

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEAR ENDED SEPTEMBER 30, 2005

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2005

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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, 2005, 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 cash and cash equivalents, 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 cash and cash equivalents, 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, 2005.

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, 2005.

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, 2005, 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 72%, 37% and 80% of the assets, net assets and revenues, respectively, of the State's aggregate discretely presented component units.

Because of inadequacies in the accounting records, detailed records regarding accounts payable and underlying supporting documentation evidencing the validity of operating expenses for the Chuuk State Health Care Plan have not been maintained and certain supporting data were not made available for our audit. The financial activities of the Chuuk State Health Care Plan are included in the State's basic financial statements as a discretely presented component unit and represent 17%, 39% and 4% of the assets, net assets and revenues, respectively, of the State's aggregate discretely presented component units.

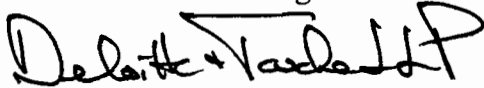
The financial statements of the Chuuk State Housing Authority have not been audited, and we were not engaged to audit these financial statements as part of our engagement to audit the State's basic financial statements. The financial activities of the Chuuk State Housing Authority are included in the State's basic financial statements as a discretely presented component unit and represent 11%, 24% and 16% 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 ninth 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 41 and 42, 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 11, 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, appearing to read "Deloitte + Touche LLP", written in a cursive style.

July 11, 2006

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Management's Discussion and Analysis
September 30, 2005

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, 2005. We encourage readers to consider this information in conjunction with Chuuk State's financial statements, which follow. Fiscal year 2004 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, 2005, Chuuk State's total net assets decreased by \$4.55 million (or 7.1%) from \$64.05 million in the prior year to \$59.5 million. This decrease is primarily attributable to operating deficits incurred in the General and Compact Capital Projects Funds.
- During fiscal year 2005, Chuuk State's revenues of \$29.77 million were less than total expenditures (\$33.21 million) by \$3.44 million. Both revenues and expenditures (including capital outlays) increased from fiscal year 2004, by \$3.15 million (or 11.8%) and \$1.57 million (or 5.0%), respectively. Revenue increases primarily resulted from increased Compact funding and the increase in investment income. Expenditure increases were primarily in the health and education sectors.
- Budgetary deficits were incurred in fiscal year 2005: budgeted revenues of \$9.78 million exceeded actual collections of \$7.53 million by \$2.25 million (or 23%) primarily as the result of over-estimates of local revenue collections. The expenditure budget also reflected a negative budget variance. General fund expenditures of \$10.51 million were \$0.73 million (or 7.5%) over general fund appropriations of \$9.78 million.
- During fiscal year 2005, Chuuk State's general fund balance deficit increased by \$2.3 million (up 13.3%); growing from \$17.5 million in the prior year to \$19.8 million. 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.

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.

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- 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, the Compact Sector grants, the Compact Capital Projects fund, and the 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 2005, Chuuk State's assets exceeded liabilities by \$59.5 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, 2005, with comparable balances for fiscal year 2004, discloses this relationship:

	<u>2005</u>	<u>2004</u>
Current and other non-capital assets	\$27,152,498	\$31,937,410
Capital assets	<u>63,786,062</u>	<u>64,785,023</u>
Total assets	<u>90,938,560</u>	<u>96,722,433</u>
Long-term liabilities	6,278,770	6,028,122
Other liabilities	<u>25,154,546</u>	<u>26,639,692</u>
Total liabilities	<u>31,433,316</u>	<u>32,667,814</u>
Net assets		
Invested in capital assets, net of related debt	63,456,883	64,455,844
Restricted	22,257,535	22,425,941
Unrestricted	<u>(26,209,174)</u>	<u>(22,827,166)</u>
Total net assets	<u>\$59,505,244</u>	<u>\$63,054,619</u>

At the end of fiscal year 2005, Chuuk State's unrestricted assets showed a deficit of \$26.21 million, an increase of \$3.38 million (or 14.8%) 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

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Management's Discussion and Analysis
September 30, 2005

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.

Net assets declined \$4.55 million (or 7.1%) from the prior year. Key elements are the decrease and the differences from the prior year are shown in the following schedule:

	<u>2005</u>	<u>2004</u>
Revenues:		
Program Revenues:		
Charges for services	\$ 766,295	\$ 860,789
Operating grants and contributions	21,987,937	18,370,411
Capital grants and contributions	188,306	500,000
General Revenues:		
Taxes	4,569,517	4,948,921
Unrestricted investment earnings	2,200,242	1,226,783
Other	<u>59,670</u>	<u>718,888</u>
Total revenues	<u>29,771,967</u>	<u>26,625,792</u>
Expenses:		
General government	7,105,179	6,290,497
Health services	6,082,949	4,612,016
Education	9,319,566	8,866,946
Economic development	1,043,742	1,288,254
Public safety	1,290,369	1,131,681
Public works and transportation	3,502,730	5,879,492
Community affairs	276,756	307,879
Boards and commissions	871,973	631,795
Judiciary	593,853	575,126
Payments to components	354,811	1,040,813
Municipal affairs	1,042,459	380,081
Other	<u>2,836,955</u>	<u>2,199,948</u>
Total expenses	<u>34,321,342</u>	<u>33,204,528</u>
Change in net assets	(4,549,375)	(6,578,736)
Net assets at the beginning of the year	<u>64,054,619</u>	<u>70,633,355</u>
Net assets at the end of the year	<u>\$59,505,244</u>	<u>\$64,054,619</u>

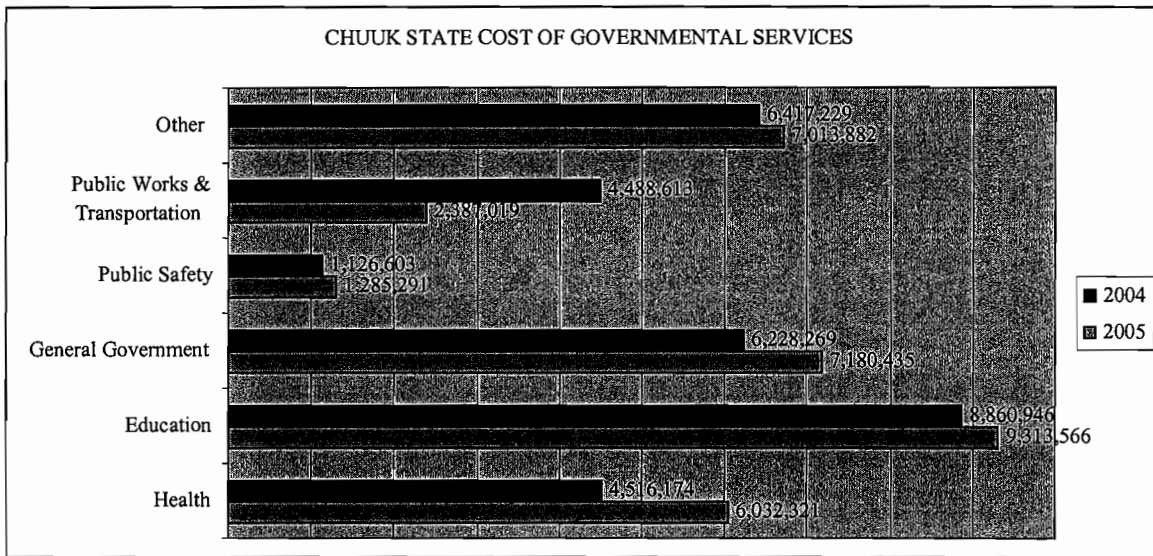
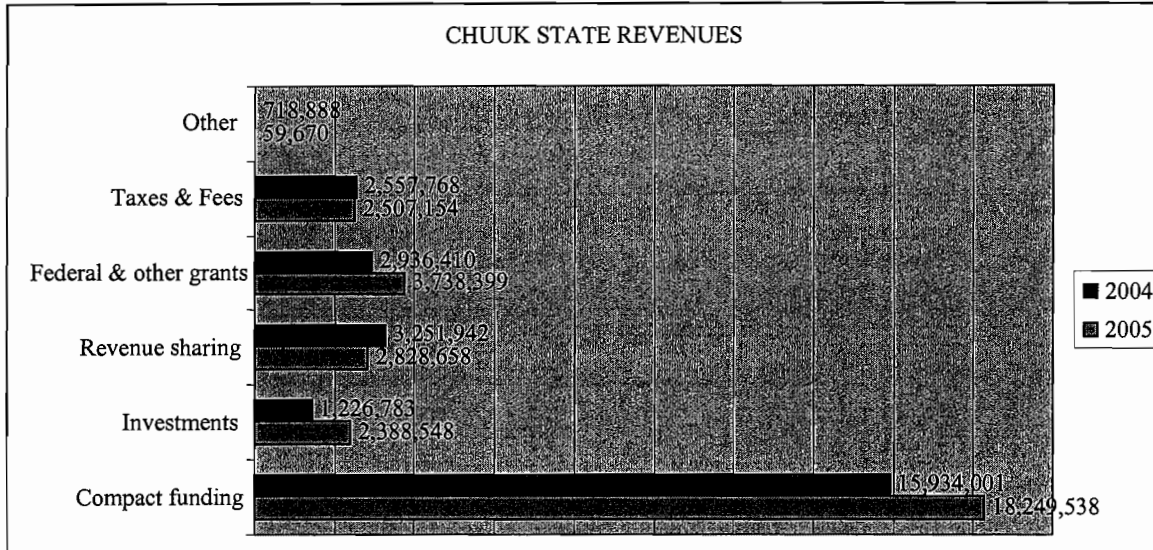
Total revenues in FY-05 of \$29.77 million increased \$3.15 million from the prior year's \$26.62 million (up 11.8%) primarily due to increases in Compact sector grants and the increase in investment earnings. In fiscal year 2005, Compact sector grants comprised 61% of all Chuuk State funding sources whereas general fund revenue from local sources comprised only 25%.

Total expenses of \$34.32 million reflected a \$1.1 million (or 3.4%) increase from the prior year primarily from increases in health, education and general government expenditures.

The following graphs show the major components or revenues and expenditures of governmental funds for the year ended September 30, 2005.

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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 2005, Chuuk State's governmental funds reported a combined fund balance of \$2.44 million which represents a \$2.96 million decrease (or 55%) from the \$5.4 million recorded at the end of fiscal 2004. This decrease is attributable to the deficit resulting from expenditures exceeding revenues. Of this total combined fund balance, \$29.16 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 (\$19.96 million); 2) to liquidate contracts and purchase orders of the prior period (\$1.39 million); 3) to fund specific general fund and compact CIP-related activities (\$4.39 million); or 4) for on-going capital projects (\$3.42 million). These reserved fund balances are off-set by a combined deficit of \$26.7 million, an increase of \$2.8 million (or 11.8%) from fiscal year 2004.

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GENERAL FUND BUDGETARY HIGHLIGHTS

During the course of the fiscal year, management and elected officials of Chuuk State revised the General Fund budget. The revised budget included an increase in overall revenue projections of \$1.8 million with a corresponding increase in budgetary appropriations. The primary reason for the upward revision in revenue projections was due to estimated increases in local revenue collections and investment earnings that ultimately did not increase to the levels anticipated, resulting in the general fund deficit.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Chuuk State's investment in capital assets for the primary government as of September 30, 2005, amounted to \$78.64 million, net of accumulated depreciation of \$14.85 million, leaving a net book value of \$63.79 million. This represents a net decrease of \$1.0 million (or 1.5 %) from fiscal year 2004. No significant fixed asset additions or retirements occurred in fiscal year 2005, but incremental additions were made to land, buildings and seaport facilities. The table below summarizes Chuuk State's capital assets:

	<u>2005</u>	<u>2004</u>
Land	\$21,851,468	\$21,765,468
Airport Facilities	25,007,582	25,710,239
Buildings	4,661,130	4,625,302
Seaport Facilities	4,873,243	4,858,819
Vehicles	179,917	202,193
Infrastructure	<u>7,212,722</u>	<u>7,623,002</u>
	<u>\$63,786,062</u>	<u>\$64,785,023</u>

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

Long-Term Debt

The following schedule shows Chuuk State's noncurrent liabilities for fiscal year 2005 and comparable amounts for fiscal year 2004:

	<u>2005</u>	<u>2004</u>
ADB Early Retirement Loan	\$5,300,000	\$5,300,000
ADB Private Sector Development Program Loan	458,176	-
ADB Private Sector Development Project Loan	21,984	-
Compensated absences payable	<u>939,075</u>	<u>829,208</u>
Total noncurrent liabilities	<u>\$6,719,235</u>	<u>\$6,129,208</u>

Long-term debt obligations increased by \$0.59 million (or 9.6%) in fiscal year 2005, primarily as the result increases in the liability for compensated annual leave and draw downs for the ADB loan for Private Sector Reform.

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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

Noting the lackluster conditions in the local economy, general fund revenues in fiscal year 2006 are expected to remain relatively the same as in fiscal year 2005.

As noted previously, Compact sector revenues comprise 61% of Chuuk State's budget. These funding sources, based on JEMCO approved budgets, are projected to increase 2% in fiscal year 2006. The following table highlights these changes:

CHUUK STATE COMPACT SECTOR BUDGETS

	BUDGET 2006	BUDGET 2005	2006 Increase (Decrease)	%
<u>Compact Sector</u>				
Education Sector	\$ 9,053,618	\$ 8,808,759	\$244,859	2.78%
Health Sector	5,972,395	5,591,245	381,150	6.82%
Private Sector	1,458,616	1,403,876	54,740	3.90%
Environmental Sector	715,053	502,499	212,554	42.30%
Capacity Bldg. Sector	2,724,099	3,001,410	(277,311)	-9.24%
Infrastructure Sector	<u>9,743,183</u>	<u>9,743,183</u>	<u>0</u>	
	<u>\$29,666,964</u>	<u>\$29,050,972</u>	<u>\$615,992</u>	2.12%

Significantly, as of June, 2006, none of the annual \$9.7 million infrastructure budgets have been allotted to Chuuk State since fiscal year 2004. Consequently, \$29.2 million of impending spending power will be released once the project plans are approved and implemented; a positive ripple effect on local revenues is expected. Although the first allotments are expected in the final quarter of fiscal year 2006, no revenue estimates have been made of these potential revenues because of uncertainties as to the timing and amounts of the anticipated allotments. Nevertheless, management remains cautiously optimistic that they will work to the improvement of Chuuk State's operating results and financial position.

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.

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Statement of Net Assets
September 30, 2005

	Primary Government	Component Units
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 1,474,608	\$ 922,167
Time certificates of deposit	-	501,198
Equity interest in internal investment pool	9,520,694	-
Receivables, net of allowance for uncollectibles	902,204	1,384,186
Advances	-	-
Inventories	-	195,861
Prepayments	-	183,038
Restricted assets:		
Cash and cash equivalents	34,301	-
Total current assets	11,931,807	3,186,450
Noncurrent assets:		
Restricted assets:		
Investments	11,545,186	-
Investments	3,675,505	-
Capital assets, net of accumulated depreciation	63,786,062	6,474,598
Total noncurrent assets	79,006,753	6,474,598
Total assets	\$ 90,938,560	\$ 9,661,048
<u>LIABILITIES</u>		
Current liabilities:		
Bank overdraft	\$ 2,509,048	\$ 124,513
Current portion of long-term debt	-	681,255
Notes payable	1,808,215	-
Accounts payable	20,361,274	277,669
Compensated absences payable	440,465	-
Other liabilities and accruals	34,326	783,606
Deferred revenue	1,218	50,000
Total current liabilities	25,154,546	1,917,043
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	5,780,160	3,461,734
Compensated absences payable	498,610	-
Other noncurrent liabilities	-	-
Total noncurrent liabilities	6,278,770	3,461,734
Total liabilities	31,433,316	5,378,777
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	63,456,883	2,331,609
Restricted for:		
Future operations	6,743,794	-
Compact related	14,446,380	-
Other purposes	1,067,361	-
Unrestricted	(26,209,174)	1,950,662
Total net assets	59,505,244	4,282,271
Total liabilities and net assets	\$ 90,938,560	\$ 9,661,048

See accompanying notes to basic financial statements.

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Statement of Activities
Year Ended September 30, 2005

Functions/Programs	Program Revenues			Net (Expenses) Revenues and Changes in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government	Component Units
Primary government:						
Governmental activities:						
General government	\$ 7,105,179	\$ 188,663	\$ 2,694,327	\$ -	\$ (4,222,189)	\$ -
Health services	6,082,949	-	6,146,685	-	63,736	-
Education	9,319,566	-	9,568,146	-	248,580	-
Economic development	1,043,742	-	984,529	-	(59,213)	-
Public safety	1,290,369	-	1,184,365	-	(106,004)	-
Public works and transportation	3,502,730	577,632	-	-	(2,925,098)	-
Community affairs	276,756	-	-	-	(276,756)	-
Boards and commissions	871,973	-	432,293	-	(439,680)	-
Judiciary	593,853	-	590,330	-	(3,523)	-
Payments to component units	354,811	-	204,797	-	(150,014)	-
Municipal affairs	1,042,459	-	-	-	(1,042,459)	-
Future operations	-	-	-	188,306	188,306	-
Other	2,836,955	-	182,465	-	(2,654,490)	-
Total primary government	\$ 34,321,342	\$ 766,295	\$ 21,987,937	\$ 188,306	(11,378,804)	-
Component units:						
Chuuk State Health Care Plan	\$ 364,659	\$ 795,142	\$ -	\$ -	-	430,483
Chuuk Public Utility Corporation	7,327,015	3,140,136	643,696	-	-	(3,543,183)
Chuuk State Housing Corporation	240,495	83,627	85,074	-	-	(71,794)
Total component units	\$ 7,932,169	\$ 4,018,905	\$ 728,770	\$ -	-	(3,184,494)
General revenues:						
Taxes:						
Revenue sharing					2,828,658	-
Excise taxes					1,740,859	-
Unrestricted investment earnings					2,200,242	-
Other					59,670	85,746
Total general revenues					6,829,429	85,746
Change in net assets					(4,549,375)	(3,098,748)
Net assets at the beginning of the year					64,054,619	7,381,019
Net assets at the end of the year					\$ 59,505,244	\$ 4,282,271

See accompanying notes to basic financial statements.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Balance Sheet
Governmental Funds
September 30, 2005

	General	Special Revenue		Capital Projects	Permanent	Other Governmental Funds	Total
		U.S. Federal Grants	Compact Sector Grants	Compact Capital Projects	Compact Trust		
ASSETS							
Cash and cash equivalents	\$ 1,474,608	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,474,608
Equity interest in internal investment pool	9,520,694	-	-	-	-	-	9,520,694
Investments	-	-	-	3,675,505	-	-	3,675,505
Receivables, net:							
FSM National Government	860,962	-	-	41,242	-	-	902,204
Due from other funds	-	1,081,798	2,110,796	9,181,878	-	5,230,048	17,604,520
Restricted assets:							
Cash and cash equivalents	34,301	-	-	-	-	-	34,301
Investments	4,801,392	-	-	-	6,743,794	-	11,545,186
Total assets	<u>\$ 16,691,957</u>	<u>\$ 1,081,798</u>	<u>\$ 2,110,796</u>	<u>\$ 12,898,625</u>	<u>\$ 6,743,794</u>	<u>\$ 5,230,048</u>	<u>\$ 44,757,018</u>
LIABILITIES AND FUND BALANCES							
Liabilities:							
Bank overdraft	\$ 2,509,048	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 2,509,048
Accounts payable	14,892,683	1,072,042	1,451,131	1,257,459	-	1,687,959	20,361,274
Other liabilities and accruals	940	-	-	-	-	-	940
Intergovernmental payables	33,386	-	-	-	-	-	33,386
Notes payable	1,479,036	-	-	329,179	-	-	1,808,215
Deferred revenue	1,218	-	-	-	-	-	1,218
Due to other funds	17,604,520	-	-	-	-	-	17,604,520
Total liabilities	<u>36,520,831</u>	<u>1,072,042</u>	<u>1,451,131</u>	<u>1,586,638</u>	<u>-</u>	<u>1,687,959</u>	<u>42,318,601</u>
Fund balances (deficits):							
Reserved for:							
Related assets	5,300,000	-	659,665	3,716,747	6,743,794	3,542,089	19,962,295
Encumbrances	589,547	-	-	794,139	-	10,229	1,393,915
Continuing appropriations	1,010,210	-	-	3,379,240	-	-	4,389,450
Capital projects funds	-	-	-	3,421,861	-	-	3,421,861
Unreserved:							
General fund	(26,728,631)	-	-	-	-	-	(26,728,631)
Special revenue funds	-	9,756	-	-	-	(10,229)	(473)
Total fund balances (deficits)	<u>(19,828,874)</u>	<u>9,756</u>	<u>659,665</u>	<u>11,311,987</u>	<u>6,743,794</u>	<u>3,542,089</u>	<u>2,438,417</u>
Total liabilities and fund balances	<u>\$ 16,691,957</u>	<u>\$ 1,081,798</u>	<u>\$ 2,110,796</u>	<u>\$ 12,898,625</u>	<u>\$ 6,743,794</u>	<u>\$ 5,230,048</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							63,786,062
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							(5,780,160)
Compensated absences							(939,075)
							(6,719,235)
Net assets of governmental activities							<u>\$ 59,505,244</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, 2005

	General	Special Revenue		Capital Projects	Permanent	Other Governmental Funds	Total
		U.S. Federal Grants	Compact Sector Grants	Compact Capital Projects	Compact Trust		
Revenues:							
Compact funding	\$ -	\$ -	\$ 18,249,538	\$ -	\$ -	\$ -	\$ 18,249,538
Net increase in the fair value of investments	2,200,242	-	-	-	188,306	-	2,388,548
Federal contributions and other grants	-	3,738,399	-	-	-	-	3,738,399
Revenue sharing	2,828,658	-	-	-	-	-	2,828,658
Excise taxes	1,740,859	-	-	-	-	-	1,740,859
Fees and charges	188,663	-	-	-	-	62,655	251,318
Departmental charges	514,977	-	-	-	-	-	514,977
Other	59,670	-	-	-	-	-	59,670
Total revenues	7,533,069	3,738,399	18,249,538	-	188,306	62,655	29,771,967
Expenditures:							
Current:							
General government	4,188,182	1,854,500	1,137,753	-	-	-	7,180,435
Health services	-	548,696	5,483,625	-	-	-	6,032,321
Education	12,294	1,805,980	7,495,196	-	-	96	9,313,566
Economic development	59,213	-	984,529	-	-	-	1,043,742
Public safety	100,926	-	1,184,365	-	-	-	1,285,291
Public works and transportation	1,416,659	-	-	970,360	-	-	2,387,019
Community affairs	270,089	-	-	-	-	-	270,089
Boards and commissions	436,584	-	435,389	-	-	-	871,973
Payments to component units	150,014	-	204,797	-	-	-	354,811
Judiciary	3,523	-	590,330	-	-	-	593,853
Municipal affairs	1,042,459	-	-	-	-	-	1,042,459
Other	2,654,490	-	182,465	-	-	-	2,836,955
Total expenditures	10,334,433	4,209,176	17,698,449	970,360	-	96	33,212,514
Excess (deficiency) of revenues over (under) expenditures	(2,801,364)	(470,777)	551,089	(970,360)	188,306	62,559	(3,440,547)
Other financing sources:							
Loan proceeds	480,160	-	-	-	-	-	480,160
Net change in fund balances (deficit)	(2,321,204)	(470,777)	551,089	(970,360)	188,306	62,559	(2,960,387)
Fund balances (deficits) at the beginning of the year	(17,507,670)	480,533	108,576	12,282,347	6,555,488	3,479,530	5,398,804
Fund balances (deficits) at the end of the year	\$ (19,828,874)	\$ 9,756	\$ 659,665	\$ 11,311,987	\$ 6,743,794	\$ 3,542,089	\$ 2,438,417

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, 2005

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	\$ (2,960,387)
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period, including increases to construction in progress	(998,961)
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. For the current year, these activities consist of: Compensated absences	(109,867)
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>(480,160)</u>
Change in net assets of governmental activities as presented on page 11	\$ <u>(4,549,375)</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, 2005

<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	\$ 472,260	\$ 1,314	\$ 448,593	\$ 922,167
Time certificates of deposit	501,198	-	-	501,198
Receivables, net:				
Federal agencies	-	-	-	-
General	46,292	275,867	152,232	474,391
Loans	-	-	909,795	909,795
Inventories	-	195,861	-	195,861
Prepayments	1,800	181,238	-	183,038
	<u>1,021,550</u>	<u>654,280</u>	<u>1,510,620</u>	<u>3,186,450</u>
Noncurrent assets:				
Capital assets, net of accumulated depreciation	29,341	6,286,416	158,841	6,474,598
	<u>29,341</u>	<u>6,286,416</u>	<u>158,841</u>	<u>6,474,598</u>
Total assets	\$ <u>1,050,891</u>	\$ <u>6,940,696</u>	\$ <u>1,669,461</u>	\$ <u>9,661,048</u>
 <u>LIABILITIES AND NET ASSETS</u>				
Current liabilities:				
Bank overdraft	-	124,513	-	124,513
Current portion of long-term debt	-	681,255	-	681,255
Accounts payable	27,312	250,357	-	277,669
Accrued liabilities	-	783,188	418	783,606
Deferred income	-	50,000	-	50,000
	<u>27,312</u>	<u>1,889,313</u>	<u>418</u>	<u>1,917,043</u>
Total current liabilities	<u>27,312</u>	<u>1,889,313</u>	<u>418</u>	<u>1,917,043</u>
Noncurrent liabilities:				
Noncurrent portion of long-term debt	-	3,461,734	-	3,461,734
	<u>-</u>	<u>3,461,734</u>	<u>-</u>	<u>3,461,734</u>
Total noncurrent liabilities	<u>-</u>	<u>3,461,734</u>	<u>-</u>	<u>3,461,734</u>
Total liabilities	<u>27,312</u>	<u>5,351,047</u>	<u>418</u>	<u>5,378,777</u>
Net assets:				
Invested in capital assets, net of related debt	29,341	2,143,427	158,841	2,331,609
Unrestricted	994,238	(553,778)	1,510,202	1,950,662
	<u>1,023,579</u>	<u>1,589,649</u>	<u>1,669,043</u>	<u>4,282,271</u>
Total net assets	<u>1,023,579</u>	<u>1,589,649</u>	<u>1,669,043</u>	<u>4,282,271</u>
Total liabilities and net assets	\$ <u>1,050,891</u>	\$ <u>6,940,696</u>	\$ <u>1,669,461</u>	\$ <u>9,661,048</u>

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, 2005

	Chuuk State Health Care Plan	Chuuk Public Utility Corporation	Chuuk State Housing Corporation	Totals
Operating revenues:				
Charges for services	\$ 781,370	\$ 3,126,580	\$ 83,627	\$ 3,991,577
Other	13,772	13,556	-	27,328
Total operating revenues	<u>795,142</u>	<u>3,140,136</u>	<u>83,627</u>	<u>4,018,905</u>
Operating expenses:				
Cost of services	228,768	2,159,962	-	2,388,730
Depreciation	7,297	1,301,082	32,494	1,340,873
Administration and general	128,594	1,293,824	208,001	1,630,419
Total operating expenses	<u>364,659</u>	<u>4,754,868</u>	<u>240,495</u>	<u>5,360,022</u>
Operating income (loss)	<u>430,483</u>	<u>(1,614,732)</u>	<u>(156,868)</u>	<u>(1,341,117)</u>
Nonoperating revenues (expenses):				
Contributions from primary government	-	643,696	85,074	728,770
Other income	-	85,746	-	85,746
Interest expense	-	(269,327)	-	(269,327)
Other	-	(2,302,820)	-	(2,302,820)
Total nonoperating revenues (expenses), net	<u>-</u>	<u>(1,842,705)</u>	<u>85,074</u>	<u>(1,757,631)</u>
Net income (loss)	430,483	(3,457,437)	(71,794)	(3,098,748)
Net assets at the beginning of the year	<u>593,096</u>	<u>5,047,086</u>	<u>1,740,837</u>	<u>7,381,019</u>
Net assets at the end of the year	<u>\$ 1,023,579</u>	<u>\$ 1,589,649</u>	<u>\$ 1,669,043</u>	<u>\$ 4,282,271</u>

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(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, 2005

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

Development Authorities - The Northern Namoneas Economic Development Authority, the Southern Namoneas Development Authority, the Inner Faichuk Social and Economic Development Authority, the Outer Faichuk Development Authority, the Faichuk Transportation and Economic Development Authority, the Hall Islands Economic Development Authority, the Pattiw Islands Development Authority, and the Witto Resources and Development Authority. These development authorities were established to identify the development needs and promote economic development within the various municipalities, in coordination and cooperation with the State and the FSM National Government.

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

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

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

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

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

ii. Omitted Governmental Funds, Continued

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

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

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

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

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

Chuuk Farmers', Fishermen'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.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

iii. Omitted Component Units

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

Chuuk State Coconut Authority (CSCA): CSCA was created by TSL No. 1-1-12 and is responsible for the manufacturing, processing, buying, collecting, marketing, selling, exporting and dealing with, in general, all products derived from the coconut tree. CSCA is governed by a five-member Board of Directors appointed by the Governor subject to the advice and consent of the Legislature.

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 (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.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

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

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

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

The government-wide Statement of Net Assets reports \$22,257,535 of restricted net assets, of which \$1,067,361 is restricted by enabling legislation.

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

C. Fund Financial Statements

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

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

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(1) Summary of Significant Accounting Policies, Continued

C. Fund Financial Statements, Continued

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

D. Measurement Focus and Basis of Accounting

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

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

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

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

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

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(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:

U.S. Federal Grants Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for all activities of U.S. special federal assistance grants and contracts utilized by the State to finance general governmental operations.

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, 2005

(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

Cash and cash equivalents include cash held in demand accounts as well as short-term investments in U.S. Treasury obligations 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.

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.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(1) Summary of Significant Accounting Policies, Continued

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 \$34,301 and \$4,801,392, respectively. Furthermore, investments recorded in the Compact Trust Fund of \$6,743,794 are restricted in that they are not available to be used in current operations.

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.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(1) Summary of Significant Accounting Policies, Continued

K. Capital Assets, Continued

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.

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.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(1) Summary of Significant Accounting Policies, Continued

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, 2005, is represented by the following assets:

	General	Special Revenue		Capital	Permanent	Other	Totals
		U.S. Federal Grants	Compact Sector Grants	Projects Capital Projects	Compact Trust	Governmental Funds	
Investments	\$ 464,307	\$ -	\$ -	\$ 3,675,505	\$ -	\$ -	\$ 4,139,812
Due from other funds	-	-	659,665	-	-	3,542,089	4,201,754
Receivables:							
FSM National Government	-	-	-	41,242	-	-	41,242
Restricted assets:							
Cash and cash equivalents	34,301	-	-	-	-	-	34,301
Investments	<u>4,801,392</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>6,743,794</u>	<u>-</u>	<u>11,545,186</u>
	<u>\$ 5,300,000</u>	<u>\$ -</u>	<u>\$ 659,665</u>	<u>\$ 3,716,747</u>	<u>\$ 6,743,794</u>	<u>\$ 3,542,089</u>	<u>\$ 19,962,295</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.

Q. Estimates

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

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(1) Summary of Significant Accounting Policies, Continued

R. New Accounting Standards

During fiscal year 2005, the State implemented 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.

For fiscal year 2006, the State will be implementing GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment to NCGA Statement 1*, and GASB Statement No. 47, *Accounting for Termination Benefits*. GASB Statement No. 42 establishes standards for impairment of capital assets when service utility has declined significantly and unexpectedly. 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. GASB Statement No. 47 establishes guidance for state and local governmental employers on accounting and financial reporting for termination benefits. These benefits include incentives for voluntary terminations (e.g., early retirement window programs) and severance payments with respect to involuntary terminations. Management does not believe that the implementation of these Statements 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 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.

In December 2004, GASB issued Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefit Expenditures/Expense and Liabilities by cost-Sharing Employers*. GASB Technical Bulletin No. 2004-2 clarifies the requirements of GASB Statement Nos. 27 and 45 for recognition of pension and other postemployment benefit expenditures/expense and liabilities by cost-sharing employers. Management does not believe the implementation of this pronouncement 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, 2005

(2) Deposits and Investments

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 rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

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. 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 deposit and investment policies of the State are governed by State legislation. The Treasurer is responsible for ensuring that deposits of the General Fund are maintained in commercial checking or savings accounts of any financial institution whose assets are at least \$1 billion and whose deposits are subject to Federal Deposit Insurance Corporation (FDIC) insurance. The Governor is responsible for the investment of any monies of the State that are deemed not necessary for immediate use.

The Federated Development Authority has selected investment managers who are given authority to buy and sell securities. These investment managers may invest in stocks, bonds and cash equivalents, for which minimum standards of quality of such investments at the time of purchase shall be as follows:

- i. Cash equivalents - the investment manager may engage in all normally accepted short-term investment practices including, but not limited to U.S. Treasury and government 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 & Poor 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 \$2 billion. Deposits in smaller institutions are acceptable, but must not exceed the amount of the insurance, unless collateralized by U.S. Treasury obligations at 102%.
- ii. 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.
- iii. Bonds - Confined to issues rated "A" or higher by a national rating service, except in the case of U.S. Treasury or government agency obligations which are not rated.

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.

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.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(2) Deposits and Investments, Continued

A. Deposits

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

Category 1 - Deposits that are federally insured or collateralized with securities held by the State or its agent in the State's name;

Category 2 - Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in the State's name; or

Category 3 - Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in the State's name and non-collateralized deposits.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the State's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The State does not have a deposit policy for custodial credit risk or foreign currency risk.

As of September 30, 2005, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit were \$1,508,909 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, 2005, 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. Accordingly, these deposits are exposed to custodial credit risk.

As of September 30, 2005, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit were \$1,423,365 and the corresponding bank balances were \$1,642,195. Of the bank balance amounts, \$1,394,939 is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. The remaining amount of \$247,256 represents deposits maintained in Philippine Peso denominated bank accounts. Accordingly, these deposits are subject to foreign currency risk. As of September 30, 2005, bank deposits in the amount of \$301,314 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. Accordingly, these deposits are exposed to custodial credit risk.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(2) Deposits and Investments, Continued

B. Investments

GASB Statement No. 3 previously required government entities to present investment risks in terms of whether the investments fell into the following categories:

Category 1 - Investments that are insured or registered, or securities held by the State or its agent in the State's name;

Category 2 - Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the State's name; or

Category 3 - Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the State's name.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for investments falling into categories 1 and 2, and provided for disclosure requirements addressing other common risks of investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. GASB Statement No. 40 did retain and expand the element of custodial credit risk in GASB Statement No. 3.

As of September 30, 2005, the State's investments at fair value are as follows:

Fixed income securities:

Domestic fixed income	\$ <u>4,435,973</u>
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Other investments:

Domestic equities	9,082,943
Money market funds	803,087
Cash management account	<u>6,743,877</u>

16,629,907

\$ 21,065,880

As of September 30, 2005, the Compact Capital Projects Fund holds 16.08% of the shares of the Bank of the Federated States of Micronesia in the amount of \$1,500,000, 7.36% of the shares of the Pacific Islands Development Bank in the amount of \$250,000, 50% of the shares in a joint venture with the National Fisheries Corporation of Chuuk Fresh Tuna, Inc. in the amount of \$1,202,005, and 1% of the shares of the FSM Development Bank in the amount of \$300,000. As the fair market value of these investments is not readily available, such have been recorded at cost.

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

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(2) Deposits and Investments, Continued

B. Investments, Continued

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. With the exception of investments in U.S. government securities, which are explicitly or implicitly guaranteed by the United States government, all other investments must be rated in accordance with the State's investment policy.

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the State will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The State's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the State's name by the State's custodial financial institutions at September 30, 2005.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the State. As of September 30, 2005, the State did not hold an investment in any one issuer that represented more than 5% of the State's total investments.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. The State does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

As of September 30, 2005, the State's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

	Credit Ratings	Investment Maturities (In Years)					Fair Value
		Less Than 1	1 to 5	6 to 10	Greater Than 10		
U.S. government obligations	Aaa	\$ 200,818	\$ 432,368	\$ 256,195	\$ 331,245	\$ 1,220,626	
U.S. government agency obligations	Aaa	215,019	419,368	128,980	827,915	1,591,282	
Municipal obligations	Aaa	-	-	-	28,202	28,202	
Corporate notes and bonds	Aaa	15,025	177,058	203,659	14,843	410,585	
Corporate notes and bonds	Aa1	-	14,453	-	-	14,453	
Corporate notes and bonds	Aa2	-	48,968	31,074	-	80,042	
Corporate notes and bonds	Aa3	-	107,925	85,399	4,277	197,601	
Corporate notes and bonds	A1	24,178	62,175	15,860	50,691	152,904	
Corporate notes and bonds	A2	65,099	90,150	47,330	23,242	225,821	
Corporate notes and bonds	A3	-	123	-	-	123	
Corporate notes and bonds	Baa1	-	50,075	87,663	44,974	182,712	
Corporate notes and bonds	Baa2	-	48,169	55,185	68,491	171,845	
Corporate notes and bonds	Baa3	-	-	50,502	19,698	70,200	
Corporate notes and bonds	Not rated	-	51,271	20,667	17,639	89,577	
		<u>\$ 520,139</u>	<u>\$ 1,502,103</u>	<u>\$ 982,514</u>	<u>\$ 1,431,217</u>	<u>\$ 4,435,973</u>	

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(3) Receivables

Receivables as of September 30, 2005, 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.S. Federal <u>Grants</u>	Compact Sector <u>Grants</u>	Compact Capital <u>Projects</u>	Compact <u>Trust</u>	Nonmajor And Other <u>Funds</u>	<u>Totals</u>
Receivables:							
FSM National Government	\$ 862,962	\$ -	\$ -	\$ 41,242	\$ -	\$ 1,004,872	\$ 1,909,076
Other	<u>102,013</u>	-	-	-	-	-	<u>102,013</u>
	964,975	-	-	41,242	-	1,004,872	2,011,089
Less: allowance for uncollectible accounts	<u>(102,013)</u>	-	-	-	-	<u>(1,004,872)</u>	<u>(1,177,886)</u>
Net receivables	<u>\$ 860,962</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 41,242</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 902,204</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, 2005, are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
U.S. Federal Grants	General	\$ 1,081,798
Compact Sector Grants	General	2,110,796
Compact Capital Projects	General	9,181,878
Nonmajor governmental funds	General	<u>5,230,048</u>
		<u>\$ 17,604,520</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>
Major Governmental Funds:		
Compact Sector Grants	General	\$ 659,665
Nonmajor governmental funds:		
Chuuk Airport Authority	General	1,067,361
Compact Other Grants	General	1,346,945
Compact Special Block Section 221(b)	General	<u>1,127,783</u>
		<u>\$ 4,201,754</u>

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(5) Fixed Assets

Capital asset activities of the primary government for the year ended September 30, 2005, are as follows:

	Balance October <u>1, 2004</u>	<u>Additions</u>	<u>Retirements</u>	Balance September <u>30, 2005</u>
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 21,765,468	\$ 86,000	\$ -	\$ 21,851,468
Capital assets, being depreciated:				
Airport facilities	29,906,300	-	-	29,906,300
Buildings	9,274,947	165,000	-	9,439,947
Seaport facilities	6,537,700	278,094	-	6,815,794
Vehicles and other equipment	369,244	-	-	369,244
Infrastructure	<u>10,257,000</u>	<u>-</u>	<u>-</u>	<u>10,257,000</u>
Total capital assets, being depreciated	<u>56,345,191</u>	<u>443,094</u>	<u>-</u>	<u>56,788,285</u>
Less accumulated depreciation for:				
Airport facilities	(4,196,061)	(702,657)	-	(4,898,718)
Buildings	(4,649,645)	(129,172)	-	(4,778,817)
Seaport facilities	(1,678,881)	(263,670)	-	(1,942,551)
Vehicles	(167,051)	(22,276)	-	(189,327)
Infrastructure	<u>(2,633,998)</u>	<u>(410,280)</u>	<u>-</u>	<u>(3,044,278)</u>
	<u>(13,325,636)</u>	<u>(1,528,055)</u>	<u>-</u>	<u>(14,853,691)</u>
Total capital assets, being depreciated, net	<u>43,019,555</u>	<u>(1,084,961)</u>	<u>-</u>	<u>41,934,594</u>
Governmental activities capital assets, net	<u>\$ 64,785,023</u>	<u>\$ (998,961)</u>	<u>\$ -</u>	<u>\$ 63,786,062</u>

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

General government	\$ 65,877
Health services	50,628
Education	6,000
Public safety	5,078
Public works and transportation	1,393,805
Community affairs	<u>6,667</u>
	<u>\$ 1,528,055</u>

Capital asset activities of the discretely presently component units for the year ended September 30, 2005, are as follows:

	Balance October <u>1, 2004</u>	<u>Additions</u>	<u>Retirements</u>	Balance September <u>30, 2005</u>
Capital assets, being depreciated:				
Electric plant facilities	\$ 14,825,752	\$ 708,003	\$ 17,720	\$ 15,551,475
Water and sewer plant facilities	10,088,112	-	-	10,088,112
Machinery and equipment	310,360	-	(17,720)	292,640
Other	<u>581,110</u>	<u>18,688</u>	<u>-</u>	<u>599,798</u>
Total capital assets, being depreciated	<u>25,805,334</u>	<u>726,691</u>	<u>-</u>	<u>26,532,025</u>
Less accumulated depreciation	<u>(17,906,175)</u>	<u>(1,340,873)</u>	<u>(810,379)</u>	<u>(20,057,427)</u>
	<u>\$ 7,899,159</u>	<u>\$ (614,182)</u>	<u>\$ (810,379)</u>	<u>\$ 6,474,598</u>

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(6) Notes Payable

Notes payable of the primary government is 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, 2005.

(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 ERS 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, 2005. As of September 30, 2005, 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 \$4,801,392 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 and other ADB related debt set forth below.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(7) Long-term Obligations, Continued

ADB Loan Number 1873 FSM (SF) - Private Sector Development Program Loan

ADB Loan Number 1873 FSM (SF) - Private Sector Development Program Loan (SDR 1,017,120), bearing interest at 1% per annum during the grace period and 1.5% thereafter. The loan is payable semiannually commencing May 15, 2010 in an amount of \$40,625 plus interest, with a maturity date of November 15, 2025. As of September 30, 2005, the amount outstanding against this loan was \$458,176.

ADB Loan Number 1874 FSM (SF) - Private Sector Development Project Loan

ADB Loan Number 1874 FSM (SF) - Private Sector Development Project Loan (SDR 1,392,783), bearing interest at of 1% per annum during the grace period and at 1.5% thereafter. The loan is payable semiannually commencing May 15, 2010 in an amount of \$37,083 plus interest, with a maturity date of November 15, 2033. As of September 30, 2005, the amount outstanding against this loan was \$21,984.

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>
2006	\$ -	\$ 4,802	\$ 4,802
2007	-	4,802	4,802
2008	176,667	4,802	181,469
2009	176,667	4,802	181,469
2010	239,276	6,263	245,539
2011 - 2015	1,289,585	13,035	1,302,620
2016 - 2020	894,636	-	894,636
2021 - 2025	883,335	-	883,335
2026 - 2030	883,335	-	883,335
2031 - 2035	883,335	-	883,335
2036 - 2037	353,324	-	353,324
	<u>\$5,780,160</u>	<u>\$38,506</u>	<u>\$5,818,666</u>

During the year ended September 30, 2005, 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, 2004</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance September 30, 2005</u>	<u>Due Within One Year</u>
Loan payable:					
ADB loans	\$ 5,300,000	\$ 480,160	\$ -	\$ 5,780,160	\$ -
Other:					
Compensated absences	829,208	210,953	(101,086)	939,075	440,465
	<u>\$ 6,129,208</u>	<u>\$ 691,113</u>	<u>\$ (101,086)</u>	<u>\$ 6,719,235</u>	<u>\$ 440,465</u>

Other long-term liabilities will be liquidated in the future from governmental funds.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(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.	599,334
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>\$ 4,142,989</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>
2006	\$ 681,255	\$ 269,327	\$ 950,582
2007	29,869	192,168	222,037
2008	59,737	189,113	248,850
2009	59,737	185,039	244,776
2010	59,737	180,965	240,702
2011 - 2015	298,685	843,711	1,142,396
2016 - 2020	647,222	706,204	1,353,426
2021 - 2025	796,595	444,753	1,241,348
2026 - 2030	796,595	173,114	969,709
2031	<u>713,557</u>	<u>4,823</u>	<u>718,380</u>
	<u>\$4,142,989</u>	<u>\$3,189,217</u>	<u>\$7,332,206</u>

(8) Contingencies

Sick Leave

It is the policy of the State to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave as of September 30, 2005 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, 2005

(8) 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 \$8,464,942 relating to fiscal years 1999 through 2005 have been set forth in the State's Single Audit Report for the year ended September 30, 2005. 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, 2005 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, 2005, the loan balance is \$3,461,734

(9) Individual Deficit Fund Balances

Specific individual funds which had significant individual deficit fund balances as at September 30, 2005, are as follows:

Major Governmental Funds

General Fund	\$ <u>19,828,874</u>
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STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2005

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Schedule of Revenues, Expenditures and Changes in Deficit
Budget and Actual - General Fund
Year Ended September 30, 2005

	Budgeted Amounts		Actual - Budgetary Basis (see Note 1)	Variance with Final Budget - Positive (Negative)
	Original	Final		
Revenues:				
Local revenues	\$ 7,962,390	\$ 7,962,390	\$ 5,332,827	\$ (2,629,563)
Net increase in the fair value of investments	-	1,816,477	2,200,242	383,765
Total revenues	<u>7,962,390</u>	<u>9,778,867</u>	<u>7,533,069</u>	<u>(2,245,798)</u>
Expenditures:				
Current:				
General government	3,585,139	4,146,166	4,235,825	(89,659)
Education	-	-	20,823	(20,823)
Economic development	-	-	68,661	(68,661)
Public safety	78,000	80,000	100,926	(20,926)
Public works and transportation	1,236,450	1,333,982	1,407,198	(73,216)
Community affairs	-	251,392	270,197	(18,805)
Boards and commissions	392,825	420,304	455,789	(35,485)
Judiciary	-	-	3,523	(3,523)
Payments to component units	120,000	120,000	150,014	(30,014)
Municipal affairs	1,558,172	1,538,548	1,079,480	459,068
Other	991,804	1,888,475	2,722,518	(834,043)
Total expenditures	<u>7,962,390</u>	<u>9,778,867</u>	<u>10,514,954</u>	<u>(736,087)</u>
Deficiency of revenues under expenditures	-	-	(2,981,885)	(2,981,885)
Other financing sources:				
Loan proceeds	-	-	480,160	480,160
Net change in deficit	-	-	(2,501,725)	(2,501,725)
Other changes in unreserved deficit				
Decrease in reserve for continuing appropriations	-	-	189,790	189,790
Unreserved deficit at the beginning of the year	(24,416,696)	(24,416,696)	(24,416,696)	-
Unreserved deficit at the end of the year	<u>\$ (24,416,696)</u>	<u>\$ (24,416,696)</u>	<u>\$ (26,728,631)</u>	<u>\$ (2,311,935)</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, 2005

(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, 2005

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

GENERAL FUND

September 30, 2005

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, 2005
(with comparative totals for the year ended September 30, 2004)

	2005	2004
Revenues:		
FSM revenue sharing	2,828,658	3,251,942
Excise taxes:		
Sales tax	1,231,063	1,232,140
Hotel	137,259	129,489
Tobacco	73,201	41,621
Alcoholic beverages	105,135	71,612
Delinquent tax collections	27,989	55,156
Other excise taxes	166,212	166,961
	1,740,859	1,696,979
Fees and charges:		
Licenses and permits	178,494	201,266
Leases and other rentals	10,169	102,646
	188,663	303,912
Departmental charges:		
Transportation collections	514,977	492,100
Hospital and utility collections	-	5,527
	514,977	497,627
Net increase in the fair value of investments	2,200,242	1,226,783
Other revenues	59,670	718,888
Total revenues	7,533,069	7,696,131
Expenditures:		
Current:		
General government:		
Office of the Governor	648,901	744,249
State Legislature	3,193,218	2,770,312
Department of Treasury	346,063	322,838
Office of Budget	-	4,190
Department of Planning and Statistics	-	4,243
Office of Personnel	-	2,001
	4,188,182	3,847,833
Health services:		
Department of Health Services	-	197,504
Education:		
Department of Education	12,294	484,894
Economic Development:		
Department of Agriculture	1,491	15,347
Department of Commerce and Industry	49,737	402,727
Department of Marine Resources	7,985	27,302
	59,213	445,376

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, 2005
(with comparative totals for the year ended September 30, 2004)

	<u>2005</u>	<u>2004</u>
Expenditures, continued:		
Current, continued:		
Public Safety:		
Office of the Attorney General	9,062	11,477
Department of Public Safety	<u>91,864</u>	<u>30,011</u>
	<u>100,926</u>	<u>41,488</u>
Public Works and Transportation:		
Department of Transportation	<u>1,416,659</u>	<u>1,198,891</u>
Community Affairs:		
Department of Public Affairs	<u>270,089</u>	<u>301,212</u>
Boards and Commissions:		
Chuuk Recreation Board	75,020	56,942
Land Commission	-	2,482
Environmental Protection Agency	6,099	-
Election Commission	316,741	142,150
Mortlocks Commission	18,750	20,729
Faichuk Commission	<u>19,974</u>	<u>9,478</u>
	<u>436,584</u>	<u>231,781</u>
Judiciary:		
State Court	<u>3,523</u>	<u>21,078</u>
Payments to component units:		
Chuuk Coconut Authority	64,940	112,923
Chuuk Public Utility Corporation	-	500,000
Chuuk State Housing Authority	85,074	87,227
Chuuk Visitors' Bureau	<u>-</u>	<u>25,512</u>
	<u>150,014</u>	<u>725,662</u>
Municipal Affairs:		
Payments to municipalities	<u>1,042,459</u>	<u>380,081</u>
Other:		
Public Auditor	-	59
Small Business Development Center	(5,189)	4,214
Farmers Home Administration	47,165	47,817
Land lease and acquisition	527,481	-
Disaster assistance	173,424	124,155
Legal services	40,000	-
Red Cross	32,222	18,301
Peace Corps	10,800	10,800
Other	<u>1,828,587</u>	<u>1,806,380</u>
	<u>2,654,490</u>	<u>2,011,726</u>
Total expenditures	<u>10,334,433</u>	<u>9,887,526</u>
Deficiency of revenues under expenditures	<u>(2,801,364)</u>	<u>(2,191,395)</u>
Other financing sources:		
Loan proceeds	<u>480,160</u>	<u>171,665</u>
Net change in deficit	(2,321,204)	(2,019,730)
Deficit at the beginning of the year	<u>(17,507,670)</u>	<u>(15,487,940)</u>
Deficit at the end of the year	<u>\$ (19,828,874)</u>	<u>\$ (17,507,670)</u>

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, 2005

	Budgeted Amounts		Actual Budgetary Basis (see Note 1)	Variance with Final Budget Positive/(Negative)
	Original	Final		
Revenues:				
Local revenues	\$ 7,962,390	\$ 7,962,390	\$ 5,332,827	\$ (2,629,563)
Net increase in the fair value of investments	-	1,816,477	2,200,242	383,765
Total revenues	7,962,390	9,778,867	7,533,069	(2,245,798)
Expenditures:				
Current:				
General government:				
Office of the Governor	630,472	652,472	650,502	1,970
State Legislature	2,617,911	3,188,445	3,261,086	(72,641)
Department of Treasury	336,756	305,249	346,063	(40,814)
Department of Planning and Statistics	-	-	(21,826)	21,826
	3,585,139	4,146,166	4,235,825	(89,659)
Education:				
Department of Education	-	-	20,823	(20,823)
Economic Development:				
Department of Agriculture	-	-	1,491	(1,491)
Department of Commerce and Industry	-	-	59,185	(59,185)
Department of Marine Resources	-	-	7,985	(7,985)
	-	-	68,661	(68,661)
Public Safety:				
Office of Attorney General	-	10,000	9,062	938
Department of Public Safety	78,000	70,000	91,864	(21,864)
	78,000	80,000	100,926	(20,926)
Public Works and Transportation:				
Department of Transportation	1,236,450	1,333,982	1,407,198	(73,216)
Community Affairs:				
Department of Public Affairs	-	251,392	270,197	(18,805)
Boards and Commissions:				
Chuuk Recreation Board	52,783	67,783	85,020	(17,237)
Environmental Protection Agency	-	-	6,099	(6,099)
Election Commission	300,042	313,771	326,774	(13,003)
Mortlocks Commission	20,000	18,750	18,750	-
Faichuk Commission	20,000	20,000	19,146	854
	392,825	420,304	455,789	(35,485)
Judiciary:				
State Court	-	-	3,523	(3,523)
Payments to component units:				
Chuuk Coconut Authority	35,000	35,000	64,940	(29,940)
Chuuk State Housing Authority	85,000	85,000	85,074	(74)
	120,000	120,000	150,014	(30,014)
Municipal Affairs:				
Payments to municipalities	1,558,172	1,538,548	1,079,480	459,068
Other:				
Small Business Development Center	-	-	(5,189)	5,189
Farmers Home Administration	47,500	47,500	47,165	335
Land lease and acquisition	528,503	528,000	527,481	519
Disaster assistance	-	25,953	173,793	(147,840)
Legal services	40,000	40,000	40,000	-
Red Cross	25,000	25,000	32,222	(7,222)
Peace Corps	10,800	10,800	10,800	-
Other	340,001	1,211,222	1,896,246	(685,024)
	991,804	1,888,475	2,722,518	(834,043)
Total expenditures	7,962,390	9,778,867	10,514,954	(736,087)
Deficiency of revenues under expenditures	-	-	(2,981,885)	(2,981,885)
Other financing sources:				
Loan proceeds	-	-	480,160	480,160
Net change in deficit	-	-	(2,501,725)	(2,501,725)
Other changes in unreserved deficit:				
Decrease in reserve for continuing appropriations	-	-	189,790	189,790
Unreserved deficit at the beginning of the year	(24,416,696)	(24,416,696)	(24,416,696)	-
Unreserved deficit at the end of the year	\$ (24,416,696)	\$ (24,416,696)	\$ (26,728,631)	\$ (2,311,935)

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS - SPECIAL REVENUE FUNDS

September 30, 2005

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, 2005, 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, 2005

	<u>Chuuk Airport Authority</u>	<u>CFSM Grants</u>	<u>Compact Other Grants</u>	<u>Compact Special Block Section 221(b)</u>	<u>Total</u>
<u>ASSETS</u>					
Due from other funds	\$ 1,071,654	\$ 14,162	\$ 1,438,356	\$ 2,705,876	\$ 5,230,048
Total assets	<u>\$ 1,071,654</u>	<u>\$ 14,162</u>	<u>\$ 1,438,356</u>	<u>\$ 2,705,876</u>	<u>\$ 5,230,048</u>
<u>LIABILITIES AND FUND BALANCES</u>					
Liabilities:					
Accounts payable	\$ 4,293	\$ 14,162	\$ 91,411	\$ 1,578,093	\$ 1,687,959
Total liabilities	<u>4,293</u>	<u>14,162</u>	<u>91,411</u>	<u>1,578,093</u>	<u>1,687,959</u>
Fund balances:					
Reserved for:					
Related assets	1,067,361	-	1,346,945	1,127,783	3,542,089
Encumbrances	-	-	1,089	9,140	10,229
Unreserved (deficit)	-	-	(1,089)	(9,140)	(10,229)
Total fund balances	<u>1,067,361</u>	<u>-</u>	<u>1,346,945</u>	<u>1,127,783</u>	<u>3,542,089</u>
Total liabilities and fund balances	<u>\$ 1,071,654</u>	<u>\$ 14,162</u>	<u>\$ 1,438,356</u>	<u>\$ 2,705,876</u>	<u>\$ 5,230,048</u>

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
 Year Ended September 30, 2005

	<u>Chuuk Airport Authority</u>	<u>CFSM Grants</u>	<u>Compact Other Grants</u>	<u>Compact Special Block Section 221(b)</u>	<u>Total</u>
Revenues:					
Fees and charges	\$ 62,655	\$ -	\$ -	\$ -	\$ 62,655
Total revenues	<u>62,655</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>62,655</u>
Expenditures by function:					
Current:					
Education	<u>-</u>	<u>-</u>	<u>-</u>	<u>96</u>	<u>96</u>
Total expenditures	<u>-</u>	<u>-</u>	<u>-</u>	<u>96</u>	<u>96</u>
Net change in fund balances (deficits)	62,655	-	-	(96)	62,559
Fund balances at the beginning of the year	<u>1,004,706</u>	<u>-</u>	<u>1,346,945</u>	<u>1,127,879</u>	<u>3,479,530</u>
Fund balances at the end of the year	<u>\$ 1,067,361</u>	<u>\$ -</u>	<u>\$ 1,346,945</u>	<u>\$ 1,127,783</u>	<u>\$ 3,542,089</u>

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, 2005

	<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>						
Due from other funds	\$ 1,172,615	\$ 390,742	\$ 215,302	\$ 108,675	\$ 223,462	\$ 2,110,796
	<u>\$ 1,172,615</u>	<u>\$ 390,742</u>	<u>\$ 215,302</u>	<u>\$ 108,675</u>	<u>\$ 223,462</u>	<u>\$ 2,110,796</u>
<u>LIABILITIES AND FUND BALANCES (DEFICITS)</u>						
Liabilities:						
Accounts payable	\$ 828,600	\$ 278,767	\$ 114,502	\$ 65,675	\$ 163,587	\$ 1,451,131
Total liabilities	<u>828,600</u>	<u>278,767</u>	<u>114,502</u>	<u>65,675</u>	<u>163,587</u>	<u>1,451,131</u>
Fund balances:						
Reserved for:						
Related assets	<u>344,015</u>	<u>111,975</u>	<u>100,800</u>	<u>43,000</u>	<u>59,875</u>	<u>659,665</u>
Total fund balances	<u>344,015</u>	<u>111,975</u>	<u>100,800</u>	<u>43,000</u>	<u>59,875</u>	<u>659,665</u>
Total liabilities and fund balances	<u>\$ 1,172,615</u>	<u>\$ 390,742</u>	<u>\$ 215,302</u>	<u>\$ 108,675</u>	<u>\$ 223,462</u>	<u>\$ 2,110,796</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, 2005

	Education Sector	Health Sector	Capacity Building Sector	Environment Sector	Private Sector Development	Total
Revenues:						
Compact funding	\$ 7,762,166	\$ 5,597,989	\$ 3,036,193	\$ 433,686	\$ 1,419,504	\$ 18,249,538
	<u>7,762,166</u>	<u>5,597,989</u>	<u>3,036,193</u>	<u>433,686</u>	<u>1,419,504</u>	<u>18,249,538</u>
Expenditures by function:						
Current:						
General government	-	-	1,137,753	-	-	1,137,753
Health services	-	5,483,625	-	-	-	5,483,625
Education	7,495,196	-	-	-	-	7,495,196
Economic development	-	-	-	134,820	849,709	984,529
Public safety	-	-	1,184,365	-	-	1,184,365
Boards and commissions	3,096	-	-	302,431	129,862	435,389
Payment to component units	-	-	-	-	204,797	204,797
Judiciary	-	-	590,330	-	-	590,330
Other	-	-	-	22,247	160,218	182,465
Total expenditures	<u>7,498,292</u>	<u>5,483,625</u>	<u>2,912,448</u>	<u>459,498</u>	<u>1,344,586</u>	<u>17,698,449</u>
Net change in fund balances (deficits)	263,874	114,364	123,745	(25,812)	74,918	551,089
Fund balances (deficits) at the beginning 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>
Fund balances at the end of the year	<u>\$ 344,015</u>	<u>\$ 111,975</u>	<u>\$ 100,800</u>	<u>\$ 43,000</u>	<u>\$ 59,875</u>	<u>\$ 659,665</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, 2005, which collectively comprise the State's basic financial statements. Our report dated July 11, 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 cash and cash equivalents, 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; 7) our inability to determine the propriety of accounts payable and expenses of the Chuuk State Health Care Plan; and 8) the inclusion of unaudited financial statements of the Chuuk State Housing Authority.

Internal Control Over Financial Reporting

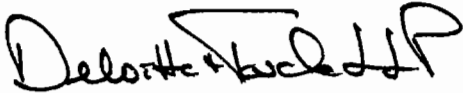
In planning the audit, we considered the State's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted 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 66 through 100) as items 2005-09 through 2005-21.

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 2005-09 through 2005-16 and 2005-18 through 2005-20 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 2005-01 through 2005-08.

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, appearing to read "Deloitte & Touche LLP", with a stylized flourish at the end.

July 11, 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, 2005. 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 66 through 100). 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 2005-01 through 2005-08 and 2005-19 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 (#15.875 Sector Grants and #84.027), equipment and real property management (all major programs), and period of availability (#15.875 Sector Grants, #83.544/97.036 and #84.027). 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, 2005.

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.

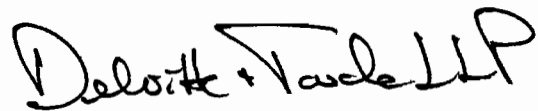
We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance 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 2005-01 through 2005-08 and 2005-19.

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 all 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, 2005. Our report dated July 11, 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 cash and cash equivalents, 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; 7) our inability to determine the propriety of accounts payable and expenses of the Chuuk State Health Care Plan; and 8) the inclusion of unaudited financial statements of the Chuuk State Housing Authority. The accompanying Schedule of Expenditures of Federal Awards (pages 57 through 62) 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 that reads "Deloitte + Touche LLP". The signature is written in a cursive, flowing style.

July 10, 2006

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Summary Schedule of Expenditures of Federal Awards, by Grantor
Year Ended September 30, 2005

Agency/Program	CFDA#	Expenditures
U.S. Department of Agriculture		\$ 60,333
U.S. Department of the Interior		18,687,916
U.S. Department of Labor		594,525
U.S. Department of Homeland Security		1,180,632
U.S. Department of Education		1,805,980
U.S. Department of Health and Human Services		548,695
 GRAND TOTAL		 <u>\$ 22,878,081</u>
 Reconciliation to the basic financial statements:		
U.S. Federal Grants Fund		\$ 4,209,176
Compact Sector Grants Fund		17,698,449
Compact Capital Projects Fund		970,360
Compact Special Block Section 211(b) Fund		96
		<u>\$ 22,878,081</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, 2005

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF AGRICULTURE		
Urban & Com. Forestry Prog.	10.664	\$ <u>60,333</u>
U.S. DEPARTMENT OF AGRICULTURE TOTAL		\$ <u><u>60,333</u></u>

Note: 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, 2005

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF THE INTERIOR		
Economic, Social and Political Development of the Territories and the Freely Associated States:		
Compact Capital Improvement Projects	15.875	\$ 970,360
Compact Special Block Grant	15.875	96
Compact Sector Grants - Capacity Build		2,912,448
Compact Sector Grants - Education		7,498,292
Compact Sector Grants - Environment		459,498
Compact Sector Grants - Health		5,483,625
Compact Sector Grants - Private		1,344,586
Total Compact Sector Grants Fund	15.875	17,698,449
Historic Preservation	15.904	19,011
U.S. DEPARTMENT OF THE INTERIOR TOTAL		\$ 18,687,916

Note: 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, 2005

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF LABOR		
WIA Administration	17.255	\$ 58,482
WIA Adult Program	17.258	158,425
WIA Youth Activities	17.259	131,578
WIA Dislocated Workers	17.260	164,517
WIA National Emergency/TS Chat	17.260	81,523
U.S. DEPARTMENT OF LABOR TOTAL		<u>\$ 594,525</u>

Note: 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, 2005

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF HOMELAND SECURITY		
Public Assistance Grant	83.544	\$ 1,154,905
FEMA 1427 DR-FM PA (Chaatan)	83.544	<u>25,727</u>
U.S. DEPARTMENT OF HOMELAND SECURITY TOTAL		<u>\$ 1,180,632</u>

Note: 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, 2005

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF EDUCATION		
School Improvement Project (SIP)	84.256A	\$ 512,564
BECLEPS (Bilingual Education)	84.290	263,304
Vocational Education Improvement Project	84.994	146,112
FY04 Special Education	84.027B	171,524
FY05 Special Education	84.027B	710,365
FY04 TQEG (Teacher Enhancement)	84.336	<u>2,111</u>
U.S. DEPARTMENT OF EDUCATION TOTAL		<u>\$ 1,805,980</u>

Note: The above grants are received in a subrecipient capacity through the FSM National Government, except for the following, which are received directly from U.S. Department of Education: CFDA # 84.256, CFDA # 84.290, and CFDA # 84.994.

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, 2005

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 the Interior
- U.S. Department of Labor
- U.S. Department of Homeland Security
- U.S. Department of Education
- U.S. Department of Health and Human Services

2. Summary of Significant Accounting Policies

A. Basis of Accounting

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

B. Reporting Entity

The State, for purposes of the general purpose financial statements, includes all of the funds of the primary government as defined by Governmental Accounting Standards Board (GASB) Statement 14, "The Financial Reporting Entity."

C. Subgrantees

Certain program funds are passed through the State to subgrantee organizations. The Schedule of Expenditures of Federal Awards does not contain separate schedules disclosing how all the subgrantees outside of the State's control utilize these funds.

D. Indirect Cost Allocation

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

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2005

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 2005 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 2005 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, 2005

<u>Grantor</u> <u>Program Title</u>	<u>CFDA No.</u>	<u>2005</u> <u>Fiscal Year</u> <u>Expenditures</u>
<u>U.S. Dept. of the Interior</u>		
Compact of Free Association:		
211(A) Capital Account	15.875	\$ 970,360
Sector Grants	15.875	<u>17,698,449</u>
Total Major Programs Under CFDA # 15.875		<u>18,668,809</u>
<u>U.S. Department of Homeland Security</u>		
Federal Emergency Management Agency:		
Public Assistance Grants	83.544/97.036	1,180,632
<u>U.S. Department of Education</u>		
Special Education – Grants to States	84.027	<u>881,889</u>
Total U.S. Federal program expenditures selected		\$ <u>20,731,330</u>
Total U.S. Federal program expenditures		\$ <u>22,878,081</u>
% of total U.S. Federal expenditures covered by major programs		<u>91%</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2005

Part I - Summary of Auditors' Results

1. The Independent Auditors' Report on the general purpose 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 cash and cash equivalents, 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; 7) our inability to determine the propriety of accounts payable and expenses of the Chuuk State Health Care Plan; and 8) 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 general purpose financial statements were disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal award programs were identified, some of which are considered to be material weaknesses.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. The State's major programs were:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
U.S. Department of the Interior - Compact of Free Association Capital Account	15.875
U.S. Department of the Interior – Compact of Free Association, Sector Grants	15.875
U.S. Department of Homeland Security – FEMA Public Assistance Grant	83.544/97.036
U.S. Department of Education – Special Education	84.027

8. A threshold of \$686,342 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
Year Ended September 30, 2005

Part II - Financial Statement Findings Section

<u>Reference Number</u>	<u>Findings</u>
2005-09	Cash
2005-10	Accounts Receivable
2005-11	Accounts Payable
2005-12	Supporting Documents – Search for Unreconciled Liabilities
2005-13	Encumbrances
2005-14	Travel Advance
2005-15	Expenditures
2005-16	Annual Leave
2005-17	Employee Ceiling
2005-18	Revenues
2005-19	Implementation of Fixed Assets for GASB Statement No. 34
2005-20	Investment Balance Reconciliations
2005-21	Compact Capital Debt Remaining Unpaid

Part III - Federal Award Findings and Questioned Cost Section

<u>Reference Number</u>	<u>CDFA Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
2005-01	15.875	Allowable Costs/Cost Principles and Procurement	\$452,657
2005-02	15.875	Allowable Costs/Cost Principles	Undeterminable
2005-03	15.875	Period of Availability	\$22,361
2005-04	83.544/97.036	Allowable Costs/Cost Principles	\$716,980
2005-05	83.544/97.036	Period of Availability	Undeterminable
2005-06	15.875	Allowable Costs/Cost Principles	\$459,285
2005-07	84.027	Period of Availability	\$25,000
2005-08	84.027	Allowable Costs/Cost Principles and Procurement	\$52,530
2005-19	All major programs	Implementation of Fixed Assets for GASB Statement No. 34	\$ -

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-01
 CFDA #: 15.875
 Agency: Department of the Interior, Office of Insular Affairs
 Grant: Compact Sector Grants
 Program Name: Economic, Social and Political Development of the Territories
 Requirement: Allowable Costs/Cost Principles and Procurement
 Question Costs: \$452,657

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

Condition: For 54 of 71 (76%) non-payroll expenditures (\$452,657 of the aggregate amount of \$1,164,752 tested), financial records (canceled checks, invoices, receiving reports, competitive procurement documentation, etc.) were not on file to substantiate the following transactions:

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>Vendor #</u>	<u>APV #</u>	<u>Check #</u>	<u>Questioned Costs</u>
731222	Chuuk State Health Care Plan	8302	XFTER EXPENDITURE	73JVB305		\$ 90,000
741105	Accounting	8405	20108	500213401	2836	63,695
731201	Hospital & Management	8307	3783	500307101	3023	62,500
731201	Hospital & Management	8314	45478	500634205	4115	29,440
731222	Chuuk State Health Care Plan	8302	XFTER EXPENDITURE	73JVB308		25,000
731201	Hospital & Management	8314	45478	500634109	4115	24,480
751159	Environ.Protection Agency	8201	24538	500950101	6613	22,361
731201	Hospital & Management	8307	3783	500006201	76326	20,833
731201	Hospital & Management	8314	45478	500634005	2716	17,760
741601	Attorney General	8201	2539	500702001	5082	11,402
721411	Elementary Education	8313	3154	500939401		10,099
721401	Education Admin.	8210	2536	500837901	5284	9,995
731201	Hospital & Management	8314	35158	500158602	2835	9,979
721776	Non Public School	8302	3548	500587101	2281	6,630
731222	Chuuk State Health Care Plan	8302	XFTER EXPENDITURE	73JVB302		6,000
731201	Hospital & Management	8314	45478	500633604	4115	5,600
731201	Hospital & Management	8405	2397	500730101	4495	5,284
731201	Hospital & Management	8314	45478	500633906	2716	5,040

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-01, Continued
 CFDA #: 15.875
 Agency: U. S. Department of the Interior, Office of Insular Affairs
 Grant: Compact Sector Grants
 Program Name: Economic, Social and Political Development of the Territories
 Requirement: Allowable Costs/Cost Principles and Procurement
 Question Costs: \$452,657

Condition, Continued:

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>Vender #</u>	<u>APV #</u>	<u>Check #</u>	<u>Questioned Costs</u>
731204	Public Health	8405	28007	500828801	5072	4,211
761780	Visitors Bureau	8302	80155	560240801	5602	2,613
731201	Hospital & Management	8314	45478	500668505	4115	2,320
761790	Com Land Grant	8302	2971	500307002	3778	2,000
721765	Scholarship	8454	28509	500018601		1,750
731222	Chuuk State Health Care Plan	8302	XFTER EXPENDITURE/BENEFIT	73JVB206		1,613
721765	Scholarship	8454	29183	500245201	3627	1,500
721765	Scholarship	8454	28612	500031001	1619	1,500
731201	Hospital & Management	8314	2474	500530706	1659	1,354
721765	Scholarship	8454	22050	500236601	3300	1,250
721765	Scholarship	8454	28176	500065001		1,000
721765	Scholarship	8454	28580	500226701	3206	900
721765	Scholarship	8454	29514	500267801	3647	900
761521	Land Management	8101	3061	560143701	2769	830
731201	Hospital & Management	8302	12112	500853701	5257	550
731221	Dental	8408	3705	500016101	1869	500
721765	Scholarship	8454	26803	500087101	1393	500
741621	Administration	8110	83420	560098101		468
721765	Scholarship	8454	28237	500054101	1457	400
721765	Scholarship	8454	28965	500258001	3600	400
					Total	<u>\$452,657</u>

Cause: There appears to be a lack of controls over record keeping and ensuring that program expenditures are substantiated by such financial records as checks, invoices and receiving reports, etc., and that goods and services are procured competitively.

Effect: The State appears to be in noncompliance with applicable allowable costs/cost principles and procurement and procurement requirements, and questioned costs result from the condition.

Recommendation: Chuuk State Government should comply with the criteria.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-01, Continued
CFDA #: 15.875
Agency: U. S. Department of the Interior, Office of Insular Affairs
Grant: Compact Sector Grants
Program Name: Economic, Social and Political Development of the Territories
Requirement: Allowable Costs/Cost Principles and Procurement
Question Costs: \$452,657

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. We acknowledge that there were deficiencies in the filing system in Chuuk State that complicate document retrieval for audit review. We note, however that the above expenditures are authorized program expenditures for the appropriate sector grant. 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, 2005

Finding No.: 2005-02
 CFDA #: 15.875
 Agency: U. S. Department of the Interior, Office of Insular Affairs
 Grant: Compact Sector Grants
 Program Name: Economic, Social and Political Development of the Territories
 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 53 of 53 (100%) payroll items tested, there were no documents (personnel action form, allotment information, timesheet, and/or pay register) on file to substantiate the following transactions:

<u>Fund Acct</u>	<u>Amount</u>	<u>Date</u>	<u>Empl #</u>
721411	\$ 615	12/12/2004	602008
721411	115,602	11/14/2004	A
721411	2,626	12/26/2004	1358
721411	1,402	6/26/2005	51340
721411	181	8/21/2005	65391
721411	108,335	7/24/2005	A
721411	108,066	5/01/2005	A
721411	106,898	4/03/2005	A
721411	106,486	2/06/2005	A
721411	105,526	3/06/2005	A
721411	96,493	9/18/2005	A
721411	230	5/29/2005	26464
721421	433	4/17/2005	54428
721421	374	6/26/2005	31224
721421	42,126	9/18/2005	A
721421	461	11/28/2004	609638
721421	41,113	2/06/2005	A
721411	13,158	11/14/2004	A
731205	12,624	1/23/2005	A
721411	562	11/28/2004	8908
741951	1,308	6/26/2005	1011
721411	11,763	7/24/2005	A
721411	11,656	10/03/2004	A
741951	11,514	12/12/2004	A
731205	11,004	10/02/2005	A
721411	227	8/21/2005	613275
731201	9,500	73JVB275	A
731206	9,500	73JVB298	A
741624	146	9/04/2005	308368
731206	505	5/29/2005	15190
731201	7,377	10/03/2004	A
731201	1,346	6/12/2005	99888

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-02, Continued
 CFDA #: 15.875
 Agency: U. S. Department of the Interior, Office of Insular Affairs
 Grant: Compact Sector Grants
 Program Name: Economic, Social and Political Development of the Territories
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: Undeterminable

Condition, Continued:

<u>Fund Acct</u>	<u>Amount</u>	<u>Date</u>	<u>Empl #</u>
731201	6,105	10/31/2004	A
731206	6,089	2/20/2005	A
741105	5,352	10/02/2005	A
741624	235	6/26/2005	71743
731201	652	11/28/2004	16789
741051	4,607	10/03/2004	A
731221	4,500	73JVB290	A
721421	4,469	10/02/2005	A
731201	4,176	7/24/2005	A
731201	1,405	3/20/2005	611368
731206	345	4/17/2005	19735
761532	2,606	5/15/2005	A
741624	2,538	3/06/2005	A
741624	2,436	10/03/2004	A
721403	2,185	4/03/2005	A
761542	2,001	10/02/2005	A
741601	1,979	10/9/2005	A
741061	578	6/26/2005	38605
721403	1,180	10/03/2004	A
731201	1,540	4/17/2005	52239
761541	992	10/03/2004	A

A - We were unable to sub-select due to the absence of authoritative support 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: The Chuuk State Government appears to be in noncompliance with allowable costs/cost principles requirements. Since Personnel Action Forms are not on file, amounts of questioned costs are undeterminable since we do not know the effective dates of employment and the effective employee pay rates.

Recommendation: Chuuk State Government should comply with the criteria.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-02, Continued
CFDA #: 15.875
Agency: U. S. Department of the Interior, Office of Insular Affairs
Grant: Compact Sector Grants
Program Name: Economic, Social and Political Development of the Territories
Requirement: Allowable Costs/Cost Principles
Questioned Costs: Undeterminable

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Under the prior administration all the personnel files were removed to the Supply warehouse in order to free up space and we have been unable to locate the respective files. We note, however, that all employees paid under the sector grants are authorized to do so and payments are supported by timesheets and pay registers. For fiscal year 2006 audit, Chuuk finance will obtain copies of the relevant personnel action forms from the Personnel office and will implement other changes over internal controls of personnel records to readily permit document retrieval for audit purposes. Such changes will be effective by November 2006.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-03
 CFDA #: 15.875
 Agency: U. S. Department of the Interior, Office of Insular Affairs
 Grant: Compact Sector Grants
 Program Name: Economic, Social and Political Development of the Territories
 Requirement: Period of Availability
 Questioned Costs: \$22,361

Criteria: In accordance with applicable period of availability requirements, expenditures should be encumbered at fiscal year end (09/30/05) and be liquidated by December 31, 2005. There should be no expenditures charged to the account for amounts that are not encumbered at September 30, 2005.

Condition: Per review of detailed expenditures, the following expenditures were recorded after the period of availability:

Fund Acct	Fund Description	Acct	Vender #	APV #	Check #	Questioned Costs
751159	Environ. Protection Agency	8201	24538	500950101	6613	\$ 22,361

Cause: There appears to be a lack of controls over ensuring that expenditures are encumbered and liquidated within the period of availability.

Effect: The State is in noncompliance with applicable period of availability requirements, and a questioned cost exists.

Recommendation: The State should comply with applicable period of availability requirements.

Auditee Response and Corrective Action Plan: We agree with the finding but do not believe this should be a questioned cost. The expenditure was encumbered on September 23, 2005. The payment in question was made on January 6, 2006 and represented the final payment on a boat for EPA, subsequent to delivery of the boat. We believe this represents substantial compliance with the 90-day liquidation requirement even though it was six days after the liquidation period.

Auditors' Response: The liquidation period ended on December 31, 2005, and no grantor-approved extension was provided to us. Therefore, the questioned cost remains.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-04
 CFDA #: 83.544/97.036
 Agency: U. S. Department of Homeland Security
 Grant #: FEMA
 Program Name: Public Assistance Grants
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$716,980

Criteria: In accordance with applicable allowable costs/costs principles 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 83 of 84 (99%) non-payroll expenditures (\$739,482 of the aggregate amount of \$746,713 tested), no financial records (invoices, receiving reports, etc.) were on file to substantiate the expenditure and its relationship to the program:

<u>Fund Acct</u>	<u>Acct</u>	<u>Description</u>	<u>APV #</u>	<u>Vendor #</u>	<u>Check #</u>	<u>Questioned Costs</u>
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500295701	3302	79136	\$161,334
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500164301	3302	78172	86,394
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500357501	3302	81175	48,199
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500792501	3302	84870	38,920
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500792601	3302	84870	38,920
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500414901	3302	81266	33,601
301037	8302	FEMA 1449-DR-FM (PONGSONA)	500107701	3990	773313	29,133
301037	8302	OUTER ISLAND H2O STORAGE TANKS	500145501	3064	79148	23,184
301037	8302	FEMA 1449-DR-FM (PONGSONA)	500345501	2471	81173	22,651
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500794301	3302	84947	22,160
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500625601	3302	87252	21,801
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500986801	3302	91127	19,258
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500794401	3302	89431	16,760
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500538101	3302	82541	12,731
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500540204	4133	87259	12,000
301037	8302	OUTER ISLAND H2O STORAGE TANKS	500145503	3064		11,088
301037	8302	FEMA 1449-DR-FM (PONGSONA)	500888401	4133	87259	11,000
301037	8310	FEMA 1449-DR-FM (PONGSONA)	400802601	3064	78475	7,113
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500695601	4133	87259	6,400
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500493117	4133	87259	5,400
301037	8302	FEMA 1449-DR-FM (CHATAAN)	500968801	3302	89790	5,117
301037	8302	FEMA 1449-DR-FM (PONGSONA)	500288301	3675	79083	4,875
301037	8302	FEMA 1449-DR-FM (PONGSONA)	500816901	11799	86938	4,527
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500171601	11694	78326	4,500
301037	8302	OUTER ISLAND H2O STORAGE TANKS	500145502	3064	79148	4,095
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500973001	4133		3,840

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-04, Continued
 CFDA #: 83.544/97.036
 Agency: U. S. Department of Homeland Security
 Grant #: FEMA
 Program Name: Public Assistance Grants
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$716,980

Condition, Continued:

<u>Fund Acct</u>	<u>Acct</u>	<u>Description</u>	<u>APV #</u>	<u>Vendor #</u>	<u>Check #</u>	<u>Questioned Costs</u>
301037	8302	FEMA 1449-DR-FM (PONGSONA)	JV5M0286	TRANSFERED MISCHARGE		\$3,555
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500343401	4133	79879	3,375
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500625401	3302	87252	3,183
301037	8302	FEMA 1449-DR-FM (PONGSONA)	500157401	10974	78102	3,071
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500535501	35275	87500	2,880
301037	8310	FEMA 1449-DR-FM (PONGSONA)	400802501	3064	78475	2,698
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500511001	11039	87284	2,640
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500160007	4133	78173	2,400
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500386801	3075	87658	2,340
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500887411	4133	87259	2,150
301037	8302	FEMA 1449-DR-FM (PONGSONA)	500354303	4133	81178	1,995
301037	8310	FEMA 1449-DR-FM (PONGSONA)	400802701	3064	78475	1,900
301036	8405	FEMA-DR-FM (CHAATAN)	500332601	31194	79631	1,882
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500101301	4133	77680	1,880
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500968001	4133	89709	1,880
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500201401	80650	78866	1,800
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500115803	4133	77680	1,614
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500342601	3075	79725	1,600
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500411401	5457	81272	1,450
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500454701	3075	87684	1,404
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500169503	6810	78317	1,050
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500766704	4133	87259	1,024
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500403301	8493	81179	990
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500540402	4133	87259	945
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500098701	3075	81471	917
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500114002	4133	77796	899
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500984901	4133		798
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500095801	11032	77202	600
301037	8302	FEMA 1449-DR-FM (PONGSONA)	560021402	3061	77300	548
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500887501	2155	87246	531
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500327901	35551	79700	520
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500101401	2155	77672	506
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500536501	4133	87259	500

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-04, Continued
 CFDA #: 83.544/97.036
 Agency: U. S. Department of Homeland Security
 Grant #: FEMA
 Program Name: Public Assistance Grants
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$716,980

Condition, Continued:

<u>Fund Acct</u>	<u>Acct</u>	<u>Description</u>	<u>APV #</u>	<u>Vendor #</u>	<u>Check #</u>	<u>Questioned Costs</u>
301037	8302	FEMA 1449-DR-FM (PONGSONA)	500433304	3064	81470	\$ 499
301037	8302	FEMA 1449-DR-FM (PONGSONA)	500202701	13501	78846	468
301037	8302	FEMA 1449-DR-FM (PONGSONA)	500974803	4133		456
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500011801	30386	76805	450
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500460701	4133	81473	450
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500097102	3064	77676	405
301037	8302	FEMA 1449-DR-FM (PONGSONA)	500963501	825110	89759	400
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500696001	3075	87251	395
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500142801	27538	78188	375
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500442601	17760	87323	375
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500014102	4133	76799	318
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500487102	3075	87251	278
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500072706	4133	77680	240
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500206402	3075	79725	212
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500402301	27911	81282	182
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500971304	4133		180
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500493102	4133	87259	160
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500437201	26169	81506	152
301037	8302	FEMA 1449-DR-FM (PONGSONA)	500889401	26157	87370	142
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500137401	26905	77906	121
301037	8301	FEMA 1449-DR-FM (PONGSONA)	500987101	4133	91728	100
301037	8405	FEMA 1449-DR-FM (PONGSONA)	500128701	23507	77705	96
					Total	<u>\$716,980</u>

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

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

Recommendation: The State 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, 2005

Finding No.: 2005-04, Continued
CFDA #: 83.544/97.036
Agency: U. S. Department of Homeland Security
Grant #: FEMA
Program Name: Public Assistance Grants
Requirement: Allowable Costs/Cost Principles
Questioned Costs: \$716,980

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation but believe that FEMA expenditures have been substantially supported and internal controls over these expenditures are adequate. For example, the first six expenditures to the Doorri Corporation are for progress payments on the Weno dock contract and are supported by progress payment reports, invoices and other contractor documents, as well as approvals by the Chuuk State program manager. Moreover, all expenditures were made for approved DSR's and in close coordination with the FSM Disaster audit. Moreover, all the FEMA expenditures were reviewed by the FSM Public auditor's office, and there were no material findings about lack of documentation. Nevertheless, the necessary documents will be submitted to the FSMNG for audit clearance on these pass-through grants.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-05
 CFDA #: 83.544/97.036
 Agency: U. S. Department of Homeland Security
 Grant #: FEMA
 Program Name: Public Assistance Grants
 Requirement: Period of Availability
 Questioned Costs: Undeterminable

Criteria: In accordance with applicable period of availability requirements, expenditures should be incurred 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>Description</u>	<u>APV #</u>	<u>PO #</u>	<u>Vendor #</u>	<u>Amount</u>
8302	OUTER ISLAND H2O STORAGE TANKS	500145501	L5000301	3064	\$ 23,184
8405	FEMA 1449-DR-FM (PONGSONA)	500986801	C5008501	3302	19,258
8405	FEMA 1449-DR-FM (PONGSONA)	500538101	C5015201	3302	12,731
8301	FEMA 1449-DR-FM (PONGSONA)	500540204	L5061405	4133	12,000
8302	OUTER ISLAND H2O STORAGE TANKS	500145503	L5000303	3064	11,088
8302	FEMA 1449-DR-FM (PONGSONA)	500888401	L5048101	4133	11,000
8405	FEMA-DR-FM (CHAATAN)	500968801	C30240	3302	5,117
8302	OUTER ISLAND H2O STORAGE TANKS	500145502	L5000302	3064	4,095
8301	FEMA 1449-DR-FM (PONGSONA)	500973001	L5142701	4133	3,840
8302	FEMA 1449-DR-FM (PONGSONA)	JV5M0286	JV5M0286	TRANSFERED MISCHARGE	3,555
8302	FEMA 1449-DR-FM (PONGSONA)	500157401	M5008101	10974	3,071
8301	FEMA 1449-DR-FM (PONGSONA)	500115803	L5011803	4133	1,614
8301	FEMA 1449-DR-FM (PONGSONA)	500766704	L5218904	4133	1,024
8301	FEMA 1449-DR-FM (PONGSONA)	500540402	L5141602	4133	945
8301	FEMA 1449-DR-FM (PONGSONA)	500984901	L5131801	4133	798
8302	FEMA 1449-DR-FM (PONGSONA)	560021402	A5011301	3061	548
8302	FEMA 1449-DR-FM (PONGSONA)	500974803	L5280603	4133	456
8405	FEMA 1449-DR-FM (PONGSONA)	500442601	L5117301	17760	375
8301	FEMA 1449-DR-FM (PONGSONA)	500487102	L5116502	3075	278
8301	FEMA 1449-DR-FM (PONGSONA)	500971304	L5038104	4133	180
8405	FEMA 1449-DR-FM (PONGSONA)	500137401	L5035701	26905	121
8301	FEMA 1449-DR-FM (PONGSONA)	500987101	L5052501	4133	100
				Total	<u>\$115,378</u>

Cause: There appears to be a lack of controls over demonstrating that expenditures are used within the proper 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.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-05, Continued
CFDA #: 83.544/97.036
Agency: U. S. Department of Homeland Security
Grant #: FEMA
Program Name: Public Assistance Grants
Requirement: Period of Availability
Questioned Costs: Undeterminable

Recommendation: The State Government should maintain project worksheets to demonstrate compliance with the criteria.

Auditee Response and Corrective Action Plan: Documents supporting compliance with the period of availability requirements are with the FSMNG disaster office. We do not believe there is a problem with the period of availability because throughout fiscal years 2005, program expenditures and related drawdowns for typhoons Chaatan, Pongsona, and for related Hazard Mitigation programs were made in close coordination with the FSM Disaster Office. The understanding was these grants were available until related DSR's are expended. Chuuk State Finance will clear these [conditions] with the FSMNG no later than December 2006.

Auditors' Response: Supporting project worksheets were not provided to us; therefore, the finding remains.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-06
 CFDA #: 15.875
 Agency: U. S. Department of the Interior, Office of Insular Affairs
 Grant #: Compact Capital Section 211 {a}
 Program Name: Economic, Social and Political Development of the Territories
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$459,285

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 the program objectives. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

Condition: For 68 of 97 (70%) non-payroll expenditures (\$559,803 of the aggregate amount of \$799,598 tested), no financial records (canceled checks, invoices, detail breakdowns, authorizing signatures, etc.) were on file to substantiate the following transactions:

<u>Acct</u>	<u>Amount</u>	<u>Date</u>	<u>Fund Org</u>	<u>APV</u>
8201	\$ 11,200	1/13/05	601807	500146501
8201	2,800	1/12/05	601807	500146701
8201	2,900	1/12/05	601807	500146702
8201	3,300	1/12/05	601807	500146703
8201	20,571	9/30/05	601812	500951101
8210	20,000	9/30/05	601811	JV5RE003
8210	10,000	9/30/05	601831	JV5RE003
8210	8,000	9/30/05	601801	JV5RE005
8210	5,000	9/30/05	601801	JV5RE004
8210	4,000	9/30/05	601815	JV5RE001
8302	5,623	4/8/05	601051	JV5M0250
8303	12,178	9/30/05	601801	JV5RE005
8303	6,944	9/30/05	601801	JV5RE004
8303	5,200	9/30/05	601815	JV5RE001
8303	5,095	9/30/05	601801	JV5RE004
8303	5,076	9/30/05	601815	JV5RE001
8303	5,000	9/30/05	601801	JV5RE004
8303	4,786	9/30/05	601840	JV5RE002
8303	4,762	9/30/05	601815	JV5RE001
8303	4,500	9/30/05	601801	JV5RE003
8303	4,500	9/30/05	601801	JV5RE005

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-06, Continued
 CFDA #: 15.875
 Agency: U. S. Department of the Interior, Office of Insular Affairs
 Grant #: Compact Capital Section 211 {a}
 Program Name: Economic, Social and Political Development of the Territories
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$459,285

Condition, Continued:

<u>Acct</u>	<u>Amount</u>	<u>Date</u>	<u>Fund Org</u>	<u>APV</u>
8303	4,000	9/30/05	601801	JV5RE004
8303	3,924	9/30/05	601815	JV5RE001
8303	3,453	9/30/05	601801	JV5RE004
8304	4,200	9/30/05	601803	JV5RE003
8304	4,000	9/30/05	601803	JV5RE003
8310	500	4/18/05	601811	500424901
8310	1,500	9/30/05	601815	JV5RE001
8310	1,500	9/30/05	601815	JV5RE001
8311	4,610	9/30/05	601825	JV5RE002
8401	24,000	1/25/05	601051	500164601
8401	3,000	2/2/05	601051	500184201
8401	5,000	2/4/05	601051	500194601
8401	9,000	2/4/05	601051	500194701
8401	3,000	2/17/05	601051	500213101
8401	3,000	2/18/05	601051	500213601
8401	3,000	3/2/05	601812	500303001
8401	9,000	4/8/05	601811	500407901
8401	3,000	7/30/05	601803	500660401
8401	3,000	8/5/05	601051	500667901
8405	27,299	9/30/05	601051	JV5RE005
8405	10,000	9/30/05	601822	JV5RE001
8405	9,800	9/30/05	601801	JV5RE004
8405	5,750	9/30/05	601815	JV5RE001
8405	5,000	9/30/05	601837	JV5RE005
8405	4,462	9/30/05	601815	JV5RE001
8405	4,329	4/15/05	601051	JV5M0702
TX7203	63,269	2/9/2005	443889	5200144
C2823	4,762	Aug-05	601815	5200219
CC3114	2,000		506214	Check #10400
C2862	5,095		601801	Check #10477
CC3018	6,944		506214	Check #10489
cc3144	3,453	4/28/05	506214	5200163
CC3148	<u>21,000</u>	7/21/05	506214	5200203
Total	<u>\$417,285</u>			

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-06, Continued
 CFDA #: 15.875
 Agency: U. S. Department of the Interior, Office of Insular Affairs
 Grant #: Compact Capital Section 211 {a}
 Program Name: Economic, Social and Political Development of the Territories
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$459,285

Condition, Continued:

For eight of 102 non-payroll transactions tested (8%, \$42,000) are improper fund charges, as follows:

Equiv. Units	Acct	Amount	Fund Org	Payee	APV	Check No	Invoice Date	Invoice No.	Remarks
4	8401	\$ 24,000	601051	BEN ENLET	500164601	32960	1/20/2004	M50109	Land lease
1	8401	3,000	601812	FELISA S. NAT	500303001	32966	2/22/2005	M50175	Land lease
1	8401	9,000	601811	KS & FAMILY R	500407901	32981	1/6/2005	M50153	Rental Purpose not indicated
1	8401	3,000	601803	ANAS ANDREW ELSICHER	500660401	33099	8/2/2005	claim	Property damage caused by government agent
1	8401	<u>3,000</u>	601051	EMUL	500667901	33081	12/16/1996	M50479	Land lease
		<u>\$ 42,000</u>							

Cause: There appears to be a lack of controls over record keeping and documenting the manner in which the expenditure serves the program objective.

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

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

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. In fiscal year 2005, restrictions on the use of Compact CIP funds have been lifted by OIA to where they were available for discretionary expenditures of the State and not just for "Capital" purposes. Consequently, we are not in concurrence that some of the expenditures were improper. We acknowledge that there were problems in maintaining the applicable supporting documents with the payment vouchers and have taken steps to tighten internal controls on filing to ensure adequate supporting documents will be available for the FY06 audit, no later than November 2006.

Auditors' Response: We have not been provided with the referenced documentation from OIA that lifts the use restrictions and allows for discretionary spending. Therefore, non-capital expenditures are determined to be improper fund charges. Additionally, the State has yet to redesignate the Compact Capital funds, as provided for by FSM law, and therefore, the State must conform to the requirements set forth in the Fiscal Procedures Agreement.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-07
 CFDA #: 84.027
 Agency: U.S. Department of Education
 Program Name: Special Education – Grants to States
 Requirement: Period of Availability
 Question Costs: \$25,000

Criteria: Completion and approval of purchase orders should occur prior to the acquisition of goods and services.

Condition: One of one hundred twenty-three federal grants non-payroll expenditure tested (0.81%, \$25,000) is supported by a purchase order dated six years after the related invoice date (1999).

<u>Acct</u>	<u>Amount</u>	<u>Fund Org</u>	<u>Org Name</u>	<u>Payee</u>	<u>APV</u>	<u>Description</u>
8201	\$25,000	301401	Education Administration	Moria Store	500748001	5 computer set

Cause: There appears to be weak internal controls over ensuring that purchase orders are issued prior to the acquisition of goods and services. We also note that the Special Education Program was administered by the FSM National Government in prior years and the State assumed responsibility for this program only in fiscal year 2005.

Effect: It appears that purchase and payments occurred without proper approval as the purchase order was prepared approximately six years subsequent to the invoice date. As a result, it appears the period of availability for this transaction has expired. A questioned cost exists.

Recommendation: The State should strengthen internal controls to ensure proper authorization of purchase orders.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The payment in question pertained to unpaid invoices for the Spec. Ed. program from 1999. It was the Spec. Ed. coordinator's understanding that old, unused balances from prior year balances could be aggregated and used for old invoices. In the future, effective immediately, specific grantor agency approval will be obtained before any payments will be made by Chuuk State Finance.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-08
CFDA #: 84.027
Agency: U.S. Department of Education
Program Name: Special Education – Grants to States
Requirement: Allowable Costs/Cost Principles and Procurement
Question Costs: \$52,530

Criteria: In accordance with applicable allowable costs/cost principles and procurement requirements, expenditures should be necessary and reasonable for program needs and in accordance with the objectives of the Federal Program. Also, in accordance with applicable procurement requirements, the grantee will maintain records sufficient to detail the significant history of a procurement, including a rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price.

Conditions: Of twenty-two transactions tested, we noted the following:

1. Seven (or 32%) did not have the following support:

<u>Account</u>	<u>Description</u>	<u>Amount</u>	<u>APV No.</u>	<u>Support Needed</u>
8303	Office Supplies and Materials	\$ 6,801	500380901	competitive procurement support, invoice
8201	Fixed Asset Budget	4,798	500915601	competitive procurement support
8101	Travel Budget	3,472	560153301	Travel expense report
				APV, invoice/contract, competitive procurement, purchase
8201	Fixed Asset Budget	4,700	500212401	order/purchase requisition
8101	Travel Budget	3,230	560246601	Travel expense report
8301	Consumable Goods Budget	5,244	500214801	Utility billing statement from CPUC
8301	Consumable Goods Budget	3,289	500601601	Utility billing statement from CPUC
	Total	<u>\$31,533</u>		

The above includes utility billings from a prior year and no basis of allocation to the program was on file:

<u>Account</u>	<u>Description</u>	<u>Amount</u>	<u>APV No.</u>
8301	Consumable Goods Budget	\$5,244	500214801

The above includes utility billings of one entire school charged to the program and no basis of allocation to the program was on file:

<u>Account</u>	<u>Description</u>	<u>Amount</u>	<u>APV No.</u>
8301	Consumable Goods Budget	\$3,289	500601601

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-08, Continued
 CFDA #: 84.027
 Agency: U.S. Department of Education
 Program Name: Special Education – Grants to States
 Requirement: Allowable Costs/Cost Principles and Procurement
 Question Costs: \$52,530

Conditions, Continued:

2. The following appears to be in non-compliance with the 2004-2005 Approved Budget.

Pacific Rim Conference in Honolulu:

<u>Account</u>	<u>Description</u>	<u>Amount</u>	<u>APV Ref</u>	<u>TA Ref</u>
8101	Travel Budget	\$ 3,918	560081501	A5021601
8101	Travel Budget	3,608	560083801	A5021301
8101	Travel Budget	3,454	JVF05006	A50248
8101	Travel Budget	3,378	560071301	A5024801
8101	Travel Budget	3,360	560077301	A5021801
8101	Travel Budget	3,350	560077401	A5021501
8101	Travel Budget	3,350	560077501	A5021401
8101	Travel Budget	3,350	560079701	A5021701
8101	Travel Budget	<u>3,230</u>	560246601	A5021901
	Total	30,997		
	Approved Budget for Trip	<u>10,000</u>		
	In Excess of Budget	<u>\$20,997</u>		

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

Effect: The State appears to be in noncompliance with applicable allowable costs/cost principles requirements and procurement requirements. A questioned cost results from the condition.

Recommendation: Chuuk State Government should establish and enforce internal controls over ensuring compliance with applicable allowable costs/cost principles requirements and procurement requirements.

Auditee Response and Corrective Action Plan:

1. We disagree with the above findings. The above APV Nos. 5003809 and 5009156 are on file with their corresponding supporting documents such as competitive procurement support and invoices, together with the receiving reports. For Travel APV no. 5601533 attachments are the traveler's itinerary, and the Travel Authorization (TA), and upon liquidation, APV No. 5602312 was prepared with the attached travel expense reports, invoices, and other documents related to the travel.

Auditor Response: The documentation has yet to be provided us and therefore, we are unable to verify the accuracy of the auditee response.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-08, Continued
CFDA #: 84.027
Agency: U.S. Department of Education
Program Name: Special Education – Grants to States
Requirement: Allowable Costs/Cost Principles and Procurement
Question Costs: \$52,530

Auditee Response and Corrective Action Plan, Continued:

2. We agree on the above finding. However, the reason why the travel expense report was not filled out is because the traveler lost all the documents required for liquidating his travel expenses. An affidavit is attached on the travel expense report.

Auditor Response: This documentation has yet to be provided us and therefore, we are unable to verify the accuracy of the auditee response.

3. We agree on the above finding. However, the payment of \$ 5,243.60 covered the 7-month period (from May 6, 2004 to December 8, 2005). At the average monthly rate of \$ 749.00 (\$5243.60/7), the amount may seem reasonable.

Auditor Response: The audit concern is the manner in which the expenditure relates to the program. This linkage has yet to be provided and we are unable to determine if there was any allocation of this cost between the program and the State. It appears that the program bore the entire cost of this service.

4. We disagree on the above finding. The utility expenditures of \$3,289 covered 5 months of FY2004 and 2 months of FY2005. The carry forward budget from FY 2004 is sufficient enough to cover the utility costs.

Auditor Response: Again, we have not seen any allocation to determine the State share of this expenditure and it appears that the entire charge was lodged against the federal program and no documentation is on file to substantiate this basis and the auditee response does not address this issue.

5. We disagreed on the above finding. It is incorrect to say the approved SEPPPIE travel budget was exceeded. First of all, the actual OSSEPPPIE travel budget was \$ 87,500 (ref. FSM allotment advice 4205124). That is also the amount in the FMIS system (301401 /TA5091). The actual expenditures against this grant were \$ 65,989. There was also a carry forward travel budget for the FY2004 SEPPPIE of \$ 17,873, but the actual expenditures against this grant were \$ 17,803.

Auditor Response: The State appears to be looking at the budget in its entirety and not at its components. Certain limits for the attendance at certain events were set and were substantially exceeded. We did not see communication with the grantor with respect to requesting budget revisions and no prior approval appears to have been sought. Therefore, we believe that the costs should be questioned.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-09 - Cash

Criteria: Cash accounts should be properly reconciled in a timely manner.

Conditions:

1. For the following account, the validated bank deposit slip and reconciliation to deposit in bank statement were not provided for the following deposit in transit.

<u>Account No.</u>	<u>Amount</u>
129	\$ 31,359

2. For the following accounts, we noted numerous unreconciled differences on the bank reconciliations.

<u>Account No.</u>	<u>Amount</u>
108	\$ 25
125	85,613
126	11,090
129	663,314
130	313,063
135	(10)
140	(264)
144	133,219
600	152,283
111	42,501
112	309
113	163

3. For the following accounts, we noted the following amounts of stale dated checks that may not be substantiable.

<u>Account No.</u>	<u>Amount</u>
108	\$ 178,373
125	814,669
126	7,394
135	1,984
144	7,268
600	225,008

Cause: There appears to be weak internal controls over ensuring that accurate monthly bank reconciliations are performed in a timely manner.

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

Prior Year Status: The above conditions are reiterative of a prior year finding.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-09 – Cash, Continued

Recommendation: The State should strengthen internal controls to ensure that accurate monthly bank reconciliations are performed in a timely manner.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Chuuk finance continues to make improvements on bank reconciliations but acknowledges that many problems remain. Bank reconciliations are current for the general account for all months for which good copies of the bank statement exists; there have been repeated problems with local banks, however, in the timely receipt of bank statements. For fiscal year 2006 we have taken steps to ensure that all FY-06 bank reconciliations will be completed by December 2006 and to write-off old, unreconciled differences and stale-dated checks.

Finding No. 2005-10 -Accounts Receivable

Criteria: Accounts receivable should be supported by aging detailed sub-ledgers and should be properly monitored for receivable validity, and all invalid receivables should be written off. Furthermore, such support should be maintained on file and made available for review.

Conditions:

1. For the following accounts, no detailed aging sub-ledger was provided.

<u>Fund</u>	<u>Account No.</u>	<u>Amount</u>
General Fund		
10	200	\$ 8,932
10	267	55,525
64	263	(93,081)
Other Governmental Funds		
37	262	41,959
40	262	70,503

2. For Fund 10, Account 280, Travel Advances, we noted \$164,278 or 79% of the total accounts receivable of \$208,284, is outstanding greater than 90 days.
3. For Fund 60, Account 266, account represents funds administered by the FSM National Government on behalf of Chuuk State in which we noted an absence of reconciliations and proper monitoring of the account.

Cause: There appears to be weak internal controls over ensuring that accounts receivable is supported by detailed sub-ledgers and is properly monitored for receivable validity and that such support is maintained on file and made available for review.

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

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-10 -Accounts Receivable, Continued

Recommendation: The State should strengthen internal controls to ensure that accounts receivable is supported by detailed sub-ledgers and is properly monitored for receivable validity, that all invalid receivables are written of, and that the supporting sub-ledgers are maintained on file and made available for review.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Travel advances in fund 10 are now being reconciled to the general ledger and written-off where appropriate. Outstanding advances and overpayments are being deducted from the employees' paychecks.

The reconciliation of Compact CIP expenditures was complicated in FY-05 because the expenditures were being made by the FSMNG and there were poor communications to the State with respect to the amounts and balances; cancelled checks remain with the FSMNG. Effective October 1, 2005 Chuuk State began processing its own Compact CIP expenditures again so we are now able to reconcile the account on a timely basis

Sub-ledgers will be obtained for other accounts receivable accounts by November 2006.

Finding No. 2005-11 - Accounts Payable

Criteria: Detailed aging accounts payable sub-ledgers should be reconciled with the accounts payable balance per the general ledger. Furthermore, the detailed aging accounts payable sub-ledgers should be made available for review.

Condition:

1. For the following accounts, we noted the accounts payable balance per the general ledger does not agree with the accounts payable sub-ledger:

<u>Fund</u>	<u>Account No.</u>	<u>Balance per GL</u>	<u>Balance per Sub-ledger</u>	<u>Variance</u>
General Fund				
10	800	\$ 1,425,669	\$ 1,419,787	\$ 5,882
61	800	\$ 185,705	\$ 126,175	\$ 59,530
10	871	\$ 8,959,151	\$ 9,439,178	\$ (480,027)
Federal Grants				
20	800	\$ 1,578,093	\$ 1,510,804	\$ 67,289
Capital Projects Funds				
60	800	\$ 1,257,460	\$ 1,340,670	\$ (83,210)
Other Governmental Funds				
37	800	\$ 70,943	\$ 52,418	\$ 18,525

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-11 - Accounts Payable, Continued

Condition, Continued:

2. For the following General Fund accounts, no detailed aging sub-ledger was provided:

<u>Fund</u>	<u>Account No.</u>	<u>Account Name</u>	<u>Amount</u>
10	802	PAYABLE FRO	(71,905)
10	813	PAYABLES -	19,000
10	814	PAYABLES -	30
10	815	PAYABLE - D	46,072
10	874	PAYABLES-OT	126,075
10	875	PAYABLES -	(458,176)
10	876	PAYABLE - R	(25,544)
10	887	PAYABLES-DE	12,273
10	888	CHUUK ENVIR	(13,213)
10	889	PAYABLES -	(33,386)
66	600	PAYROLL CAS	(327,799)
66	601	INCOME TAX	(49,852)
66	603	SOCIAL SECU	(79,127)
66	604	GHI	(12,110)
66	606	CHUUK HEALT	(33,581)
66	607	SUPPLEMENTA	(13,501)
66	608	BANK OF GUA	(46,321)
66	609	BANK OF FSM	(90,668)
66	611	KUCHUA CU	(70)
66	613	ED CU	(282)
66	614	PAC BASIN I	(17)
66	615	MOCH MUNI	(32)
66	616	AMERICAN LI	(89)
66	617	HPG	(187)
66	618	HS REHAB LF	(3,083)
66	619	PIS M CU	(135)
66	620	TRUK DEV	(3,143)
66	621	KIOMASA	(935)
66	622	VIN	(50)
66	624	EDLF CHUUK	(1,269)
66	625	SHIGETO	(395)
66	626	M.O. TAXI S	(549)
66	628	CHRISTOPHER	(25)
66	629	TTU	(4,788)
66	631	MOEN HR	(2,089)
66	632	PAATA HR	(3,112)
66	634	CHUUK CU 1	(20,155)
66	635	T&S	(6,100)
66	636	WENO	2,752
66	637	TRUK TRANS	(228)
66	638	HOUSING AUT	(3,033)
66	639	TRUK TRADIN	(2,613)

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-11 - Accounts Payable, Continued

Condition, Continued:

3. For the following General Fund accounts, no detailed aging sub-ledger was provided:

<u>Fund</u>	<u>Account No.</u>	<u>Account Name</u>	<u>Amount</u>
66	640	J&R STORE	(601)
66	641	M&S STORE	(1,959)
66	642	ANNA STORE	(858)
66	643	FSM TELECOM	(3,431)
66	644	CARMEN SS	(1,029)
66	645	BS DIST CO	(1,822)
66	646	DEAL FAIR	(41,632)
66	647	CHUUK FHA	(7,675)
66	650	LJ MORI	(12,515)
66	651	ST CECELIA	(2,252)
66	652	SARAMEN CK	(1,540)
66	653	CHEE YOUNG	(3,545)
66	654	CHUUK UTILI	(1,386)
66	655	ISLAND CABL	(265)
66	657	FSM INSURAN	(2,915)
66	658	KURASSA STO	(8,729)
66	659	FEFAN HOUSE	(130)
66	660	PJ STORE	(90)
66	661	SBA ADMIN	(3,289)
66	664	KUCHU CU	(439)
66	667	FSM SOCSEC	(120)
66	668	MOCH MUNI	10
66	671	P/LOSAP	(5)
66	672	NETCARE	(11,754)
66	673	LOVER'S STO	(1,872)
66	674	ETTEN CU	(25)
66	679	MORIA STORE	(4,494)
66	680	ALLOTMENT C	(15)
66	682	HRT'S	(2,799)
66	683	TONAS RURAL	(824)
66	684	NET-TO-BANK	(1,226)
66	691	CHUUK MEDIC	(55)
66	693	DJ'S STORE	(1,894)
66	694	TUPUNION RE	(161)
66	695	NORTHWEST R	(981)
66	698	TRAVEL ADVA	(22,078)
66	699	PAYROLL ACC	62,914

Cause: There appears to be weak internal controls over ensuring detailed aging sub-ledgers are reconciled to the general ledger and such are maintained on file and made available for review.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-11 - Accounts Payable, Continued

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

Recommendation: The State should strengthen internal controls to ensure detailed aging sub-ledgers are reconciled to the general ledger and such are maintained on file and made available for review.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Effective in FY-06 all open invoices will be reviewed and general ledger balances in the 800 number A/P accounts adjusted to a valid sub-ledger of open liabilities. The payroll liability accounts in fund 66 will also be adjusted to reflect open payroll allotment deductions. Most of the other liability accounts will be written-off (effective September 30, 2006) insofar as the liabilities are no longer considered valid.

Finding No. 2005-12 - Supporting Documents – Search for Unrecorded Liabilities

Criteria: Expenditures should be supported by purchase orders, vendor invoices, contracts and other appropriate authoritative documents.

Conditions:

1. For 77 items tested, aggregating \$2,569,934, during our search for unrecorded liabilities, the supporting purchase order, vendor invoice, contract, receiving report or any other supporting documents were not provided for review.
2. For 24 items, aggregating \$804,382, tested during our search for unrecorded liabilities, it appears that expenditures were recorded before goods or services were received.

Cause: There appears to be weak internal controls over ensuring that expenditures are supported by purchase orders, vendor invoices, contracts and any other supporting documents.

Additionally, in 2005, it appears that the State has essentially adopted a cash-basis method of expenditure recording and as a result, actual payables and accrued liabilities are not being recorded, and the State's internal financial statements do not reflect an accurate picture of its financial position.

Effect: The condition may result in a potential misstatement of expenditures and accounts payable.

Recommendation: The State should strengthen internal controls to ensure that expenditures are supported by purchase orders, vendor invoices, contracts and any other supporting documents.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Management will implement procedures whereby an entry for unrecorded liabilities will be recorded as of September 20, 2006, and this procedure will be incorporated into the State's year-end fiscal and audit preparation procedures. Moreover, documentation and filing procedures have been strengthened to ensure adequate support and timely retrieval for all transactions.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-13 - Encumbrances

Criteria: Encumbrance balances per the general ledger should be reconciled to the supporting sub-ledgers. Furthermore, the sub-ledger should be reviewed to reflect encumbrance validity and such should be supported by purchase orders, contracts and agreements, which should be made available for review.

Condition:

1. For the following accounts, encumbrances per the general ledger do not reconcile to supporting sub-ledgers.

<u>Fund</u>	<u>Balance per GL</u>	<u>Balance per Sub-ledger</u>	<u>Difference</u>
General Fund 10 and 61	\$452,253	\$ 589,547	\$ (137,295)
Federal Grants 30, 20, 25	\$ 458,199	\$ 488,601	\$ (30,402)
Capital Projects Fund 60	\$ 794,139	\$ 797,833	\$ (3,694)

2. No purchase order, contract, agreement or any other supporting documents were provided for review for the following:
 - a. 12 General Fund encumbrances, aggregating \$336,207.
 - b. 18 Federal Grants Fund encumbrances, aggregating \$320,160.
 - c. 123 Capital Projects Fund encumbrances, aggregating \$724,866.

Cause: There appears to be weak internal controls over ensuring that encumbrance balances per the general ledger are reconciled to supporting sub-ledgers. Furthermore, there is no review of the sub-ledger to determine that encumbrances are valid and are supported by purchase orders, contracts and agreements, and that such are available for review.

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

Recommendation: The State should strengthen internal controls to ensure that encumbrance balances per the general ledger are reconciled to the supporting sub-ledgers. Furthermore, review of the sub-ledgers should be performed to assess encumbrance validity and such supporting purchase orders, contracts and agreements should be made available for review.

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.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-14 - Travel Advance

Criteria: In accordance with the travel advance policy, only 80% of the allowed Per Diem and other non-special allowance and non-flight costs are advanced. Furthermore, such advancement should be cleared within 10 days upon return.

Conditions:

1. For the following transaction tested, no travel advance file was provided:

<u>VEN No.</u>	<u>TA No.</u>	<u>PFORG</u>	<u>Date</u>	<u>Amount</u>
81862	A030438	101201	8/7/2003	\$2,489

2. For the following transactions tested, we were unable to determine the manner in which the 80% travel advance was calculated.

<u>VEN No.</u>	<u>TA No.</u>	<u>PFORG</u>	<u>Date</u>	<u>Amount</u>
80059	A40442	Not Provided	1/3/05	\$5,490
87207	A50139	Not Provided	9/13/05	3,569

3. For the following transactions, the travel advance was not cleared in a timely manner.

<u>VEN No.</u>	<u>TA No.</u>	<u>PFORG</u>	<u>Date</u>	<u>Amount</u>
81862	A030438	101201	8/7/03	\$2,489
81758	A30438	101001	7/28/04	3,000
80059	A40442	Not Provided	1/3/05	5,490
87207	A50139	Not Provided	9/13/05	3,569

Cause: There appears to be weak internal controls over ensuring that policies for travel advances are complied with and supporting documents are maintained on file and made available for review.

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

Recommendation: The State should strengthen internal controls to ensure that its travel advance policies are complied with and supporting documents are maintained on file and made available for review.

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 traveler's payroll check, and the outstanding TA receivable is closely monitored and reconciled to the general ledger.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-15 - Expenditures

Criteria: All expenditures should be supported by vendor invoices, purchase orders, contracts, timesheets and other support. Furthermore, such should be properly approved and made available for review.

Conditions:

1. For the following transactions tested, the following documents were not provided for review:
 - a. Eighty-one of four hundred forty-nine non-payroll expenditure transactions were not supported by APV, invoices, purchase order, contract or any other support.
 - b. Seventy-seven of two hundred thirty-two payroll expenditure transactions (33%, \$159,687.53) were not supported by personnel action forms, timesheets, journal voucher details, or other support.
2. For the following payroll transactions tested, we noted variances in the calculation of gross pay and employee benefits.

General Fund

Seven of ninety-seven transactions (7%, \$1,974.99) have variances in gross pay calculations.

Federal Grants

Seven of sixty-four transactions (11%, \$11,460.72) have variances in gross pay and employee benefits calculations.

3. For thirty-eight of one hundred two journal vouchers tested (37%, \$194,538.28), proper approval was not obtained for the expenditure.

Cause: There appears to be weak internal controls over ensuring that expenditures are correctly calculated, documented, processed, authorized, and charged to the proper account.

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

Recommendation: The State should strengthen internal controls to ensure all expenditures are substantiated by such supporting documents as vendor invoices, purchase orders, contracts, timesheets, accurate calculations, and approvals.

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 and that such documentation is readily available for review.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-16 - Annual Leave

Criteria: Annual leave balances should be supported by annual leave hours and personnel action forms.

Condition: For the following employee, there was no personnel action form provided for review:

<u>Last Name</u>	<u>First Name</u>	<u>A/L hours</u>	<u>A/L Balance</u>	<u>Rate</u>	<u>Function</u>	<u>Balance</u>
HAINRICK	ADER	474	\$1,446	8.03	721401	\$1,446

Cause: There appears to be weak internal controls over ensuring that rates applied to annual leave balances are supported by personnel action forms.

Effect: The condition may result in a potential misstatement of annual leave balances.

Recommendation: The State should strengthen internal controls to ensure rates applied to annual leave balances are supported by personnel action forms.

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.

Finding Number: 2005-17 - Employee Ceiling

Criteria: Per Public Law No. 7-04-11, the maximum positions funded from the General fund of 2,330 employees must be distributed to the different departments as follows:

Executive Branch	2,116
Legislative Branch	99
Judicial Branch	65
Public Auditor	3
Boards/Commission	47
Total	<u>2,330</u>

Condition: For the following departments, total employees exceeded what is allowed per public law:

<u>Department</u>	<u>Count</u>	<u>Total</u>	<u>Per PL</u>	<u>Variance</u>
Agriculture Total	62	62	60	2
Board/Commission Total	51	51	47	4
Education Total	1,092	1,092	1,080	12
Governor's Office Total	36	36	10	26
Health Total	414	414	413	1
Legislature Total	108	108	99	9
Public Safety Total	203	203	148	55
Dept/Admin Total	164	164	147	17

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding Number: 2005-17 - Employee Ceiling, Continued

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

Effect: The condition may result in an unauthorized hire of employees.

Recommendation: The State should strengthen internal controls to ensure that the government is in compliance with maximum positions funded from the general fund per public law.

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 Number: 2005-18 - Revenues

Criteria: Revenues should be supported by authorized journal vouchers, cash receipts, taxation collection reports, validated deposit slips, and bank statements. Receipts should be pre-numbered and issued sequentially. Moreover, taxation receipts should be remitted within the day revenue is collected and deposited on the following business day.

Conditions:

1. For 2 (or 3%) of General Fund revenue samples tested, we noted the revenue was not remitted within one business day
2. For 17 (or 27%) of General Fund revenue samples tested, we noted the revenue was not deposited in a timely manner.
3. For 5 (or 8%) of General Fund revenue samples tested, we noted the cash receipts were not issued sequentially.
4. For 1 (or 2%) of General Fund revenue samples tested, we noted no supporting deposit into the bank was provided for review.
5. For 3 (or 20%) of General Fund revenue samples tested, we noted no supporting journal voucher or cash receipt was provided for review.
6. For 2 (or 13%) of General Fund revenue samples tested, we noted the journal voucher was not properly approved.

Cause: There appears to be weak internal controls over ensuring revenues are supported by authorized documents, receipts are remitted and deposited in a timely manner, and receipts are issued sequentially.

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

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding Number: 2005-18 – Revenues, Continued

Recommendation: The State should strengthen internal controls to ensure that revenues are supported by authorized documents and that receipts are issued sequentially.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. It is standard operating procedure to require adequate documentation for cash receipts, sequential issuing of cash receipts and timely deposit of all cash. These policies will be reiterated to Treasury personnel.

Finding No. 2005-19 – 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, and significant footnote changes, among others.

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

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

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

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

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

Auditee Response and Corrective Action Plan: We have been requesting assistance from the FSM National Government with respect to fixed assets to prepare for GASB 34 and believe that such will be implemented in fiscal year 2006. We understand that the FSM National Government has contracted with a party to assist us in resolving this matter.

Finding No. 2005-20 - 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, 2005

Finding No. 2005-20 - 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. 2005-21 - 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 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 therefor has not been available for alternative purposes.

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

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.

**STATE OF CHUUK
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Resolution of Prior Years' Findings and Questioned Costs
Year Ended September 30, 2005

For the year ended September 30, 2005, the following questioned costs were noted and prior questioned costs resolved:

	Questioned Costs Set Forth in Prior Audit Report <u>2004</u>	Questioned Costs Resolved for Fiscal Year <u>2004</u>	Questioned Costs at <u>September 30, 2005</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	4,101,675	-	4,101,675
Unresolved Questioned Costs FY 05	<u>-</u>	<u>-</u>	<u>1,728,813</u>
	<u>\$ 6,736,129</u>	<u>\$ -</u>	<u>\$ 8,464,942</u>