&A) for the fiscal year ended September 30, 2003. This is the first year that MD&A is prepared in compliance with the GASB-34 requirement. Readers are requested to read this MD&A in conjunction with the State's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The Chuuk State's primary government's total net assets for the year are \$95,122,053.
- The net change in the primary government's net assets is an increase of \$10,472,395. The total revenues reported is \$44,808,091 with total expenditures of \$34,335,696.
- Actual revenues for the general fund were \$3,632,113 greater than the budgetary revenues and the total expenditures, budgetary basis showed unfavorable variance of \$5,188,076. The general fund reported an unreserved fund deficit of \$21,424,949 as of the end of the fiscal year.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of four parts-management's discussion and analysis (this section), the basic financial statements, required supplementary information and the notes to the financial statements.

The basic financial statements include two kinds of statements that present different views of the State:

Government-Wide Financial Statements

The government-wide financial statements report information about the State as a whole using accounting method similar to those used by the private-sector companies. It provides both long-term and short-term information about the State's financial status.

The statement of net assets includes all of the government's assets and liabilities. The difference between the two is called net assets. Over time, increases or decreases in the State's net assets serve as an indicator to measure the State's financial position.

The statement of activities, on the other hand, accounts for the State's current year's revenues and expenses regardless of when cash is received or paid.

The government-wide financial statements of the State consist of its governmental activities, which include public works, health, education and general administration. Sales taxes, revenue sharing and federal grants are the major sources of these activities. Governmental activities are also financed by the Compact Grant; however, fiscal year 2003 is the last year of Compact I funding.

Fund Financial Statements

The fund financial statements provide more detailed information about the State's significant funds. The State uses fund accounting to comply with financial related legal requirements. The fund financial statements present a balance sheet and a statement of revenues, expenditures, and changes in fund balances for its major and aggregated non-major funds.

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Management's Discussion and Analysis
September 30, 2003

Most of the State's basic services are included in governmental funds which focus on how cash and other financial assets that can readily be converted to cash flow in and out and the balances left at year-end that are available for spending. Unlike the government-wide financial statements, the governmental funds statements focus on the short-term financial requirements of the State. Because this information does not encompass the additional long-term focus of the government wide statements, we provide a reconciliation at the bottom of the governmental funds statement or on the subsequent page to explain the relationship between them.

The State maintains individual governmental funds, which are categorized as major and non-major. The major fund includes the General Fund. The other major funds consisted of the Federal Grants and Compact CIP funds.

FINANCIAL ANALYSIS OF THE STATE AS A WHOLE (GOVERNMENT-WIDE)

The following is a summary of the State's net assets as of September 30, 2003:

	<u>Governmental Activities</u>
Current and other assets	\$ 27,397,316
Capital assets	59,908,642
Other non-current assets	<u>7,816,095</u>
Total assets	<u>95,122,053</u>
Current liabilities	25,075,316
Long-term debt	5,128,335
Other non-current liabilities	<u>728,122</u>
Total liabilities	<u>30,931,773</u>
Net Assets:	
Invested in capital assets, net of related debt	59,579,463
Restricted	25,737,025
Unrestricted fund balance	<u>(21,126,208)</u>
Total net assets	<u>\$ 64,190,280</u>

The State's Statement of Changes in Net Assets for fiscal year ended September 30, 2003 follows:

	<u>Governmental Activities</u>
Revenues	
Program revenues:	
Charges for services	\$ 900,852
Operating grants and contributions	6,615,667
Capital grants and contributions	12,215,296
General revenues:	
Taxes	5,482,469
Grants and contributions not related to specific programs	17,527,677
Investment earnings	1,861,448
Other	<u>204,682</u>
Total revenues	<u>44,808,091</u>

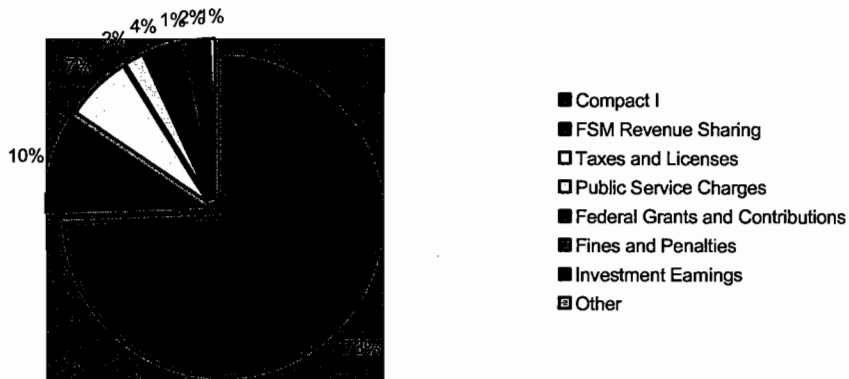
**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2003

Expenses:	
General government	5,457,792
Education	8,183,530
Health services	3,635,038
Public works and transportation	2,873,537
Economic development	1,047,819
Public safety	1,146,843
Boards, commission and other appropriations	4,211,632
Unallocated interest	225,000
Capital projects	5,295,567
Other miscellaneous	<u>2,258,938</u>
 Total expenses	 <u>34,335,696</u>
 Change in net assets	 \$ <u>10,472,395</u>

Based on Exhibit 1 presented below, the huge chunk of the State's revenue sources come from Compact I (73%) and almost 20% from taxes and licenses (both local and FSM revenue sharing). The State's expenses encompass a range of services. Exhibit 2 showed that education and General government represent the highest percentage which is combined 41% of the State's total expenses. The accrual of expense for land purchased attributed to 23% of the State's total expenses.

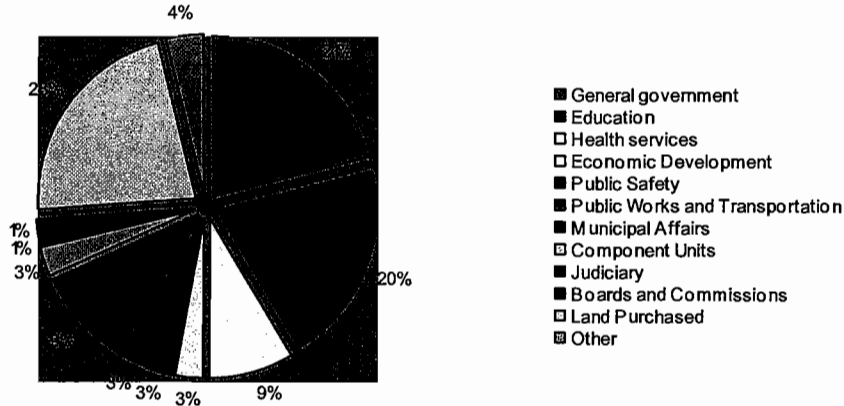
**Sources of Revenues for Fiscal Year 2003
Exhibit 1**



**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2003

**Expenses by Function for Fiscal Year 2003
Exhibit 2**



GOVERNMENTAL ACTIVITIES

General Fund

The revenues increased \$4,373,737 compared to FY 2002 figures and the total expenditures increased by \$5,784,965 mainly due to a \$9M land lease and acquisition.

Capital Projects

The increase or decrease in revenues and expenditures of the fund cannot be compared due to transfer of most of the funds into other governmental funds.

Other Governmental Funds

All the non-major funds from Special Revenue were lodged under this category. The revenues and expenditures decreased by \$61,881 and \$481,467, respectively, compared with FY 2002 figures.

FINANCIAL ANALYSIS OF THE STATE GOVERNMENT'S FUNDS

The State's governmental fund changes in fund balances (deficits) for the year ended September 30, 2003 are shown below.

Changes in Fund Balances (Deficits)

	<u>General Fund</u>	<u>Other Funds</u>	<u>Total</u>
Revenues:			
Taxes, fees and charges	\$ 6,309,569	\$ 73,752	\$ 6,383,321
Compact funding	17,527,677	17,175,687	34,703,364
Federal and CFSM grants	-	1,655,276	1,655,276
Other	<u>1,995,720</u>	<u>70,410</u>	<u>2,066,130</u>
Total revenues	25,832,966	18,975,125	44,808,091
Expenditures and transfers	<u>30,834,900</u>	<u>10,885,522</u>	<u>41,720,422</u>
Net change in fund balance (deficit)	\$ <u>(5,001,934)</u>	\$ <u>8,089,603</u>	\$ <u>3,087,669</u>

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Management's Discussion and Analysis
September 30, 2003

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The State's capital assets at the end of fiscal year 2003 consist basically of equipment, buildings, roads, bridges, and water and sewer lines. The summary of capital assets at the end of the year is shown below:

	Primary Government Governmental <u>Activities</u>
Land	\$ 15,322,393
Buildings	9,274,947
Airport facilities	29,906,300
Seaport facilities	6,537,700
Infrastructure	10,257,000
Machinery, equipment and others	<u>308,744</u>
Total capital assets	71,607,084
Less: Accumulated depreciation	<u>11,698,442</u>
Governmental activities capital assets, net	\$ <u>59,908,642</u>

The notes to the financial statements present more information about the State's capital assets.

Non-Current liabilities

As of September 30, the State had non-current liabilities of \$5,856,457 as shown below:

	Governmental <u>Activities</u>
Long-term debt (non-current portion)	\$ 5,128,335
Compensated absences payable	<u>728,122</u>
Total non-current liabilities	\$ <u>5,856,457</u>

Economic Factors and Next Year's Budget

Funding for the operations of most of the government service in fiscal year 2004 will be coming from the Compact II, as amended.

Fiscal year 2004 is the beginning of the implementation of the economic assistance under the Compact II, as amended funding which replaces the funding sources from the old Compact I. Under the amended compact, annual finding for the following will be available as follows:

- The education sector grant that shall support and improve the educational system of the Federated States of Micronesia, including, without limitation, the systems for primary, secondary, and post-secondary education.

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Management's Discussion and Analysis
September 30, 2003

- The health sector grant that shall support and improve the delivery of preventive, curative and environmental care, and develop the human and material resources necessary for the Federated States of Micronesia to perform these services.
- The sector grant for private sector development shall support the efforts of the Federated States of Micronesia to attract new foreign investment and increase indigenous business activity. Priorities will be in advancing the private development of fisheries, tourism and agriculture; employing new telecommunications technologies; and analyzing and developing new systems, laws, and policies to foster private sector development, to facilitate investment by potential private investors, and develop business and entrepreneurial skills.
- The sector for capacity building shall support the efforts of the Federated States of Micronesia to build effective, accountable and transparent national and local government and other public sector institutions and systems.
- The environment sector shall support the efforts of the Federated States of Micronesia to protect the Nation's land and marine environment and to conserve and achieve sustainable use of its natural resources.
- Public infrastructure grant shall give priority to primary and secondary education capital projects and programs that directly affect health and safety including water and wastewater projects, solid waste disposal projects and health care facilities.

The locally generated revenues and the revenue shares from the National Government are expected to remain at a range of \$ 6,000,000 plus in FY2004. Carry-over balances from the Compact I may be used to fund municipals' operating activities.

FINANCIAL CONTACT

This financial report is designed to provide all interested users with a general overview of the State of Chuuk's finances. If you have questions about this report or need additional financial information, please contact the Office of the Director of Treasury and Administration, P.O. Box 189, Weno, Chuuk FM 96942.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Statement of Net Assets
September 30, 2003

	<u>Primary Government</u>	<u>Component Units</u>
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 765,983	\$ 555,372
Equity interest in internal investment pool	23,263,481	-
Receivables, net of allowance for uncollectibles	3,188,756	2,537,890
Advances	68,939	-
Inventories	-	22,973
Prepayments	-	12,197
Restricted assets:		
Cash and cash equivalents	110,157	-
Total current assets	<u>27,397,316</u>	<u>3,128,432</u>
Noncurrent assets:		
Restricted assets:		
Investments	4,140,590	-
Investments	3,675,505	-
Capital assets, net of accumulated depreciation	59,908,642	8,983,945
Total noncurrent assets	<u>67,724,737</u>	<u>8,983,945</u>
Total assets	<u>\$ 95,122,053</u>	<u>\$ 12,112,377</u>
<u>LIABILITIES</u>		
Current liabilities:		
Bank overdraft	\$ 1,118,123	\$ 115,330
Current portion of long-term obligations	-	340,869
Notes payable	1,808,215	-
Accounts payable	22,002,021	406,282
Compensated absences payable	101,086	-
Other liabilities and accruals	44,871	479,573
Deferred revenue	1,000	50,418
Total current liabilities	<u>25,075,316</u>	<u>1,392,472</u>
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	5,128,335	3,751,847
Compensated absences payable	728,122	-
Total noncurrent liabilities	<u>5,856,457</u>	<u>3,751,847</u>
Total liabilities	<u>30,931,773</u>	<u>5,144,319</u>
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	59,579,463	4,826,082
Restricted for:		
Compact related	2,673,619	-
Capital projects	22,117,950	-
Other purposes	945,456	-
Unrestricted	<u>(21,126,208)</u>	<u>2,141,976</u>
Total net assets	<u>64,190,280</u>	<u>6,968,058</u>
Total liabilities and net assets	<u>\$ 95,122,053</u>	<u>\$ 12,112,377</u>

See accompanying notes to basic financial statements.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Statement of Activities
Year Ended September 30, 2003

Functions/Programs	Program Revenues			Net (Expenses) Revenues and Changes in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government	Component Units
Primary government:						
Governmental activities:						
General government	\$ 5,457,792	\$ 197,621	\$ 505,625	\$ -	\$ (4,754,546)	\$ -
Health services	3,635,038	6,280	1,293,986	-	(2,334,772)	-
Education	8,183,530	-	3,050,826	-	(5,132,704)	-
Economic development	1,047,819	-	35,676	-	(1,012,143)	-
Public safety	1,146,843	-	-	-	(1,146,843)	-
Public works and transportation	2,873,537	696,951	107,756	-	(2,068,830)	-
Community affairs	259,238	-	-	-	(259,238)	-
Boards and commissions	552,019	-	-	-	(552,019)	-
Judiciary	585,919	-	-	-	(585,919)	-
Payments to component units	1,274,721	-	999,998	-	(274,723)	-
Municipal affairs	1,539,735	-	-	-	(1,539,735)	-
Unallocated interest	225,000	-	-	-	(225,000)	-
Capital projects	5,295,567	-	-	12,215,296	6,919,729	-
Other	2,258,938	-	621,800	-	(1,637,138)	-
Total primary government	\$ 34,335,696	\$ 900,852	\$ 6,615,667	\$ 12,215,296	(14,603,881)	-
Component units:						
Chuuk Public Utility Corporation	\$ 4,508,424	\$ 2,407,281	\$ 1,227,998	\$ -	-	(873,145)
Chuuk State Housing Corporation	249,217	134,231	67,386	-	-	(47,600)
Total component units	\$ 4,757,641	\$ 2,541,512	\$ 1,295,384	\$ -	-	(920,745)
General revenues:						
Taxes:						
Revenue sharing					3,283,610	-
Excise taxes					2,198,859	-
Grants and contributions not restricted to specific programs					17,527,677	-
Unrestricted investment earnings					1,861,448	28,132
Other					204,682	(67,811)
Total general revenues and transfers					25,076,276	(39,679)
Change in net assets					10,472,395	(960,424)
Net assets at the beginning of the year					53,717,885	7,928,482
Net assets at the end of the year					\$ 64,190,280	\$ 6,968,058

See accompanying notes to basic financial statements.

STATE OF CHUUK
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Balance Sheet
Governmental Funds
September 30, 2003

	General	Capital Projects Compact Capital Projects	Other Governmental Funds	Total
ASSETS				
Cash and cash equivalents	\$ 765,983	\$ -	\$ -	\$ 765,983
Equity interest in internal investment pool	2,920,250	20,343,231	-	23,263,481
Investments	-	3,675,505	-	3,675,505
Receivables, net:				
FSM National Government	-	2,660,983	41,959	2,702,942
Other	485,814	-	-	485,814
Due from other funds	-	-	6,497,123	6,497,123
Advances	68,939	-	-	68,939
Restricted assets:				
Cash and cash equivalents	110,157	-	-	110,157
Investments	4,140,590	-	-	4,140,590
Total assets	\$ 8,491,733	\$ 26,679,719	\$ 6,539,082	\$ 41,710,534
LIABILITIES AND FUND BALANCES				
Liabilities:				
Bank overdraft	\$ 1,118,123	\$ -	\$ -	\$ 1,118,123
Accounts payable	14,839,520	4,232,590	2,929,911	22,002,021
Other liabilities and accruals	11,485	-	-	11,485
Intergovernmental payables	33,386	-	-	33,386
Notes payable	1,479,036	329,179	-	1,808,215
Deferred revenue	1,000	-	-	1,000
Due to other funds	6,497,123	-	-	6,497,123
Total liabilities	23,979,673	4,561,769	2,929,911	31,471,353
Fund balances (deficits):				
Reserved for:				
Related assets	5,238,492	5,854,119	-	11,092,611
Encumbrances	589,751	1,072,337	68,146	1,730,234
Continuing appropriations	108,766	9,493,058	-	9,601,824
Capital projects	-	5,698,436	-	5,698,436
Unreserved:				
General fund	(21,424,949)	-	-	(21,424,949)
Special revenue funds	-	-	3,541,025	3,541,025
Total fund balances (deficits)	(15,487,940)	22,117,950	3,609,171	10,239,181
Total liabilities and fund balances	\$ 8,491,733	\$ 26,679,719	\$ 6,539,082	
Amounts reported for governmental activities in the statement of net assets are different because:				
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds				59,908,642
Long-term liabilities, including loans payable, are not due and payable in the current period and, therefore, are not reported in the funds. The liabilities include:				
Long-term obligations			(5,128,335)	
Compensated absences			(829,208)	
				(5,957,543)
Net assets of governmental activities				\$ 64,190,280

See accompanying notes to basic financial statements.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficits)
Governmental Funds
Year Ended September 30, 2003

	General	Capital Projects Compact Capital Projects	Other Governmental Funds	Total
Revenues:				
Compact funding	\$ 17,527,677	\$ 12,215,296	\$ 4,960,391	\$ 34,703,364
Net increase in the fair value of investments	1,861,448	-	-	1,861,448
Federal contributions	-	-	1,646,887	1,646,887
CFSM Grants	-	-	8,389	8,389
Revenue sharing	3,283,610	-	-	3,283,610
Excise taxes	2,198,859	-	-	2,198,859
Fees and charges	197,621	-	73,752	271,373
Departmental charges	629,479	-	-	629,479
Other	134,272	-	70,410	204,682
Total revenues	25,832,966	12,215,296	6,759,829	44,808,091
Expenditures:				
Current:				
General government	4,918,724	3,073,254	469,609	8,461,587
Health services	2,792,832	-	745,864	3,538,696
Education	5,689,522	-	2,488,008	8,177,530
Economic development	1,012,143	32,498	35,676	1,080,317
Public safety	1,141,765	-	-	1,141,765
Public works and transportation	1,124,902	-	357,756	1,482,658
Community affairs	252,571	-	-	252,571
Boards and commissions	552,019	-	-	552,019
Judiciary	585,919	-	-	585,919
Payments to component units	274,723	-	999,998	1,274,721
Municipal affairs	1,539,735	2,189,815	-	3,729,550
Other	10,596,289	-	621,800	11,218,089
Debt service	225,000	-	-	225,000
Total expenditures	30,706,144	5,295,567	5,718,711	41,720,422
Excess (deficiency) of revenues over (under) expenditures	(4,873,178)	6,919,729	1,041,118	3,087,669
Other financing sources (uses):				
Operating transfers in	-	-	128,756	128,756
Operating transfers out	(128,756)	-	-	(128,756)
	(128,756)	-	128,756	-
Net change in fund balances (deficit)	(5,001,934)	6,919,729	1,169,874	3,087,669
Fund balances (deficits) at the beginning of the year	(10,486,006)	15,198,221	2,439,297	7,151,512
Fund balances (deficits) at the end of the year	\$ (15,487,940)	\$ 22,117,950	\$ 3,609,171	\$ 10,239,181

See accompanying notes to basic financial statements.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Reconciliation of the Statement of Revenues, Expenditures,
and Changes in Fund Balances of Governmental Funds
to the Statement of Activities
Year Ended September 30, 2003

Amounts reported for governmental activities in the statement of activities on page 11 are different because:

Net change in fund balances (deficit) - total governmental funds from page 13	\$ 3,087,669
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period, including increases to construction in progress	<u>7,384,726</u>
Change in net assets of governmental activities as presented on page 11	\$ <u>10,472,395</u>

See accompanying notes to basic financial statements.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

DISCRETELY PRESENTED COMPONENT UNITS
Combining Statement of Net Assets
September 30, 2003

<u>ASSETS</u>	Chuuk Public Utility Corporation	Chuuk State Housing Corporation	Total
Current assets:			
Cash and cash equivalents	\$ 152	\$ 555,220	\$ 555,372
Receivables, net:			
Federal agencies	444,105	-	444,105
General	951,444	146,446	1,097,890
Loans, net	-	995,895	995,895
Inventories	22,973	-	22,973
Prepayments	-	12,197	12,197
	1,418,674	1,709,758	3,128,432
Total current assets			
Noncurrent assets:			
Capital assets, net of accumulated depreciation	8,772,313	211,632	8,983,945
	8,772,313	211,632	8,983,945
Total assets	\$ 10,190,987	\$ 1,921,390	\$ 12,112,377
<u>LIABILITIES AND NET ASSETS</u>			
Current liabilities:			
Bank overdraft	\$ 115,330	\$ -	\$ 115,330
Current portion of long-term debt	340,869	-	340,869
Accounts payable	406,282	-	406,282
Accrued liabilities	479,573	-	479,573
Deferred income	50,000	418	50,418
	1,392,054	418	1,392,472
Total current liabilities			
Noncurrent liabilities:			
Noncurrent portion of long-term debt	3,751,847	-	3,751,847
	3,751,847	-	3,751,847
Total noncurrent liabilities	3,751,847	-	3,751,847
Total liabilities	5,143,901	418	5,144,319
Net assets:			
Invested in capital assets, net of related debt	4,614,450	211,632	4,826,082
Unrestricted	432,636	1,709,340	2,141,976
	5,047,086	1,920,972	6,968,058
Total net assets	5,047,086	1,920,972	6,968,058
Total liabilities and net assets	\$ 10,190,987	\$ 1,921,390	\$ 12,112,377

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

DISCRETELY PRESENTED COMPONENT UNITS
Combining Statement of Revenues, Expenses, and Changes in Net Assets
Year Ended September 30, 2003

	Chuuk Public Utility Corporation	Chuuk State Housing Corporation	Totals
Operating revenues:			
Charge for services	\$ 2,385,689	\$ 96,683	\$ 2,482,372
Other	21,592	37,548	59,140
	<u>2,407,281</u>	<u>134,231</u>	<u>2,541,512</u>
Operating expenses:			
Fuel	1,964,851	-	1,964,851
Depreciation	1,276,261	29,870	1,306,131
Administration and general	1,267,312	-	1,267,312
Personnel services	-	68,428	68,428
Travel	-	31,944	31,944
Bad debt	-	24,168	24,168
Rent	-	19,285	19,285
Incentive pay	-	16,000	16,000
Board fees	-	15,846	15,846
Professional fees	-	10,000	10,000
Others	-	33,676	33,676
Total operating expenses	<u>4,508,424</u>	<u>249,217</u>	<u>4,757,641</u>
Operating loss	<u>(2,101,143)</u>	<u>(114,986)</u>	<u>(2,216,129)</u>
Nonoperating revenues (expenses):			
Contributions from primary government	1,227,998	67,386	1,295,384
Other income	28,132	-	28,132
Interest expense	(67,811)	-	(67,811)
Total nonoperating revenues (expenses), net	<u>1,188,319</u>	<u>67,386</u>	<u>1,255,705</u>
Net loss	<u>(912,824)</u>	<u>(47,600)</u>	<u>(960,424)</u>
Net assets at beginning of year	<u>5,959,910</u>	<u>1,968,572</u>	<u>7,928,482</u>
Net assets at end of year	<u>\$ 5,047,086</u>	<u>\$ 1,920,972</u>	<u>\$ 6,968,058</u>

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies

The accompanying financial statements of the State of Chuuk (the State) have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the State's accounting policies are described below.

A. Reporting Entity

The State is one of the four states that make up the Federated States of Micronesia (FSM), along with the states of Kosrae, Pohnpei and Yap. The State is a constitutional government comprised of three branches: the Legislative Branch, consisting of the Senate (10 members elected for a term of four years by qualified voters of their respective election districts with the President of the Senate as its highest officer) and the House of Representatives (28 members elected for a term of two years by qualified voters of their respective election districts with the Speaker as its highest officer); the Executive Branch, headed by the Governor and Lt. Governor who are primarily responsible for executing the laws and administering state government services; and the Judiciary Branch made up of the State Supreme Court, which consists of a Chief Justice and four Associate Justices, such inferior courts that may be created by law, and the municipal courts.

For financial reporting purposes, the State has included all funds, organizations, agencies, boards, commissions and institutions. The State has also considered all potential component units for which it is financially accountable as well as other entities for which the nature and significance of their relationship with the State are such that exclusion would cause the State's financial statements to be misleading or incomplete. The criteria to be considered in determining financial accountability include whether the State, as the primary government, has appointed a voting majority of an organization's governing body and either has the ability to impose its will on that organization or there is potential for the organization to provide specific financial benefits to or impose specific financial burdens on the State. Financial accountability also exists if an organization is determined to be fiscally dependent on the primary government, although the primary government does not appoint a voting majority of the organization's governing board.

Each blended and discretely presented component unit of the State has a September 30 year-end.

Once financial accountability has been determined for a potential component unit, that component unit is either blended into the primary government or discretely presented from the primary government. Potential component units that do not meet the financial accountability criteria, but where a voting majority of the governing board is appointed by the State, are deemed to be related organizations. The nature and relationship of the State's component units and related organizations are disclosed in the following section.

Blended component units are entities that are legally separate from the State, but are so related to the State that they are, in substance, the same as the State or entities providing services entirely or almost entirely to the State. The net assets and results of operations of the following legally separate entities are presented as part of the State's operations:

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

i. Blended Component Units

The following Component Unit should be blended within the Primary Government:

Chuuk Visitors Bureau (CVB), a Governmental Fund Type - Special Revenue Fund. This fund was created by Chuuk State Law (CSL) No. 6-39 and is responsible for improving and developing the State's tourism industry. CVB is governed by a nine-member Board of Directors, five of whom are appointed by the Governor subject to the advice and consent of the Legislature and the remaining four of whom are appointed by the President and Speaker of the Legislature. However, the net assets of the CVB are immaterial as its primary expenses are included within the general fund presentation.

ii. Omitted Governmental Funds

The following governmental funds have been omitted from the basic financial statements due to the lack of available financial information:

Development Authorities - The Northern Namoneas Economic Development Authority, the Southern Namoneas Development Authority, the Inner Faichuk Social and Economic Development Authority, the Outer Faichuk Development Authority, the Faichuk Transportation and Economic Development Authority, the Hall Islands Economic Development Authority, the Pattiw Islands Development Authority, and the Witto Resources and Development Authority. These development authorities were established to identify the development needs and promote economic development within the various municipalities, in coordination and cooperation with the State and the FSM National Government. However, the State's Attorney General has opined that the aforementioned development authorities are inactive and contain no net assets. Accordingly, they have been omitted from the accompanying financial statements.

The following funds are considered to be nonmajor governmental funds of the State but are not included in the accompanying basic financial statements due to absence of account balances and financial activities. The financial activities of these omitted governmental funds are not considered material to the basic financial statements:

Representation Fund: This fund was established under CSL No. 3-95-09 for the use of members of the State Legislature to provide assistance to constituents' legitimate emergencies, educational, and civic needs not met by other appropriations.

Chuuk State Legislature Entertainment Fund: This fund was established under Title 21, Section 751 of the Truk District Code (TDC), for the use by the Legislature to entertain guests or other distinguished persons living or visiting the State.

Legislature Emergency Fund: This fund was established under Truk District Law (TDL) No. 21-1 to defray salaries of personnel of the Legislature and office expenses of the Legislature during a period of time between the close of a fiscal year and the signing into law of an appropriation for salaries and expenses of the Legislature office and staff for the next succeeding fiscal year.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

ii. Omitted Governmental Funds, Continued

Chuuk State Travel Fund: This fund was established under TDL No. 22-27 to enable members of the Legislature, Magistrates of municipalities, members of municipal councils, and other leaders in the State to travel outside of the State for the purposes of attending functions prescribed by the enabling legislation.

Association of Pacific Island Legislatures Fund: This fund was established under TDL No. 24-9 for the purpose of funding donations or membership fees to the Association of Pacific Island Legislatures.

Municipal Operations and Projects Fund: This fund was established under TDL No. 25-23 for the purpose of funding operational expenses of municipalities in the State, and providing funds for municipal projects and programs.

Fire Disaster Relief Fund: This fund was established under 7 TDC Section 51 for the purpose of providing relief to persons suffering loss or damage to homes or furnishings as a result of accidental fires.

Economic Development Loan Fund: This fund was established under 13 TDC Section 1 for the purpose of providing loans to any private citizen of the State or any Chuukese corporation or cooperative, wishing to begin, operate, or improve business operations in the State.

Chuuk Farmers, Fishermen, and Handicrafts Fair Fund: This fund was established under TDL No. 23-28 for the purpose of paying for supplies, materials, prizes and other expenses incurred in the preparation for and holding of the Chuuk Farmers, Fishermen and Handicrafts Fair.

Chuuk State Local Farmers Revolving Fund: This fund was established under TDL No. 21-25 for the purpose of purchasing agricultural supplies, livestock, feeds, assorted tools and other materials, for the use of local farmers in the State.

Chuuk State Health Care Plan Trust Fund: This fund was established under CSL No. 2-94-06 for the purpose of establishing a financial system to provide universal coverage of an essential level of health care for all eligible enrollees and to create a means for collection of health care premiums for additional coverage. This fund commenced operations in fiscal year 2004 and is prospectively accounted for as a component unit – proprietary fund.

Chuuk State Hospital Transportation Fund: This fund was established under TDL No. 22-32 for the purpose of transporting patients of the State, who require periodic medical treatment and care, to the Chuuk State Hospital, to provide return transportation to their homes after treatment at the Chuuk State Hospital, and to provide for each of these patients a one dollar and fifty cents (\$1.50) noon meal during such travel, treatment and care.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

iii. Omitted Component Units

The following component units have been omitted from the basic financial statements due to the lack of available financial information:

Chuuk State Coconut Authority (CSCA): CSCA was created by TSL No. 1-1-12 and is responsible for the manufacturing, processing, buying, collecting, marketing, selling, exporting and dealing with, in general, all products derived from the coconut tree. CSCA is governed by a five-member Board of Directors appointed by the Governor subject to the advice and consent of the Legislature. The financial activities of this omitted component unit are not considered material to the basic financial statements.

Chuuk Public Fisheries Corporation (CPFC): CPFC was created by CSL No. 5-99-22 and is responsible for promoting the development of pelagic fisheries and related industries for the economic benefit of the people of the State. CPFC is governed by a five-member Board of Directors, which comprises of the Director of the Department of Marine Resources, the Director of the Department of Commerce and Industry, one member who is appointed by the Governor representing the Chamber of Commerce, and two members who are appointed by the President and the Speaker. The financial activities of this omitted component unit are not considered material to the basic financial statements as the State is of the opinion that no net assets exist within the fund as of September 30, 2005 as all have been liquidated and distributed to the owners.

iv. Component Units

Chuuk State Housing Authority (CSHA): CSHA was created by TSL No. 3-30 and is responsible for monitoring the U.S. Department of Housing and Urban Development Section 8 and CDBG housing renovation loan programs. Additionally, CSHA monitors the GLF loan fund of the State which provides low cost housing loans to the general public. CSHA is governed by a five-member Board of Directors appointed by the Governor subject to the advice and consent of the Legislature.

Chuuk Public Utility Corporation (CPUC): CPUC was created by CSL No. 3-97-05 and is responsible for providing electrical services to the public through the operation and the maintenance of the State's electrical power system. CPUC is governed by a five-member Board of Directors appointed by the Governor subject to the advice and consent of the Legislature.

B. Government-Wide Financial Statements

The Statement of Net Assets and the Statement of Activities report financial information on all of the non-fiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been eliminated from these statements except for other charges between the primary government and the discretely presented component units. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

Primary government activities are defined as either governmental or business-type activities. Governmental activities, which normally are supported by taxes, intergovernmental revenues and other non-exchange revenues, are reported separately from business-type activities, which rely to a significant extent on fees charged to external parties for goods or services. As such, business-type activities account for operations similarly to a for-profit business. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable. Discretely presented component unit activities are presented with their business-type focus.

The Statement of Net Assets presents all of the reporting entity's non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets.
- Restricted net assets result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.
- Unrestricted net assets consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, (for example, internally restricted), to indicate that management does not consider them to be available for general operations.

The government-wide Statement of Net Assets reports \$25,737,025 of restricted net assets, of which \$945,456 is restricted by enabling legislation.

The Statement of Activities demonstrates the degree to which the direct expenses of given functions or segments are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function or segment. Program revenues include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not meeting the definition of program revenues are, instead, reported as general revenue.

C. Fund Financial Statements

The fund financial statements present a balance sheet and a statement of revenues, expenditures, and changes in fund balances for its major and aggregated non-major funds.

Major individual governmental funds are reported as separate columns in the fund financial statements pursuant to GASB reporting standards, with nonmajor governmental funds being combined into a single column.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

C. Fund Financial Statements, Continued

The State reports its financial position and results of operations in funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures/expenses. Transactions between funds within a fund type, if any, have not been eliminated.

D. Measurement Focus and Basis of Accounting

The government-wide financial statements are reported using the economic resources management focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements account for the general governmental activities of the State and are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become susceptible to accrual; generally when they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the State considers revenues to be available if they are collected within sixty days of the end of the current fiscal period.

Significant revenues susceptible to accrual include income and gross revenue taxes, federal grants, federal reimbursements and other reimbursements for use of materials and services. Miscellaneous revenues from other financing sources are recognized when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned, since they are both measurable and available. Investments and related investment earnings are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Expenditures generally are recorded in the period in which the related fund liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Amounts reported as program revenue include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources are reported as general revenues rather than as program revenues. General revenue is derived from taxation, investment income and other fees that are not allocated to specific programs.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All other revenues are reported as nonoperating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

The State reports the following fund types:

1. Governmental Funds

i. General Fund

This fund is the primary operating fund of the State. It is used to account for all governmental transactions, except those required to be accounted for in another fund.

ii. Special Revenue Funds

These funds account for specific revenue sources that have been aggregated according to enabling legislation to support specific governmental activities.

iii. Capital Projects Funds

These funds account for the acquisition or construction of major State capital facilities financed primarily from loans and federal reimbursements.

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - Omnibus*, sets forth minimum criteria (percentage of the assets, liabilities, revenues or expenditures/expenses for either fund category or the governmental and enterprise combined) for the determination of major funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The nonmajor funds are combined in a column in the fund financial statements and detailed in the combining statements. The State reports the following major fund:

Compact Capital Projects Fund, a Governmental Fund Type - Capital Projects Fund. This fund is used to account for financial transactions related to Compact Capital Account funds as provided under Section 211(a) of the Compact of Free Association.

E. Reporting Standards

As allowed by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the State's proprietary funds follow all GASB pronouncements and those Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

F. Cash and Cash Equivalents and Time Certificates of Deposit

The State pools cash resources of its various funds in order to facilitate the management of cash. Unless otherwise required by law, interest income received on pooled cash accrues to the General Fund. Cash and cash equivalents applicable to a particular fund are readily identifiable. Cash and cash equivalents include cash held in demand accounts as well as short-term investments with a maturity date within three months of the date acquired by the State. Deposits maintained in time certificates of deposit with original maturity dates greater than three months are separately classified on the statement of net assets/balance sheet.

As of September 30, 2003, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit were \$765,983 and the corresponding bank balances were \$1,106,186, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2003, bank deposits in the amount of \$200,000 were FDIC insured. The State does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized.

G. Receivables

In general, tax revenue is recognized on the government-wide statements, when assessed or levied and on the governmental fund financial statements to the extent that it is both measurable and available. Receivables are stated net of estimated allowances for uncollectible accounts. Reimbursements due to the State for expenditures on federally funded reimbursement and grant programs are reported as "receivables from federal agencies".

Receivables of the primary government are primarily due from businesses and individuals residing in the State. The allowance for uncollectible accounts primarily represents those accounts that are more than ninety days delinquent as of September 30, 2003.

H. Prepaid Items

Certain payments made to vendors or persons for services reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

I. Interfund Receivables/Payables

During the course of its operations, the State records transactions between individual funds for goods provided or services rendered. Receivables and payables resulting from transactions between funds are classified as "due from other funds" or "due to other funds" on the governmental fund balance sheet.

These balances result from the time lag between the dates that 1) interfund goods and services are provided or reimbursable expenditures occur, 2) transactions are recorded in the accounting system, and 3) payments between funds are made, and are scheduled to be collected in the subsequent year.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

J. Restricted Assets

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through loan agreements or enabling legislation. Specifically, the State has collateralized Asian Development Bank loan proceeds and earnings in the amount of \$4,140,590 for the Chuuk State Early Retirement Scheme.

K. Capital Assets

Capital assets, which include property, plant, equipment and infrastructure assets (e.g. roads, bridges, docks, water and sewer lines, water catchments, and other similar items), are reported in the governmental activity column of the government-wide financial statements. Such assets, whether purchased or constructed, are recorded at historical cost or estimated historical cost. Donated capital assets are recorded at estimated fair market value at the date of donation.

The State currently holds no title to land. Machinery and equipment, other than vehicles and boats, are capitalized when the cost of individual items exceed \$50,000. Vehicles and boats, along with significant repair and maintenance qualifying as a betterment of such, are capitalized regardless of cost and depreciated. Buildings and infrastructure projects, along with significant improvements or reconstruction qualifying as a betterment of such, are capitalized when the cost of individual items or projects exceed \$100,000. The costs of normal maintenance and repairs that do not add to the value of the capital asset or materially extend capital asset lives are not capitalized.

Capital assets of the primary government and the component units are depreciated using the straight-line method over their estimated useful lives, with a full year's depreciation charged in the year of acquisition and disposal, regardless of date. Estimated useful lives are as follows:

Buildings	40 - 50 years
Infrastructure	25 - 50 years
Facilities	3 - 40 years
Machinery and equipment	3 - 25 years
Furniture and fixtures	3 - 10 years

L. Interfund/Intrafund Transactions

As a general rule, the effect of interfund activity has been eliminated in the government-wide financial statements. Exceptions to this rule are: 1) activities between funds reported as governmental activities and funds reported as business-type activities and 2) activities between funds that are reported in different functional categories in either the governmental or business-type activities column. Elimination of these activities would distort the direct costs and program revenues for the functions concerned.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

M. Deferred Revenue

In the government-wide financial statements, deferred revenue is recognized when cash, receivables or other assets are recorded prior to being earned. In the governmental fund financial statements deferred revenue represents monies received or revenues accrued which have not been earned or do not meet the "available" criterion for revenue recognition under the modified accrual basis of accounting. The deferred revenue in the governmental fund types has primarily resulted as federal funds are received in advance of eligible expenditures.

N. Compensated Absences

It is the government's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since the government does not have a policy to pay any amounts when employees separate from service with the government. All vacation pay is accrued when incurred in the government-wide fund financial statements. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements. Annual leave accumulates at the rate of one working day per bi-weekly pay period.

O. Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

The unreserved fund balances for the governmental funds represent the amount available for budgeting future operations. The reserve for related assets as of September 30, 2003, is represented by the following assets:

	<u>General</u>	<u>Compact Capital Projects</u>	<u>Other Governmental Funds</u>	<u>Totals</u>
Investments	\$ 987,745	\$ 3,675,505	\$ -	\$ 4,663,250
Receivables:				
FSM National	-	2,178,614	-	2,178,614
Government				
Restricted assets:				
Cash and cash equivalents	110,157	-	-	110,157
Investments	4,140,590	-	-	4,140,590
	<u>\$ 5,238,492</u>	<u>\$ 5,854,119</u>	<u>\$ -</u>	<u>\$ 11,092,611</u>

The reserve for related assets within the General Fund includes the amount of \$5,128,335 set aside for future repayment of the Early Retirement Program Loan.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

P. Risk Financing

The State is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. It is the policy of the primary government not to purchase commercial insurance for the risks of loss to which it is exposed. Instead, the State management believes it is more economical to manage its risks internally. In the event of claim settlements and judgments, the State reports all of its risk management activities in its General Fund. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported.

Q. Reclassifications and Restatements

During fiscal year 2003, the State implemented GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - Omnibus*. GASB Statement No. 34 establishes new financial reporting standards for state and local governments. The requirements of this statement result in a significant change in the financial reporting model used by governments, including statement formats and changes in fund types. In addition to the traditional fund financial statements, governments are required to report government-wide financial statements, prepared using the accrual basis of accounting and the economic resources measurement focus. As a result, fund reclassifications and adjustments to the fund equities reported in the prior financial statements were required.

In addition, the State implemented the following new accounting standards issued by GASB:

GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, amends certain note disclosures and adds additional note disclosure requirements related to GASB Statement Nos. 34 and 37.

GASB Statement No. 41, *Budgetary Comparison Schedules - Perspective Differences*, amends required supplemental information disclosure of adopted budget and actual amounts per GASB Statement No. 34. Should there be a perspective difference between these amounts and fund perspective revenues and expenditures, reconciliation is required.

Due to the implementation of GASB Statement Nos. 34 and 37, the beginning net assets of the governmental activities in the statement of net assets have been restated. Fund balances of the governmental funds at September 30, 2002 (as disclosed below) were increased by \$40,113,080 for the cumulative effect of these changes on years prior to fiscal year 2003:

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

Q. Reclassifications and Restatements, Continued

The effect of those items is as follows:

Fund balances as of September 30, 2002	\$ <u>7,151,512</u>
GASB Statement No. 34 adjustments:	
Long-term debt payable	(5,128,335)
Compensated absences payable	(829,208)
Land	6,363,242
Capital assets	56,224,691
Accumulated depreciation	<u>(10,064,017)</u>
	<u>46,566,373</u>
Beginning net assets as of October 1, 2002	\$ <u>53,717,885</u>

Due to the implementation of GASB Statement No. 34, certain governmental funds have been reclassified to conform with the GASB Statement No. 34 reporting model. The effects of such are as follows:

	September 30, 2002 As Previously Reported	Fund Reclassifications	Adjustments	September 30, 2002 As Restated
<u>Governmental Funds and Activities</u>				
Major governmental funds:				
General Fund	\$ (10,486,006)	\$ -	\$ -	\$ (10,486,006)
Previously reported as Capital Projects Funds:				
Compact Capital Projects Fund	<u>-</u>	<u>15,198,221</u>	<u>-</u>	<u>15,198,221</u>
	<u>\$ (10,486,006)</u>	<u>\$ 15,198,221</u>	<u>\$ -</u>	<u>\$ 4,712,215</u>
Nonmajor governmental funds:				
Special Revenue Funds	\$ <u>2,439,297</u>	<u>\$ -</u>	<u>\$ -</u>	\$ <u>2,439,297</u>
	<u>2,439,297</u>	<u>-</u>	<u>-</u>	<u>2,439,297</u>
Previously reported as Capital Projects Funds:				
Capital Projects Funds	15,198,221	-	-	15,198,221
Compact Capital Projects Fund	<u>-</u>	<u>(15,198,221)</u>	<u>-</u>	<u>(15,198,221)</u>
	<u>15,198,221</u>	<u>(15,198,221)</u>	<u>-</u>	<u>-</u>
	<u>\$ 17,637,518</u>	<u>\$ (15,198,221)</u>	<u>\$ -</u>	<u>\$ 2,439,297</u>

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

R. New Accounting Standards

In May 2002, GASB issued Statement No. 39, *Determining Whether Certain Organizations Are Component Units* (an amendment of GASB Statement 14), which provides additional guidance on GASB Statement No.14, in determining whether an entity should be reported as a component unit based on the nature and significance of its relationship with a primary government. The provisions of this Statement are effective for periods beginning after June 15, 2003. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In March 2003, GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures* (an amendment of GASB Statement No. 3), which addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest risk, GASB Statement No. 40 requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. The provisions of this Statement are effective for periods beginning after June 15, 2004. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In June 2003, GASB issued Technical Bulletin No. 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets*, which clarifies guidance on derivative disclosures, pending the results of the GASB's project on reporting and measurement of derivatives and hedging activities. This Technical Bulletin applies to derivatives that are not reported at fair value on the statement of net assets. The provisions of this Technical Bulletin are effective for periods beginning after June 15, 2003. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

S. Estimates

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

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(2) Investments

The State has invested the majority of its excess Compact Funds in a pooled investment fund which is managed under the control of the Federated Development Authority, an entity comprised of the FSM National Government and its four component states. Investment income originating from the pool accrues to the general fund.

The Federated Development 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:

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, bankers acceptances, certificates of deposit, commercial paper and repurchase agreements using any of the foregoing as collateral. The following restrictions apply: (1) Commercial paper must be rated A-1/P-1 or higher by Standard & Poors Corporation and Moody's Investor Services; and (2) Certificates of deposit must be from FDIC insured banks or FSLIC insured savings and loan associations, both of 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%.

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.

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.

- 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 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 of the Secretary of Finance.

GASB Statement No. 3 requires government entities to categorize investments to give an indication of the level of credit risk assumed by the entity at year end. The three categories are described below:

- | | |
|------------|--|
| Category 1 | Insured or registered, or securities held by the State or its agent in the State's name; |
| Category 2 | Uninsured and unregistered, with securities held by the broker's or dealer's trust department or agent in the State's name; or |
| Category 3 | Uninsured and unregistered, with securities held by the broker or dealer, or by its trust department or agent but not in the State's name. |

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(2) Investments, Continued

Investments of the primary government as of September 30, 2003, are as follows:

	Categories			Carrying Value
	1	2	3	
General Fund:				
Money market funds				\$ <u>4,140,590</u>
Compact Capital Projects Fund:				
Common stock	\$ <u>3,675,505</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>3,675,505</u>
Pooled Investments:				
U.S. Government obligations	\$ -	\$ 8,833,808	\$ -	\$ 8,833,808
Common stock	-	7,587,091	-	7,587,091
U.S. Government agencies	-	4,972,093	-	4,972,093
Corporate notes and bonds	-	659,488	-	659,488
	\$ -	\$ <u>22,052,480</u>	\$ -	22,052,480
Money market funds				<u>1,211,001</u>
				<u>\$ 23,263,481</u>

As of September 30, 2003, the Compact Capital Projects Fund holds 16.08% of the shares of the Bank of the Federated States of Micronesia in the amount of \$1,500,000, 7.36% of the shares of the Pacific Islands Development Bank in the amount of \$250,000, 50% of the shares in a joint venture with the National Fisheries Corporation of Chuuk Fresh Tuna, Inc. in the amount of \$1,202,005, and 1% of the shares of the FSM Development Bank in the amount of \$300,000. As the fair market value of these investments is not readily available, such have been recorded at cost.

In addition, the Compact Capital Projects Fund holds 0.01% of the shares of the Bank of Guam in the amount of \$423,500. This investment is carried at fair value based on 70,000 shares at \$6.05 per share as determined by the last closing value on the Pacific Stock Exchange.

(3) Receivables

Receivables as of September 30, 2003, for the primary government's individual major funds and nonmajor funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	<u>General</u>	<u>Compact Capital Projects</u>	<u>Nonmajor And Other Funds</u>	<u>Totals</u>
Receivables:				
FSM National Government	\$ -	\$ 2,660,983	\$ 1,046,831	\$ 3,707,814
Other	658,828	-	-	658,828
	658,828	2,660,983	1,046,831	4,366,642
Less: allowance for uncollectible accounts	(173,014)	-	(1,004,872)	(1,177,886)
Net receivables	\$ 485,814	\$ 2,660,983	\$ 41,959	\$ 3,188,756

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(4) Interfund Receivables and Payables

Receivables and payables between funds reflected as due to/from other funds in the combined balance sheet at September 30, 2003, are summarized as follows:

Receivable Fund	Payable Fund	Amount
Nonmajor governmental funds	General	\$ <u>6,497,123</u>

(5) Fixed Assets

Capital asset activities of the primary government for the year ended September 30, 2003, are as follows:

	Balance October <u>1, 2002</u>	Additions	Retirements	Balance September <u>30, 2003</u>
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 6,363,242	\$ 8,959,151	\$ -	\$ 15,322,393
Capital assets, being depreciated:				
Airport facilities	29,906,300	-	-	29,906,300
Buildings	9,214,947	60,000	-	9,274,947
Seaport facilities	6,537,700	-	-	6,537,700
Vehicles	308,744	-	-	308,744
Infrastructure	<u>10,257,000</u>	<u>-</u>	<u>-</u>	<u>10,257,000</u>
Total capital assets, being depreciated	56,224,691	60,000	-	56,284,691
Less accumulated depreciation for:				
Airport facilities	(2,790,746)	(702,657)	-	(3,493,403)
Buildings	(4,185,701)	(230,972)	-	(4,416,673)
Seaport facilities	(1,155,865)	(261,508)	-	(1,417,373)
Vehicles	(118,267)	(27,008)	-	(145,275)
Infrastructure	<u>(1,813,438)</u>	<u>(410,280)</u>	<u>-</u>	<u>(2,223,718)</u>
	<u>(10,064,017)</u>	<u>(1,634,425)</u>	<u>-</u>	<u>(11,698,442)</u>
Total capital assets, being depreciated, net	<u>46,160,674</u>	<u>(1,574,425)</u>	<u>-</u>	<u>44,588,249</u>
Governmental activities capital assets, net	<u>\$ 52,523,916</u>	<u>\$ 7,384,726</u>	<u>\$ -</u>	<u>\$ 59,908,642</u>

Depreciation expense was charged to functions/programs of the primary government's governmental activities as follows:

General government	\$ 69,459
Health services	156,342
Education	6,000
Public safety	5,078
Public works and transportation	1,390,879
Community affairs	<u>6,667</u>
	<u>\$ 1,634,425</u>

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(6) Notes Payable

Notes payable of the primary government are as follows:

Major Governmental Funds

General Fund:

Note payable to the FSM National Government, payable in quarterly installments of \$416,667, non-interest bearing with a service charge of 1% per annum, due on September 30, 2001. \$ 1,479,036

Compact Capital Projects Fund:

Note payable to a contractor for prior services performed, payable in monthly installments, with interest at 12% per annum. An agreement has not been executed by the State's Attorney General and some amounts due are being renegotiated. Until a mutual settlement occurs, payment will not be made. 329,179

\$ 1,808,215

No change in the above notes occurred during the year ended September 30, 2003.

(7) Long-term Obligations

Asian Development Bank (ADB) Early Retirement Program Loan

During the year ended September 30, 1998, the State implemented an Early Retirement Scheme (ERS) in which employees holding certain nonessential positions as identified by the State were retired early with a payout of the equivalent of two-years' wages. This ERS program is funded by a \$5,300,000 loan from the ADB through the FSM National Government, non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The activities of the ERS Program are recorded in the General Fund.

The ADB loan has a grace period of ten years with the first payment due in February 2008 and the last payment in August 2038. However, pursuant to the terms of the Financing Agreement between the State and the FSM National Government, the State is required to deposit into the ERS Trust account held in the name of the State within the FSM National Government investment portfolio, 100% of the outstanding principal balance by September 30, 2002.

Funds for the repayment of the ADB loan are expected to be derived from the annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The Financing Agreement requires the State to continue to appropriate salaries for the abolished positions and deposit the appropriate funds into the ERS Trust Account. These funds had not been deposited to the Trust Account as of September 30, 2002. \$5,128,335 identified for future debt service payments is included in the General Fund reserve for related assets of which \$4,140,590 is actually deposited in an investment account held jointly with the FSM National Government. That investment account is restricted for the repayment of this debt.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(7) Long-term Obligations, Continued

Asian Development Bank (ADB) Early Retirement Program Loan, Continued

Annual debt service requirements to maturity for principal and interest are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ -	\$ -	\$ -
2005	-	-	-
2006	-	-	-
2007	-	-	-
2008	170,945	-	170,945
2009 - 2013	854,722	-	854,722
2014 - 2018	854,722	-	854,722
2019 - 2023	854,722	-	854,722
2024 - 2028	854,722	-	854,722
2029 - 2033	854,722	-	854,722
2034 - 2038	<u>683,780</u>	<u>-</u>	<u>683,780</u>
	<u>\$ 5,128,335</u>	<u>\$ -</u>	<u>\$ 5,128,335</u>

Other long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2003, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net assets:

	<u>Balance October 1, 2002</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance September 30, 2003</u>	<u>Due Within One Year</u>
Loan payable:					
ADB loan	\$ 5,128,335	\$ -	\$ -	\$ 5,128,335	\$ -
Other:					
Compensated absences	<u>829,208</u>	<u>-</u>	<u>-</u>	<u>829,208</u>	<u>101,086</u>
	<u>\$ 5,957,543</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,957,543</u>	<u>\$ 101,086</u>

The net change in compensated absences for the year ended September 30, 2003 is immaterial and, therefore, no change is presented.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2003

(8) Contingencies

Sick Leave

It is the policy of the State to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave as of September 30, 2003 is \$3,396,836.

Insurance Coverage

The State does not maintain insurance coverage for a significant amount of fixed assets. In the event of a catastrophe, the State may be self-insured to a material extent.

Federal Grants

The State participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of \$2,634,454 relating to fiscal years 1999 through 2003 have been set forth in the State's Single Audit Report for the year ended September 30, 2003. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

Litigation

The State is a party to various legal proceedings. 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 and a corresponding allotment from the Executive Branch. No appropriation currently exists to finance these judgements. The State's Attorney General indicates that pending cases and other claims against the State exist at September 30, 2003 in the amount of approximately \$7.2 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.

Loan Guarantee

The State has guaranteed repayment of a note payable of Chuuk Public Utility Corporation to the Asian Development Bank. The loan additionally passed through the FSM National Government. At September 30, 2003, the loan balance is \$3,461,734.

(9) Individual Deficit Fund Balances

Specific individual funds which had significant individual deficit fund balances as at September 30, 2003, are as follows:

Major Governmental Funds

General Fund	\$ <u>15,487,940</u>
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Nonmajor Governmental Funds

U.S. Federal Grant Assistance Fund	\$ <u>9,904</u>
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STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2003

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Schedule of Revenues, Expenditures and Changes in Deficit
Budget and Actual - General Fund
Year Ended September 30, 2003

	<u>Budgeted Amounts</u>		Actual - Budgetary Basis (see Note 1)	Variance with Final Budget - Positive (Negative)
	<u>Original</u>	<u>Final</u>		
Revenues:				
Compact funds	\$ 13,619,147	\$ 13,619,147	\$ 17,527,677	\$ 3,908,530
Local revenues	8,581,706	8,581,706	6,443,841	(2,137,865)
Net increase in the fair value of investments	-	-	1,861,448	1,861,448
Total revenues	<u>22,200,853</u>	<u>22,200,853</u>	<u>25,832,966</u>	<u>3,632,113</u>
Expenditures:				
Current:				
General government	-	4,850,679	4,853,454	(2,775)
Health services	-	3,145,836	2,792,832	353,004
Education	-	6,957,899	6,136,712	821,187
Economic development	-	1,046,119	1,013,731	32,388
Public safety	-	1,169,962	1,142,488	27,474
Public works and transportation	-	1,137,116	1,124,902	12,214
Community affairs	-	261,571	252,571	9,000
Boards and commissions	-	558,542	564,272	(5,730)
Judiciary	-	632,597	586,094	46,503
Payments to component units	-	287,679	277,230	10,449
Municipal affairs	-	1,504,826	1,540,477	(35,651)
Debt service	-	225,009	225,000	9
Other	-	455,657	10,415,162	(9,959,505)
Total expenditures	<u>-</u>	<u>22,233,492</u>	<u>30,924,925</u>	<u>(8,691,433)</u>
Excess (deficiency) of revenues over (under) expenditures	<u>22,200,853</u>	<u>(32,639)</u>	<u>(5,091,959)</u>	<u>(5,059,320)</u>
Other financing uses:				
Operating transfers out	-	-	(128,756)	(128,756)
Net change in unreserved deficit	<u>22,200,853</u>	<u>(32,639)</u>	<u>(5,220,715)</u>	<u>(5,188,076)</u>
Other changes in unreserved fund balance:				
Decrease in reserve for related assets	-	-	1,904,407	1,904,407
Unreserved fund balance at the beginning of the year	<u>(18,108,641)</u>	<u>(18,108,641)</u>	<u>(18,108,641)</u>	<u>-</u>
Unreserved fund balance at the end of the year	<u>\$ 4,092,212</u>	<u>\$ (18,141,280)</u>	<u>\$ (21,424,949)</u>	<u>\$ (3,283,669)</u>

See accompanying notes to required supplementary information - budgetary reporting.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Required Supplementary Information - Budgetary Reporting
September 30, 2003

(1) Budgetary Information

An annual appropriated budget is adopted by the State's Legislature for the General Fund and Compact Programs through an Appropriations Act. However, additional appropriations and budget modifications occur throughout the year. The majority of unencumbered appropriations lapse as of year end unless specifically extended by the State's Legislature. Budgets for special revenue funds, except the Compact Program Fund, are not included in the annual Appropriations Act. Accordingly, a budget to actual presentation for special revenue funds, except the Compact Program Fund, is not required or presented. Project-length financial plans are generally adopted for all capital project funds.

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 as reservations of fund balance until becoming expended or canceled. If an encumbrance is subsequently canceled, the funds revert to the applicable unreserved fund balance unless otherwise required by law.

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

Encumbrance accounting is employed in governmental funds. For budgetary purposes, the encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be reappropriated and honored during the subsequent fiscal year.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2003

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Combining Schedule of Expenditures by Account
Governmental Funds
Year Ended September 30, 2003

	General	Capital Projects Compact Capital Projects	Other Governmental Funds	Total
Expenditures:				
Salaries and wages	\$ 16,718,672	\$ 45,460	\$ 1,761,633	\$ 18,525,765
Grants and subsidies	-	-	999,998	999,998
Contractual services	892,940	3,655,829	1,260,563	5,809,332
Capital outlay	9,028,910	556,513	84,862	9,670,285
Travel	755,438	-	73,152	828,590
Other	3,310,184	1,037,765	1,538,503	5,886,452
	<u>\$ 30,706,144</u>	<u>\$ 5,295,567</u>	<u>\$ 5,718,711</u>	<u>\$ 41,720,422</u>

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

GENERAL FUND

September 30, 2003

The general fund is used to account for resources traditionally associated with government which are not required legally or by sound financial management to be accounted for in another fund. The United States Compact of Free Association current account and inflation adjustment funds associated with the current account are accounted for in this fund in addition to local taxes and other revenues.

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function, and Changes in Deficit
General Fund
Year Ended September 30, 2003
(with comparative totals for the year ended September 30, 2002)

	2003	2002
Revenues:		
Compact funds:		
Current Section 211(a) base grant	\$ 11,093,467	\$ 11,093,467
Current Section 217 inflation adjustment	6,434,210	6,434,210
	17,527,677	17,527,677
FSM revenue sharing	3,283,610	2,878,990
Excise taxes:		
Sales tax	1,610,838	1,148,109
Hotel	203,551	139,170
Tobacco	63,190	41,357
Alcoholic beverages	116,954	6,277
Delinquent tax collections	14,533	4,223
Other excise taxes	189,793	88,994
	2,198,859	1,428,130
Fees and charges:		
Licenses and permits	122,879	49,693
Leases and other rentals	74,742	86,125
	197,621	135,818
Departmental charges:		
Transportation collections	623,199	462,072
Hospital and utility collections	6,280	1,215
	629,479	463,287
Net increase (decrease) in the fair value of investments	1,861,448	(1,165,534)
Contributions from component units	-	300,000
Other revenues	134,272	190,861
Total revenues	25,832,966	21,759,229
Expenditures:		
Current:		
General government:		
Office of the Governor	983,310	557,827
State Legislature	2,909,157	2,977,476
Department of Treasury	608,588	993,506
Office of Budget	127,241	198,379
Department of Planning and Statistics	183,783	183,614
Office of Personnel	106,645	105,642
	4,918,724	5,016,444
Health services:		
Department of Health Services	2,792,832	3,027,163
Education:		
Department of Education	5,689,522	5,814,248
Economic Development:		
Department of Agriculture	309,519	363,007
Department of Commerce and Industry	308,721	284,451
Department of Marine Resources	393,903	431,793
	1,012,143	1,079,251

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function, and Changes in Deficit, Continued
General Fund
Year Ended September 30, 2003
(with comparative totals for the year ended September 30, 2002)

	2003	2002
Expenditures, continued:		
Current, continued:		
Public Safety:		
Office of the Attorney General	193,321	242,529
Department of Public Safety	948,444	1,288,278
	1,141,765	1,530,807
Public Works and Transportation:		
Department of Transportation	1,124,902	1,189,151
Community Affairs:		
Department of Public Affairs	252,571	247,232
Boards and Commissions:		
Chuuk Recreation Board	49,432	236,717
Land Commission	140,756	168,831
Education Board	(1,446)	2,250
Election Commission	297,574	118,625
Investment Board	3,850	-
Mortlocks Commission	12,780	-
Faichuk Commission	49,073	-
	552,019	526,423
Judiciary:		
State Court	585,919	585,740
Payments to component units:		
Chuuk Coconut Authority	102,963	107,347
Chuuk State Housing Authority	84,429	100,983
Chuuk Visitors' Bureau	87,331	-
	274,723	208,330
Municipal Affairs:		
Payments to municipalities	1,539,735	-
Debt service:		
Debt service payments	225,000	-
Other:		
Public Auditor	21,309	15,176
Small Business Development Center	65,815	40,000
Farmers Home Administration	50,488	-
Land lease and acquisition	8,959,151	-
Other	1,499,526	5,890,544
	10,596,289	5,945,720
Total expenditures	30,706,144	25,170,509
Deficiency of revenues under expenditures	(4,873,178)	(3,411,280)
Other financing uses:		
Operating transfers out	(128,756)	-
Net change in deficit	(5,001,934)	(3,411,280)
Deficit at the beginning of the year	(10,486,006)	(7,074,726)
Deficit at the end of the year	\$ (15,487,940)	\$ (10,486,006)

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures and Changes in Deficit
Budget and Actual - General Fund
Year Ended September 30, 2003

	Budgeted Amounts		Actual Budgetary Basis (see Note 1)	Variance with Final Budget Positive/(Negative)
	Original	Final		
Revenues:				
Compact funds:				
Current Account Sections 211(a) and 217	\$ 13,619,147	\$ 13,619,147	\$ 17,527,677	\$ 3,908,530
Local revenues	8,581,706	8,581,706	6,443,841	(2,137,865)
Net increase in the fair value of investments	-	-	1,861,448	1,861,448
Total revenues	22,200,853	22,200,853	25,832,966	3,632,113
Expenditures:				
Current:				
General government:				
Office of the Governor	-	964,627	986,884	(22,257)
State Legislature	-	2,899,177	2,854,425	44,752
Department of Treasury	-	577,689	608,588	(30,899)
Office of Budget	-	136,163	127,241	8,922
Department of Planning and Statistics	-	168,346	169,424	(1,078)
Office of Personnel	-	104,677	106,892	(2,215)
	-	4,850,679	4,853,454	(2,775)
Health services:				
Department of Health Services	-	3,145,836	2,792,832	353,004
Education:				
Department of Education	-	6,957,899	6,136,712	821,187
Economic Development:				
Department of Agriculture	-	332,256	309,519	22,737
Department of Commerce and Industry	-	298,999	310,309	(11,310)
Department of Marine Resources	-	414,864	393,903	20,961
	-	1,046,119	1,013,731	32,388
Public Safety:				
Office of Attorney General	-	197,280	194,044	3,236
Department of Public Safety	-	972,682	948,444	24,238
	-	1,169,962	1,142,488	27,474
Public Works and Transportation:				
Department of Transportation	-	1,137,116	1,124,902	12,214
Community Affairs:				
Department of Public Affairs	-	261,571	252,571	9,000
Boards and Commissions:				
Chuuk Recreation Board	-	53,434	49,432	4,002
Land Commission	-	139,654	140,756	(1,102)
Education Board	-	1,350	(1,446)	2,796
Election Commission	-	316,673	308,692	7,981
Investment Board	-	-	3,850	(3,850)
Mortlocks Commission	-	13,681	12,780	901
Faichuk Commission	-	33,750	50,208	(16,458)
	-	558,542	564,272	(5,730)
Judiciary:				
State Court	-	632,597	586,094	46,503
Payments to component units:				
Chuuk Coconut Authority	-	92,000	102,963	(10,963)
Chuuk State Housing Authority	-	107,800	84,429	23,371
Chuuk Visitors' Bureau	-	87,879	89,838	(1,959)
	-	287,679	277,230	10,449
Municipal Affairs:				
Payments to municipalities	-	1,504,826	1,540,477	(35,651)
Debt service:				
Debt service payments	-	225,009	225,000	9
Other:				
Public Auditor	-	47,083	21,309	25,774
Small Business Development Center	-	70,000	68,262	1,738
Farmers Home Administration	-	47,500	50,488	(2,988)
Land lease and acquisition	-	-	8,959,151	(8,959,151)
Other	-	291,074	1,315,952	(1,024,878)
	-	455,657	10,415,162	(9,959,505)
Total expenditures	-	22,233,492	30,924,925	(8,691,433)
Deficiency of revenues under expenditures	22,200,853	(32,639)	(5,091,959)	(5,059,320)
Other financing uses:				
Other transfers out	-	-	(128,756)	(128,756)
Net change in deficit	22,200,853	(32,639)	(5,220,715)	(5,188,076)
Other changes in unreserved deficit:				
Decrease in reserve for related assets	-	-	1,904,407	1,904,407
Unreserved deficit at the beginning of the year	(18,108,641)	(18,108,641)	(18,108,641)	-
Unreserved deficit at the end of the year	\$ 4,092,212	\$ (18,141,280)	\$ (21,424,949)	\$ (3,283,669)

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS - SPECIAL REVENUE FUNDS

September 30, 2003

Special revenue funds are used to account for specific revenues that are legally restricted for particular purposes. A brief discussion of the State's Nonmajor Governmental Funds - Special Revenue Funds as of September 30, 2003, follows:

Chuuk Visitors' Bureau

This fund accounts for funds received by the Chuuk Visitors' Bureau (CVB) to improve and develop Chuuk's tourism industry. The CVB financial statements are immaterial and accordingly, are not presented herein.

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) Scholarship Fund: 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.

STATE OF CHUUK
 FEDERATED STATES OF MICRONESIA
 NONMAJOR GOVERNMENTAL FUNDS
 SPECIAL REVENUE FUNDS

Combining Balance Sheet
 September 30, 2003

	Chuuk Airport Authority	U.S. Federal Grant Assistance	CFSM Grants	Compact Other Grants	Compact Special Block Section 221(b)	Total
ASSETS						
Receivable from CFSM	\$ -	\$ 41,959	\$ -	\$ -	\$ -	\$ 41,959
Due from other funds	949,749	751,338	22,355	1,686,082	3,087,599	6,497,123
Total assets	\$ 949,749	\$ 793,297	\$ 22,355	\$ 1,686,082	\$ 3,087,599	\$ 6,539,082
LIABILITIES AND FUND BALANCES (DEFICITS)						
Liabilities:						
Accounts payable	\$ 4,293	\$ 803,201	\$ 22,355	\$ 153,265	\$ 1,946,797	\$ 2,929,911
Total liabilities	4,293	803,201	22,355	153,265	1,946,797	2,929,911
Fund balances (deficits):						
Reserved for:						
Encumbrances	-	59,608	-	-	8,538	68,146
Unreserved (deficit)	945,456	(69,512)	-	1,532,817	1,132,264	3,541,025
Total fund balances (deficits)	945,456	(9,904)	-	1,532,817	1,140,802	3,609,171
Total liabilities and fund balances (deficits)	\$ 949,749	\$ 793,297	\$ 22,355	\$ 1,686,082	\$ 3,087,599	\$ 6,539,082

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
 FEDERATED STATES OF MICRONESIA
 NONMAJOR GOVERNMENTAL FUNDS
 SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures By Function,
 and Changes in Fund Balances (Deficits)
 Year Ended September 30, 2003

	Chuuk Airport Authority	U.S. Federal Grant Assistance	CFSM Grants	Compact Other Grants	Compact Special Block Section 221(b)	Total
Revenues:						
Compact funding	\$ -	\$ -	\$ -	2,230,391	2,730,000	4,960,391
Federal contributions	-	1,646,887	-	-	-	1,646,887
CFSM grants	-	-	8,389	-	-	8,389
Fees and charges	73,752	-	-	-	-	73,752
Other	-	64,250	6,160	-	-	70,410
Total revenues	73,752	1,711,137	14,549	2,230,391	2,730,000	6,759,829
Expenditures by function:						
Current:						
General government	-	-	-	380,918	88,691	469,609
Health services	-	51,899	-	273,725	420,240	745,864
Education	-	974,349	-	-	1,513,659	2,488,008
Economic development	-	35,676	-	-	-	35,676
Public works and transportation	-	-	-	250,000	107,756	357,756
Payments to component units	-	-	-	999,998	-	999,998
Other	-	584,963	-	-	36,837	621,800
Total expenditures	-	1,646,887	-	1,904,641	2,167,183	5,718,711
Excess of revenues over expenditures	73,752	64,250	14,549	325,750	562,817	1,041,118
Other financing sources:						
Operating transfers in	-	-	128,756	-	-	128,756
Net change in fund balances (deficits)	73,752	64,250	143,305	325,750	562,817	1,169,874
Fund balances (deficits) at the beginning of the year	871,704	(74,154)	(143,305)	1,207,067	577,985	2,439,297
Fund balances (deficits) at the end of the year	\$ 945,456	\$ (9,904)	\$ -	\$ 1,532,817	\$ 1,140,802	\$ 3,609,171

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
 FEDERATED STATES OF MICRONESIA
 NONMAJOR GOVERNMENTAL FUNDS
 SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures By Account,
 and Changes in Fund Balances (Deficits)
 Year Ended September 30, 2003

	Chuuk Airport Authority	U.S. Federal Grant Assistance	CFSM Grants	Compact Other Grants	Compact Special Block Section 221(b)	Total
Revenues:	\$ -	\$ -	\$ -	\$ 2,230,391	\$ 2,730,000	\$ 4,960,391
Compact funding	-	-	-	-	-	1,646,887
Federal contributions	-	1,646,887	-	-	-	8,389
CFSM grants	73,752	-	8,389	-	-	73,752
Fees and charges	-	-	-	-	-	70,410
Other	-	64,250	6,160	-	-	-
Total revenues	73,752	1,711,137	14,549	2,230,391	2,730,000	6,759,829
Expenditures by account:						
Salaries and wages	-	340,717	-	25,595	1,395,321	1,761,633
Grants and subsidies	-	-	-	999,998	-	999,998
Contractual services	-	776,414	-	456,558	27,591	1,260,563
Travel	-	69,174	-	1,268	2,710	73,152
Capital outlay	-	79,213	-	-	5,649	84,862
Other	-	381,369	-	421,222	735,912	1,538,503
Total expenditures	-	1,646,887	-	1,904,641	2,167,183	5,718,711
Excess of revenues over expenditures	73,752	64,250	14,549	325,750	562,817	1,041,118
Other financing sources:						
Operating transfers in	-	-	128,756	-	-	128,756
Net change in fund balances (deficits)	73,752	64,250	143,305	325,750	562,817	1,169,874
Fund balances (deficits) at the beginning of the year	871,704	(74,154)	(143,305)	1,207,067	577,985	2,439,297
Fund balances (deficits) at the end of the year	\$ 945,456	\$ (9,904)	\$ -	\$ 1,532,817	\$ 1,140,802	\$ 3,609,171

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 Wesley Simina
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, 2003, and have issued our report thereon dated May 31, 2006, which report was qualified due to 1) obligations for land leases being excluded from the General Fund; 2) our inability to determine the propriety of fixed assets; 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 the inclusion of unaudited financial statements of the Chuuk Public Utility Corporation and the Chuuk State Housing Authority and 6) our inability to form an opinion on accounts payable and reserve for encumbrances of the Governmental Fund types and the aggregate remaining fund information. 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

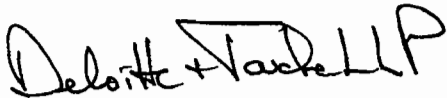
In planning and performing our audit, we considered the State's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide an opinion on the internal control over financial 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 2003-07 through 2003-16.

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 2003-10 and 2003-16 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 61 through 76) as items 2003-01 through 2003-06.

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.

May 31, 2006

**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 Wesley Simina
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, 2003. 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 59 and 60). 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 2003-01 through 2003-06 and 2003-16 in the accompanying Schedule of Findings and Questioned Costs, the State did not comply with requirements regarding activities allowed or unallowed and allowable costs/cost principles (CFDA #15.875), procurement and suspension and debarment (CFDA #84.256A and #83.544), equipment and real property management (all major programs), and special tests and requirements governing the Compact of Free Association Scholarship Program (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, 2003.

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 2003-01 through 2003-06 and item 2003-16.

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 2003-01 through 2003-06 and item 2003-16 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, 2003, and have issued our report thereon dated May 31, 2006, which report was qualified due to 1) obligations for land leases being excluded from the General Fund; 2) our inability to determine the propriety of fixed assets; 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 the inclusion of unaudited financial statements of the Chuuk Public Utility Corporation and the Chuuk State Housing Authority and 6) our inability to form an opinion on accounts payable and reserve for encumbrances of the Governmental Fund types and the aggregate remaining fund information. 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 54 through 58) 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

May 31, 2006

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards
Federal Grant Assistance Fund
Year Ended September 30, 2003

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	\$ (1,901)
School Improvement Project	FG3003	84.256A	10,755
School Improvement Project	FG3004	84.256A	576,791
96 School Improvement Project	TX4010	84.256A	215,615
Total CFDA 84.256a			801,260
BECLEPS (EDUCATION)6-01-21	FG4001	84.290	83,710
<u>Received in a Pass through Capacity From:</u>			
<u>Pacific Resources for Education and Learning (PREL)</u>			
Vocational Education Improvement Project	3874	84.994	89,379
Total Pacific Resources for Education and Learning (CFDA #84.994)			89,379
Total U.S. Department of Education			974,349
<u>FSM National Government:</u>			
<u>U.S. Department of Homeland Security</u>			
FEMA 1427-DR-FM (Chataan)	TX7203	83.544	583,483
FEMA 1427-DR-FM (Chataan)	TX7204	83.544	950
El Nino Drought/Public Assistance	TX8500	83.544	530
Total CFDA #83.544			584,963
<u>U.S. Department of Health and Human Services</u>			
AIDS Prevention	TV0230	93.940	4,852
Immunization	TV0240	93.268	13,887
MCH Programs/6-01-21	TV1203	93.994	6,246
Tuberculosis Control Prog	TV2721	93.116	13,172
Substance Abuse (6-01-21)	TV2802	93.959	13,742
Total Department of Health and Human Services			51,899
<u>U.S. Department of Agriculture</u>			
Urban and Community Forestry	TE1201	10.664	35,676
Total CFDA #10.664			35,676
Total Federal Financial Assistance Fund			\$ 1,646,887

Reconciliation to the general purpose financial statements:

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
Year Ended September 30, 2003

Grantor Account Title	Org./Cost Center #	CFDA I.D. #	Expenditures
Total Compact of Free Association			
Capital Projects Fund-Section 211 (A)(2)	Various	15.875	\$ 5,295,567
Section 214 (c) Energy Grants	CT2783/272783	15.875 (A) (B)	1,380,916
Special Development Assistance		15.875	250,000
Medical and Health 216(A)(2)	HM6091	15.875	273,725
Scholarship Funding		15.875	188,862
Block Grant Fund-Section 221(b)	Various	15.875	<u>2,167,183</u>
Total Compact of Free Association - Other Grants Fund			<u>\$ 9,556,253</u>

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 reallocates such to the component States.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2003

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, 2003

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 2003 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 2003 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, 2003

<u>Grantor Program Title</u>	<u>CFDA No.</u>	<u>2003 Fiscal Year Expenditures</u>
<u>U.S. Dept. of the Interior</u>		
Compact of Free Association:		
211(A) Capital Account	15.875	\$ 5,295,567
Block Grant Fund – Section 221(b)	15.875	2,167,183
Scholarship Grant Funding	15.875	<u>188,862</u>
Total Major Programs Under CFDA # 15.875 excluding Compact Section 211 (A) Current Account expenditures		<u>7,651,612</u>
 <u>U.S. Department of Education</u>		
School Improvement Project	84.256A	<u>801,200</u>
 <u>U.S. Department of Homeland Security</u>		
Chataan	83.544	<u>584,963</u>
Total U.S. Federal program expenditures selected excluding Compact Section 211 (A) Current Account expenditures		\$ <u>9,037,775</u>
Total U.S. Federal program expenditures excluding Compact Section 211 (A) Current Account expenditures		\$ <u>11,203,140</u>
% of total U.S. Federal expenditures covered by major programs excluding Compact Section 211 (A) Current Account expenditures		<u>81%</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, 2003

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 the Interior – Compact of Free Association, Block Grant Fund	15.875
U.S. Department of the Interior – Compact of Free Association, Scholarship Fund	15.875
U.S. Department of Education - School Improvement Project	84.256A
U.S. Department of Homeland Security - Chataan	83.544

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>
2003-07	Hospital Collections
2003-08	Compact Capital Debt Remaining Unpaid
2003-09	Education Employee Ceiling
2003-10	Non-Reconciliation of Bank Accounts
2003-11	Timely Clearing of Reconciling Items on the Bank Reconciliations
2003-12	Accounts Payable Imbalance
2003-13	Lack of Timely Deposits and Numerical Sequence of Receipts
2003-14	Personnel Action Forms Not in Agreement with Actual Pay Rates
2003-15	Write-off of Travel Advances of \$464,917
2003-16	Implementation of Fixed Assets for GASB Statement No. 34

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2003

Part III - Federal Award Findings and Questioned Cost Section

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
2003-01	Compact of Free Association - Section 211A Capital Funds	\$389,496
2003-02	Compact of Free Association - Special Revenue Funds, Special Block Grant and Health and Education	\$167,798
2003-03	Typhoon Chataan – Procurement, Suspension and Debarment	\$583,483
2003-04	Section 211(A) – Compact Capital Funds	\$545,052
2003-05	School Improvement Project – Procurement, Suspension and Debarment	\$122,029
2003-06	Scholarship Program – Special Terms and Conditions	\$ 32,500
2003-16	Implementation of Fixed Assets for GASB Statement No. 34	\$ -

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Finding No.: 2003-01
CFDA No.: 15.875
Agency: U.S. Department of the Interior
Program Name: Compact of Free Association
Requirement: Section 211A Capital Funds
Questioned Costs: \$389,496

Criteria: Compact Capital expenditures should be adequately supported to indicate conformance with eligible use criteria incorporated in to the Compact of Free Association.

Condition: We tested 48 payments made by the State and charged to the Compact Capital account. The majority of these payments relate to the acquisition of land at the airport complex. However, we were unable to locate actual payment agreements for thirteen payments aggregating \$259,496. Additionally, we located payments made for airport land acquisition that were not listed on the State's official debt listing, which itemized payments and the balance owing to the respective landowners.

<u>CK #</u>	<u>Check Amount</u>
32012	\$20,000.00
32013	15,000.00
32016	25,000.00
32018	23,463.00
32023	15,428.58
32027	25,000.00
32032	13,674.00
32052	23,463.00
32068	20,000.00
32086	25,000.00
32106	23,466.50
32110	20,000.00
32122	14,000.00

We additionally noted two payments aggregating \$130,000 (check numbers 32214 and 32215) made for leases that appear operating in nature and do not appear to conform to the underlying Compact Capital criteria. These lease payments relate to the lease of the Attorney Generals' office and of the Courthouse.

Cause: The cause of this condition appears to be deficiencies in the State's recordkeeping and noncompliance with Compact Capital requirements.

Effect: The effect of this condition is questioned costs in the amount of \$389,496.

Recommendation: The State should ensure that it maintains adequate documentation in support of its expenditures and that Compact Capital expenditures conform to the terms of the subsidiary agreements.

Auditee Response and Corrective Action Plan: Most of the documents mentioned above (10 APVs package) were already moved to the storage room of Supplies Office, which made it difficult to retrieve certain documents. Filing system has been improved to solve this problem in the future. Effective FY 2006, every document being taken out from the storage room has to be properly accounted for. A log book will be maintained to monitor the users of the documents.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Finding No.: 2003-02
CFDA No.: 15.875
Agency: U.S. Department of the Interior
Program Name: Compact of Free Association
Requirement: Special Revenue Funds, Special Block Grant and Health and Education
Questioned Costs: \$167,798

Criteria: The State should be able to locate payment documentation supporting the use of Federal funds.

Condition: In eight of twenty-five expenditures tested, the State was unable to provide us with detail supporting the basis of the expenditure. These amounts aggregate \$167,798.

<u>CK #</u>	<u>Check Amount</u>
64077	\$29,807.00
59432	24,228.61
60788	24,205.52
61894	21,632.07
61894	21,406.00
59680	15,865.00
61892	15,653.20
59160	15,000.00

Cause: The State is not able to locate the accounts payable vouchers for the applicable payments.

Effect: The effect of this condition is questioned costs due to the State's inability to support actual payments made.

Recommendation: The State should ensure that adequate support is maintained on file to support expenditures of federal funds.

Auditee Response and Corrective Action Plan: Most of the documents mentioned above were already transferred to the storage room of Supplies Office, which makes it difficult to retrieve certain documents. Filing system has been improved to solve this problem in the future. Effective FY 2006, every document being taken into and out of the storage room has to be properly accounted for. A log book will be maintained to monitor the users of the documents.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Finding No.: 2003-03
CFDA No.: 83.544
Agency: U.S. Department of Homeland Security
Program Name: Typhoon Chataan
Requirement: Procurement, Suspension & Debarment
Questioned Costs: \$583,483

Criteria: The State should conform to federal procurement requirements and should not record expenditures until underlying goods or services have been received.

Condition: Questioned costs of \$583,483 exist due to the absence of competitive procurement and due to the expenditures being recorded prior to a contract being entered into and any actual goods or services being received. Based on our analysis, it appears that underlying contracts/agreements were entered into in fiscal year 2004 and therefore, it is inappropriate to record these expenditures in fiscal year 2003.

Cause: The cause of this condition appears to be an absence of compliance with federal rules or regulations. Additionally, it appears that the State advanced these funds to vendors to ensure that related materials could be ordered as it was represented that otherwise, local vendors would not have the capacity to order requested materials.

Effect: The impact of this condition is questioned costs in the amount of \$583,483.

Recommendation: The State should examine the reason that these expenditures were recorded and paid prior to any goods or services being received and prior to actual contracts being entered into.

Auditee Response and Corrective Action Plan: Most local vendors do not accept Chuuk State Purchase Orders without advance payment because of Chuuk State's inability to pay these vendors on time. For many years in the past, our local vendors were not paid on time. As a result, many local vendors no longer accept Chuuk State Purchase Orders. Chuuk State Financial Management Act allows the Director of Finance or his designee to approve advance payment on a purchase order when a vendor requires advance payment and refuses to accept PO and the item being purchased is not available anywhere. (Part 6.9.c). However, with the new Compact II as amended, advance payment is limited only to procurement of pharmaceutical products purchased abroad.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Finding No.: 2003-04
 CFDA No.: 15.875
 Agency: U. S. Department of the Interior
 Program Name: Section 211 (A) – Compact Capital Funds
 Requirement: Activities Allowed or Unallowed
 Questioned Costs: \$545,052

Criteria: Compact Capital Funds should be expended in accordance with applicable criteria set forth in the Fiscal Procedures Agreement.

Condition: The following expenditures, which were paid for by the FSM National Government on behalf of the State of Chuuk, under a memorandum of understanding, do not appear to conform to the requirements of the Fiscal Procedures Agreement.

<u>Check Date</u>	<u>Check Number</u>	<u>Amount</u>	<u>Comments</u>
2/9/2004	10043	\$5,453	For Polle Municipality:
		62	Staples
		16	Stapler
		6	Puncher
		50	Fasteners
		197	Pens
		32	Pencils
		334	Letter size papers
		450	Legal size papers
		5	Glue
		423	Bond paper
2/9/2004	10044	2,000	Rakes, machetes, saws, etc
2/12/2004	10048	289	Worker's stipend for Chuuk State Health Care Plan
2/12/2004	10050	368	Worker's stipend for Chuuk State Health Care Plan
2/12/2004	10049	69	Worker's stipend for Chuuk State Health Care Plan
2/12/2004	10051	822	Worker's stipend for Chuuk State Health Care Plan
2/26/2004	10073	822	Worker's stipend for Chuuk State Health Care Plan
2/26/2004	10072	230	Worker's stipend for Chuuk State Health Care Plan
2/26/2004	10070	305	Worker's stipend for Chuuk State Health Care Plan
10/17/2003	9850	101	Health deductions re. Health Care Plan people
11/7/2003	9877	822	Chuuk State Health Care Plan (CSHCP) (Gross pay = \$2,077.06) for PPE 11/16/03)
11/14/2003	9884	729 2,077	Gas & fuel - for office use only PPE 11/16/03 - CSHCP
12/4/2003	9877	525	Fuel for Municipal vehicles
7/18/2003	Enc #L53186	16,610	Charged 10% sales tax - Legal sales tax is 5%
9/30/2003	9820	485	Fuel for CSH Care Plan vehicles
9/30/2003	9825	3,600	Rent for CSH Care Plan (Oct - March 2003)
8/12/2003	9717	147	Propeller
8/12/2003	9722	265	Gas for Uman Municipality vehicles
9/11/2003	9746	783	Phone bills of CSH Care Plan
9/11/2003	9747	282	Supplies - no invoices attached
9/11/2003	9748	245	Labor & for CSH Care Plan & photo copies

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Finding No.: 2003-04, Continued
 CFDA No.: 15.875
 Agency: U. S. Department of the Interior
 Program Name: Section 211 (A) – Compact Capital Funds
 Requirement: Activities Allowed or Unallowed
 Questioned Costs: \$545,052

Condition, Continued:

<u>Check Date</u>	<u>Check Number</u>	<u>Amount</u>	<u>Comments</u>
5/16/2003	9630	\$ 1,626	This is a municipal employee - labor costs, no taxes withheld? (paid out of 1.5% admin. Fee)
5/30/2003	9644	30,000	Lease/Purchase for Municipal use operation
6/5/2003	9650	296	Telephone bills - Jan to April '03
4/29/2003	9607	843	Contract payment
4/30/2003	9611	371	WH Tax - CSH Care Plan
7/18/2003	9694	16,610	Weno Municipal Court House Renovation
7/18/2003	9699	3,118	Weno Municipal Court House Renovation
7/18/2003	9701	375	Purchased fish
7/18/2003	9703	555	Purchased fish
7/18/2003	9704	3,457	Oneisom Jailhouse lease agreement
4/4/2003	9460	2,500	Includes 1 coffee pot @ \$120
4/25/2003	9581	843	Supported by timesheet only (Agriculture contract)
4/25/2003	9582	796	Supported by timesheet only (Agriculture contract)
4/25/2003	9583	843	Supported by timesheet only (Agriculture contract)
4/25/2003	9584	843	Supported by timesheet only (Agriculture contract)
4/25/2003	9586	843	Supported by timesheet only (Agriculture contract)
4/25/2003	9588	843	Supported by timesheet only (Agriculture contract)
3/17/2003	7549	228	Appears to be fuel for Uman Municipality operating expenses
3/17/2003	7551	1,000	Weno Court Rental to Municipality
3/27/2003	7558	3,843	Ordinary repair & maintenance, hull repair for MS Fuun
3/27/2003	7559	3,000	Labor cost for landfill
3/27/2003	7561	700	Meeting allowance for Chuuk State Health Care Plan board
3/27/2003	7563	500	Check - no invoices
3/27/2003	7565	995	Reef fish and other food
3/28/2003	7573	1,650	CSH Care Plan says house rental for Mr. Leis Archy (07/02-10/02)
3/28/2003	7574	3,600	CSH Care Plan rental - April to September '03
6/17/2003	9662	5,000	Revolving fund to sell fish
2/21/2003	7466	1,520	Leases for Murilo Elem School site?
2/21/2003	7467	1,520	Elementary School Building
2/21/2003	7468	1,520	Elementary School Building

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Finding No.: 2003-04, Continued
 CFDA No.: 15.875
 Agency: U. S. Department of the Interior
 Program Name: Section 211 (A) – Compact Capital Funds
 Requirement: Activities Allowed or Unallowed
 Questioned Costs: \$545,052

Condition, Continued:

<u>Check Date</u>	<u>Check Number</u>	<u>Amount</u>	<u>Comments</u>
2/21/2003	7469	\$ 500	Only \$348 seems to be for Fishing Project, the rest seems to be for operations
2/21/2003	7471	1,500	Murilo Elementary School leases
2/21/2003	7472	1,500	Murilo Elementary School leases
2/21/2003	7473	1,500	Murilo Elementary School leases
2/21/2003	7474	500	Payment of octopus & fish
2/21/2003	7475	60	CSH Care Plan (food)
1/31/2003	5099	80,000	This is advance payment-no competitive procurement on file. Indicates is for a replacement part & engine, pls refer to check. # 4582, as also paid for replacement parts for this vessel
1/31/2003	5106	75,000	Appears to have been approved by FSM Nat. Govt. and this is a subrecipient (Weno Housing Authority)
2/18/2002	2716	3,830	Contract payment for Ruo Meeting Hall, no invoice, contract, or contract certificate on file.
12/18/02	2717	1,520	Contract certificate not on file.
12/27/2002	3041	25,000	Fanapangas Municipal lease agreement (2/92-12/02)
1/17/2003	4582	23,853	Drydocking of Fuun Metaw including engine parts & repair (see above check # 5099).
1/17/2003	4863	25,000	Shall be deposited in a bank checking account strictly for copra purchases in the name of Chuuk Coconut Authority, a defunct component unit).
1/17/2003	4864	15,000	Says "Fefen Municipality sand mining & damage payable to lessor.
1/17/2003	4865	20,000	Says "Fefen Municipality sand mining & damage payable to lessor.
12/3/2002	1880	1,405	CSH Care Plan billings
12/3/2002	1886	500	CSH Care Plan billings (Vehicle repairs, gas & services)
12/3/2002	1889	505	CSH Care utility cost
12/3/2002	1892	72,772	Municipal lease for payment on land when airport has not been constructed and also it appears alot is due. Court judgment payment
12/3/2002	2311	3,000	Payment to individual Murilo Municipal employees
12/31/2002	2703	5,901	(\$2,651.32). Weno youth beautification project (bush cutter, rakes, etc).
12/31/2002	2706	14,995	Land acquisition of \$150k, says must all be paid within 3 years of 11/19/02 and no indication such occurred.
12/13/2002	2707	46	Uman Municipality
10/30/2002	442	29,720	Court judgment & interest - Approved by Contracting Officer for FSM National Government. Uman Municipal Lease Rental.
10/18/2002	146	13,000	Payment of Apartment rental for 2002 - 2004 rental (2 years & 2 months)

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Finding No.: 2003-04, Continued
CFDA No.: 15.875
Agency: U. S. Department of the Interior
Program Name: Section 211 (A) – Compact Capital Funds
Requirement: Activities Allowed or Unallowed
Questioned Costs: \$545,052

Cause: The cause of this condition is noncompliance with the terms of the Compact Capital requirements.

Effect: The effect of this condition is questioned costs of \$545,052.

Recommendation: The above items should be reviewed and should be discussed with the FSM National Government, to resolve the abovementioned items.

Auditee Response and Corrective Action Plan: Discussion with the FSM National Government is being undertaken to resolve the issue. FSM National Government has ceased the disbursements of Compact Capital Funds effective September 30, 2005.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Finding No.: 2003-05
CFDA No.: 84.256A
Agency: U.S. Department of Education
Program Name: School Improvement Project
Requirement: Procurement, Suspension and Debarment
Questioned Costs: \$122,029

Criteria: Goods and services should be obtained in accordance with applicable federal requirements. Additionally, documentation supporting the receipt of such goods or services should be retained on file.

Condition: Questioned costs of \$122,029 for the School Improvement Program exist due either to the absence of competitive procurement or an inability to locate underlying documentation supporting the expenditure (invoices/contracts/receiving reports, etc.).

<u>Check Date</u>	<u>Check Number</u>	<u>Amount</u>	<u>Comments</u>
1/23/2003	5012	\$10,293	Supporting documents not provided
10/17/2002	4792	8,357	Supporting documents not provided
5/9/2003	5286	6,900	No competitive bidding or quotation documented
3/31/2003	5171	6,000	No competitive bidding or quotation documented
4/15/2003	5218	6,000	Computer - No competitive bidding or price quotation
4/25/2003	5239	5,882	Supporting documents not provided
10/17/2002	4792	5,376	Supporting documents not provided
10/17/2002	4792	5,243	Supporting documents not provided
1/16/2003	4978	5,045	Supporting documents not provided
3/10/2003	5129	5,000	No invoices to support the travel liquidation (car rental, other expenses)
11/14/2002	4857	4,893	File not documented on why only one vendor quote solicited.
3/11/2003	5134	4,480	Supporting documents not provided
12/20/2002	4945	4,485	Genesis Computer - File not documented on why only one vendor quote solicited.
6/12/2003	5339	4,332	Supporting documents not provided
12/12/2002	4913	4,325	File not documented on why only one vendor quote solicited.
10/31/2002	4817	4,296	Supporting documents not provided
11/7/2002	58687	4,275	Supporting documents not provided
3/12/2003	5146	3,843	Supporting documents not provided
10/15/2002	4785	3,800	Supporting documents not provided
7/16/2003	5450	3,544	Supporting documents not provided
12/20/2002	59450	3,500	Supporting documents not provided
5/2/2003	5249	3,215	File not documented on why only one vendor quote solicited.
3/31/2003	5171	3,000	Computer - No competitive bidding or price quotation
8/12/2003	63785	3,000	Supporting documents not provided
4/3/2003	5184	2,945	Supporting documents not provided

Cause: Either non-competitive procurement methods were utilized or the underlying documentation was not locatable.

Effect: The impact of this matter is questioned costs in the amount of \$122,029.

Prior Year Status: Noncompliance with the criteria was cited in the prior year audit of the School Improvement Program.

Recommendation: The State should ensure that competitive procurement procedures required by the federal government are utilized and documented in the expenditure process involving federal programs.

**CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Finding No.: 2003-05, Continued
CFDA No.: 84.256A
Agency: U.S. Department of Education
Program Name: School Improvement Project
Requirement: Procurement, Suspension and Debarment
Questioned Costs: \$122,029

Auditee Response and Corrective Action Plan: Many of the documents mentioned above were already moved to the storage room of Supplies Office, which made it difficult to retrieve certain documents. Filing system has been improved to solve this problem in the future. Effective FY 2006, every document being taken out from the storage room has to be properly accounted for. A log book will be maintained to monitor the users of the documents.

**CHUUK STATE GOVERNMENT
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Finding No.: 2003-06
CFDA No.: 15.875
Agency: U.S. Department of the Interior
Program Name: Scholarship Program
Requirement: Special Terms and Conditions
Questioned Costs: \$32,500

Criteria: All scholarship checks should be made out jointly to the institution and the awardee.

Condition: In 12 of 28 instances tested, the scholarship check was not made out jointly to the College/University and the student. This is contrary to required policy.

<u>Last Name</u>	<u>First Name</u>	<u>Amount Awarded</u>
Jacob	Joanna	\$ 5,000
Paul	Enriena	3,500
Beverl	Simina	3,500
Lokopwe	Toren	3,500
Yesiki	Iris	3,000
Selifis	Chen	2,000
Tilim	Cynthia	2,000
Trifonovi	Jay	2,000
Andon	Jenryna	2,000
Michiu	Johnmy	2,000
Tipekis	Joyny	2,000
Sabas	Kenally	<u>2,000</u>
		<u>\$ 32,500</u>

Cause: The State failed to make the scholarship payment jointly to the student and the applicable institution of higher learning.

Effect: The impact of this matter is noncompliance with Scholarship requirements.

Recommendation: All scholarship checks should be made out jointly to the institution and the awardee.

Auditee Response and Corrective Action Plan: We acknowledge that due to the volume of checks issued, there was an oversight in ensuring that all checks complied with this requirement. To avoid this kind of oversight in the future, the checks are being double-checked by different individuals prior to releasing them to the awardees.

**CHUUK STATE GOVERNMENT
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Finding No. 2003-07 - Hospital Collections

Criteria: Unless otherwise mandated by law, all cash collections should be deposited to the general fund.

Condition: The hospital collected general fund revenues but kept certain fees to fund its operations. This course of action appears to be in contravention of the State Constitution that requires that all funds, unless otherwise directed by law, be deposited to the general fund.

Cause: The Hospital appears to have taken a position that contravenes the State's constitution.

Effect: Various revenues and expenses are not being reported in the State financial statements and funds are being expended without being subjected to the appropriation/allotment process.

Recommendation: The practice of not depositing State collections to the General Fund should be discontinued.

Auditee Response and Corrective Action Plan: All revenues collected by the Hospital are now being turned over to Chuuk Treasury. We had established a special account under Chuuk Health Program Income, which will be used for emergency medical needs by the hospital such as oxygen, gasoline and the like that require immediate delivery of goods without the normal state procurement procedures. This special account is approved by the Chuuk Funds Control Commission (CFCC) which also authorizes the reimbursements of this special account's expenditures.

Finding No. 2003-08 - Compact Capital Debt Remaining Unpaid

Criteria: The State should ensure that liabilities represent amounts expected to be paid.

Condition: The State has recorded a Compact Capital note payable of \$329,179 that has been outstanding since the inception of the Compact. The debt has remained unpaid and prior audits have recommended that a legal determination be made as to whether this amount should continue to be recorded or whether it should be written off.

Cause: The State has not obtained a legal opinion to determine the appropriate action on this matter.

Effect: The related liability has been recorded and the applicable funding therefore has not been available for alternative purposes.

Recommendation: The State should obtain a ruling from the Attorney General as to whether this liability is still valid.

Auditee Response and Corrective Action Plan: We have already requested the Attorney General as to the legal determination of such liability. The Attorney General is in the process of writing a formal opinion suggesting writing off these old outstanding accounts.

**CHUUK STATE GOVERNMENT
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Finding No. 2003-09 - Education Employee Ceiling

Criteria: Compliance with established employee ceilings should occur.

Condition: It appears that the Department of Education exceeded their employment ceiling, as set by the State's appropriation law, by 27 positions. Additionally, given the number of Education employees who were grouped under the "Administration" category, it was not possible to determine if additional violations of the employment ceiling may have occurred.

Cause: Timely review of employment ceilings set by law with actual employment data did not occur.

Effect: The impact of this condition is that a violation of State law may have occurred.

Recommendation: The State should routinely report its compliance with applicable personnel ceilings.

Auditee Response and Corrective Action Plan: This matter will be discussed with the Budget and Personnel to ensure that no additional employees will be hired beyond the employment ceiling set by Chuuk State Public Law.

Finding No. 2003-10 - Non-Reconciliation of Bank Accounts

Criteria: Bank reconciliations should be timely performed and should agree with related book balances.

Condition: The September 30, 2003 bank reconciliation differs materially from book balances. The bank reconciliations for the following general ledger bank accounts differed from the reconciled book balances by the following amounts:

Bank 125	\$527,151
Bank 600	\$ 76,297
Bank 129	\$ 76,222
Bank 126	\$ 70,240

Cause: The cause of this condition appears to be uncertainty as to whether certain reported expenditures were ever actually made and whether related checks were ever released. It is suspected that the list of outstanding checks utilized in the bank reconciliation is inflated. For example, for the Bank 125 account above, some \$636,000 of listed outstanding checks have not cleared by December 2005, though they have been outstanding since September 30, 2003.

Effect: The impact of this condition is that the bank reconciliations differ materially from the book balances.

Recommendation: The bank reconciliations should be revisited and the outstanding checklists should be investigated to determine the reason for this finding.

Auditee Response and Corrective Action Plan: Bank reconciliations are being updated and reconciling items are being reviewed. Outstanding checks issued in 2003 will be checked for accuracy and will be voided accordingly. The payments to vendors will be reprocessed, if needed. Reconciling items that may only involve bank transactions will be discussed with the bank to ensure that necessary adjustments will be made by the bank.

**CHUUK STATE GOVERNMENT
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Finding No. 2003-11 - Timely Clearing of Reconciling Items on the Bank Reconciliations

Criteria: Reconciling items arising from bank reconciliations should be resolved in a timely manner.

Condition: There exist, as in the prior year, numerous reconciling items evidencing mispostings in the system, differences in bank statements versus book entries and other amounts that should be corrected in the books in a timely manner. Additionally, as in the prior year, numerous differences exist between the State's handling of transactions and the respective bank recordation. Follow up on these items appears to have been oral only and has not been reduced to writing.

Cause: Higher level management should be involved in the review and follow up on bank reconciling items.

Effect: The impact of this condition is that funds can be lost and the books remain unadjusted for items that have not been properly reflected in the accounts.

Recommendation: Management should ensure that bank reconciliations are timely reviewed, that reconciling items are timely resolved and that communications with the State's banks be reduced to writing and be follow up on.

Auditee Response and Corrective Action Plan: Bank reconciliations are being updated and reconciling items are being reviewed on a monthly basis. Once we update all the bank accounts, reconciling items that may only involve bank transactions will be discussed with the bank to ensure that necessary adjustments will be made by the bank.

Finding No. 2003-12 - Accounts Payable Imbalance

Criteria: Accounts payable details should be periodically reconciled with the general ledger account.

Condition: The accounts payable subsidiary and the automatic general ledger control account differs by \$142,197 with the general ledger balance exceeding the subsidiary ledger.

Cause: The system is not able to balance when a deletion of an existing liability occurs via a journal voucher. It appears that, in this instance, the reduction in the subsidiary ledger occurs, but the general ledger is not impacted. This condition was reported in prior years and no corrective action has been undertaken. The State does not have the resources to correct this condition. This system was implemented via OIA with support from the FSM National Government. The National Government has been contacted in prior years and no assistance has been rendered.

Effect: The impact of this condition is a \$142,197 difference between the general ledger and the subsidiary ledger.

Recommendation: The system should be investigated and it should be determined why such an imbalance exists.

**CHUUK STATE GOVERNMENT
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Finding No. 2003-12 - Accounts Payable Imbalance, Continued

Auditee Response and Corrective Action Plan: Our Advance Data Processing (ADP) is trying to figure out the imbalance between the computer generated Subsidiary Ledger Accounts (SL) against the General Ledger Accounts (GL). We have requested the assistance of the national government to help us correct the deficiency in the existing accounting program as it does not support the General ledger. There is a need to analyze the whole computerized system and correct the computer program currently being used to make sure that there is accurate recording of transactions and avoid discrepancy between balances of the SL and GL.

Finding No. 2003-13 - 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 receipts retained.

Condition: At September 30, 2003, three cash receipts from the State Revenue Office were not deposited timely. The time span between receipt by the Revenue Office and deposit to Finance was between 2 to 3 weeks. In addition two cash receipts from the State Revenue Office were not included in the cash receipt report and no explanation for this discrepancy was noted. There were no original invoices attached to file in these two cases. In two out of thirty samples tested, there was no receipt on file.

Furthermore, cash receipts reported are to be prepared by the Revenue Officer and approved by the supervisor. In six of the thirty samples tested, there was no approving signature on the cash receipt reported remitted to Treasury.

Cause: The cause of this condition appears to be 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 receipts sequences.

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

Auditee Response and Corrective Action Plan: We had already detected the irregularities in handling of receipts, particularly the late deposits. We've recently established control procedures to prevent the likelihood of lapping or any other kinds of frauds or thefts and overall improve our internal control. Responsibility for receiving and depositing of cash are assigned to different individuals. We have improved the documentation procedures for cash receipts and deposits to include internal verification of supervisors. Cash receipts and deposits are being monitored on a daily basis. Likewise, pre-numbered documents such as cash receipts forms are accounted for on a daily basis.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Finding No. 2003-14 - Personnel Action Forms not in Agreement with Actual Pay Rates

Criteria: Personnel action forms should agree with actual payroll pay rates.

Condition: In 19 of 58 items tested, the personnel action form did not agree with the actual rate paid.

Cause: As in the prior years, this condition may result from a timing difference with the receipt of the actual personnel action revision, but this condition has not been adequately investigated by the State.

Effect: The impact of this condition is that actual personnel costs vary from rates per underlying personnel action forms.

Recommendation: The State should investigate this matter and should determine the reason for such a large number of discrepancies.

Auditee Response and Corrective Action Plan: Internal Control procedures for payroll processing will be in place soon, which will include a review of all incoming Personnel Action Forms and pay rates to ensure that the corresponding pay rates are in compliance with the established classification and compensation standards for Chuuk state government employees and are within the allowable salary ranges for the position.

Finding No. 2003-15 - Write-Off of Travel Advances of \$464,917

Criteria: Travel advances should be reconciled and should be timely collected.

Condition: In 2003, the State wrote off \$464,917 of travel advances that it failed to collect in prior years. This amount was expensed in the general fund.

Cause: The cause of this condition is failure to obtain adequate documentation from travelers and due to the inadequate accounting system that does not appear to account for travel advances in a consistent manner.

Effect: The impact of this condition is an unbudgeted general fund expenditure of \$464,917.

Recommendation: Travel advances should be reconciled to the general ledger control account on a monthly basis. Additionally, the State should enforce timely submission of travel vouchers and should enforce payroll deductions for non-filers.

Auditee Response and Corrective Action Plan: The Travel Advance account is being updated and is currently being reviewed. All travel advances will be accounted for. Travelers who are delinquent with their outstanding travel advances will be given a deadline (which is within 30 days from completion of travel) to submit their request for reimbursement of their travel expenses and/or accounting of their travel advances. We will issue the traveler involved a notification of his or her failure to submit an accounting of his/ her travel advance in due time, and accordingly, the entire amount of his/ her travel advance will be deducted from his / her pay and a written warning will be issued that his/her future travel will not be approved unless the outstanding travel advance has been paid in full.

**CHUUK STATE GOVERNMENT
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Finding No. 2003-16 – Implementation of Fixed Assets for GASB Statement No. 34

Criteria: The provisions of GASB 34 were 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 made substantive progress in detailing an inventory of capital assets, inclusive of infrastructure, to allow for the financial presentation required by GASB 34. However, the State has not been able to establish the basis of its carrying values, has not ensured compliance with federal equipment requirements and has yet to ensure whether all assets have been inventoried.

Cause: The cause of this condition is that the State has yet to complete its 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 resolution 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 2006. We understand that the FSM National Government has contracted with a party to assist us in resolving this matter.

**CHUUK STATE GOVERNMENT
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Resolution of Prior Years' Findings and Questioned Costs
Year Ended September 30, 2003

For the year ended September 30, 2003, the following questioned costs were noted and prior questioned costs resolved:

	Questioned Costs Set Forth in Prior Audit Report <u>2002</u>	Questioned Costs Resolved for Fiscal Year <u>2003</u>	Questioned Costs at <u>September 30, 2003</u>
Unresolved Questioned Costs FY 99	\$ 28,619	\$ -	\$ 28,619
Unresolved Questioned Costs FY 00	241,908	-	241,908
Unresolved Questioned Costs FY 01	369,497	-	369,497
Unresolved Questioned Costs FY 02	154,072	-	154,072
Unresolved Questioned Costs FY 03	<u>-</u>	<u>-</u>	<u>1,840,358</u>
	\$ <u>794,096</u>	\$ <u>-</u>	\$ <u>2,634,454</u>