

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEAR ENDED SEPTEMBER 30, 2004

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2004

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INDEPENDENT AUDITORS' REPORT

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

We were engaged to audit the accompanying financial statements of the governmental activities, the aggregate discretely presented component units, 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, 2004, which collectively comprise the State's basic financial statements as set forth in Section II of the foregoing table of contents. These financial statements are the responsibility of the management of the State.

As discussed in Note 2 to the financial statements, the State reports its investment in Chuuk Fresh Tuna, Inc., a 50%-owned corporation, at cost. Accounting principles generally accepted in the United States of America requires investments to be adjusted to reflect the State's equity in the losses of that corporation, which would decrease the investment, decrease net assets, and change the expenses of the governmental activities, and 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, net assets, and expenses of the governmental activities and effect investments, fund balance, and expenditures of the Compact Capital Projects Fund is not reasonably determinable.

As discussed in Note 8 to the financial statements, the State has not recorded a liability for land leases payable in the governmental activities and General Fund and, accordingly, has not recorded an expenditure/expense 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/expenses, which would increase the liabilities, decrease net assets, and change the expenses of the governmental activities and increase the liabilities, increase fund deficit, and change the expenditures of the General Fund. The amount by which this departure would affect the liabilities, net assets and expenses of the governmental activities and the liabilities, fund deficit, and expenditures of the General Fund is not reasonably determinable.

Because of inadequacies in the accounting records, detailed records regarding receivables due from the FSM National Government, accounts payable, the reserve for continuing appropriations, and the reserve for encumbrances for the primary government have not been maintained and certain supporting data were not made available for our audit. Therefore, we were not able to satisfy ourselves about the amounts at which receivables due from the FSM National Government and accounts payable are recorded for the governmental activities, each major fund and the aggregate remaining fund information, and the amounts at which the reserves for continuing appropriations and encumbrances are recorded for each major fund and the aggregate remaining fund information. Furthermore, the amount at which receivables due from the FSM National Government and accounts payable are recorded enters into the determination of results of operations for the governmental activities, each major fund and the aggregate remaining fund information for the year ended September 30, 2004.

Because of inadequacies in the accounting records, underlying supporting documentation evidencing the validity of expenditures/expenses for the primary government have not been maintained and were not made available for our audit. Therefore we are not able to satisfy ourselves about the amounts at which expenses for the governmental activities are recorded in the accompanying statement of activities, and the amounts at which expenditures for each major fund and the aggregate remaining fund information are recorded in the accompanying statement of revenues, expenditures, and changes in fund balances (deficits) for the year ended September 30, 2004.

While detailed property records exist, prior-year records and supporting data were not made available for our audit concerning the underlying costs for capital assets or the bases supporting such costs. Therefore, we are not able to satisfy ourselves about the amounts at which capital assets and related accumulated depreciation are recorded for the governmental activities in the accompanying statement of net assets at September 30, 2004, and the amount of depreciation expense for the year then ended.

Because of inadequacies in the accounting records, detailed records regarding cash and cash equivalents, receivables, capital assets, accounts payable, and other liabilities and accruals for the Chuuk Public Utilities Corporation have not been maintained and certain supporting data were not made available for our audit. The financial activities of the Chuuk Public Utilities Corporation are included in the State's basic financial statements as a discretely presented component unit and represent 79%, 64% and 76% of the assets, net assets and revenues, respectively, of the State's aggregate discretely presented component units.

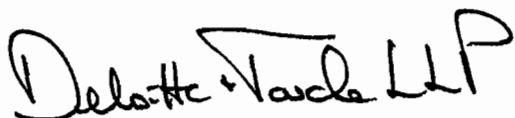
The financial statements of the Chuuk State Housing Authority have not been audited, and we were not engaged to audit these financial statements as part of our engagement to audit the State's basic financial statements. The financial activities of the Chuuk State Housing Authority are included in the State's basic financial statements as a discretely presented component unit and represent 15%, 27% and 5% of the assets, net assets and revenues, respectively, of the State's aggregate discretely presented component units.

Because of the significance of the matters discussed in the second through eighth paragraphs above, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the respective financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information, as set forth in Section II of the foregoing table of contents.

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 39 and 40, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. 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.

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. Because of the significance of the matters discussed in the third through fifth paragraphs above, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the additional information in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 10, 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 engagement to audit in accordance with *Government Auditing Standards* and should be considered in assessing the results of our engagement to audit.

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

July 10, 2006

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2004

This analysis, prepared by the Department of Treasury and Administration, offers readers of the Chuuk State Government's (Chuuk State) financial statements a narrative overview of the activities of the government for the fiscal year ended September 30, 2004. We encourage readers to consider this information in conjunction with Chuuk State's financial statements, which follow. Fiscal year 2003 comparative information has been included, where appropriate. This analysis is required by the Governmental Accounting Standards Board, (GASB) which provides guidelines on what must be included and excluded from this analysis.

FINANCIAL HIGHLIGHTS

- For the fiscal year ended September 30, 2004, Chuuk State's total net assets decreased by \$6.58 million (or 9.3%) from \$70.63 million in the prior year to \$64.05 million. This decrease is primarily attributable to operating deficits incurred in the General and Compact Capital Projects Funds.
- During fiscal year 2004, Chuuk State's revenues of \$26.63 million were less than total expenditures (\$31.64 million) by \$5.01 million. Both revenues and expenditures (including capital outlays) were down from fiscal year 2003, by \$18.15 million (or 40.6%) and \$10.1 million (or 24.2%), respectively. This decrease was primarily due to the decline in compact funding (\$18.77 million). Compact revenues decreased from \$34.7 million in fiscal year 2003 to \$15.93 million in fiscal year 2004 (down 54%).
- Budgetary deficits were incurred in fiscal year 2004: revenues available for appropriation were \$2.6 million less than budgeted for the general fund, primarily as the result of incorrect over-estimates of local revenue collections. The expenditure budget also reflected a small negative budget variance. General fund expenditures of \$9.7 million were \$0.1 million (or 1%) under general fund appropriations of \$9.6 million.
- Chuuk State's general fund balance deficit increased by \$2 million (up 13.3%); increasing from \$15.5 million in the prior year to \$17.5 million in FY-04. The increase primarily reflects the deficit spending in the general fund as the result of expenditures exceeding revenues.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to Chuuk State's basic financial statements. Chuuk State's basic financial statements comprise three components: 1) governmental-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains additional required supplementary information in the form of budgetary schedules, which are prepared on the budgetary basis of accounting, and other optional supplementary information, in addition to the basic financial statements themselves, which includes combining statements for governmental funds and component units.

Government-Wide Financial Statements

The government-wide statements report information about Chuuk State as a whole using accounting methods similar to those used by 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 the government's assets and liabilities. The difference in the two is called net assets. Over time, increases or decreases in the State's net assets serve as indicator to measure the State's financial position.

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

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The government-wide financial statements of Chuuk State are divided into two categories:

- Governmental activities -- Most of Chuuk State's basic services are included here, such as education, health, special appropriations, finance, judiciary, and general administration. Compact sector and other federal grants finance most of these activities.
- Component Units -- Chuuk State includes the operating results of the the Chuuk State Health Care Plan, the Chuuk Public Service Corporation, and the Chuuk Housing Authority in its report. Although legally separate, these "component units" are important because Chuuk State is financially accountable for them.

Fund Financial Statements

The fund financial statements provide more detailed information about Chuuk State's significant funds. Funds are accounting devices that Chuuk State uses to keep track of specific sources of funding and spending for particular services. The State uses fund accounting to comply with financial and 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.

Most of Chuuk State's basic services are included in governmental funds, which focus on (1) how cash and other financial assets that can be readily be converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance Chuuk State programs. Because this information does not encompass the additional long-term focus of the government-wide statements, we provide additional information at the bottom of the governmental funds statement, or on the subsequent page, that explains and reconciles the relationship (or differences) between them.

The State maintains individual governmental funds, which are categorized as major and non-major. The major funds comprise the general fund, new special revenue funds for the Compact Sector grants, the Compact Capital Projects fund, and the new permanent Compact Trust fund.

FINANCIAL ANALYSIS OF CHUUK STATE AS A WHOLE

Net assets may serve over time as a useful indicator of a government's financial position. At the end of fiscal year 2004, Chuuk State's assets exceeded liabilities by \$63.40 million. However, all these net assets are restricted as to the purposes they can be used for or are invested in capital assets. Chuuk State uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although Chuuk State's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. The following summary of Chuuk State's net assets as of September 30, 2004, with comparable balances for fiscal year 2003, discloses this relationship:

	<u>2004</u>	<u>2003</u>
Current and other non-capital assets	\$ 31,937,410	\$ 35,213,411
Capital assets	<u>64,785,023</u>	<u>66,351,717</u>
Total assets	<u>96,722,433</u>	<u>101,565,128</u>
Long-term liabilities	6,028,122	5,856,457
Other liabilities	<u>26,639,692</u>	<u>25,075,316</u>
Total liabilities	<u>32,667,814</u>	<u>30,931,773</u>

**STATE OF CHUUK
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Management's Discussion and Analysis
September 30, 2004

Net assets:

Invested in capital assets, net of related debt	64,455,844	66,022,538
Restricted	22,425,941	25,737,025
Unrestricted	<u>(22,827,166)</u>	<u>(21,126,208)</u>
Total net assets	\$ <u>64,054,619</u>	\$ <u>70,633,355</u>

At the end of fiscal year 2004, Chuuk State's unrestricted assets showed a deficit of \$22.83 million, an increase of \$1.7 million (or 8.1%) from the prior year. This deficit is the result of having current and long-term commitments that are greater than currently available resources. Specifically, Chuuk State did not include in past annual budgets the full amounts needed to finance its current liabilities to vendors and others or its long-term liabilities arising from Asian Development Bank (ADB) loans and unused employee leave balances. Chuuk State will include these amounts in future years' budgets as funding permits.

The \$6.58 million decline in net assets (or 9.3%) from the prior year was notable for the marked differences in revenues and expenditures from fiscal year 2003. Key elements of this decrease and the differences from the prior year are shown in the following summary of the statement of activities:

	<u>2004</u>	<u>2003</u>
Revenues:		
Program revenues:		
Charges for services	\$ 860,789	\$ 900,852
Operating grants and contributions	18,370,411	6,615,667
Capital grants and contributions	500,000	12,215,296
General revenues:		
Taxes	4,948,921	5,482,469
Grants and contributions not restricted	-	17,527,677
Unrestricted investment earnings	1,226,783	1,861,448
Other	<u>718,888</u>	<u>204,682</u>
Total revenues	<u>26,625,792</u>	<u>44,808,091</u>
Expenses:		
General government	6,290,497	5,457,792
Health services	4,612,016	3,635,038
Education	8,866,946	8,183,530
Economic development	1,288,254	1,047,819
Public safety	1,131,681	1,146,843
Public works and transportation	5,879,492	2,873,537
Community affairs	307,879	259,238
Unallocated interest expense	-	225,000
Boards and commissions	631,795	552,019
Judiciary	575,126	585,919
Payments to component units	1,040,813	1,274,721

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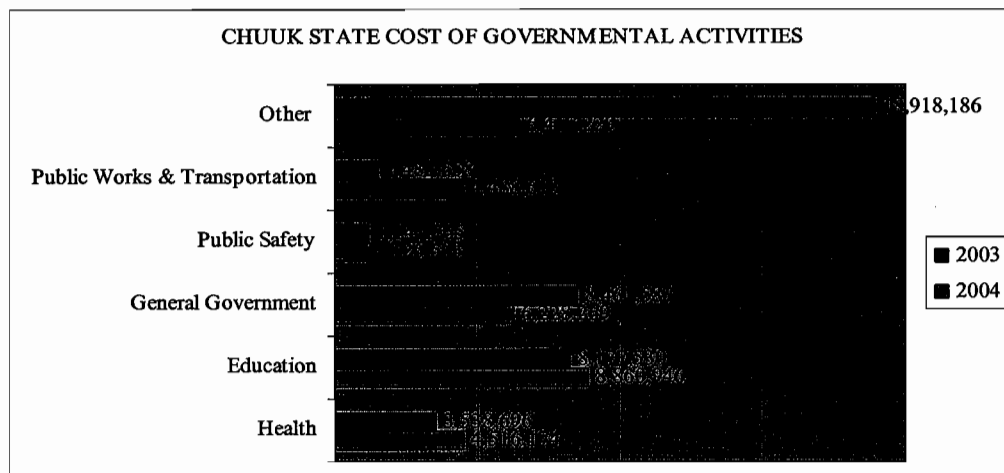
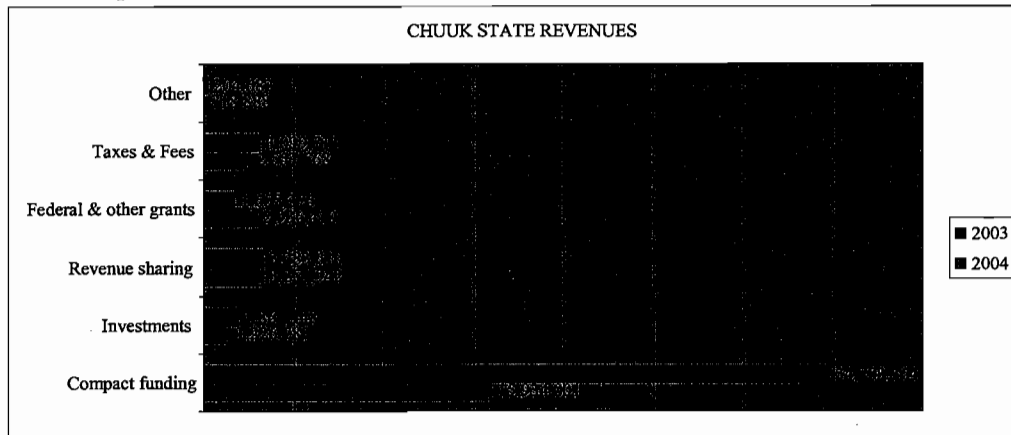
Management's Discussion and Analysis
September 30, 2004

Municipal affairs	380,081	1,539,735
Capital projects	-	5,295,567
Other	<u>2,199,948</u>	<u>2,258,938</u>
Total expenses	<u>33,204,528</u>	<u>34,335,696</u>
Change in net assets	(6,578,736)	10,472,395
Net assets at beginning of year	<u>70,633,355</u>	<u>60,160,960</u>
Net assets at end of year	\$ <u>64,054,619</u>	\$ <u>70,633,355</u>

Total revenues in FY-04 of \$26.63 million significantly decreased from the prior year's \$44.8 million (down 40.6 %) primarily due to the notable declines of capital grants and discretionary operating grants as the result of the amended fiscal provisions of the *Compact of Free Association* ("Compact") and the delay in the implementation of the new Compact public infrastructure grants.

Total expenditures of \$33.2 million reflected a \$1.13 million decrease (or 3.3%) from the prior year primarily from the stoppage of capital project funding in fiscal year 2004.

The following graphs show the major components or revenues and expenditures of governmental funds for the year ended September 30, 2004.



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The large difference in the "other" category of expenditures reflects approximately \$9 million of capital outlays for land acquisitions in fiscal year 2003 that did not occur in the current year.

FINANCIAL ANALYSIS OF CHUUK STATE'S FUNDS

As noted earlier, Chuuk State uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. As of the end of fiscal year 2004, Chuuk State's governmental funds reported a combined fund balance of \$5.40 million which represents a \$4.84 million decrease (or 47.3%) from the \$10.24 million recorded at the end of fiscal 2003. This decrease is attributable to the deficit resulting from expenditures exceeding revenues. Of this total combined fund balance, \$29.30 million is reserved to indicate that it is not available for new spending because it has already been committed: 1) to generate income for future operations (\$19.43 million); 2) to liquidate contracts and purchase orders of the prior period (\$1.21 million); 3) to fund specific general fund and compact CIP-related activities (\$2.73 million); or 4) for on-going capital projects (\$5.93 million). These reserved fund balances are off-set by a combined fund deficit of \$23.90 million, an increase of \$6.01 million (or 33.6%) from fiscal year 2003.

GENERAL FUND BUDGETARY HIGHLIGHTS

During fiscal year 2004, Chuuk State did not revise either its general fund revenue or expenditure budget. Various disbursements from the general fund were required to fund expenditures later covered by late-allotted Compact sector grants, but most were appropriately transferred to the sector grant special revenue funds during the year. The \$3 million increase in the general fund deficit was primarily the result of revenues not meeting budget targets and increases in continuing appropriations.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Chuuk State's investment in capital assets for the primary government as of September 30, 2004, amounted to \$78.11 million, net of accumulated depreciation of \$13.33 million, leaving a net book value of \$64.78 million. This represents a net decrease of \$1.57 million (or 2.4 %) from fiscal year 2003. No significant fixed asset additions or retirements occurred in fiscal year 2004, but construction in progress began on several public works projects. The table below summarizes Chuuk State's capital assets:

	<u>2004</u>	<u>2003</u>
Land	\$ 21,765,468	\$ 21,765,468
Airport facilities	25,710,239	26,410,897
Buildings	4,625,302	4,858,274
Seaport facilities	4,858,819	5,120,327
Vehicles	202,193	163,469
Infrastructure	<u>7,623,002</u>	<u>8,033,282</u>
	\$ <u>64,785,023</u>	\$ <u>66,351,717</u>

Additional information on Chuuk State's capital assets can be found in note 5 to the financial statements.

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Management's Discussion and Analysis
September 30, 2004

Long-Term Debt

The following schedule reflects Chuuk State's noncurrent liabilities for fiscal year 2004 and comparable amounts for fiscal year 2003:

	<u>2004</u>	<u>2003</u>
ADB Early Retirement Loan	\$ 5,300,000	\$ 5,128,335
Compensated absences payable	<u>829,208</u>	<u>829,208</u>
Total noncurrent liabilities	\$ <u>6,129,208</u>	\$ <u>5,957,543</u>

Long-term debt obligations increased by \$0.17 million (or 2.9%) in fiscal year 2004, primarily as the result of drawing the final tranche of proceeds from an ADB loan for Early Retirement. Principal payments do not commence until 2008.

Additional information on Chuuk States long-term debt obligations can be found in note 7 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

No new major budget initiatives will be undertaken in fiscal year 2005. The economy remains relatively stagnant and limited by regional economic forces. Although the new administration has made major efforts to improve its local revenue collections, no significant increases in local revenues are budgeted.

Chuuk State is also taking a cautious approach with respect to the budgeting and expenditure of the Compact sector grants. The allotment of public infrastructure grants remains stalled because of implementation concerns of the U.S. Department of Interior. Likewise in fiscal year 2005, there has been delayed implementation by the United States of the Supplemental Education Grants (SEG). It is not known when expenditures can be incurred from these sources.

CONTACTING CHUUK STATE'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors, a general overview of Chuuk State's finances to demonstrate its accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Director, Office 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, 2004

	Primary Government	Component Units
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 1,275,733	\$ 1,300,288
Equity interest in internal investment pool	12,159,230	-
Receivables, net of allowance for uncollectibles	3,663,991	2,049,529
Advances	39,939	-
Inventories	-	22,973
Prepayments	-	12,066
Restricted assets:		
Cash and cash equivalents	139,111	-
Total current assets	17,278,004	3,384,856
Noncurrent assets:		
Restricted assets:		
Investments	10,983,901	-
Investments	3,675,505	-
Capital assets, net of accumulated depreciation	64,785,023	7,899,159
Total noncurrent assets	79,444,429	7,899,159
Total assets	\$ 96,722,433	\$ 11,284,015
<u>LIABILITIES</u>		
Current liabilities:		
Bank overdraft	\$ 1,176,052	\$ -
Current portion of long-term debt	-	618,244
Notes payable	1,808,215	-
Accounts payable	21,848,146	290,545
Compensated absences payable	101,086	-
Other liabilities and accruals	34,326	467,919
Deferred revenue	1,671,867	50,000
Total current liabilities	26,639,692	1,426,708
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	5,300,000	3,461,734
Compensated absences payable	728,122	-
Total noncurrent liabilities	6,028,122	3,461,734
Total liabilities	32,667,814	4,888,442
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	64,455,844	3,754,034
Restricted for:		
Future operations	6,555,488	-
Compact related	14,865,747	-
Other purposes	1,004,706	-
Unrestricted	(22,827,166)	2,641,539
Total net assets	64,054,619	6,395,573
Total liabilities and net assets	\$ 96,722,433	\$ 11,284,015

See accompanying notes to basic financial statements.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Statement of Activities
Year Ended September 30, 2004

Functions/Programs	Expenses	Program Revenues		Net (Expenses) Revenues and Changes in Net Assets		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government	Component Units
Primary government:						
Governmental activities:						
General government	\$ 6,290,497	\$ 303,912	\$ 2,372,074	\$ -	\$ (3,614,511)	\$ -
Health services	4,612,016	5,527	4,300,723	-	(305,766)	-
Education	8,866,946	-	8,459,339	-	(407,607)	-
Economic development	1,288,254	-	827,835	-	(460,419)	-
Public safety	1,131,681	-	1,070,065	-	(61,616)	-
Public works and transportation	5,879,492	551,350	-	-	(5,328,142)	-
Community affairs	307,879	-	-	-	(307,879)	-
Boards and commissions	631,795	-	468,826	-	(162,969)	-
Judiciary	575,126	-	554,048	-	(21,078)	-
Payments to component units	1,040,813	-	129,279	-	(911,534)	-
Municipal affairs	380,081	-	-	-	(380,081)	-
Future operations	-	-	-	500,000	500,000	-
Other	2,199,948	-	188,222	-	(2,011,726)	-
Total primary government	<u>\$ 33,204,528</u>	<u>\$ 860,789</u>	<u>\$ 18,370,411</u>	<u>\$ 500,000</u>	<u>(13,473,328)</u>	<u>-</u>
Component units:						
Chuuk State Health Care Plan	\$ 296,121	\$ 741,659	\$ -	\$ -	-	445,538
Chuuk Public Utility Corporation	4,088,775	1,121,024	125,010	-	-	(2,842,741)
Chuuk State Housing Corporation	399,069	93,571	87,227	-	-	(218,271)
Total component units	<u>\$ 4,783,965</u>	<u>\$ 1,956,254</u>	<u>\$ 212,237</u>	<u>\$ -</u>	<u>-</u>	<u>(2,615,474)</u>
General revenues:						
Taxes:						
Revenue sharing					3,251,942	-
Excise taxes					1,696,979	-
Unrestricted investment earnings					1,226,783	-
Other					718,888	1,895,357
Total general revenues					<u>6,894,592</u>	<u>1,895,357</u>
Change in net assets					(6,578,736)	(720,117)
Net assets at the beginning of the year, as restated					<u>70,633,355</u>	<u>7,115,690</u>
Net assets at the end of the year					<u>\$ 64,054,619</u>	<u>\$ 6,395,573</u>

See accompanying notes to basic financial statements.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Balance Sheet
Governmental Funds
September 30, 2004

	General	Special Revenue Compact Sector Grants	Capital Projects Compact Capital Projects	Permanent Compact Trust	Other Governmental Funds	Total
ASSETS						
Cash and cash equivalents	\$ 1,275,733	\$ -	\$ -	\$ -	\$ -	\$ 1,275,733
Equity interest in internal investment pool	12,159,230	-	-	-	-	12,159,230
Investments	-	-	3,675,505	-	-	3,675,505
Receivables, net:						
FSM National Government	1,752,395	1,450,254	419,383	-	41,959	3,663,991
Due from other funds	794,544	49,876	12,113,733	-	7,876,577	20,834,730
Advances	39,939	-	-	-	-	39,939
Restricted assets:						
Cash and cash equivalents	139,111	-	-	-	-	139,111
Investments	4,428,413	-	-	6,555,488	-	10,983,901
Total assets	<u>\$ 20,589,365</u>	<u>\$ 1,500,130</u>	<u>\$ 16,208,621</u>	<u>\$ 6,555,488</u>	<u>\$ 7,918,536</u>	<u>\$ 52,772,140</u>
LIABILITIES AND FUND BALANCES						
Liabilities:						
Bank overdraft	\$ 1,176,052	\$ -	\$ -	\$ -	\$ -	\$ 1,176,052
Accounts payable	15,366,435	597,010	3,597,095	-	2,287,606	21,848,146
Other liabilities and accruals	940	-	-	-	-	940
Intergovernmental payables	33,386	-	-	-	-	33,386
Notes payable	1,479,036	-	329,179	-	-	1,808,215
Deferred revenue	1,000	-	-	-	1,670,867	1,671,867
Due to other funds	20,040,186	794,544	-	-	-	20,834,730
Total liabilities	<u>38,097,035</u>	<u>1,391,554</u>	<u>3,926,274</u>	<u>-</u>	<u>3,958,473</u>	<u>47,373,336</u>
Fund balances (deficits):						
Reserved for:						
Related assets	5,300,000	-	4,094,888	6,555,488	3,479,530	19,429,906
Encumbrances	409,026	2,380	723,370	-	67,726	1,202,502
Continuing appropriations	1,200,000	-	1,532,184	-	-	2,732,184
Capital projects funds	-	-	5,931,905	-	-	5,931,905
Unreserved:						
General fund	(24,416,696)	-	-	-	-	(24,416,696)
Special revenue funds	-	106,196	-	-	412,807	519,003
Total fund balances (deficits)	<u>(17,507,670)</u>	<u>108,576</u>	<u>12,282,347</u>	<u>6,555,488</u>	<u>3,960,063</u>	<u>5,398,804</u>
Total liabilities and fund balances	<u>\$ 20,589,365</u>	<u>\$ 1,500,130</u>	<u>\$ 16,208,621</u>	<u>\$ 6,555,488</u>	<u>\$ 7,918,536</u>	
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, reported in the funds						64,785,023
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						(5,300,000)
Compensated absences						(829,208)
						(6,129,208)
Net assets of governmental activities						<u>\$ 64,054,619</u>

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, 2004

	General	Special Revenue Compact Sector Grants	Capital Projects Compact Capital Projects	Permanent Compact Trust	Other Governmental Funds	Total
Revenues:						
Compact funding	\$ -	\$ 15,934,001	\$ -	\$ -	\$ -	\$ 15,934,001
Net increase in the fair value of investments	1,226,783	-	-	-	-	1,226,783
Federal contributions and other grants	-	-	-	500,000	2,436,410	2,936,410
Revenue sharing	3,251,942	-	-	-	-	3,251,942
Excise taxes	1,696,979	-	-	-	-	1,696,979
Fees and charges	303,912	-	-	-	59,250	363,162
Departmental charges	497,627	-	-	-	-	497,627
Other	718,888	-	-	-	-	718,888
Total revenues	7,696,131	15,934,001	-	500,000	2,495,660	26,625,792
Expenditures:						
Current:						
General government	3,847,833	940,994	-	-	1,439,442	6,228,269
Health services	197,504	4,303,112	-	-	15,558	4,516,174
Education	484,894	7,381,763	-	-	994,289	8,860,946
Economic development	445,376	842,878	-	-	-	1,288,254
Public safety	41,488	1,085,115	-	-	-	1,126,603
Public works and transportation	1,198,891	-	3,289,678	-	44	4,488,613
Community affairs	301,212	-	-	-	-	301,212
Boards and commissions	231,781	400,014	-	-	-	631,795
Payments to component units	725,662	129,279	-	-	185,872	1,040,813
Judiciary	21,078	554,048	-	-	-	575,126
Municipal affairs	380,081	-	-	-	-	380,081
Other	2,011,726	188,222	-	-	-	2,199,948
Total expenditures	9,887,526	15,825,425	3,289,678	-	2,635,205	31,637,834
Excess (deficiency) of revenues over (under) expenditures	(2,191,395)	108,576	(3,289,678)	500,000	(139,545)	(5,012,042)
Other financing sources (uses):						
Loan proceeds	171,665	-	-	-	-	171,665
Operating transfers in	-	-	-	6,055,488	490,437	6,545,925
Operating transfers out	-	-	(6,545,925)	-	-	(6,545,925)
Total other financing sources (uses), net	171,665	-	(6,545,925)	6,055,488	490,437	171,665
Net change in fund balances (deficit)	(2,019,730)	108,576	(9,835,603)	6,555,488	350,892	(4,840,377)
Fund balances (deficits) at the beginning of the year	(15,487,940)	-	22,117,950	-	3,609,171	10,239,181
Fund balances (deficits) at the end of the year	\$ (17,507,670)	\$ 108,576	\$ 12,282,347	\$ 6,555,488	\$ 3,960,063	\$ 5,398,804

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, 2004

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	\$ (4,840,377)
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 depreciation exceeded capital outlays in the current period.	(1,566,694)
The issuance of long-term debt (e.g. bonds, leases) provides current financial resources to governmental funds, while the repayment of principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction has any effect on net assets. This amount is the net effect of these differences in the treatment of long - term debt and related items	<u>(171,665)</u>
Change in net assets of governmental activities as presented on page 11	\$ <u>(6,578,736)</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, 2004

<u>ASSETS</u>	<u>Chuuk State Health Care Plan</u>	<u>Chuuk Public Utility Corporation</u>	<u>Chuuk State Housing Corporation</u>	<u>Total</u>
Current assets:				
Cash and cash equivalents	\$ 552,486	\$ 306,720	\$ 441,082	\$ 1,300,288
Receivables, net:				
Federal agencies	-	444,105	-	444,105
General	31,334	474,423	150,174	655,931
Loans	-	-	949,493	949,493
Inventories	-	22,973	-	22,973
Prepayments	2,000	-	10,066	12,066
	<hr/>	<hr/>	<hr/>	<hr/>
Total current assets	585,820	1,248,221	1,550,815	3,384,856
Noncurrent assets:				
Capital assets, net of accumulated depreciation	18,845	7,689,874	190,440	7,899,159
	<hr/>	<hr/>	<hr/>	<hr/>
Total assets	\$ 604,665	\$ 8,938,095	\$ 1,741,255	\$ 11,284,015
	<hr/>	<hr/>	<hr/>	<hr/>
<u>LIABILITIES AND NET ASSETS</u>				
Current liabilities:				
Bank overdraft	\$ -	\$ -	\$ -	\$ -
Current portion of long-term debt	-	618,244	-	618,244
Accounts payable	11,569	278,976	-	290,545
Accrued liabilities	-	467,501	418	467,919
Deferred income	-	50,000	-	50,000
	<hr/>	<hr/>	<hr/>	<hr/>
Total current liabilities	11,569	1,414,721	418	1,426,708
Noncurrent liabilities:				
Noncurrent portion of long-term debt	-	3,461,734	-	3,461,734
	<hr/>	<hr/>	<hr/>	<hr/>
Total noncurrent liabilities	-	3,461,734	-	3,461,734
	<hr/>	<hr/>	<hr/>	<hr/>
Total liabilities	11,569	4,876,455	418	4,888,442
Net assets:				
Invested in capital assets, net of related debt	18,845	3,544,749	190,440	3,754,034
Unrestricted	574,251	516,891	1,550,397	2,641,539
	<hr/>	<hr/>	<hr/>	<hr/>
Total net assets	593,096	4,061,640	1,740,837	6,395,573
	<hr/>	<hr/>	<hr/>	<hr/>
Total liabilities and net assets	\$ 604,665	\$ 8,938,095	\$ 1,741,255	\$ 11,284,015
	<hr/>	<hr/>	<hr/>	<hr/>

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, 2004

	Chuuk State Health Care Plan	Chuuk Public Utility Corporation	Chuuk State Housing Corporation	Totals
Operating revenues:				
Charges for services	\$ 739,639	\$ 1,104,999	\$ 93,571	\$ 1,938,209
Other	2,020	16,025	-	18,045
Total operating revenues	741,659	1,121,024	93,571	1,956,254
Operating expenses:				
Cost of services	188,084	2,021,928	-	2,210,012
Depreciation	9,265	1,296,175	32,196	1,337,636
Administration and general	98,772	744,950	366,873	1,210,595
Total operating expenses	296,121	4,063,053	399,069	4,758,243
Operating income (loss)	445,538	(2,942,029)	(305,498)	(2,801,989)
Nonoperating revenues (expenses):				
Contributions from primary government	-	125,010	87,227	212,237
Other income	-	1,857,295	38,062	1,895,357
Interest expense	-	(25,722)	-	(25,722)
Total nonoperating revenues (expenses), net	-	1,956,583	125,289	2,081,872
Net income (loss)	445,538	(985,446)	(180,209)	(720,117)
Net assets at the beginning of the year	147,558	5,047,086	1,921,046	7,115,690
Net assets at the end of the year	\$ 593,096	\$ 4,061,640	\$ 1,740,837	\$ 6,395,573

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(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, 2004

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

i. Blended Component Units

The following Component Unit is 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 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:

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.

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.

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.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

ii. Omitted Governmental Funds, Continued

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's, 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 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.

iii. Omitted Component Units

The following component units have been omitted from the basic financial statements due to the lack of available financial information. The omission of these component units is not considered material to aggregate discretely presented component unit reporting unit:

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.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

iii. Omitted Component Units, Continued

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.

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.

Chuuk State Health Care Plan Fund (CSHCP): CSHCP 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.

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.

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.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

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 \$22,425,941 of restricted net assets, of which \$1,004,706 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.

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.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

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, 2004

(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.

iv. Permanent Fund

This fund accounts for resources that are legally restricted to the extent that only earnings, and not principal, may be used to support programs for the benefit of the government.

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 funds:

Compact Sector Grants Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for United States Congress appropriations under United States Public Law 99-239, as amended, Title II, Article I, Section 211(a) and approved by the FSM Congress to promote economic advancement and budgetary self-reliance. These appropriations are to be used for assistance in education, health care, the environment, public sector capacity building, and private sector development, or for other areas as mutually agreed, with priorities in the education and health care sectors.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

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.

Compact Trust Fund, a Governmental Fund Type - Permanent Fund. This fund accounts for United States Congress appropriations under United States Public Law 99-239, as amended, Title II, Article I, Section 215 and approved by the FSM Congress to provide for an additional source of revenue for the government budget that will be needed to substitute for the absence of Compact of Free Association funding. Earnings from funds invested would not be available for distribution until October 2023.

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.

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 ninety days are separately classified on the statement of net assets/balance sheet.

As of September 30, 2004, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit were \$1,414,844 and the corresponding bank balances were \$1,446,840, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2004, 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.

As of September 30, 2004, the carrying amount of the discretely presented component units' total cash and cash equivalents was \$1,300,288 and the corresponding bank balance was \$954,713, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2004, bank deposits in the amount of \$273,631 were FDIC insured. The discretely presented component units do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

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 and discretely presented component units are primarily due from businesses and individuals residing in the State. The allowance for uncollectible accounts primarily represents estimated uncollectible amounts based on past collection experience and the aging of the accounts.

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.

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 for the Chuuk State Early Retirement Scheme with a cash account and investments recorded in the General Fund of \$139,111 and \$4,428,413, respectively. Furthermore, investments recorded in the Compact Trust Fund of \$6,555,488 are restricted in that they are not available to be used in current operations.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

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.

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.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

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 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, 2004, is represented by the following assets:

	<u>General</u>	<u>Special Revenue Compact Sector Grants</u>	<u>Capital Projects Compact Capital Projects</u>	<u>Permanent Compact Trust</u>	<u>Other Governmental Funds</u>	<u>Totals</u>
Investments	\$ 732,476	\$ -	\$ 3,675,505	\$ -	\$ -	\$ 4,407,981
Due from other funds	-	-	-	-	3,479,530	3,479,530
Receivables:						
FSM National Government	-	-	419,383	-	-	419,383
Restricted assets:						
Cash and cash equivalents	139,111	-	-	-	-	139,111
Investments	<u>4,428,413</u>	<u>-</u>	<u>-</u>	<u>6,555,488</u>	<u>-</u>	<u>10,983,901</u>
	<u>\$ 5,300,000</u>	<u>\$ -</u>	<u>\$ 4,094,888</u>	<u>\$ 6,555,488</u>	<u>\$ 3,479,530</u>	<u>\$ 19,429,906</u>

The reserve for related assets within the General Fund includes the amount of \$5,300,000 set aside for future repayment of the Early Retirement Program Loan.

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.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

Q. New Accounting Standards

During fiscal year 2004, the State implemented GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units (an amendment of GASB Statement 14)*. GASB Statement No. 39 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.

For fiscal year 2005, the State will be implementing GASB Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3)*. GASB Statement No. 40 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. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In November 2003, GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. GASB Statement No. 42 establishes standards for impairment of capital assets when its service utility has declined significantly and unexpectedly. The provisions of this Statement are effective for periods beginning after December 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 April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments. The provisions of this Statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In May 2004, GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment to NCGA Statement 1*. GASB Statement No. 44 improves the understandability and usefulness of statistical section information and adds information from the new financial reporting model for state and local governments required by GASB Statement No. 34. The provisions of this Statement are effective for periods beginning after June 15, 2005. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In July 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other postemployment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

R. 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.

S. Restatement of Government-Wide Net Assets

Primary Government

Net assets, as previously reported September 30, 2003	\$ 64,190,280
Understatement of capital assets:	
Land	<u>6,443,075</u>
Net assets, as restated September 30, 2003	\$ <u>70,633,355</u>

(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.

STATE OF CHUUK
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Notes to Financial Statements
September 30, 2004

(2) Investments, Continued

- 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 Poor 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.

Investments of the primary government as of September 30, 2004, are as follows:

	Categories			Carrying Value
	1	2	3	
General Fund:				
Pooled investments				\$ <u>4,428,413</u>
Compact Capital Projects Fund:				
Common stock	\$ <u>3,675,505</u>	\$ -	\$ -	\$ <u>3,675,505</u>
Pooled investments:				
Mixed Income	\$ -	\$ 6,743,794	\$ -	\$ 6,743,794
Common Stock	-	5,341,818	-	5,341,818
U.S Government agencies	-	2,325,206	-	2,325,206
Corporate Bonds	-	1,327,743	-	1,327,743
U.S. Treasury Obligations	-	<u>937,775</u>	-	<u>937,775</u>
	\$ -	\$ <u>16,676,336</u>	\$ -	16,676,336
Money market funds				<u>2,038,382</u>
				\$ <u>18,714,718</u>

As of September 30, 2004, 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.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(2) Investments, Continued

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 closing value on the Pacific Stock Exchange.

(3) Receivables

Receivables as of September 30, 2004, 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 Sector Grants</u>	<u>Compact Capital Projects</u>	<u>Compact Trust</u>	<u>Nonmajor And Other Funds</u>	<u>Totals</u>
Receivables:						
FSM National Government	\$ 1,752,395	\$ 1,450,254	\$ 419,383	\$ -	\$ 1,046,831	\$ 4,668,863
Other	<u>102,013</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>102,013</u>
	1,854,408	1,450,254	419,383	-	1,046,831	4,770,876
Less: allowance for uncollectible accounts	<u>(102,013)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,004,872)</u>	<u>(1,177,886)</u>
Net receivables	<u>\$ 1,752,395</u>	<u>\$ 1,450,254</u>	<u>\$ 419,383</u>	<u>\$ -</u>	<u>\$ 41,959</u>	<u>\$ 3,663,991</u>

(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, 2004, are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Compact Sector Grants	\$ 794,544
Compact Sector Grants	General	49,876
Compact Capital Projects	General	12,113,733
Nonmajor governmental funds	General	<u>7,876,577</u>
		<u>\$ 20,834,730</u>

Interfund receivables not expected to be repaid within the next twelve months are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Nonmajor governmental funds:		
Chuuk Airport Authority	General	\$ 1,004,706
Compact Other Grants	General	1,346,945
Compact Special Block Section 221(b)	General	<u>1,127,879</u>
		<u>\$ 3,479,530</u>

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(5) Fixed Assets

Capital asset activities of the primary government for the year ended September 30, 2004, are as follows:

	Balance October <u>1, 2003</u>	<u>Additions</u>	<u>Retirements</u>	Balance September <u>30, 2004</u>
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 21,765,468	\$ -	\$ -	\$ 21,765,468
Capital assets, being depreciated:				
Airport facilities	29,906,300	-	-	29,906,300
Buildings	9,274,947	-	-	9,274,947
Seaport facilities	6,537,700	-	-	6,537,700
Vehicles	308,744	60,500	-	369,244
Infrastructure	<u>10,257,000</u>	<u>-</u>	<u>-</u>	<u>10,257,000</u>
Total capital assets, being depreciated	<u>56,284,691</u>	<u>60,500</u>	<u>-</u>	<u>56,345,191</u>
Less accumulated depreciation for:				
Airport facilities	(3,493,403)	(702,658)	-	(4,196,061)
Buildings	(4,418,673)	(230,972)	-	(4,649,645)
Seaport facilities	(1,417,373)	(261,508)	-	(1,678,881)
Vehicles	(145,275)	(21,776)	-	(167,051)
Infrastructure	<u>(2,223,718)</u>	<u>(410,280)</u>	<u>-</u>	<u>(2,633,998)</u>
	<u>(11,698,442)</u>	<u>(1,627,194)</u>	<u>-</u>	<u>(13,325,636)</u>
Total capital assets, being depreciated, net	<u>44,586,249</u>	<u>(1,566,694)</u>	<u>-</u>	<u>43,019,555</u>
Governmental activities capital assets, net	<u>\$ 66,351,717</u>	<u>\$ (1,566,694)</u>	<u>\$ -</u>	<u>\$ 64,785,023</u>

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

General government	\$ 62,228
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>\$ 1,627,194</u>

Capital asset activities of the discretely presently component units for the year ended September 30, 2004, are as follows:

	Balance October <u>1, 2003</u>	<u>Additions</u>	<u>Retirements</u>	Balance September <u>30, 2004</u>
Capital assets, being depreciated:				
Electric plant facilities	\$ 14,612,016	\$ 213,736	\$ -	\$ 14,825,752
Water and sewer plant facilities	10,088,112	-	-	10,088,112
Machinery and equipment	310,360	-	-	310,360
Other	<u>566,981</u>	<u>14,129</u>	<u>-</u>	<u>581,110</u>
Total capital assets, being depreciated	<u>25,577,469</u>	<u>227,865</u>	<u>-</u>	<u>25,805,334</u>
Less accumulated depreciation	<u>(16,568,539)</u>	<u>(1,337,636)</u>	<u>-</u>	<u>(17,906,175)</u>
	<u>\$ 9,008,930</u>	<u>\$ (1,109,771)</u>	<u>\$ -</u>	<u>\$ 7,899,159</u>

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(6) Notes Payable

Notes payable of the primary government are as follows:

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 changes in this debt occurred during the year ended September 30, 2004.

(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 2037. 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, 2004. As of September 30, 2004, the amount outstanding against this loan was \$5,300,000. This amount has been identified as future debt service payments and is included in the General Fund reserve for related assets of which \$4,428,413 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, 2004

(7) Long-term Obligations, 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>
2005	\$ -	\$ -	\$ -
2006	-	-	-
2007	-	-	-
2008	176,667	-	176,667
2009	176,667	-	176,667
2010 - 2014	883,333	-	883,333
2015 - 2019	883,333	-	883,333
2020 - 2024	883,333	-	883,333
2025 - 2029	883,333	-	883,333
2030 - 2034	883,333	-	883,333
2035 - 2037	<u>530,001</u>	<u>-</u>	<u>530,001</u>
	<u>\$5,300,000</u>	<u>\$ -</u>	<u>\$5,300,000</u>

During the year ended September 30, 2004, 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, 2003</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance September 30, 2004</u>	<u>Due Within One Year</u>
Loan payable:					
ADB loan	\$5,128,335	\$171,665	\$ -	\$5,300,000	\$ -
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>\$171,665</u>	<u>\$ -</u>	<u>\$6,129,208</u>	<u>\$101,086</u>

Other long-term liabilities will be liquidated in the future from governmental funds. The net change in compensated absences for the year ended September 30, 2004 is immaterial and, therefore, no change is presented.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(7) Long-term Obligations, Continued

Discretely Presented Component Units

Chuuk Public Utilities Corporation

Note payable to a commercial bank, 90 day terms, interest at prime plus 2% on a \$150,000 line of credit. The loan is collateralized by a bank deposit and security interest in fixed assets, accounts receivable and inventories.	\$ 81,921
Note payable to the FSM Development Bank, interest at 9%, due in monthly installments of \$11,412. The loan is collateralized by major machinery, equipment and assignment of income.	536,323
Note payable to the FSM National Government, interest at 6.82%, due in semi-annual installments commencing August 1, 2007.	<u>3,461,734</u>
	<u>\$ 4,079,978</u>

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>
2005	\$ 618,244	\$ 206,333	\$ 824,577
2006	-	194,997	194,997
2007	29,869	192,168	222,037
2008	59,737	189,113	248,850
2009	59,737	185,039	244,776
2010 - 2014	298,685	864,082	1,162,767
2015 - 2019	547,640	745,251	1,292,891
2020 - 2024	796,595	227,441	1,024,036
2025 - 2029	796,595	227,441	1,024,036
2030 - 2031	<u>872,876</u>	<u>17,715</u>	<u>890,591</u>
	<u>\$4,079,978</u>	<u>\$3,049,580</u>	<u>\$7,129,558</u>

STATE OF CHUUK
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Notes to Financial Statements
September 30, 2004

(8) Operating Transfers In/Out

Operating transfers in/out for each major governmental fund and nonmajor governmental funds in the aggregate, for the year ended September 30, 2004, are as follows:

<u>Source</u>	<u>Recipient</u>	<u>Transfers Out</u>	<u>Transfers In</u>
<u>Major Governmental Funds</u>			
Compact Capital Projects	Compact Trust	\$ 6,055,488	\$ 6,055,488
Compact Capital Projects	Nonmajor governmental funds	<u>490,437</u>	<u>-</u>
		<u>6,545,925</u>	<u>6,055,488</u>
<u>Nonmajor Governmental Funds</u>			
Compact Capital Projects	Nonmajor governmental funds	<u>-</u>	<u>490,437</u>
		<u>\$ 6,545,925</u>	<u>\$ 6,545,925</u>

Transfers are used to 1) move revenues from the fund that enabling legislation or budget requires to collect them to the fund that enabling legislation or budget requires to expend them, 2) use unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations, and 3) record reductions in interfund loans for amounts that are not expected to be repaid.

During the year ended September 30, 2004, the State made a one-time transfer of \$6,055,488 from the Compact Capital Projects Fund to the Compact Trust Fund representing the establishment of the Trust Fund in accordance with Section 215 of the Compact of Free Association.

(9) 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, 2004 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.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(9) Contingencies, Continued

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 \$6,736,129 relating to fiscal years 1999 through 2004 have been set forth in the State's Single Audit Report for the year ended September 30, 2004. 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 judgment 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 judgments. The State's Attorney General indicates that pending cases and other claims against the State exist at September 30, 2004 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.

Delinquent Taxes

The State is delinquent in remitting certain social security and withholding taxes. Management is of the opinion that no significant penalties or interest from this matter and that if any such changes occur, they will be accounted for prospectively.

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, 2004, the loan balance is \$3,461,734.

(10) Individual Deficit Fund Balances

Specific individual funds which had significant individual deficit fund balances as at September 30, 2004, are as follows:

Major Governmental Funds

General Fund	\$ <u>17,507,670</u>
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STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2004

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Schedule of Revenues, Expenditures and Changes in Deficit
Budget and Actual - General Fund
Year Ended September 30, 2004

	<u>Budgeted Amounts</u>		Actual - Budgetary Basis (see Note 1)	Variance with Final Budget - Positive (Negative)
	<u>Original</u>	<u>Final</u>		
Revenues:				
Local revenues	\$ -	\$ 9,602,131	\$ 6,469,348	\$ (3,132,783)
Net increase in the fair value of investments	-	-	1,226,783	1,226,783
Total revenues	<u>-</u>	<u>9,602,131</u>	<u>7,696,131</u>	<u>(1,906,000)</u>
Expenditures:				
Current:				
General government	-	3,818,496	3,903,225	(84,729)
Health services	-	707,388	197,504	509,884
Education	-	1,098,206	191,632	906,574
Economic development	-	467,613	440,996	26,617
Public safety	-	43,735	41,488	2,247
Public works and transportation	-	1,274,387	1,213,605	60,782
Community affairs	-	232,720	302,442	(69,722)
Boards and commissions	-	240,818	222,423	18,395
Judiciary	-	26,166	20,903	5,263
Payments to component units	-	225,661	723,155	(497,494)
Municipal affairs	-	388,630	395,804	(7,174)
Other	-	1,078,311	2,053,624	(975,313)
Total expenditures	<u>-</u>	<u>9,602,131</u>	<u>9,706,801</u>	<u>(104,670)</u>
Deficiency of revenues under expenditures	<u>-</u>	<u>-</u>	<u>(2,010,670)</u>	<u>(2,010,670)</u>
Other financing sources:				
Loan proceeds	-	-	171,665	171,665
Net change in deficit	<u>-</u>	<u>-</u>	<u>(1,839,005)</u>	<u>(1,839,005)</u>
Other changes in unreserved deficit				
Decrease in reserve for related assets	-	-	(61,508)	(61,508)
Increase in reserve for continuing appropriations	-	-	(1,091,234)	(1,091,234)
Unreserved deficit at the beginning of the year	<u>(21,424,949)</u>	<u>(21,424,949)</u>	<u>(21,424,949)</u>	<u>-</u>
Unreserved deficit at the end of the year	<u>\$ (21,424,949)</u>	<u>\$ (21,424,949)</u>	<u>\$ (24,416,696)</u>	<u>\$ (2,991,747)</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, 2004

(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, 2004

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

GENERAL FUND

September 30, 2004

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, 2004
(with comparative totals for the year ended September 30, 2003)

	2004	2003
Revenues:		
Compact funds:		
Current Section 211(a) base grant	-	17,527,677
Federal contributions and other grants	-	-
FSM revenue sharing	3,251,942	3,283,610
Excise taxes:		
Sales tax	1,232,140	1,610,838
Hotel	129,489	203,551
Tobacco	41,621	63,190
Alcoholic beverages	71,612	116,954
Delinquent tax collections	55,156	14,533
Other excise taxes	166,961	189,793
	1,696,979	2,198,859
Fees and charges:		
Licenses and permits	201,266	122,879
Leases and other rentals	102,646	74,742
	303,912	197,621
Departmental charges:		
Transportation collections	492,100	623,199
Hospital and utility collections	5,527	6,280
	497,627	629,479
Net increase in the fair value of investments	1,226,783	1,861,448
Other revenues	718,888	134,272
Total revenues	7,696,131	25,832,966
Expenditures:		
Current:		
General government:		
Office of the Governor	744,249	983,310
State Legislature	2,770,312	2,909,157
Department of Treasury	322,838	608,588
Office of Budget	4,190	127,241
Department of Planning and Statistics	4,243	183,783
Office of Personnel	2,001	106,645
	3,847,833	4,918,724
Health services:		
Department of Health Services	197,504	2,792,832
Education:		
Department of Education	484,894	5,689,522
Economic Development:		
Department of Agriculture	15,347	309,519
Department of Commerce and Industry	402,727	308,721
Department of Marine Resources	27,302	393,903
	445,376	1,012,143

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, 2004
(with comparative totals for the year ended September 30, 2003)

	2004	2003
Expenditures, continued:		
Current, continued:		
Public Safety:		
Office of the Attorney General	11,477	193,321
Department of Public Safety	30,011	948,444
	41,488	1,141,765
Public Works and Transportation:		
Department of Transportation	1,198,891	1,124,902
Community Affairs:		
Department of Public Affairs	301,212	252,571
Boards and Commissions:		
Chuuk Recreation Board	56,942	49,432
Land Commission	2,482	140,756
Education Board	-	(1,446)
Election Commission	142,150	297,574
Investment Board	-	3,850
Mortlocks Commission	20,729	12,780
Faichuk Commission	9,478	49,073
	231,781	552,019
Judiciary:		
State Court	21,078	585,919
Payments to component units:		
Chuuk Coconut Authority	112,923	102,963
Chuuk Public Utility Corporation	500,000	-
Chuuk State Housing Authority	87,227	84,429
Chuuk Visitors' Bureau	25,512	87,331
	725,662	274,723
Municipal Affairs:		
Payments to municipalities	380,081	1,539,735
Debt service:		
Debt service payments	-	225,000
Other:		
Public Auditor	59	21,309
Small Business Development Center	4,214	65,815
Farmers Home Administration	47,817	50,488
Land lease and acquisition	-	8,959,151
Disaster assistance	124,155	-
Other	1,835,481	1,499,526
	2,011,726	10,596,289
Total expenditures	9,887,526	30,706,144
Deficiency of revenues under expenditures	(2,191,395)	(4,873,178)
Other financing sources (uses):		
Loan proceeds	171,665	-
Operating transfers out	-	(128,756)
Total financing sources (uses), net	171,665	(128,756)
Net change in deficit	(2,019,730)	(5,001,934)
Deficit at the beginning of the year	(15,487,940)	(10,486,006)
Deficit at the end of the year	\$ (17,507,670)	\$ (15,487,940)

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, 2004

	Budgeted Amounts		Actual Budgetary Basis (see Note 1)	Variance with Final Budget Positive/(Negative)
	Original	Final		
Revenues:				
Local revenues	\$ -	\$ 9,602,131	\$ 6,469,348	\$ (3,132,783)
Net increase in the fair value of investments	-	-	1,226,783	1,226,783
Total revenues	-	9,602,131	7,696,131	(1,906,000)
Expenditures:				
Current:				
General government:				
Office of the Governor	-	603,036	748,769	(145,733)
State Legislature	-	2,641,259	2,802,941	(161,682)
Department of Treasury	-	39,825	322,838	(283,013)
Office of Budget	-	2,429	4,190	(1,761)
Department of Planning and Statistics	-	506,962	22,733	484,229
Office of Personnel	-	24,985	1,754	23,231
	-	3,818,496	3,903,225	(84,729)
Health services:				
Department of Health Services	-	707,388	197,504	509,884
Education:				
Department of Education	-	1,098,206	191,632	906,574
Economic Development:				
Department of Agriculture	-	36,795	15,347	21,448
Department of Commerce and Industry	-	401,566	398,347	3,219
Department of Marine Resources	-	29,252	27,302	1,950
	-	467,613	440,996	26,617
Public Safety:				
Office of Attorney General	-	10,470	11,477	(1,007)
Department of Public Safety	-	33,265	30,011	3,254
	-	43,735	41,488	2,247
Public Works and Transportation:				
Department of Transportation	-	1,274,387	1,213,605	60,782
Community Affairs:				
Department of Public Affairs	-	232,720	302,442	(69,722)
Boards and Commissions:				
Chuuk Recreation Board	-	57,709	56,942	767
Land Commission	-	2,973	2,482	491
Election Commission	-	134,943	131,938	3,005
Mortlocks Commission	-	20,193	20,729	(536)
Faichuk Commission	-	25,000	10,332	14,668
	-	240,818	222,423	18,395
Judiciary:				
State Court	-	26,166	20,903	5,263
Payments to component units:				
Chuuk Coconut Authority	-	61,033	112,923	(51,890)
Chuuk Public Utilities Corporation	-	-	500,000	(500,000)
Chuuk State Housing Authority	-	107,900	87,227	20,673
Chuuk Visitors' Bureau	-	56,728	23,005	33,723
	-	225,661	723,155	(497,494)
Municipal Affairs:				
Payments to municipalities	-	388,630	395,804	(7,174)
Other:				
Public Auditor	-	-	59	(59)
Small Business Development Center	-	4,397	1,767	2,630
Farmers Home Administration	-	47,500	47,817	(317)
Disaster assistance	-	-	124,155	(124,155)
Other	-	1,026,414	1,879,826	(853,412)
	-	1,078,311	2,053,624	(975,313)
Total expenditures	-	9,602,131	9,706,801	(104,670)
Deficiency of revenues under expenditures	-	-	(2,010,670)	(2,010,670)
Other financing sources:				
Loan proceeds	-	-	171,665	171,665
Net change in deficit	-	-	(1,839,005)	(1,839,005)
Other changes in unreserved deficit:				
Decrease in reserve for related assets	-	-	(61,508)	(61,508)
Increase in reserve for continuing appropriations	-	-	(1,091,234)	(1,091,234)
Unreserved deficit at the beginning of the year	(21,424,949)	(21,424,949)	(21,424,949)	-
Unreserved deficit at the end of the year	\$ (21,424,949)	\$ (21,424,949)	\$ (24,416,696)	\$ (2,991,747)

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS - SPECIAL REVENUE FUNDS

September 30, 2004

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, 2004, follows:

Chuuk Visitors' Bureau

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

Chuuk Airport Authority

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

Federal Grant Assistance Fund

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

CFSM Grant Fund

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

Compact Other Grants Fund:

Compact Section 212 - Special Development Assistance Fund: This grant is restricted for special development assistance and is granted under the Compact of Free Association with the United States.

Compact 214(c) - Energy Grant Fund: This fund accounts for funds, granted under the Compact of Free Association with the United States, specifically restricted for energy programs.

Compact 216 (a)(2) Health and Medical Fund: This fund accounts for funds granted under the Compact of Free Association with the United States, specifically restricted for health and medical programs including referrals to hospital and treatment centers.

Compact Section 216(a)(3) 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, 2004

	Chuuk Airport Authority	U.S. Federal Grant Assistance	CFSM Grants	Compact Other Grants	Compact Special Block Section 221(b)	Total
ASSETS						
Receivables:						
CFSM	\$ -	\$ 41,959	\$ -	\$ -	\$ -	\$ 41,959
Due from other funds	1,008,999	2,666,175	21,478	1,438,356	2,741,569	7,876,577
Total assets	\$ 1,008,999	\$ 2,708,134	\$ 21,478	\$ 1,438,356	\$ 2,741,569	\$ 7,918,536
LIABILITIES AND FUND BALANCES (DEFICITS)						
Liabilities:						
Accounts payable	\$ 4,293	\$ 556,734	\$ 21,478	\$ 91,411	\$ 1,613,690	\$ 2,287,606
Deferred revenue	-	1,670,867	-	-	-	1,670,867
Due to other funds	-	-	-	-	-	-
Total liabilities	\$ 4,293	\$ 2,227,601	\$ 21,478	\$ 91,411	\$ 1,613,690	\$ 3,958,473
Fund balances (deficits):						
Reserved for:						
Related assets	1,004,706	-	-	1,346,945	1,127,879	3,479,530
Encumbrances	-	57,497	-	1,089	9,140	67,726
Unreserved (deficit)	-	423,036	-	(1,089)	(9,140)	412,807
Total fund balances (deficits)	\$ 1,004,706	\$ 480,533	\$ -	\$ 1,346,945	\$ 1,127,879	\$ 3,960,063
Total liabilities and fund balances (deficits)	\$ 1,008,999	\$ 2,708,134	\$ 21,478	\$ 1,438,356	\$ 2,741,569	\$ 7,918,536

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, 2004

	Chuuk Airport Authority	U.S., Federal Grant Assistance	CFSM Grants	Compact Other Grants	Compact Special Block Section 221(b)	Total
Revenues:						
Federal contributions	\$ -	\$ 2,436,410	\$ -	\$ -	\$ -	\$ 2,436,410
Fees and charges	59,250	-	-	-	-	59,250
Total revenues	59,250	2,436,410	-	-	-	2,495,660
Expenditures by function:						
Current:						
General government	-	1,438,975	-	-	467	1,439,442
Health services	-	-	-	-	15,558	15,558
Education	-	997,435	-	-	(3,146)	994,289
Public works and transportation	-	-	-	-	44	44
Payments to component units	-	-	-	185,872	-	185,872
Total expenditures	-	2,436,410	-	185,872	12,923	2,635,205
Excess (deficiency) of revenues over (under) expenditures	59,250	-	-	(185,872)	(12,923)	(139,545)
Other financing sources:						
Operating transfers in	-	490,437	-	-	-	490,437
Net change in fund balances (deficits)	59,250	490,437	-	(185,872)	(12,923)	350,892
Fund balances (deficits) at the beginning of the year	945,456	(9,904)	-	1,532,817	1,140,802	3,609,171
Fund balances (deficits) at the end of the year	1,004,706	480,533	\$ -	1,346,945	1,127,879	\$ 3,960,063

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

COMPACT OF FREE ASSOCIATION
SECTION 211(a) SECTOR GRANT FUNDS

Combining Balance Sheet
September 30, 2004

	<u>Education Sector</u>	<u>Health Sector</u>	<u>Capacity Building Sector</u>	<u>Environment Sector</u>	<u>Private Sector Development</u>	<u>Total</u>
<u>ASSETS</u>						
Receivables:						
CFSM	\$ 678,357	\$ 390,975	\$ 237,817	\$ 31,533	\$ 111,572	\$ 1,450,254
Due from other funds	-	-	-	49,876	-	49,876
	<u>\$ 678,357</u>	<u>\$ 390,975</u>	<u>\$ 237,817</u>	<u>\$ 81,409</u>	<u>\$ 111,572</u>	<u>\$ 1,500,130</u>
 <u>LIABILITIES AND FUND BALANCES (DEFICITS)</u>						
Liabilities:						
Accounts payable	\$ 161,675	\$ 294,538	\$ 45,641	\$ 12,597	\$ 82,559	\$ 597,010
Due to other funds	436,541	98,826	215,121	-	44,056	794,544
Total liabilities	<u>598,216</u>	<u>393,364</u>	<u>260,762</u>	<u>12,597</u>	<u>126,615</u>	<u>1,391,554</u>
Fund balances (deficits):						
Reserved for:						
Encumbrances	2,380	-	-	-	-	2,380
Unreserved	77,761	(2,389)	(22,945)	68,812	(15,043)	106,196
Total fund balances (deficits)	<u>80,141</u>	<u>(2,389)</u>	<u>(22,945)</u>	<u>68,812</u>	<u>(15,043)</u>	<u>108,576</u>
Total liabilities and fund balances	<u>\$ 678,357</u>	<u>\$ 390,975</u>	<u>\$ 237,817</u>	<u>\$ 81,409</u>	<u>\$ 111,572</u>	<u>\$ 1,500,130</u>

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

COMPACT OF FREE ASSOCIATION
SECTION 211(a) SECTOR GRANT FUNDS

Combining Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances (Deficits)
Year Ended September 30, 2004

	Education Sector	Health Sector	Capacity Building Sector	Environment Sector	Private Sector Development	Total
Revenues:						
Compact funding	\$ 7,461,904	\$ 4,300,723	\$ 2,597,212	\$ 346,861	\$ 1,227,301	\$ 15,934,001
	<u>7,461,904</u>	<u>4,300,723</u>	<u>2,597,212</u>	<u>346,861</u>	<u>1,227,301</u>	<u>15,934,001</u>
Expenditures by function:						
Current:						
General government	-	-	940,994	-	-	940,994
Health services	-	4,303,112	-	-	-	4,303,112
Education	7,381,763	-	-	-	-	7,381,763
Economic development	-	-	-	-	842,878	842,878
Public safety	-	-	1,085,115	-	-	1,085,115
Boards and commissions	-	-	-	278,049	121,965	400,014
Payment to component units	-	-	-	-	129,279	129,279
Judiciary	-	-	554,048	-	-	554,048
Other	-	-	40,000	-	148,222	188,222
Total expenditures	<u>7,381,763</u>	<u>4,303,112</u>	<u>2,620,157</u>	<u>278,049</u>	<u>1,242,344</u>	<u>15,825,425</u>
Net change in fund balances (deficits)	80,141	(2,389)	(22,945)	68,812	(15,043)	108,576
Fund balances at the beginning of the year	-	-	-	-	-	-
Fund balances (deficits) at the end of the year	<u>\$ 80,141</u>	<u>\$ (2,389)</u>	<u>\$ (22,945)</u>	<u>\$ 68,812</u>	<u>\$ (15,043)</u>	<u>\$ 108,576</u>

See Accompanying Independent Auditors' Report.

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

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

We were engaged to audit the financial statements of the governmental activities, the aggregate discretely presented component units, 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, 2004, which collectively comprise the State's basic financial statements. Our report dated July 10, 2006, stated that the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the respective financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information due to: 1) our inability to obtain sufficient evidence regarding the State's investment in Chuuk Fresh Tuna, Inc.; 2) obligations for land leases payable and the associated expenditure/expense being excluded from the governmental activities and the General Fund; 3) our inability to determine the propriety of receivables due from the FSM National Government and accounts payable recorded for the governmental activities, each major fund, and the aggregate remaining fund information, and of reserves for continuing appropriations and encumbrances recorded for each major fund and the aggregate remaining fund information; 4) our inability to determine the propriety of expenses recorded for the governmental activities and of expenditures recorded for each major fund and the aggregate remaining fund information; 5) our inability to determine the propriety of fixed assets, related accumulated depreciation and depreciation expense for the governmental activities; 6) our inability to determine the propriety of cash and cash equivalents, receivables, capital assets, accounts payable, and other liabilities and accruals of the Chuuk Public Utilities Corporation; and 7) the inclusion of unaudited financial statements of the Chuuk State Housing Authority.

Internal Control Over Financial Reporting

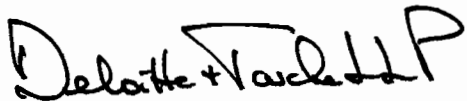
In planning the audit, we considered the State's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted 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's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs (pages 64 through 98) as items 2004-12 through 2004-30.

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 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 2004-12 through 2004-26, 2004-28 and 2004-29 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our engagement to 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 which are described in the accompanying Schedule of Findings and Questioned Costs as items 2004-01 through 2004-11.

This report is intended solely 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.

July 10, 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 State of Chuuk (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, 2004. 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 64 and 65). 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 of the State's compliance with those requirements.

As described in items 2004-01 through 2004-12 in the accompanying Schedule of Findings and Questioned Costs, the State did not comply with requirements regarding allowable costs/cost principles (all major programs), procurement and suspension and debarment (all major programs), and equipment and real property management (all major programs). Compliance with such requirements is necessary, in our opinion, for the State to comply with the requirements applicable to those 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, 2004.

Internal Control Over Compliance

The management of the State is responsible for establishing and maintaining effective internal control over compliance with the 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.

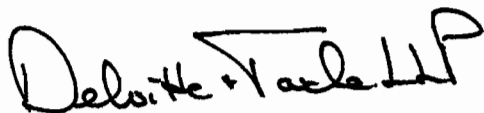
We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance 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 2004-01 through 2004-12.

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 2004-01 through 2004-12 to be material weaknesses.

Schedule of Expenditures of Federal Awards

We were engaged to audit the basic financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Chuuk as of and for the year ended September 30, 2004. Our report dated July 10, 2006, stated that the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the respective financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information due to: 1) our inability to obtain sufficient evidence regarding the State's investment in Chuuk Fresh Tuna, Inc.; 2) obligations for land leases payable and the associated expenditure/expense being excluded from the governmental activities and the General Fund; 3) our inability to determine the propriety of receivables due from the FSM National Government and accounts payable recorded for the governmental activities, each major fund, and the aggregate remaining fund information, and of reserves for continuing appropriations and encumbrances recorded for each major fund and the aggregate remaining fund information; 4) our inability to determine the propriety of expenses recorded for the governmental activities and of expenditures recorded for each major fund and the aggregate remaining fund information; 5) our inability to determine the propriety of fixed assets, related accumulated depreciation and depreciation expense for the governmental activities; 6) our inability to determine the propriety of cash and cash equivalents, receivables, capital assets, accounts payable, and other liabilities and accruals of the Chuuk Public Utilities Corporation; and 7) the inclusion of unaudited financial statements of the Chuuk State Housing Authority. The accompanying Schedule of Expenditures of Federal Awards (pages 56 through 60) is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. This schedule is the responsibility of the management of the State. Because the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the respective financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information, we do not express an opinion on the Schedule of Expenditures of Federal Awards.

This report is intended solely 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.

A handwritten signature in black ink, appearing to read "Deloitte + Touche LLP". The signature is stylized and cursive, with a large, sweeping initial letter 'D'.

July 10, 2006

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Summary Schedule of Expenditures of Federal Awards, by Grantor
Year Ended September 30, 2004

<u>Agency/Program</u>	<u>Expenditures</u>
U.S. Department of Agriculture	\$ 62,192
U.S. Department of the Interior	19,313,898
U.S. Department of Homeland Security	1,376,782
U.S. Department of Education	<u>997,436</u>
 GRAND TOTAL	 <u>\$ 21,750,308</u>
 Reconciliation to expenditures reported in the basic financial statements in the following funds:	
Compact Sector Grants Fund	\$ 15,825,425
Compact Capital Projects Fund	3,289,678
U.S. Federal Grant Assistance Fund	2,436,410
Compact Other Grants Fund	185,872
Compact Special Block Section 211(b) Fund	<u>12,923</u>
	 <u>\$ 21,750,308</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2004

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF AGRICULTURE		
Urban & Com. Forestry Prog.	10.664	\$ 54,402
Chuuk Frm Nursery Project	10.664	<u>7,790</u>
U.S. DEPARTMENT OF AGRICULTURE TOTAL		<u>\$ 62,192</u>

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

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2004

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF THE INTERIOR		
Economic, Social and Political Development of the Territories and the Freely Associated States:	15.875	
Compact Section 211(a) Capital Account		\$ 3,289,678
Compact Section 221(b) Special Block		12,923
Compact Section 214 Energy Grant		185,872
Compact Sector Grants:		
Capacity Building		2,620,157
Education		7,381,763
Environment		278,049
Health		4,303,112
Private Sector Development		<u>1,242,344</u>
U.S. DEPARTMENT OF THE INTERIOR TOTAL		<u>\$ 19,313,898</u>

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

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2004

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF HOMELAND SECURITY		
Public Assistance Grants:		
FEMA-DR-FM (Chaatan)	83.544	\$ 739,466
FEMA 1427 DR-FM PA (Chaatan)	83.544	22,095
FEMA 1449-DR-FM (Pongsona)	83.544	446,251
FEMA 1449-DR-FM (Pongsona)	83.544	28,384
Weno Road Drainage System	83.544	139,676
Sub-Grantee Admin.	83.544	910
U.S. DEPARTMENT OF HOMELAND SECURITY TOTAL		\$ 1,376,782

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

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2004

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF EDUCATION		
School Improvement Project	84.256A	\$ (395)
School Improvement Project	84.256A	82,522
School Improvement Project	84.256A	488,243
Total CFDA #84.256A		<u>570,370</u>
BECLEPS (Education) 6-01-21	84.290	45,090
BECLEPS (Bilingual Ed.)	84.290	235,081
Total CFDA #84.290		<u>280,171</u>
Vocational Education Improvement Project	84.994	6,422
Vocational Education Improvement Project	84.994	140,473
Total CFDA #84.994		<u>146,895</u>
U.S. DEPARTMENT OF EDUCATION TOTAL		<u><u>\$ 997,436</u></u>
GRAND TOTAL		<u><u>\$ 21,750,308</u></u>

The above U.S. Department of Education grants are received in a direct capacity.

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2004

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. Department of Homeland Security

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.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2004

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 discretely presented component unit, is the recipient of various pass-through funds from Chuuk State and direct grants from the U.S. Department of the Interior. The CPUC is to separately satisfy its 2004 reporting responsibilities under the Single Audit Act.

Chuuk State Housing Authority

The Chuuk State Housing Authority (CSHA), a discretely presented component unit, is the recipient of various pass-through funds from Chuuk State and certain direct grants. The CSHA has yet to satisfy its 2004 reporting responsibilities under the Single Audit Act.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Programs Selected For
Audit in Accordance with OMB Circular A-133
Year Ended September 30, 2004

<u>Grantor</u> <u>Program Title</u>	<u>CFDA No.</u>	<u>2004</u> <u>Fiscal Year</u> <u>Expenditures</u>
<u>U.S. Dept. of the Interior</u>		
Compact of Free Association:		
Section 211(A) Capital Account	15.875	\$ 3,289,678
Sector Grants	15.875	<u>15,825,425</u>
Total Major Programs under CFDA # 15.875		<u>19,115,103</u>
<u>U.S. Department of Homeland Security</u>		
Federal Emergency Management Agency:		
Public Assistance Grants	83.544	<u>1,376,782</u>
Total U.S. Federal program expenditures selected		\$ <u>20,491,885</u>
Total U.S. Federal program expenditures		\$ <u>21,750,308</u>
% of total U.S. Federal expenditures covered by major programs		<u>94%</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2004

Part I - Summary of Auditors' Results

1. The Independent Auditors' Report on the basic financial statements disclaimed an opinion on those financial statements due to 1) our inability to obtain sufficient evidence regarding the State's investment in Chuuk Fresh Tuna, Inc.; 2) obligations for land leases payable and the associated expenditure/expense being excluded from the governmental activities and the General Fund; 3) our inability to determine the propriety of receivables due from the FSM National Government and accounts payable recorded for the governmental activities, each major fund, and the aggregate remaining fund information, and of reserves for continuing appropriations and encumbrances recorded for each major fund and the aggregate remaining fund information; 4) our inability to determine the propriety of expenses recorded for the governmental activities and of expenditures recorded for each major fund and the aggregate remaining fund information; 5) our inability to determine the propriety of fixed assets, related accumulated depreciation and depreciation expense for the governmental activities; 6) our inability to determine the propriety of cash and cash equivalents, receivables, capital assets, accounts payable, and other liabilities and accruals of the Chuuk Public Utilities Corporation; and 7) the inclusion of unaudited financial statements of the Chuuk State Housing Authority.
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 basic 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 Section 211(a) Capital Account	15.875
U.S. Department of the Interior – Compact of Free Association, Sector Grants	15.875
U.S. Department of Homeland Security –Public Assistance Grants	83.544

8. A threshold of \$652,509 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.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Part II - Financial Statement Findings Section

<u>Reference Number</u>	<u>Findings</u>
2004-12	Implementation of Fixed Assets for GASB Statement No. 34
2004-13	Bank Reconciliations
2004-14	Investment Balance Reconciliations
2004-15	Payroll Expenditures Control Testing
2004-16	Unidentified Collections and Revenue Postings
2004-17	Expenditures
2004-18	Payroll Expenditures
2004-19	Substantive Testing – General Fund
2004-20	Non-Payroll Expenditures
2004-21	Search for Unrecorded Liabilities
2004-22	Cash Receipt Testing
2004-23	Cash Receipt / Revenue
2004-24	Revenue
2004-25	Revenue Testing
2004-26	Encumbrances
2004-27	Employee Ceiling
2004-28	Accounts Payable Imbalance
2004-29	Non-Payroll Expenditures Control Testing
2004-30	Compact Capital Debt Remaining Unpaid

Part III - Federal Award Findings and Questioned Cost Section

<u>Reference Number</u>	<u>CFDA Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
2004-01	15.875	Allowable Costs/Cost Principles and Procurement	\$2,607,204
2004-02	15.875	Allowable Costs/Cost Principles	Undeterminable
2004-03	83.544/97.036	Allowable Costs/Cost Principles and Procurement	\$ 719,496
2004-04	83.544/97.036	Period of Availability	Undeterminable
2004-05	15.875	Allowable Costs/Cost Principles	\$ 726,976
2004-06	84.256	Allowable Costs/Cost Principles and Procurement	\$ 23,683
2004-07	84.256	Allowable Costs/Cost Principles	Undeterminable
2004-08	84.290	Allowable Costs/Cost Principles and Procurement	\$ 14,864
2004-09	84.290	Allowable Costs/Cost Principles	Undeterminable
2004-10	84.994	Allowable Costs/Cost Principles and Procurement	\$ 9,452
2004-11	84.256, 84.290 84.994	Cash Management	\$ -
2004-12	All	Capital Assets	\$ -

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-01
 CFDA #: 15.875
 Agency: U.S. Department of the Interior, Office of Insular Affairs
 Grant Program Name: Compact of Free Association Economic, Social and Political Development
 of the Territories and the Freely Associated States Sector Grants
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Costs: \$2,607,204

Criteria: In accordance with applicable allowable costs/cost principles and procurement requirements, expenditures should be necessary and reasonable for the program needs and appears to be in accordance with program objectives. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

Condition: For 33 of 41 (80%) non-payroll expenditures tested (\$2,607,204 out of the aggregate amount of \$2,734,837 tested), either partial or no financial and/or programmatic records (canceled checks, invoices, receiving reports, etc.) were on file to substantiate the following transactions. Additionally, for almost all transactions listed below, there was insufficient documentation in support of competitive procurement activities.

<u>Fund No</u>	<u>Acct</u>	<u>Description</u>	<u>Date</u>	<u>APV #</u>	<u>Questioned Costs</u>
721411	8302	INSTRUCTIONAL HRS BY 515 TCHER	1/19/2004	JV724004	\$ 614,061
721421	8302	INSTRUCTIONAL HRS BY 189 TCHER	1/19/2004	JV724005	300,001
731201	8302	ADEQUATE MEDICAL SUPPLIES	1/18/2004	73JA001	223,115
721765	8302	ELIGILBE APPLICANTS DETERMINED	1/18/2004	JV724001	150,000
721411	8302	QTRLY RPT DATA&INFORMATION-4	1/19/2004	JV724004	139,784
731206	8302	INPATIENTS CARE	1/18/2004	73JA007	135,458
741624	8302	INVESTIGATION& PREVENTIVE PROG	1/19/2004	JVA74005	127,243
731201	8307	ADEQUATE MEDICAL SUPPLIES	9/3/2004	400758701	109,619
731201	8307	ADEQUATE MEDICAL SUPPLIES	6/11/2004	400481201	97,684
731205	8302	PATIENTS ENCOUNTERED-23302	1/18/2004	73JA006	83,157
721411	8302	QTRLY RPT DATA&INFORMATION-4	1/19/2004	JV724004	80,900
721411	8302	STDNTS FOR EDUCAITONAL SUPPRT	1/19/2004	JV724004	60,216
741951	8302	ACCURACY OF NOTARY/BIRTH CERTI	3/31/2004	JVA74027	57,733
721421	8302	MEAL SERVICES-886,922	1/19/2004	JV724005	54,402
741951	8302	ACCURACY OF NOTARY/BIRTH CERTI	1/19/2004	JVA74006	47,717
731221	8302	PATIENTS ENCOUNTERED-20,800	1/18/2004	73JA003	40,063
741051	8302	MONITORING & IMPLEMENTING OF P	1/19/2004	JVA74000	30,827
731201	8210	ADEQUATE MEDICAL SUPPLIES	4/22/2004	400404201	27,500
751533	8302	PERIODIC SURVEILLANCE, 300 PAT	1/18/2004	75JA018	27,238
721421	8302	BOARDING PROGRAM FOR 1,500	1/19/2004	JV724005	24,082
731201	8314	ADEQUATE MEDICAL SUPPLIES	3/10/2004	73JV037	21,834
741105	8302	TRAVEL AUTHORIZATIONS & PMT VO	1/19/2004	JVA74004	21,303
741625	8302	FIRE SAFETY	1/19/2004	JVA74005	20,260
761532	8302	PRODUCE 75 TON ICE PER WEEK	1/19/2004	JVA76008	17,510
761152	8302	PROPERTY CERTIFY THESE OWNERSH	1/19/2004	JVA76010	15,355
721421	8312	MEAL SERVICES-886,922	9/30/2004	400749501	14,409
721421	8312	MEAL SERVICES-886,922	2/19/2004	400136701	11,570

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-01, Continued
 CFDA #: 15.875
 Agency: U.S. Department of the Interior, Office of Insular Affairs
 Grant Program Name: Compact of Free Association Economic, Social and Political Development
 of the Territories and the Freely Associated States Sector Grants
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Costs: \$2,607,204

Condition, Continued:

<u>Fund No</u>	<u>Acct</u>	<u>Description</u>	<u>Date</u>	<u>APV #</u>	<u>Questioned Costs</u>
731201	8314	ADEQUATE MEDICAL SUPPLIES	5/18/2004	400438301	11,000
761152	8302	TO IMPROVED CADASTERAL PROGRAM	1/19/2004	JVA76010	10,733
731201	8314	ADEQUATE MEDICAL SUPPLIES	8/19/2004	400386913	9,780
731201	8314	ADEQUATE MEDICAL SUPPLIES	6/17/2004	400489001	9,000
731201	8442	PATIENTS SUPPORTED IN HAWAII	5/31/2004	73JA0111	7,000
731201	8311	PATIENTS SUPPORTED IN HAWAII	9/3/2004	400572904	6,650
					<u>\$ 2,607,204</u>

Cause: There appears to be a lack of controls over record keeping and ensuring that program expenditures are substantiated by such documents as cancelled checks, invoices, receiving reports, etc.

Effect: Chuuk State Government appears to be in noncompliance with applicable allowable costs/cost principles and procurement requirements.

Recommendation: The Chuuk State Government should comply with applicable allowable costs/cost principles and procurement requirements.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. We acknowledge that there are deficiencies in the filing system in Chuuk State that complicate document retrieval for audit review. We note, however that the above expenditures were approved by the Chuuk Financial Control Commission prior to payment and are authorized program expenditures for the appropriate sector grant. Many of the expenditures noted represent journal voucher transfers wherein expenditures first recorded in the general fund, because of late allotment of the 04 Compact sector grants, were later transferred to the appropriate compact sector fund; complete documentation supporting the transfers and the original recording in the general fund was often not attached to the journal vouchers. Chuuk State finance has implemented changes to its filing procedures that will more readily facilitate substantiating program expenditures. These changes will be effective for the fiscal year 2006 audit in November, 2006.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-02
CFDA #: 15.875
Agency: U.S. Department of the Interior, Office of Insular Affairs
Grant Program Name: Compact of Free Association Economic, Social and Political Development
of the Territories and the Freely Associated States Sector Grants
Requirement: Allowable Costs/Cost Principles
Questioned Costs: Undeterminable

Criteria: In accordance with applicable allowable costs/cost principles requirements, expenditures should be necessary and reasonable for the program needs and in accordance with program objectives. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

Condition: For 69 of 70 samples (99%) tested, personnel action forms, time sheets, journal vouchers and pay registers were not provided.

Cause: There appears to be a lack of controls exercised over record keeping, rate amendment and check disbursement policies in serving the objective of the program.

Effect: Chuuk State Government appears to be in noncompliance with applicable allowable costs/cost principles requirements.. Because Personnel Action Forms are not on file, amounts are undeterminable since we do not know the effective dates of employment and the effective employee pay rates.

Recommendation: The Chuuk State Government should comply with applicable allowable costs/cost principles requirements.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation but acknowledge that all employees were appropriately charged to the correct sector grant.. In fiscal year 2004, personnel expenditures were initially charged to the general fund, and after the sector grant allotments arrived, were subsequently transferred to the sector funds. Only 90% of the expenditures, however, were transferred leaving 10% in the general fund. Because the journal voucher supporting this transfer was done in total and not by individual employee, it was not possible to substantiate the exact amount transferred on an individual employee basis; consequently, the citation for lack of support. Finance management will make improvements to the filing of personnel records to better substantiate relevant expenditures for individual employees. This will be done before the commencement of the FY-06 audit in November, 2006.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-03
 CFDA #: 83.544/97.036
 Agency: U.S. Department of Homeland Security
 Program Name: Public Assistance Grants
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Costs: \$719,496

Criteria: In accordance with applicable allowable costs/cost principles and procurement requirements, expenditures should be necessary and reasonable for program needs and should be executed in accordance with program objectives. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

Condition: For 18 of 18 (100%) non-payroll expenditures tested (\$719,496 of the aggregate amount of \$719,496 tested), either partial or no financial and/or programmatic records (canceled checks, invoices, receiving reports, etc.) were on file to substantiate the following transactions. Additionally, for almost all transactions listed below, there was insufficient documentation in support of competitive procurement activities.

<u>Fund No</u>	<u>Fund Description</u>	<u>Acct</u>	<u>Vendor #</u>	<u>APV#</u>	<u>Check #</u>	<u>Questioned Costs</u>
301036	FEMA 1427-DR-FM (CHAATAN)	8405	4,133	300441101	70866	\$ 219,848
301037	FEMA	8405	3,302	400104801	72963	110,000
301036	FEMA 1427-DR-FM (CHAATAN)	8405	3,302	400347501	73694	51,221
301037	FEMA	8302	3,075	400727401	76214	46,550
301036	FEMA 1427-DR-FM (CHAATAN)	8405	2,471	400069901	66137	40,000
301036	FEMA 1427-DR-FM (CHAATAN)	8405	3,302	400559601	73694	37,016
301037	FEMA	8302	3,075	400727402	76214	32,339
301036	FEMA 1427-DR-FM (CHAATAN)	8405	31,194	400020501	65089	27,315
301037	FEMA	8302	4,133	400139301	71110	24,540
301037	FEMA	8405	3,302	400559501	73694	23,606
301036	FEMA 1427-DR-FM (CHAATAN)	8405	4,133	400104701	71110	18,860
301036	FEMA 1427-DR-FM (CHAATAN)	8405	31,194	400020401	65081	17,937
301036	FEMA 1427-DR-FM (CHAATAN)	8405	3,451	400022601	65147	16,709
301036	FEMA 1427-DR-FM (CHAATAN)	8405	3,451	400022301	65134	12,731
301037	FEMA	8302	3,075	400727404	76214	11,600
301036	FEMA 1427-DR-FM (CHAATAN)	8405	3,302	400430801	73192	10,361
301036	FEMA 1427-DR-FM (CHAATAN)	8302	3,302	400761701	77223	9,532
301036	FEMA 1427-DR-FM (CHAATAN)	8405	3,302	400347301	73694	9,331
					Total	\$ <u>719,496</u>

Cause: There appears to be a lack of controls over record keeping and ensuring that expenditure documentation demonstrates compliance with program objectives.

Effect: Chuuk State Government appears to be in noncompliance with applicable allowable costs/cost principles and procurement requirements, and questioned costs result.

Recommendation: Chuuk State Government should comply with applicable allowable costs/cost principles and procurement requirements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-03, Continued
CFDA #: 83.544/97.036
Agency: U.S. Department of Homeland Security
Program Name: Public Assistance Grants
Requirement: Allowable Costs/Cost Principles and Procurement
Questioned Costs: \$719,496

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. In fiscal year 2004, FEMA expenditures were made by the FSM National Government (FSMNG) through the local FSM finance office, using Chuuk State Compact CIP funds. Chuuk State does not have the documentation on file to support most of these expenditures, in particular the cancelled checks. Chuuk State will clear this finding in conjunction with the FSMNG. We are assured based on the documentation available that all these expenditures are in compliance with program objectives. Chuuk State Finance will clear these questioned costs with the FSMNG no later than December 2006.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-04
 CFDA #: 83.544/97.036
 Agency: U.S. Department of Homeland Security
 Program Name: Public Assistance Grants
 Requirement: Period of Availability
 Questioned Costs: Undeterminable

Criteria: In accordance with applicable period of availability requirements, expenditures should be recorded during the fund's period of availability.

Condition: Per review of detailed expenditures, we were unable to determine if the following expenditures were recorded outside the period of availability due to the absence of project worksheets.

<u>Acct</u>	<u>Date</u>	<u>P.O.</u>	<u>APV</u>	<u>Vendor #</u>	<u>Amount</u>
8310	2/1/2005		400802501	3064	\$ 2,698
8310	2/1/2005		400802601	3064	7,112
8310	2/1/2005		400802701	3064	1,900
8310	2/1/2005		400802801	3064	698
8310	2/1/2005		400802901	3064	698
8310	2/1/2005		400803001	3064	2,427
8310	2/1/2005		400803101	3064	309
8405	12/29/2004	L4171201	400765401	26445	42
8405	12/29/2004	L4171201	400765501	26448	42
8405	12/29/2004	L4171201	400765601	26449	42
8405	12/29/2004	L4171201	400765701	26450	42
8405	12/29/2004	L4171201	400765801	26451	42
8405	12/29/2004	L4171201	400765901	26455	42
8405	12/29/2004	L4171201	400766001	26456	42
8405	12/29/2004	L4167801	400766101	26457	26
8405	12/29/2004	L4167801	400766201	26455	26
8405	12/29/2004	L4167801	400766301	26456	26
8405	12/29/2004	L4167801	400766401	26013	26
8405	12/29/2004	L4174401	400766501	26013	117
8405	12/29/2004	L4174401	400766601	26458	100
8405	12/29/2004	L4174401	400766701	26459	100
8405	12/29/2004	L4174401	400766801	26460	100
8405	12/29/2004	L4169801	400766901	26456	58
8405	12/29/2004	L4169801	400767001	26013	58
8405	12/29/2004	L4169801	400767101	26009	58
8405	12/29/2004	L4169801	400767201	26458	58
8405	12/29/2004	L4169801	400767301	26457	58
8405	12/29/2004	L4172701	400767501	26135	100
8405	12/29/2004	L4172701	400767601	26461	100
8405	12/29/2004	L4172701	400767701	26462	100
8405	12/29/2004	L4172701	400767801	26463	100

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-04, Continued
 CFDA #: 83.544/97.036
 Agency: U.S. Department of Homeland Security
 Program Name: Public Assistance Grants
 Requirement: Period of Availability
 Questioned Costs: Undeterminable

Condition, Continued:

<u>Acct</u>	<u>Date</u>	<u>P.O.</u>	<u>APV</u>	<u>Vendor #</u>	<u>Amount</u>
8405	12/29/2004	L4172701	400767901	26464	\$ 100
8405	12/29/2004	L4172701	400768001	26465	100
8405	12/29/2004	L4172701	400768101	26466	100
8405	12/29/2004	L4170201	400768301	18875	56
8405	12/29/2004	L4170201	400768401	26464	56
8405	12/29/2004	L4174701	400768501	30901	130
8405	12/29/2004	L4174701	400768601	27540	111
8405	12/29/2004	L4174701	400768701	26467	111
8405	12/29/2004	L4174701	400768801	26468	111
8405	12/29/2004	L4174701	400768901	26469	111
8405	12/29/2004	L4174701	400769001	26470	111
8405	12/29/2004	L4174701	400769101	26471	111
8405	12/29/2004	L4174701	400769201	22468	130
8405	12/29/2004	L4174701	400769401	26472	111
8405	12/29/2004	L4174701	400769501	26473	111
8405	12/29/2004	L4173801	400769601	32112	50
8405	12/29/2004	L4173801	400769701	26475	40
8405	12/29/2004	L4173801	400769801	26476	40
8405	12/29/2004	L4172401	400780101	26478	50
8405	12/29/2004	L4172401	400780201	16427	50
8405	12/29/2004	L4169201	400780301	23512	100
8405	12/29/2004	L4169201	400780401	26479	80
8405	12/29/2004	L4169201	400780501	26480	80
8405	1/5/2005	L4173001	400763101	35265	45
8405	1/5/2005	L4173001	400763201	35266	45
8405	1/5/2005	L4173001	400763301	35267	45
8405	1/5/2005	L4170401	400780601	4377	124
8405	1/5/2005	L4170401	400780701	16427	100
8405	1/5/2005	L4170401	400780801	26481	100
8405	1/5/2005	L4170401	400780901	35268	100
8405	1/5/2005	L4185801	400781001	32094	110
8405	1/5/2005	L4185801	400781101	8131	110
8405	1/5/2005	L4185801	400781201	11974	110
8405	1/5/2005	L4185801	400781301	27011	110
8405	1/5/2005	L4157501	400781601	35286	150

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-04, Continued
 CFDA #: 83.544/97.036
 Agency: U.S. Department of Homeland Security
 Program Name: Public Assistance Grants
 Requirement: Period of Availability
 Questioned Costs: Undeterminable

Condition, Continued:

<u>Acct</u>	<u>Date</u>	<u>P.O.</u>	<u>APV</u>	<u>Vendor #</u>	<u>Amount</u>
8405	1/5/2005	L4157501	400781701	35287	\$ 150
8405	1/5/2005	L4157501	400781801	35288	150
8405	1/5/2005	L4157501	400781901	35289	150
8405	1/5/2005	L4157501	400782001	35290	150
8405	1/5/2005	L4157501	400782101	35291	150
8405	1/5/2005	L4157501	400782201	35292	150
8405	1/5/2005	L4157501	400782301	35293	150
8405	1/5/2005	L4157501	400782401	35294	150
8405	1/5/2005	L4157501	400782501	35295	150
8405	1/5/2005	L4146301	400782701	12751	100
8405	1/5/2005	L4146301	400782801	27004	100
8405	1/5/2005	L4146301	400782901	27005	100
8405	1/5/2005	L4146301	400783001	27006	100
8405	1/5/2005	L4146301	400783101	27007	100
8405	1/5/2005	L4146301	400783201	27008	100
8405	1/5/2005	L4146301	400783301	27009	100
8405	1/5/2005	L4146301	400783401	27010	100
8405	1/5/2005	L4146301	400783501	16138	100
8405	1/5/2005	L4173401	400790801	35276	100
8405	1/5/2005	L4173401	400790901	35277	92
8405	1/5/2005	L4173401	400791001	35278	92
8405	1/5/2005	L4173401	400791101	35279	92
8405	1/5/2005	L4173401	400791201	35280	92
8405	1/5/2005	L4173401	400791301	35281	92
8405	1/5/2005	L4173401	400791401	35282	92
8405	1/5/2005	L4173401	400791501	35283	92
8405	1/5/2005	L4173401	400791601	35284	92
8405	1/5/2005	L4173401	400791701	35285	92
8405	1/5/2005	L4171601	400794601	35252	90
8405	1/5/2005	L4171601	400794701	35253	90
8405	1/5/2005	L4171601	400794801	35254	90
8405	1/5/2005	L4171601	400794901	35255	90
8405	1/5/2005	L4171601	400795001	35256	90
8405	1/5/2005	L4171601	400795101	35257	90
8405	1/5/2005	L4171601	400795201	35258	90

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-04, Continued
 CFDA #: 83.544/97.036
 Agency: U.S. Department of Homeland Security
 Program Name: Public Assistance Grants
 Requirement: Period of Availability
 Questioned Costs: Undeterminable

Condition, Continued:

<u>Acct</u>	<u>Date</u>	<u>P.O.</u>	<u>APV</u>	<u>Vendor #</u>	<u>Amount</u>
8405	1/5/2005	L4171601	400795301	35259	\$ 90
8405	1/5/2005	L4171601	400795401	35260	90
8405	1/5/2005	L4183901	400795501	27016	148
8405	1/5/2005	L4183901	400795601	9372	148
8405	1/5/2005	L4183901	400795701	27017	148
8405	1/5/2005	L4183901	400795801	24649	148
8405	1/5/2005	L4183901	400795901	27018	148
8405	1/5/2005	L4184601	400796001	32102	100
8405	1/5/2005	L4184601	400796101	27013	100
8405	1/5/2005	L4184601	400796201	27014	100
8405	1/5/2005	L4184601	400796301	27015	100
8405	1/5/2005	L4184601	400796401	9972	100
8405	1/5/2005	L4186301	400796501	32092	75
8405	1/5/2005	L4186301	400796601	26927	30
8405	1/5/2005	L4158801	400796901	35248	90
8405	1/5/2005	L4158801	400797001	35249	90
8405	1/5/2005	L4158801	400797101	35250	90
8405	1/5/2005	L4158801	400797201	35251	90
8405	1/5/2005	L4158401	400797401	35272	30
8405	1/5/2005	L4158401	400797501	35273	30
8405	1/5/2005	L4158401	400797601	35274	30
8405	1/5/2005	L4158401	400797701	35275	30
8405	1/5/2005	L4167701	400797801	35269	182
8405	1/5/2005	L4167701	400797901	35270	100
8405	1/5/2005	L4167701	400798001	35271	100
8405	1/5/2005	L4147201	400798101	35261	77
8405	1/5/2005	L4147201	400798201	35262	50
8405	1/5/2005	L4147201	400798301	35263	50
8405	1/5/2005	L4147201	400798401	35264	50
8405	2/7/2005	L4175101	400804801	32109	438
8405	2/7/2005	L4175101	400804901	32108	250
8405	2/7/2005	L4175101	400805001	35292	250
8405	2/7/2005	L4175101	400805101	28946	250
8405	2/7/2005	L4175101	400805201	4377	250
8405	2/7/2005	L4175101	400805301	26133	250

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-04, Continued
 CFDA #: 83.544/97.036
 Agency: U.S. Department of Homeland Security
 Program Name: Public Assistance Grants
 Requirement: Period of Availability
 Questioned Costs: Undeterminable

Condition, Continued:

<u>Acct</u>	<u>Date</u>	<u>P.O.</u>	<u>APV</u>	<u>Vendor #</u>	<u>Amount</u>
8405	2/23/2005	L4186801	400806701	32060	\$ 53
8405	2/23/2005	L4186801	400806801	22145	53
8405	2/23/2005	L4186801	400806901	32090	53
				Total	\$ <u>28,843</u>

Cause: There appears to be a lack of controls exercised over demonstrating that expenditures are used within the period of availability and over maintaining significant programmatic records on file.

Effect: Due to the absence of project work sheets, it is undeterminable if expenditures were expended in the period of availability; therefore, Chuuk State Government appears to be in potential noncompliance with period of availability requirements.

Recommendation: Chuuk State Government should maintain project worksheets in order to demonstrate compliance with applicable period of availability requirements.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. As mentioned previously, the FSMNG handled Chuuk State FEMA expenditures and much of the documentation is with them and not with Chuuk State. We do not believe there is a problem with the period of availability because throughout fiscal years 2004 and 2005 program expenditures for typhoons Chaatan, Pongsana and related Hazard Mitigation programs were being approved by the FSM Disaster Office. Chuuk State Finance will clear these questioned costs with the FSMNG no later than December 2006.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-05
 CFDA #: 15.875
 Agency: U.S. Department of the Interior, Office of Insular Affairs
 Grant Program Name: Compact of Free Association Section 211(a) Capital Account
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$726,976

Criteria: In accordance with applicable allowable costs/cost principles requirements, expenditures should be necessary and reasonable for program needs and should be in accordance with program objectives. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

Condition: For 48 of 73 (66%) non-payroll expenditures tested (\$726,976 of the aggregate amount of \$1,365,387 tested), either partial or no financial and/or programmatic records (canceled checks, invoice, receiving reports, etc.) were on file to substantiate the following transactions:

<u>Fund No</u>	<u>Description</u>	<u>Date</u>	<u>APV #</u>	<u>Questioned Cots</u>
601802	TONOAS DISASTER RELIEF/RESTORA	9/30/2004	JV4M0001	\$ 190,921
601811	TOLENSOM MUN.FISHING/6-01-06M	9/30/2004	JV4M0003	66,276
601051	FY2003 STATE LAND LEASE & ACQ.	1/22/2004	400091201	50,000
601051	CHUUK STATE HEALTH CARE PLAN	9/30/2004	JV4M0001	46,579
601813	FANAPANGES FISHING/6-02-11	2/12/2004	400120701	38,500
601051	CHUUK LEGISLATIVE BLDG/6-02-14	9/17/2004	400620901	30,000
601816	LOSAP FISHING PROJ/6-01-06M	2/10/2004	400117601	29,799
601051	CHUUK LEGISLATIVE BLDG/6-02-14	6/3/2004	400464601	24,000
601815	POLLE OFFICE SUPPLEMENTAL/02M	9/30/2004	JV4M0003	20,447
601809	UDOT SCHOOL REPAIR/6-01-06M	7/15/2004	400310001	15,000
601051	FY2003 STATE LAND LEASE & ACQ.	1/28/2004	400103401	15,000
601051	FY2003 STATE LAND LEASE & ACQ.	2/3/2004	400110001	15,000
601803	FANIPW AGRICULTURAL/6-01-06M	9/30/2004	JV4M0002	15,000
601804	UMAN MUN.FISHING PROJ/6-02-11M	11/12/2003	400026801	14,750
601051	FY2003 STATE LAND LEASE & ACQ.	2/24/2004	400139701	12,000
601840	PIIS PANEU FISHING/6-01-06M	9/30/2004	JV4M0003	10,022
601810	ROMANUM ECON.FISHING/6-01-06M	9/30/2004	JV4M0002	10,000
601051	FY2003 STATE LAND LEASE & ACQ.	4/30/2004	400417201	10,000
601811	TOLENSOM MUN.OFFICE RENOV/03M	9/30/2004	JV4M0003	10,000
601051	FY2003 STATE LAND LEASE & ACQ.	1/22/2004	400090901	8,600
601051	FY2003 STATE LAND LEASE & ACQ.	2/3/2004	400109701	8,500
601051	FY2003 STATE LAND LEASE & ACQ.	1/22/2004	400091401	7,000
601051	FY2003 STATE LAND LEASE & ACQ.	2/3/2004	400109801	7,000
601051	FY2003 STATE LAND LEASE & ACQ.	2/6/2004	400114701	7,000
601803	UFO SEWING PROJ.FEFAN/6-01-06	9/30/2004	JV4M0001	6,999
601815	POLLE SAPOU MARKET/06-01-06M	9/30/2004	JV4M0004	6,175

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-05, Continued
 CFDA #: 15.875
 Agency: U.S. Department of the Interior, Office of Insular Affairs
 Grant Program Name: Compact of Free Association Section 211(a) Capital Account
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$726,976

Condition, Continued:

<u>Fund No</u>	<u>Description</u>	<u>Date</u>	<u>APV #</u>	<u>Questioned Cots</u>
601805	SIIS SEAWALL PROJ/6-01-06M	9/30/2004	JV4M0002	5,940
601803	INAKA FEFAN WATER/6-01-06M	9/30/2004	JV4M0002	5,781
601804	UMAN NEMERAI SAPOU FISHING/03	11/19/2003	400029101	5,160
601051	FY2003 STATE LAND LEASE & ACQ.	6/9/2004	400471901	5,000
601803	SANGKUMI FEFAN SEWING/06-01-06	9/30/2004	JV4M0002	4,000
601051	CHUUK STATE HEALTH CARE PLAN	9/30/2004	JV4M0004	3,930
601801	WENO NEPUKOS YOUTH CENTER/6-02	2/19/2004	400133201	3,475
601051	FY2003 STATE LAND LEASE & ACQ.	1/22/2004	400090301	3,000
601803	FEFAN EL NINO/6-02-11M	3/19/2004	400269901	2,145
601801	KOKUMI WENO FISHING SOPUK/02M	9/30/2004	JV4M0004	2,000
601051	FY2003 STATE LAND LEASE & ACQ.	3/16/2004	400267001	2,000
601801	NEMWAN/MECHITIW PUB.TOILET/03M	10/15/2003	400003206	1,800
601804	UMAN MUN.FISHING PROJ/6-02-11M	7/14/2004	400550501	1,250
601051	FY2003 STATE LAND LEASE & ACQ.	1/27/2004	400101001	1,000
601051	FY2003 STATE LAND LEASE & ACQ.	2/18/2004	400126401	1,000
601051	FY2003 STATE LAND LEASE & ACQ.	6/18/2004	400492701	1,000
601837	NOMWIN MULTI PURPOSE PUB.BLDG	9/30/2004	JV4M0003	1,000
601801	TUNNUK TOILET FACIL/6-02-11M	11/12/2003	400026403	974
601801	WENO WICHAP FISHING PROJECT	10/29/2003	400010301	700
601804	UMAN NEASAP COMM.CENTER/03M	11/10/2003	400012101	504
601804	UMAN NUKAN TEWENENO SEAWALL/03	10/29/2003	40008301	500
601803	FEFAN ROAD UPGRDE.SUPP/6-02-11	11/12/2003	400027405	250
Total				\$ <u>726,976</u>

Cause: There appears to be a lack of controls over record keeping and demonstrating program compliance with applicable allowable costs/cost principles requirements.

Effect: Chuuk State Government appears to be in noncompliance with applicable allowable costs/cost principles requirements.

Recommendation: Chuuk State Government should comply with applicable allowable costs/cost principles requirements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.:	2004-05, Continued
CFDA #:	15.875
Agency:	U.S. Department of the Interior, Office of Insular Affairs
Grant Program Name:	Compact of Free Association Section 211(a) Capital Account
Requirement:	Allowable Costs/Cost Principles
Questioned Costs:	\$726,976

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. We note that old Compact CIP expenditures were being handled by the FSMNG through the local FSM revenue office throughout fiscal year 2004 and much of the documentation is not available in the Chuuk State Finance Office. During this period the Compact CIP funds were used for a variety of State and municipal purposes which we believe are within the program guidelines approved by OIA. Chuuk State finance will clear these questioned costs with the FSMNG no later than December, 2006.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-06
 CFDA #: 84.256A
 Grant No.: S256A030005-04
 Agency: U.S. Department of Education
 Program Name: School Improvement Grant
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Costs: \$23,683

Criteria: In accordance with applicable allowable costs/cost principles and procurement requirements, expenditures should be necessary and reasonable for program needs and should be in accordance with program objectives. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

Condition: For 24 of 53 (45%) non-payroll expenditures tested (\$23,683 of the aggregate \$69,998 tested), either partial or no financial and/or programmatic records (canceled checks, invoice, receiving reports, etc.) were on file to substantiate the following transactions. Additionally, for almost all transactions listed below, there was insufficient documentation in support of competitive procurement activities.

<u>Fund No</u>	<u>Acct</u>	<u>Vendor #</u>	<u>APV#</u>	<u>Check #</u>	<u>Questioned Costs</u>
301401	8110	84500	460029901	5862	\$ 1,905
301401	8110	81196	460041501	5957	1,901
301401	8110	80059	460087101		994
301401	8110	3061	460081906	6172	833
301401	8110	80059	460103901		802
301401	8110	81152	460024001	5800	568
301401	8110	3061	460069803	6098	394
301401	8302	3061	460069804	6098	490
301401	8303	3332	400755004	7353	180
301401	8303	4133	400637706	VOID	130
301401	8401	4574	400058101	5670	1,500
301401	8401	3535	400067601	5681	1,500
301401	8401	3672	400123301	5810	1,350
301401	8401	4574	400124301	5811	1,350
301401	8401	60525	400418201	5985	1,350
301401	8401	6000	400419201	5980	1,350
301401	8401	4574	400420201	5979	1,350
301401	8401	6000	400312401	6237	1,350
301401	8401	9235	400341801	6269	675
301401	8401	3672	400059801	5669	500
301401	8401	2155	400554101	6225	150
301401	8405	4881	400105801	5750	2,295
301401	8405	4881	400106401	5750	765
		Total SIP			\$ 23,683

Cause: There appears to be a lack of controls exercised over record keeping and documentation relative to the manner in which expenditures meet program objectives.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-06, Continued
CFDA #: 84.256A
Grant No.: S256A030005-04
Agency: U.S. Department of Education
Program Name: School Improvement Grant
Requirement: Allowable Costs/Cost Principles and Procurement
Questioned Costs: \$23,683

Effect: Chuuk State Government appears to be in noncompliance with applicable allowable costs/cost principles and procurement requirements.

Recommendation: Chuuk State Government should comply with applicable allowable costs/cost principles and procurement requirements.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. We believe that the controls in effect in Chuuk State Department of Education and State Finance ensure that only authorized school improvement program expenditures were charged to the grant. All defects in the filing system will be corrected before the commencement of the FY-06 audit in November, 2006. Clearance of these questioned costs will be taken up with the grantor agency no later than December 2006.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-07
 CFDA #: 84.256A
 Grant No.: S256A030005-04
 Agency: U.S. Department of Education
 Program Name: School Improvement Grant
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: Undeterminable

Criteria: In accordance with applicable allowable costs/cost principles requirements, expenditures should be necessary and reasonable for program needs and should be in accordance with program objectives.

Condition: For 5 of 7 (72%) payroll items, there were no supporting documents (personnel action forms, allotments, timesheets, and/or pay registers) on file for the following:

<u>Fund No</u>	<u>Acct</u>	<u>Amount</u>	<u>CK #</u>	<u>Actual</u>	<u>PPE</u>	<u>Empl #</u>
301401	8010	\$5,472	468544	\$341.39	9/5/2004	42861
301401	8010	5,390	459024	450.00	7/11/2004	44425
301401	8010	5,357	442130	409.68	3/21/2004	35577
301401	8010	4,868	(1)	(1)	12/14/2003	(1)
301401	8010	4,825	(1)	(1)	10/19/2003	(1)

For items marked (1), the entity could not provide a payroll register, so no sample could be drawn.

Cause: There appears to be a lack of controls exercised over record keeping, rate amendments and check disbursement policies.

Effect: Chuuk State Government appears to be in noncompliance with applicable allowable costs/cost principles requirements. Since Personnel Action Forms are not on file, amounts of potential questioned costs are undeterminable because we do not know the effective dates of employment and the effective employee pay rates.

Recommendation: Chuuk State Government should comply with applicable allowable costs/cost principles requirements.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. We believe that the controls in effect in Chuuk State Department of Education and State Finance ensure that only authorized school improvement program expenditures were charged to the grant. All defects in the filing system will be corrected before the commencement of the FY-06 audit in November, 2006. Clearance of these questioned costs will be taken up with the grantor agency no later than December 2006.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-08
 CFDA #: 84.290
 Grant No.: T290U010551-04
 Agency: U.S. Department of Education
 Program Name: Bilingual Education – Comprehensive School Grants (BECLEPS)
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Costs: \$14,864

Criteria: In accordance with applicable allowable costs/cost principles and procurement requirements, expenditures should be necessary and reasonable for program needs and should be in accordance with program objectives. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

Condition: For 8 of 25 (32%) non-payroll expenditures tested (\$14,864 of the aggregate \$49,994 tested) either partial or no financial and/or programmatic records (canceled checks, invoice, receiving reports, etc.) were on file to substantiate the following transactions. Additionally, for almost all transactions listed below, there was insufficient documentation in support of competitive procurement activities.

<u>Fund No</u>	<u>Acct</u>	<u>Vendor #</u>	<u>APV#</u>	<u>Check #</u>	<u>Questioned Costs</u>
301401	8110	810003	460005201	5643	\$ 2,994
301401	8455	82541	460014301	5741	239
301401	8110	82612	460071301	6126	3,196
301401	8110	3061	460053802	6000	2,753
301401	8110	86428	460101801	7066	1,442
301401	8302	3061	460026103	5830	1,535
301401	8303	3332	400122401	5783	455
301401	8455	82501	460125101	7363	<u>2,250</u>
Total BECLEPS					<u>\$14,864</u>

Cause: There appears to be a lack of controls exercised over record keeping and documentation relative to the manner in which such expenditures meet program objectives.

Effect: Chuuk State Government appears to be in noncompliance with applicable allowable costs/cost principles and procurement requirements.

Recommendation: Chuuk State Government should comply with applicable allowable costs/cost principles and procurement requirements.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. We believe that the controls in effect in Chuuk State Department of Education and State Finance ensure that only authorized BECLEPS expenditures were charged to the grant. All defects in the filing system will be corrected before the commencement of the FY-06 audit in November, 2006. Clearance of these questioned costs will be taken up with the grantor agency no later than December 2006.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-09
 CFDA #: 84.290
 Grant No.: T290U010551-04
 Agency: U.S. Department of Education
 Program Name: Bilingual Education – Comprehensive School Grants (BECLEPS)
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: Undeterminable

Criteria:

In accordance with applicable allowable costs/cost principles requirements, expenditures should be necessary and reasonable for program needs and should be in accordance with program objectives.

Condition:

For 3 of 5 (60%) payroll items tested, there were no supporting documents (personnel action forms, allotments, timesheets, and/or pay registers) on file:

<u>Fund No</u>	<u>Acct</u>	<u>Amount</u>	<u>CK #</u>	<u>Actuals</u>	<u>PPE</u>	<u>Empl #</u>
301401	8010	\$ 4,739	433642	\$ 1,413	1/25/2004	69724
301401	8010	3,735	(1)	(1)	11/2/2003	(1)
301401	8010	3,464	446489	570	4/18/2004	11977

For (1), the entity could not provide a payroll register so no sample could be drawn.

Cause: There appears to be a lack of controls exercised over record keeping, rate amendments and check disbursement policies.

Effect: Chuuk State Government appears to be in noncompliance with applicable allowable costs/cost principles requirements. Since Personnel Action Forms are not on file, amounts are undeterminable because we do not know the effective dates of employment and the effective employee pay rates.

Recommendation: Chuuk State Government should comply with applicable allowable costs/cost principles requirements.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. We note, however, that the above payroll expenditures are for authorized BECLEPS employees. Changes in the filing system for personnel records will be implemented before the commencement of the FY-06 audit in November 2006.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-10
 CFDA #: 84.994
 Grant No.: V048B020001
 Agency: U.S. Department of Education
 Program Name: Vocational Education Improvement Plan
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Costs: \$9,452

Criteria: In accordance with applicable allowable costs/cost principles and procurement requirements, expenditures should be necessary and reasonable for program needs and should be in accordance with program objectives. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

Condition: For 7 of 15 (47%) non-payroll expenditures tested (\$9,452 out of the aggregate \$23,337 tested), either partial or no financial and/or programmatic records (canceled checks, invoices, receiving reports, etc.) were on file to substantiate the following transactions. Additionally, for almost all transactions listed below, there was insufficient documentation in support of competitive procurement activities.

<u>Fund No</u>	<u>Acct</u>	<u>Vendor #</u>	<u>APV#</u>	<u>Check #</u>	<u>Questioned Costs</u>
301401	8302	87243	400554301	6228	\$ 1,620
301401	8302	22250	400132801	5793	1,550
301401	8455	3061	460008802	5651	2,819
301401	8455	3061	460042701	Not Paid	1,512
301401	8455	81310	460024101	5802	1,024
301401	8455	3061	460083402	6213	688
301401	8455	2155	460005001	5632	239
Total PVEIP					\$ <u>9,452</u>

Cause: There appears to be a lack of controls exercised over record keeping and documentation relative to the manner in which these expenditures meet program objectives.

Effect: Chuuk State Government appears to be in noncompliance with applicable allowable costs/cost principles and procurement requirements. The amount above is less than \$10,000, but projected questioned costs exceed the threshold; therefore, the finding is reportable.

Recommendation: Chuuk State Government should comply with applicable allowable costs/cost principles and procurement requirements.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. We believe that the controls in effect in Chuuk State Department of Education and State Finance ensure that only authorized PVEIP expenditures were charged to the grant. All defects in the filing system will be corrected before the commencement of the FY-06 audit in November, 2006. Clearance of these questioned costs will be taken up with the grantor agency no later than December 2006.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-11
CFDA #: 84.256A, 84.290, 84.994
Grant Nos.: S256A030005-04, T290U010551-04, V048B020001
Agency: U.S. Department of Education
Program Name: School Improvement Grant, BECLEPS, Pacific Vocational Education
Improvement Plan
Requirement: Cash Management
Questioned Costs: \$0

Criteria: In accordance with applicable cash management requirements, the time elapsed between the receipt of Federal funds and the disbursement of checks should be minimized.

Condition: Chuuk State Government could not provide documented details of expenditure drawdowns per GAPS for the School Improvement, BECLEPS, Vocational Education Improvement Plan Grants.

Cause: There appears to be a lack of internal controls over cash management. We note that the cash management function is administered by the Chuuk State Department of Education and not by the Chuuk State Department of Finance

Effect: Chuuk State Government appears to be in noncompliance with applicable cash management requirements. Due to lack of information available and provided by grantee, the amount of questioned costs, if any, that result from this matter are undeterminable.

Recommendation: Chuuk State Government should establish internal controls over cash management and should determine whether this responsibility should remain vested in Chuuk State Department of Education.

Auditee Response and Corrective Action Plan: The finding is correct. Management believes the drawdown of direct U.S. DOE grants is correctly placed with the Chuuk State Department of Education who are able to best determine when expenditures should be made for program purposes. The real problem relates to many of the applicable deposits not being identified on a timely basis --- that is until the bank reconciliation for the month in which the drawdown was received was performed. Because the entry for the unidentified deposit was made as of the date of the bank statement ending date, it was not possible to determine from the accounting records the time elapsed between the drawdown and expenditure. In fiscal year 2006, Chuuk State finance revised its policy concerning dating bank reconciliation adjustments to ensure unidentified deposits are dated as of the date they appear on the bank statement. This improvement of internal controls over cash management will ensure that it will be possible to monitor the time elapsed between drawdowns and expenditures.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No. 2004-12 – 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 agree with the finding and recommendation. Chuuk State Finance has requested assistance from the FSM National Government to assist with GASB 34 compliance with respect to fixed assets. Implementation will be performed when such assistance is obtained.

Finding No. 2004-13 - Bank Reconciliations

Criteria: Bank reconciliations should be performed on a monthly basis, and reconciling items should be timely cleared. The bank reconciliation balances should agree with the balance per the general ledger.

Condition:

- We were not provided bank reconciliations for a payroll and a CIP account that total to approximately \$69,000.
- Net unlocated differences between the bank reconciliations and the applicable general ledger accounts total some \$225,000.
- Various reconciliations contained between \$11,000 and \$18,000 of stated bank errors that have been long outstanding.
- Certain manually issued checks cleared the bank and were not recorded in the books of some \$3,900.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No. 2004-13 - Bank Reconciliations, Continued

Condition, Continued:

- Outstanding check lists appear to include many checks that were never issued to the payees and have subsequently been paid again and therefore, an accurate listing of valid outstanding checks is unknown.
- Various bank reconciling items could not be located and were not available for inspection.
- Check number 76669 dated November 16, 2004, was erroneously included in the list of outstanding checks.
- We noted 3 checks, including the aforementioned, whose check series commenced after September 30, 2004, but were included in the outstanding check listing as of fiscal year end.

<u>Check Number</u>	<u>Amount</u>
76669	\$46,108
76445	\$ 25
76790	\$ 961

Cause: The cause of this condition is that bank reconciliations are not agreeing with general ledger balances, reconciling items are not being documented in writing and timely adjusted, and checks have been listed as outstanding when in reality, they are not outstanding.

Effect: The effect of this condition is an inability to determine the actual cash balances.

Recommendation: Bank reconciliations should be timely performed, reconciling items should be valid and should be substantiated, and checks should not be prepared until such time as they will be delivered to the payees.

Prior Year Status: Matters associated with bank reconciliations were reflected as a finding in the 2003 Single Audit.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Chuuk State is now current on its general account bank reconciliations and has incorporated procedures for reviewing outstanding checks for accuracy and canceling old outstanding checks, substantiation of reconciling items and preparing timely journal corrections, and following up with the bank for the timely correction of bank errors.

Finding No. 2004-14 - Investment Balance Reconciliations

Criteria: Investment balances should be periodically reconciled.

Condition: The State does not reconcile its investments during the year and appears to await the audit process to achieve this end.

Cause: The cause of this condition appears to be a lack of investment account understanding to achieve the reconciliation.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No. 2004-14 - Investment Balance Reconciliations, Continued

Effect: The effect of this condition is that the State does not have independent knowledge as to the status of its investments or the related impact on its revenues until substantially after the fiscal year end.

Recommendation: The investment accounts should be reconciled on a monthly basis upon the receipt of the related investment account information from the trustees.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. This has been a recurring problem with Chuuk State and has created many problems with respect to certifying investment earnings for appropriation to timely reconciliation at year-end for audit purposes. Presently, staff in Chuuk State finance do not know how to correctly reconcile the monthly statements from the trustee bank. Chuuk State finance will request the assistance of the FSMNG to provide a good reconciliation template and instructions so that it can perform its own reconciliations on a monthly basis.

Finding No. 2004-15 - Payroll Expenditures Control Testing

Criteria: All payroll-related deductions should be properly documented and be readily available for review.

Condition: For 13 of 13 (100%) payroll items tested, there were no allotment forms on file.

Cause: There appears to be a lack of controls exercised over recordkeeping that ensure payroll transactions are authorized.

Effect: This condition has no financial statement effect. However, this condition may indicate a risk that payroll deductions may not be properly authorized. This condition also indicates that controls over payroll documentation are not properly implemented.

Recommendation: All payroll transactions should be properly documented.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. It is standard procedure in the Payroll division of Finance to not made deductions from employees without properly approved allotment advises. Internal controls will be reemphasized to ensure proper filing of such allotment advices in employee files.

Finding No. 2004-16 - Unidentified Collections and Revenue Postings

Criteria: All revenue should be supported with underlying documents, such as cash receipts, transmittal documents from remitting party, or other documents to ensure proper posting of revenue.

Condition:

- As of September 30, 2004, collections of \$44,282 are still unidentified and were recorded as miscellaneous revenue.
- A number of revenue postings do not have supporting documents, such as cash receipts and transmittal documents.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No. 2004-16 - Unidentified Collections and Revenue Postings, Continued

Condition, Continued:

- There are numerous erroneous postings of remittances received from the FSM National Government.
- Various drawdowns from investments were recorded as revenues.

Cause: While part of the cause may be inadequate information from the FSM National Government supporting payments to the State, we were unable to determine the State's response as we could not locate a file of written correspondence addressing these matters. The cause of the balance of the condition is that inadequate general ledger understanding exists within the State.

Effect: The effect of this condition is that internal financial statements are materially misstated.

Recommendation: The State should ensure that all revenue transactions are substantiated by such underlying documents as cash receipts, transmittal of documents from the remitting party, or other such support prior to recording the transaction.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. There are still considerable problems with the identification and posting of remittances from the FSMNG. These problems have increased since FSM finance implemented the policy of direct drawdowns to the State bank account for pass-through grants, in contrast to the previous practice of using the national government as an intermediary and processing an FSMNG check to the State. Bank reconciliation staff have been instructed to timely follow-up in writing with the FSMNG requests to identify deposits and to ensure they are correctly posted to the proper ORG_cost centers. Drawdowns from investments are to be recorded as reduction in marketable securities rather than revenues. These policies will be reinforced by close management oversight of the timeliness of bank reconciliations and the correct disposition of unidentified deposits.

Finding No. 2004-17 - Expenditures

Criteria: Payroll-related expenditures should be supported by timesheets and personnel action forms. Non-payroll expenditures should be supported by purchase orders, contracts, vendor invoices, receiving reports, procurement documents, travel authorization forms, and any other supporting document that validate the expense.

Conditions:

1. One hundred seventy-eight of two hundred forty-seven non-payroll expenditures were not supported by APV invoice, purchase order, contract, travel authorization form, travel expense report, or any other support to validate the expenditure.
2. One hundred seventeen of one hundred twenty payroll expenditures were not supported by journal voucher details, timesheets, personnel action forms, or other support to validate the expenditure.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No. 2004-17 – Expenditures, Continued

Cause: There appears to be weak internal controls exercised over ensuring that expenditures are supported by journal voucher details, personnel action forms, timesheets, purchase orders, contracts, vendor invoices, receiving reports, procurement documents, and any other support that validates the expenditure.

Effect: This condition may result in a potential misstatement of expenditures.

Recommendation: The State should strengthen internal controls over ensuring that expenditures are supported by timesheets, personnel action forms, journal voucher details, purchase orders, contracts, vendor invoices, receiving reports, authorization forms and other such documents that validate the expenditure.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Chuuk State finance will strengthen internal controls to ensure adequate supporting documentation is available to support expenditures and journal vouchers.

Finding No. 2004-18 – Payroll Expenditures

Criteria: Employee gross salary should be computed based on the rate indicated in the personnel action form and hours indicated on the timesheet and should be recorded in the proper period.

Condition: One of three (33%) payroll expenditures indicated a difference in pay rate. For the following, the pay rate per the personnel action form does not conform with the rate indicated on the payroll register.

<u>Emp No</u>	<u>Fund Org</u>	<u>Gross</u>	<u>Hrs</u>	<u>P</u> <u>P</u>	<u>PAF Rate</u>	<u>T/S Hrs</u>	<u>Gross</u>	<u>Variance</u>
69724	301401	\$1413.40	276	02	4.796125	276	\$1323.7305	\$89.67

Cause: There appears to be weak internal controls over ensuring that employee rates applied in the pay register comply with approved pay rates on personnel action forms.

Effect: The condition may result in unauthorized payments.

Recommendation: The State should strengthen internal controls to ensure that gross salary is supported by the authorized pay rate indicated in the personnel action form.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Internal control procedures over payroll processing were implemented in fiscal year 2006 to ensure that all pay rates are supported by approved personnel action forms and within the correct grade-step tables authorized for non-exempt employees.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No. 2004-19 – Substantive Testing – General Fund

Criteria: Expenditures designated should be approved by the authorizing official.

Condition: Four of one hundred samples did not have proper approval from authorizing officials on underlying forms.

Cause: There appears to be weak internal controls over ensuring that support for expenditures is properly approved.

Effect: This condition may result in the recording of invalid expenditures.

Recommendation: The State should ensure that all documentation in support of payments is properly approved.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. It is standard procedure for all expenditures to have proper approval from authorizing officials before being made. This policy will be reiterated to finance staff.

Finding No. 2004-20 – Non-Payroll Expenditures

Criteria: Completion and approval of purchase orders should occur prior to acquiring goods or services.

Condition: Twelve of 206 expenditures tested were supported by a purchase order that was dated after the invoice date.

Cause: There appears to be weak internal controls over ensuring proper completion and approval of purchase orders prior to acquiring goods and services.

Effect: It appears that purchases and payments were made without proper approval.

Recommendation: The State should strengthen internal controls to ensure that purchase orders are issued prior to the receipt of goods and services.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. It is standard procedure to require purchase orders prior to the receipt of goods or services. This policy will be reinforced to all departments.

Finding No. 2004-21 – Search for Unrecorded Liabilities

Criteria: Cash disbursements should be supported by purchase orders, vendor invoices, cancelled checks, contracts, travel authorization forms, and other support that validate the disbursement.

Condition: In order to determine whether an appropriate cut-off of accounts payable occurred, we selected a sample of 1,135 fiscal year 2006 payments. Of the samples, 1,105 were not supported by purchase orders, vendor invoices, cancelled checks/check copy, contracts/agreements, travel authorization forms, and other support that validate the disbursement and that establish the correct accounting period that should be charged.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No. 2004-21 – Search for Unrecorded Liabilities, Continued

Cause: There appears to be weak internal controls over ensuring that subsequent cash disbursements are supported by purchase orders, vendor invoices, cancelled checks, contracts, travel authorization forms, and other support that validate the disbursement.

Effect: The condition may result in a potential misstatement of liabilities.

Recommendation: The auditee should strengthen internal controls to ensure that cash disbursements are supported by purchase orders, vendor invoices, cancelled checks, contracts, travel authorization forms, and other support that validate the disbursement.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The search of FY-06 documents was occurring during the period in which expenditures and supporting documents were being reviewed for both FY-04 and FY-05 and some pieces may have been difficult to locate. Beginning with the audit for FY-06 Chuuk Finance will make its own accrual for unrecorded liabilities and thereby reduce the sample requirements needed for audit substantiation.

Finding No. 2004-22 – Cash Receipt Testing

Criteria: Revenues should be supported by cash receipts, cash receipt reports, treasury receipts, daily summary reports, validated deposit slips, bank statements, and any other support that validates recorded revenue.

Conditions: Eleven of thirty (37%) cash receipts tested did not have an attached corresponding daily cash receipt report and/or the taxation receipt was not available for review.

Additionally, cash receipt number 31675 was not available for review. In the same test, the general ledger posting of cash receipt 31685 was not provided. It appears that this cash receipt was not posted to the general ledger.

Cause: There appears to be weak internal controls over ensuring that revenues are supported by cash receipts, cash receipt reports, treasury receipts, daily summary reports, validated deposit slips, bank statements, and any other support that validates recorded revenues.

Effect: The condition may result in a potential misstatement of revenues.

Recommendation: The State should strengthen internal controls to ensure that revenues are supported by cash receipts, cash receipt reports, treasury receipts, daily summary reports, validated deposit slips and bank statements.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Management will review internal controls over Treasury operations to ensure all revenues are properly supported and recorded.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No. 2004-23 – Cash Receipt / Revenue

Criteria: Cash receipts validating revenue should be in sequence.

Condition: Two of thirty cash receipts were not issued in sequence.

Cause: There appears to be weak internal controls over ensuring that cash receipts are utilized and reported in sequence.

Effect: This condition may result in unrecorded collections.

Recommendation: The auditee should strengthen internal control over ensuring that receipts are issued and recorded in numerical sequence.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. It is standard operating procedure that cash receipts be issued in numerical sequence and this policy will be reiterated to Treasury staff.

Finding No. 2004-24 – Revenue

Criteria: Cash receipts should be deposited on the following business day.

Condition: Eighteen of thirty (60%) cash receipts received by Revenue and Taxation were not deposited to the Treasury in a timely manner:

C.R. Date from Taxation by <u>Treasury</u>	<u>Day</u>	Chuuk State Cash <u>Receipt #</u>	<u>Amount</u>	Receipt day <u>by Taxation</u>	Deposit Slip <u>Amount</u>	Deposit <u>Slip Date</u>	Days <u>Lapsed</u>
3/15/2004	Monday, March 15, 2004	31532	\$ 907.58	3/11/04-3/15/04	\$ 8,896.21	3/18/2004	3
3/18/2004	Thursday, March 18, 2004	31536	450.00	3/16/04-3/17/04	6,465.29	3/24/2004	6
7/29/2004	Thursday, July 29, 2004	31633	652.50	7/29/04-7/30/04	9,989.19	8/5/2004	7
5/17/2004	Monday, May 17, 2004	31579	3,263.69	no Tax	3,263.69	7/8/2004	52
9/24/2004	Friday, September 24, 2004	31672	540.00	9/23/2004	4,177.30	9/27/2004	3
11/27/2003	Thursday, November 27, 2003	31441	1,290.00	11/21/03-11/24/03	7,380.54	12/1/2003	4
6/22/2004	Tuesday, June 22, 2004	31603	108,141.16	4/15/04-4/16/04	109,414.80	6/25/2004	3
2/27/2004	Friday, February 27, 2004	31519	1,192.50	2/25/04-2/27/04	13,121.14	3/4/2004	6
10/31/2003	Friday, October 31, 2003	31420	2,038.49	10/31/2003	2,570.99	11/4/2003	4
5/13/2004	Thursday, May 13, 2004	31573	1,529,585.06	no Tax	1,529,585.06	5/17/2004	4
1/21/2004	Wednesday, January 21, 2004	31489	4,852.52	1/20/2004	5,017.52	1/23/2004	2
7/29/2004	Thursday, July 29, 2004	31632	9,336.69	7/29/04-7/30/04	9,989.19	8/5/2004	7
11/27/2003	Thursday, November 27, 2003	31445	405.00	11/26/03-11/27/03	3,754.72	12/4/2003	7
11/26/2003	Wednesday, November 26, 2003	31439	1,900.00	no Tax	1,900.00	12/1/2003	5
3/22/2004	Monday, March 22, 2004	31537	18,227.69	3/17/04-3/18/04	18,640.19	3/24/2004	2
2/27/2004	Friday, February 27, 2004	31520	45.00	2/24/2004	45.00	3/4/2004	6
1/8/2004	Thursday, January 08, 2004	31475	21,933.77	1/7/03-1/8/03	21,933.77	1/20/2004	12
3/18/2004	Thursday, March 18, 2004	31535	6,015.29	3/12/04-3/15/04	6,465.29	3/24/2004	6
Total			<u>\$1,710,776.94</u>		<u>\$1,762,609.89</u>		

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No. 2004-24 – Revenue, Continued

Cause: There appears to be weak internal controls over ensuring that cash receipts are deposited in a timely manner.

Effect: The condition may result in cash misappropriations or defalcations.

Recommendation: The State should strengthen internal controls over ensuring that collections are deposited in a timely manner.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Internal controls over deposits were strengthened in fiscal year 2005 and cash receipts are now being deposited in a timely manner.

Finding No. 2004-25 – Revenue Testing

Criteria: Revenues should be supported by revenue tax receipts, be remitted within the day, and be deposited on the following business day.

Condition: One of thirty four receipts tested was not supported by a revenue tax receipt, and was deposited after eight business days.

<u>Fund</u>	<u>Object code</u>	<u>Ref</u>	<u>Amount</u>
45	7511	3159301	\$16,569

Cause: There appears to be weak internal controls over ensuring that revenues are supported by revenue tax receipts, are remitted within the day, and are deposited on the following business day.

Effect: The condition may result in a potential misstatement of revenues.

Recommendation: The State should strengthen internal controls to ensure that revenues are supported by revenue tax receipts, are remitted within the day, and are deposited on the following business day.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. It is standard operating procedure to require that revenues be supported by revenue tax receipts. Internal controls over remittances by the Revenue office were strengthened in fiscal year 2005 and cash receipts are now being remitted from the Revenue office to Treasury no later than one day following receipts.

Finding No. 2004-26 – Encumbrances

Criteria: Encumbrances should be supported by purchase orders/contracts or any other obligating support to validate the encumbrance. Moreover, valid encumbrances should be liquidated in a timely manner.

Condition: Twenty-nine of twenty-nine encumbrances tested had no purchase orders/contracts or any other obligating support on file, and were not subsequently liquidated.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No. 2004-26 – Encumbrances, Continued

Additionally, encumbrances for two funds did not reconcile between the general ledger balance and the amount per the subsidiary ledger (fund 30 and fund 60). The differences in the two funds were \$39,992 and \$151,767, respectively.

Cause: There appears to be weak internal controls over ensuring that (1) encumbrances are supported by purchase orders/contracts or any other obligating support, (2) encumbrances are liquidated in a timely manner, and 3) the subsidiary ledgers agree with general ledger balances.

Effect: This condition may result in a potential misstatement of encumbrances.

Recommendation: The State should strengthen internal controls over ensuring that encumbrances are supported by purchase orders/contracts or any other obligating support and are liquidated in a timely manner. Additionally, the general ledger control account for encumbrances should be reconciled on a monthly basis with the subsidiary ledger balances.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. There are many old encumbrances on Chuuk State accounting records that are no longer valid or for which the original documents can no longer be located. In fiscal year 2006, management will cancel all old and invalid encumbrances and ensure that remaining balances in each fund agree to the general ledger. This will be part of the clean-up procedures prior to converting to the new FMIS software in fiscal year 2007/.

Finding No. 2004-27 – Employee Ceiling

Criteria: Per Public Law (PL) No. 7-04-03, the maximum positions funded from the General fund should be distributed as follows:

Executive Branch	2,093
Legislative Branch	99
Judicial Branch	65
Public Auditor	3
Boards & Commissions	<u>44</u>
Total	<u>2,304</u>

Condition: For the following departments, total employees exceeded what is allowed *per department*, as stated in the public law:

<u>Department</u>	<u>Total</u>	<u>PL</u>	<u>Variance</u>
Board/Commission Total	61	44	17
Office of the Gov Total	22	13	9
Executive Total	150	148	<u>2</u>
Total			<u>28</u>

Cause: There appears to be weak internal controls over ensuring that the government is in compliance with the maximum positions funded from the general fund per public law.

Effect: This condition may result in a violation of law.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No. 2004-27 – Employee Ceiling, Continued

Recommendation: The auditee should strengthen internal controls over ensuring that the government is in compliance with the maximum number of positions funded from the general fund.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. General fund personnel ceilings established by the CSL in appropriation acts have been exceeded by actual employment levels for several years. Chuuk finance will advise budget and personnel departments to convey to the legislature current departmental staffing levels and thereafter control the totals within the limits established by the legislature.

Finding No. 2004-28 – Accounts Payable Imbalance

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

Condition: For the following funds, the amount per the subsidiary ledger detail does not agree with the general ledger balance.

<u>Fund No</u>	<u>Fund Name</u>	<u>Per Subsidiary Leger</u>	<u>Per General Ledger</u>	<u>Difference</u>
10	GENERAL FUND	\$1,628,670	\$1,653,018	\$ 24,348
20	FED GRANT (SBG)	1,546,402	1,613,690	67,288
25	FEDERAL GRANTS	87,525	91,411	3,886
30	FEDERAL GRANTS	481,654	485,791	4,137
37	NON-U.S. GRANTS	52,418	70,943	18,525
40	JOIN LAW	16,668	17,115	447
60	FSM CIP	3,654,357	3,597,095	(57,262)
61	CIP INTEREST INCOME FUND	178,334	237,864	59,530
66	PAYROLL FUND	16,857	16,652	(205)
	Total			<u>\$120,694</u>

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: This condition results in a potential misstatement of accounts payable, but we are not able to determine the manner in which the accounts should be adjusted.

Recommendation: Reconciliations between the subsidiary and general ledger should be performed on a regular basis and the State should seek assistance in correcting the abovementioned imbalances.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. As part of the clean-up for the FMIS conversion in fiscal year 2007, all invalid accounts payable invoices will be deleted from subsidiary ledgers and the general ledger balances adjusted to agree with the revised sub-ledgers by fund.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No. 2004-29 – Non Payroll Expenditures Control Testing

Criteria: Overpayment of travel claims should be collected in a timely manner.

Condition: For 2 of 92 (2%) non-payroll expenditures tested, an overpayment of travel claims occurred, which has not been fully collected.

<u>Fund No.</u>	<u>Account</u>	<u>APV #</u>	<u>Vendor #</u>	<u>Amount</u>
301401	8110	460087101	80059	\$ 117
301401	8110	460103901	80059	201

We also noted a special travel advance of \$3,000 that was granted, and no explanation of the special travel advance was on file, and no final travel claim documenting the use of these funds was on file.

Additionally, various travel advances tested did not indicate that the traveler ever filed a claim for the amount, and the State has not attempted to collect the balance from the traveler.

Cause: The condition above was contributed by a lack of internal controls over monitoring the collection of travel advance receivables.

Effect: No material effect on the financial statement occurs as a result of the condition above. Uncollected travel advances represent a direct charge on the general fund.

Recommendation: The State should consistently monitor the collection of accounts receivable to prevent the condition stated above.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Effective in fiscal year 2006, controls over travel advances were strengthened whereby delinquent or overpaid travel advances are deducted from the traveller's payroll check and the outstanding TA receivable closely monitored and reconciled to the general ledger.

Finding No. 2004-30 - 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.

Prior Year Status: This finding is reiterative of conditions identified in the prior year Single Audit.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No. 2004-30 - Compact Capital Debt Remaining Unpaid, Continued

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.

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Resolution of Prior Years' Findings and Questioned Costs
Year Ended September 30, 2004

For the year ended September 30, 2004, the following questioned costs were noted and prior questioned costs resolved:

	Questioned Costs Set Forth in Prior Audit Report <u>2003</u>	Questioned Costs Resolved for Fiscal Year <u>2004</u>	Questioned Costs at <u>September 30, 2004</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	1,840,358	-	1,840,358
Unresolved Questioned Costs FY 04	<u>-</u>	<u>-</u>	<u>4,101,675</u>
	\$ <u>2,634,454</u>	\$ <u>-</u>	\$ <u>6,736,129</u>