

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

**FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT**

YEAR ENDED SEPTEMBER 30, 2006

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2006

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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, 2006, 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 and other claims 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, 2006.

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, 2006.

Because of inadequacies in the accounting records, detailed records regarding land acquisitions payable and the underlying supporting documentation evidencing the validity of land acquisition expenditures/expenses for the primary government had not been maintained and were not made available for our audit. Therefore, we are not able to satisfy ourselves about the amounts at which the liabilities and expenses for the governmental activities and General Fund are recorded in the accompanying statement of net assets, statement of activities, balance sheet and statement of revenues, expenditures and changes in fund balances (deficits) for the year ended September 30, 2006.

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, 2006, 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 67% and 73% of the assets and revenues, respectively, of the State's aggregate discretely presented component units.

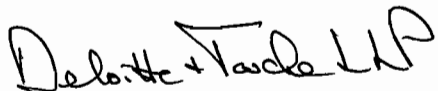
The financial statements of the Chuuk State Housing Authority have not been audited, and we were not engaged to audit these financial statements as part of our engagement to audit the State's basic financial statements. The financial activities of the Chuuk State Housing Authority are included in the State's basic financial statements as a discretely presented component unit and represent 20%, 67% and 4% 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 18, 2007, on our consideration of the State's (Primary Government only) internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an engagement to audit in accordance with *Government Auditing Standards* and should be considered in assessing the results of our engagement to audit.

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

July 18, 2007

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2006

This analysis, prepared by the Department of Administrative Services, Division of Treasury, 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, 2006. We encourage readers to consider this information in conjunction with Chuuk State's financial statements, which follow. Fiscal year 2005 (as restated) 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, 2006, Chuuk State's total net assets decreased by \$5.5 million (or 8.9%) from \$61.78 million in the prior year (as restated) to \$56.28 million. This decrease is primarily attributable to operational expenses of \$39.03 million exceeding revenues of \$33.53 million during the year.
- During fiscal year 2006, Chuuk State's revenues of \$33.53 million were less than total expenses (\$39.03 million) by \$5.5 million. Both revenues and expenses increased from fiscal year 2005, by \$3.75 million (or 12.6%) and \$6.99 million (or 21.8%), respectively. Revenue increases primarily resulted from increased Compact funding, the increase in federal contributions and other grants, and other revenues. Expense increases were primarily in the education sector and municipal affairs.
- Budgetary surpluses in the General Fund were incurred in fiscal year 2006: actual revenues and other sources of \$14.28 million exceeded budgeted revenues of \$5.80 million by \$8.48 million (or 146%) primarily as the result of the transfer of funds from the Compact Capital Projects Fund of \$6.4 million, and an increase in the fair value of investments and local revenues by \$1.12 million. The expenditure budget reflected a positive budget variance. General fund expenditures of \$13.09 million were \$2.71 million (or 17.2%) less than general fund appropriations of \$15.8 million.
- During fiscal year 2006, Chuuk State's general fund balance deficit decreased by \$1.3 million (or 6.5%); decreasing from \$19.83 million in the prior year to \$18.53 million. The decrease is primarily the result of expenditures exceeding revenues offset by a transfer of funds from the Compact Capital Projects Fund to the General Fund.

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 Chuuk 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 Chuuk State's net assets serve as indicator to measure Chuuk State's financial position.

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

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

- **Governmental Activities** - Most of Chuuk State's basic services are included here, such as education, health, special appropriations, finance, judiciary, and general administration. Compact sector and other federal grants finance most of these activities.
- **Component Units** - Chuuk State includes the operating results of the Chuuk State Health Care Plan, the Chuuk Public Utility 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 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.

Chuuk State maintains individual governmental funds, which are categorized as major and non-major. The major funds comprise the General Fund, the Compact Sector Grants Fund, the U.S. Federal Grants 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 2006, Chuuk State's assets exceeded liabilities by \$56.28 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 provide 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, 2006, with comparable balances for fiscal year 2005 (as restated), discloses this relationship.

	<u>2006</u>	<u>2005</u>
Current and other non-capital assets	\$ 23,265,364	\$ 27,152,498
Capital Assets	<u>64,853,337</u>	<u>66,064,451</u>
Total Assets	<u>88,118,701</u>	<u>93,216,949</u>
Long-term liabilities	6,578,420	6,278,770
Other liabilities	<u>25,261,408</u>	<u>25,154,546</u>
Total Liabilities	<u>31,839,828</u>	<u>31,433,316</u>

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Net Assets:		
Invested in capital assets, net of related debt	64,524,158	65,735,272
Restricted	17,231,084	22,257,535
Unrestricted	<u>(25,476,369)</u>	<u>(26,209,174)</u>
Total net assets	\$ <u>56,278,873</u>	\$ <u>61,783,633</u>

At the end of fiscal year 2006, Chuuk State's unrestricted assets showed a deficit of \$25.48 million, a decrease of \$0.73 million (or 3%) from the prior year. This deficit is the result of having current and long-term commitments that are greater than currently available resources. Specifically, Chuuk State did not include in past annual budgets the full amounts needed to finance its current liabilities to vendors and others or its long-term liabilities arising from Asian Development Bank (ADB) loans and unused employee leave balances. Chuuk State will include these amounts in future years' budgets as funding permits.

Net assets declined \$5.5 million (or 8.9%) from the prior year (as restated). Key elements of the decrease and the differences from the prior year are shown in the following schedule:

	<u>2006</u>	<u>2005</u>
Revenues:		
Program Revenues:		
Charges for services:	\$ 739,451	\$ 766,295
Operating grants and contributions	25,261,810	21,987,937
Capital Grants and contributions	488,690	188,306
General Revenues:		
Taxes	4,656,670	4,569,517
Unrestricted investment earnings	788,228	2,200,242
Other	<u>1,591,748</u>	<u>59,670</u>
Total revenues	<u>33,526,597</u>	<u>29,771,967</u>
Expenses:		
General government	8,323,336	7,105,179
Health Services	5,966,124	6,082,949
Education	11,436,624	9,319,566
Economic development	1,087,780	1,043,742
Public Safety	1,312,862	1,290,369
Public works and transportation	2,347,198	1,224,341
Community Affairs	287,572	276,756
Boards and commissions	788,324	871,973
Judiciary	541,678	593,853
Payments to components	275,307	354,811
Municipal Affairs	4,176,643	1,042,459
Other	<u>2,487,909</u>	<u>2,836,955</u>
Total expenses	<u>39,031,357</u>	<u>32,042,953</u>
Change in net assets	(5,504,760)	(2,270,986)
Net assets at the beginning of the year	<u>61,783,633</u>	<u>64,054,619</u>
Net assets at the end of the year	\$ <u>56,278,873</u>	\$ <u>61,783,633</u>

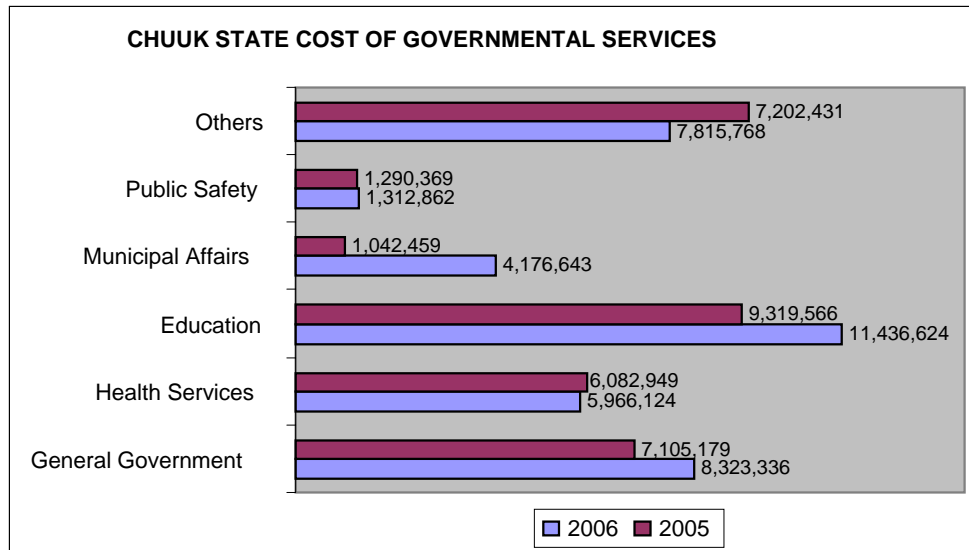
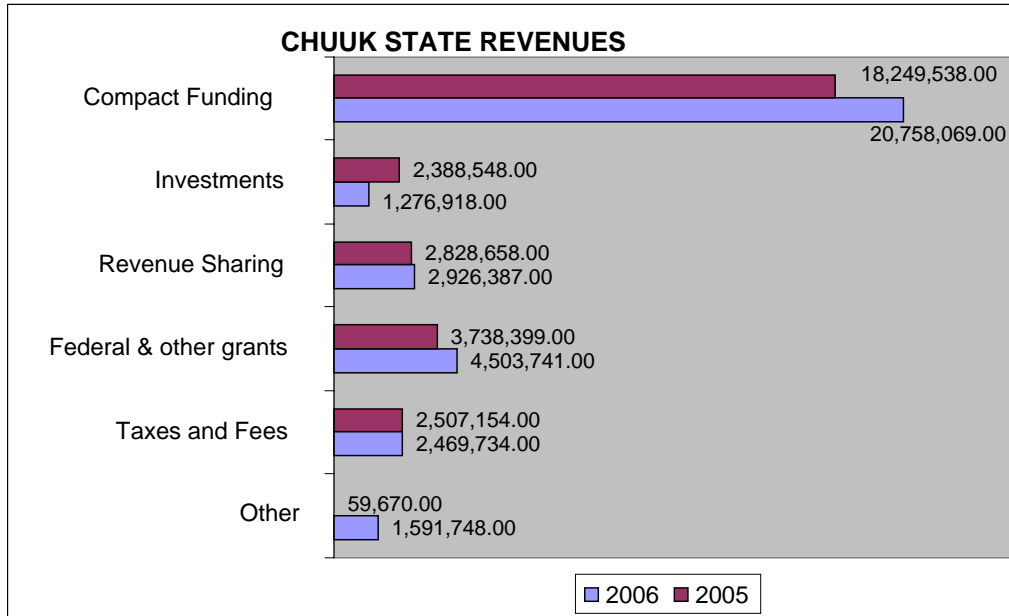
Total revenues in FY2006 of \$33.53 million increased \$3.76 million (or 12.61%) from the prior year's \$29.77 million primarily due to increases in Compact sector grants and other earnings. In fiscal year 2006, Compact sector grants comprised 61.9% of all Chuuk State funding sources whereas General Fund revenue from local sources comprised only 27.9%.

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Total expenses of \$39.03 million reflected a \$6.99 million (or 21.81%) increase from the prior year primarily from increases in municipal affairs, education, and general government expenses.

The following graphs show the major components or revenues and expenditures of governmental funds for the year ended September 30, 2006.



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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 2006, Chuuk State's governmental funds reported a combined deficit fund balance of \$1.62 million which represents a \$4.06 million increase (or 166%) from the \$2.44 million fund balance recorded at the end of fiscal 2005. This increase is attributable to the deficit resulting from expenditures exceeding revenues. Of this total combined fund balance, \$27.27 million is reversed to indicate that it is not available for new spending because it has already been committed: 1) to generate income for future operations (\$21.37 million); 2) to liquidate contracts and purchase orders of the prior period (\$2.49 million); 3) to fund specific general fund and compact CIP-related activities (\$3.05 million); or 4) for on-going capital projects (\$0.37million). These reserved fund balances are off-set by a combined deficit of \$28.8 million, an increase of \$2.12 million (or 7.9%) from fiscal year 2005.

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 a decrease in overall revenue projections of \$0.6 million with a corresponding decrease in budgetary appropriations. Although the actual revenues collected exceeded the projected revenues by \$1.9 million, and the actual expenditures were less than the budgetary appropriations by \$2.7 million, the total expenditures of \$13.1 million exceeded the total revenues of \$7.72 million, resulting in the general fund deficit of \$5.38 million. The major offset against this deficit was the transfer of \$6.4 million from the Compact Capital Projects Fund to the General Fund, resulting in an overall reduction of the general fund deficit of \$1.3 million.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Chuuk State's investment in capital assets for the primary government as of September 30, 2006, amounted to \$81.24 million, net of accumulated depreciation of \$ 16.39 million, leaving a net book value of \$64.85 million. This represents a net decrease of \$1.21 million (or 1.8%) from fiscal year 2005 (as restated). No significant fixed asset additions or retirements occurred in fiscal year 2006, but incremental additions were made to seaport facilities. The table below summarizes Chuuk State's capital assets:

	<u>2006</u>	<u>2005</u>
Land	\$ 24,129,857	\$ 24,129,857
Airport Facilities	24,304,925	25,007,582
Buildings	4,530,572	4,661,130
Seaport Facilities	4,927,900	4,873,243
Vehicles	157,641	179,917
Infrastructure	<u>6,802,442</u>	<u>7,212,722</u>
	\$ <u>64,853,337</u>	\$ <u>66,064,451</u>

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

Long-Term Debt

The following schedule shows Chuuk State's non-current liabilities for fiscal year 2006 and comparable amounts for fiscal year 2005.

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September 30, 2006

	<u>2006</u>	<u>2005</u>
ADB Early Retirement Loan	\$ 5,300,000	\$ 5,300,000
ADB Private Sector Development Program Loan	458,176	458,176
ADB Private Sector Development Project Loan	183,363	21,984
Compensated absences payable	<u>1,016,317</u>	<u>939,075</u>
 Total noncurrent liabilities	 <u>\$ 6,957,856</u>	 <u>\$ 6,719,235</u>

Long-term debt obligations increased by \$0.24million (or 3.6%) in fiscal year 2006, primarily as the result increases in the liability for compensated annual leave and draw downs for the ADB loan for Private Sector Reform.

Additional information on Chuuk State's long-term debt obligations can be found in Note 7 to the accompanying financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

Noting the lackluster conditions in the local economy, general fund revenues in fiscal year 2007 are expected to remain relatively the same as in fiscal year 2006.

As noted previously, Compact sector revenues comprise 61.9% of Chuuk State's budget. These funding sources, based on JEMCO approved budgets, are projected to increase by 0.4% in fiscal year 2007. The following table highlights these changes:

CHUUK STATE COMPACT SECTOR BUDGETS

<u>Compact Sector</u>	<u>BUDGET 2007</u>	<u>BUDGET 2006</u>	<u>2007 Increase (Decrease)</u>	<u>%</u>
Education Sector	\$ 9,710,276	\$ 8,808,759	\$ 901,517	10.20%
Health Sector	6,594,327	5,972,395	621,932	10.40%
Private Sector	506,931	1,458,616	(951,685)	-65.20%
Environmental Sector	534,312	715,053	(180,741)	-25.30%
Capacity Building Sector	2,450,592	2,724,099	(273,507)	-10.00%
Supplemental Education (SEG)	4,092,000	4,092,000	-	
Infrastructure Sector	<u>9,743,183</u>	<u>9,743,183</u>	<u>-</u>	
	<u>\$ 33,631,621</u>	<u>\$ 33,514,105</u>	<u>\$ 117,516</u>	0.4%

Significantly, as of June 2007, none of the annual \$9.7 million infrastructure budgets have been allotted to Chuuk State since fiscal year 2005. Consequently, \$38.97 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 allotment. 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

The financial report is designed to provide our citizens, taxpayers, customers, and investments 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 Administrative Services, P.O. Box 189, Weno, Chuuk FM 96942.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Statement of Net Assets
September 30, 2006

	Primary Government	Component Units
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 279,487	\$ 436,118
Time certificates of deposit	-	1,040,702
Equity interest in internal investment pool	3,440,747	-
Receivables, net of allowance for uncollectibles	2,079,139	1,391,406
Inventories	-	195,861
Prepayments	1,518,002	188,441
Restricted assets:		
Cash and cash equivalents	72,165	-
Total current assets	7,389,540	3,252,528
Noncurrent assets:		
Restricted assets:		
Investments	12,200,319	-
Investments	3,675,505	-
Capital assets, net of accumulated depreciation	64,853,337	5,126,504
Total noncurrent assets	80,729,161	5,126,504
Total assets	\$ 88,118,701	\$ 8,379,032
<u>LIABILITIES</u>		
Current liabilities:		
Bank overdraft	\$ 935,558	\$ 34,682
Current portion of long-term debt	-	711,124
Notes payable	1,653,285	-
Accounts payable	21,673,345	281,353
Compensated absences payable	379,436	-
Other liabilities and accruals	-	1,304,997
Deferred revenue	619,784	230,695
Total current liabilities	25,261,408	2,562,851
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	5,941,539	3,431,865
Compensated absences payable, net of current portion	636,881	-
Total noncurrent liabilities	6,578,420	3,431,865
Total liabilities	31,839,828	5,994,716
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	64,524,158	983,514
Restricted for:		
Nonexpendable:		
Future operations	7,232,484	-
Expendable:		
Compact related	8,870,219	-
Other purposes	1,128,381	-
Unrestricted	(25,476,369)	1,400,802
Total net assets	56,278,873	2,384,316
Total liabilities and net assets	\$ 88,118,701	\$ 8,379,032

See accompanying notes to basic financial statements.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Statement of Activities
Year Ended September 30, 2006

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	\$ 8,323,336	\$ 188,470	\$ 4,647,506	\$ -	\$ (3,487,360)	\$ -
Health services	5,966,124	-	5,915,496	-	(50,628)	-
Education	11,436,624	-	11,430,624	-	(6,000)	-
Economic development	1,087,780	-	1,086,788	-	(992)	-
Public safety	1,312,862	-	925,460	-	(387,402)	-
Public works and transportation	2,347,198	550,981	-	-	(1,796,217)	-
Community affairs	287,572	-	-	-	(287,572)	-
Boards and commissions	788,324	-	589,505	-	(198,819)	-
Judiciary	541,678	-	381,818	-	(159,860)	-
Payments to component units	275,307	-	172,874	-	(102,433)	-
Municipal affairs	4,176,643	-	-	-	(4,176,643)	-
Future operations	-	-	-	488,690	488,690	-
Other	2,487,909	-	111,739	-	(2,376,170)	-
Total primary government	<u>\$ 39,031,357</u>	<u>\$ 739,451</u>	<u>\$ 25,261,810</u>	<u>\$ 488,690</u>	<u>(12,541,406)</u>	<u>-</u>
Component units:						
Chuuk State Health Care Plan	\$ 868,456	\$ 906,079	\$ -	\$ -	-	37,623
Chuuk Public Utility Corporation	4,591,524	2,363,191	480,000	-	-	(1,748,333)
Chuuk State Housing Corporation	165,716	94,879	52,177	-	-	(18,660)
Total component units	<u>\$ 5,625,696</u>	<u>\$ 3,364,149</u>	<u>\$ 532,177</u>	<u>\$ -</u>	<u>-</u>	<u>(1,729,370)</u>
General revenues:						
Taxes:						
Revenue sharing					2,926,387	-
Excise taxes					1,730,283	-
Unrestricted investment earnings					788,228	-
Other					1,591,748	12,110
Total general revenues					<u>7,036,646</u>	<u>12,110</u>
Change in net assets					(5,504,760)	(1,717,260)
Net assets at the beginning of the year, as restated					61,783,633	4,101,576
Net assets at the end of the year					<u>\$ 56,278,873</u>	<u>\$ 2,384,316</u>

See accompanying notes to basic financial statements.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Balance Sheet
Governmental Funds
September 30, 2006

	General	Special Revenue		Capital Projects	Permanent	Other Governmental	Total
		U.S. Federal Grants	Compact Sector Grants	Compact Capital Projects	Compact Trust	Funds	
ASSETS							
Cash and cash equivalents	\$ 279,487	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 279,487
Equity interest in internal investment pool	3,440,747	-	-	-	-	-	3,440,747
Investments	-	-	-	3,675,505	-	-	3,675,505
Receivables, net:							
FSM National Government	712,367	766,989	562,511	37,272	-	-	2,079,139
Prepayments	-	-	1,518,002	-	-	-	1,518,002
Due from other funds	34,252	444,192	2,367,345	2,644,698	-	5,262,777	10,753,264
Restricted assets:							
Cash and cash equivalents	72,165	-	-	-	-	-	72,165
Investments	4,967,835	-	-	-	7,232,484	-	12,200,319
Total assets	<u>\$ 9,506,853</u>	<u>\$ 1,211,181</u>	<u>\$ 4,447,858</u>	<u>\$ 6,357,475</u>	<u>\$ 7,232,484</u>	<u>\$ 5,262,777</u>	<u>\$ 34,018,628</u>
LIABILITIES AND FUND BALANCES							
Liabilities:							
Bank overdraft	\$ 935,558	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 935,558
Accounts payable	15,061,273	1,481,179	2,301,305	1,150,807	-	1,678,781	21,673,345
Notes payable	1,324,106	-	-	329,179	-	-	1,653,285
Deferred revenue	-	-	619,784	-	-	-	619,784
Due to other funds	10,719,012	-	8,767	-	-	25,485	10,753,264
Total liabilities	<u>28,039,949</u>	<u>1,481,179</u>	<u>2,929,856</u>	<u>1,479,986</u>	<u>-</u>	<u>1,704,266</u>	<u>35,635,236</u>
Fund balances (deficits):							
Reserved for:							
Related assets	5,300,000	-	1,518,002	3,712,777	7,232,484	3,603,109	21,366,372
Encumbrances	755,679	-	921,528	794,139	-	14,758	2,486,104
Continuing appropriations	3,051,179	-	-	-	-	-	3,051,179
Capital projects related	-	-	-	370,573	-	-	370,573
Unreserved:							
General fund	(27,639,954)	-	-	-	-	-	(27,639,954)
Special revenue funds	-	(269,998)	(921,528)	-	-	(59,355)	(1,250,881)
Total fund balances (deficits)	<u>(18,533,096)</u>	<u>(269,998)</u>	<u>1,518,002</u>	<u>4,877,489</u>	<u>7,232,484</u>	<u>3,558,511</u>	<u>(1,616,608)</u>
Total liabilities and fund balances	<u>\$ 9,506,853</u>	<u>\$ 1,211,181</u>	<u>\$ 4,447,858</u>	<u>\$ 6,357,475</u>	<u>\$ 7,232,484</u>	<u>\$ 5,262,777</u>	
Amounts reported for governmental activities in the statement of net assets are different because:							
Capital assets used in governmental activities are not financial resources and, therefore, reported in the funds							64,853,337
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							(5,941,539)
Compensated absences							(1,016,317)
							(6,957,856)
Net assets of governmental activities							<u>\$ 56,278,873</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, 2006

	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	\$ -	\$ -	\$ 20,758,069	\$ -	\$ -	\$ -	\$ 20,758,069
Net increase in the fair value of investments	788,228	-	-	-	488,690	-	1,276,918
Federal contributions and other grants	-	4,503,741	-	-	-	-	4,503,741
Revenue sharing	2,926,387	-	-	-	-	-	2,926,387
Excise taxes	1,730,283	-	-	-	-	-	1,730,283
Fees and charges	188,470	-	-	-	-	61,020	249,490
Departmental charges	489,961	-	-	-	-	-	489,961
Other	1,591,748	-	-	-	-	-	1,591,748
Total revenues	7,715,077	4,503,741	20,758,069	-	488,690	61,020	33,526,597
Expenditures:							
Current:							
General government	4,109,908	2,937,993	1,130,930	-	-	-	8,178,831
Health services	-	573,548	5,341,948	-	-	-	5,915,496
Education	-	1,243,798	10,186,826	-	-	-	11,430,624
Economic development	992	-	1,086,788	-	-	-	1,087,780
Public safety	337,726	25,000	900,460	-	-	44,598	1,307,784
Public works and transportation	1,237,222	-	-	34,498	-	-	1,271,720
Community affairs	280,905	-	-	-	-	-	280,905
Boards and commissions	198,819	-	589,505	-	-	-	788,324
Payments to component units	102,433	-	172,874	-	-	-	275,307
Judiciary	159,860	-	381,818	-	-	-	541,678
Municipal affairs	4,176,643	-	-	-	-	-	4,176,643
Other	2,376,170	3,156	108,583	-	-	-	2,487,909
Total expenditures	12,980,678	4,783,495	19,899,732	34,498	-	44,598	37,743,001
Excess (deficiency) of revenues over (under) expenditures	(5,265,601)	(279,754)	858,337	(34,498)	488,690	16,422	(4,216,404)
Other financing sources (uses):							
Loan proceeds	161,379	-	-	-	-	-	161,379
Transfers in from other funds	6,400,000	-	-	-	-	-	6,400,000
Transfers out to other funds	-	-	-	(6,400,000)	-	-	(6,400,000)
Total other financing sources (uses), net	6,561,379	-	-	(6,400,000)	-	-	161,379
Net change in fund balances (deficit)	1,295,778	(279,754)	858,337	(6,434,498)	488,690	16,422	(4,055,025)
Fund balances (deficits) at the beginning of the year	(19,828,874)	9,756	659,665	11,311,987	6,743,794	3,542,089	2,438,417
Fund balances (deficits) at the end of the year	<u>\$ (18,533,096)</u>	<u>\$ (269,998)</u>	<u>\$ 1,518,002</u>	<u>\$ 4,877,489</u>	<u>\$ 7,232,484</u>	<u>\$ 3,558,511</u>	<u>\$ (1,616,608)</u>

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, 2006

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

Net change in fund balances (deficit) - total governmental funds from page 13	\$ (4,055,025)
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	(1,211,114)
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	(77,242)
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>(161,379)</u>
Change in net assets of governmental activities as presented on page 11	\$ <u>(5,504,760)</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, 2006

<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	\$ 369,361	\$ 1,314	\$ 65,443	\$ 436,118
Time certificates of deposit	700,000	-	340,702	1,040,702
Receivables, net:				
General	35,644	247,347	152,232	435,223
Loans	-	-	956,183	956,183
Inventories	-	195,861	-	195,861
Prepayments	403	188,038	-	188,441
 Total current assets	 <u>1,105,408</u>	 <u>632,560</u>	 <u>1,514,560</u>	 <u>3,252,528</u>
Noncurrent assets:				
Capital assets, net of accumulated depreciation	22,902	4,967,361	136,241	5,126,504
 Total assets	 <u>\$ 1,128,310</u>	 <u>\$ 5,599,921</u>	 <u>\$ 1,650,801</u>	 <u>\$ 8,379,032</u>
 <u>LIABILITIES AND NET ASSETS</u>				
Current liabilities:				
Bank overdraft	\$ -	\$ 34,682	\$ -	\$ 34,682
Current portion of long-term debt	-	711,124	-	711,124
Accounts payable	67,108	213,827	418	281,353
Accrued liabilities	-	1,304,997	-	1,304,997
Deferred income	-	230,695	-	230,695
 Total current liabilities	 <u>67,108</u>	 <u>2,495,325</u>	 <u>418</u>	 <u>2,562,851</u>
Noncurrent liabilities:				
Noncurrent portion of long-term debt	-	3,431,865	-	3,431,865
 Total noncurrent liabilities	 <u>-</u>	 <u>3,431,865</u>	 <u>-</u>	 <u>3,431,865</u>
 Total liabilities	 <u>67,108</u>	 <u>5,927,190</u>	 <u>418</u>	 <u>5,994,716</u>
Net assets:				
Invested in capital assets, net of related debt	22,902	824,371	136,241	983,514
Unrestricted	1,038,300	(1,151,640)	1,514,142	1,400,802
 Total net assets	 <u>1,061,202</u>	 <u>(327,269)</u>	 <u>1,650,383</u>	 <u>2,384,316</u>
 Total liabilities and net assets	 <u>\$ 1,128,310</u>	 <u>\$ 5,599,921</u>	 <u>\$ 1,650,801</u>	 <u>\$ 8,379,032</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, 2006

	Chuuk State Health Care Plan	Chuuk Public Utility Corporation	Chuuk State Housing Corporation	Totals
Operating revenues:				
Charges for services	\$ 872,006	\$ 2,356,011	\$ 94,879	\$ 3,322,896
Other	34,073	7,180	-	41,253
Total operating revenues	<u>906,079</u>	<u>2,363,191</u>	<u>94,879</u>	<u>3,364,149</u>
Operating expenses:				
Cost of services	639,251	1,999,642	-	2,638,893
Depreciation	6,439	1,154,459	22,600	1,183,498
Administration and general	222,766	1,142,048	143,116	1,507,930
Total operating expenses	<u>868,456</u>	<u>4,296,149</u>	<u>165,716</u>	<u>5,330,321</u>
Operating income (loss)	<u>37,623</u>	<u>(1,932,958)</u>	<u>(70,837)</u>	<u>(1,966,172)</u>
Nonoperating revenues (expenses):				
Contributions from primary government	-	480,000	52,177	532,177
Other income	-	12,110	-	12,110
Interest expense	-	(295,375)	-	(295,375)
Total nonoperating revenues (expenses), net	<u>-</u>	<u>196,735</u>	<u>52,177</u>	<u>248,912</u>
Net income (loss)	37,623	(1,736,223)	(18,660)	(1,717,260)
Net assets at the beginning of the year	<u>1,023,579</u>	<u>1,408,954</u>	<u>1,669,043</u>	<u>4,101,576</u>
Net assets at the end of the year	<u>\$ 1,061,202</u>	<u>\$ (327,269)</u>	<u>\$ 1,650,383</u>	<u>\$ 2,384,316</u>

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(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, 2006

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

i. Omitted Governmental Funds

The following funds are considered to be nonmajor governmental funds of the State but are not included in the accompanying basic financial statements due to absence of account balances and financial activities. Accordingly, the omission of these funds is not considered material to either the nonmajor governmental funds or the governmental activities reporting units:

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:

Chuuk Visitors Bureau 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.

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

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

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

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

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

i. Omitted Governmental Funds, Continued

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

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

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

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

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

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

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

ii. Omitted Component Units

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

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

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

ii. Omitted Component Units, Continued

Chuuk Public Fisheries Corporation (CPFC): CPFC was created by CSL No. 5-99-22 and is responsible for promoting the development of pelagic fisheries and related industries for the economic benefit of the people of the State. CPFC is governed by a five-member Board of Directors, which comprises of the Director of the Department of Marine Resources, the Director of the Department of Commerce and Industry, one member who is appointed by the Governor representing the Chamber of Commerce, and two members who are appointed by the President and the Speaker.

iii. 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.

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

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

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

- Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets.
- Restricted net assets - nonexpendable consists of permanent funds in which donors or other outside sources have stipulated that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to the principal.
- Restricted net assets - expendable consists of resources in which the State is legally or contractually obligated to spend resources in accordance with restrictions 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 \$17,231,084 of restricted net assets, of which \$1,128,381 is restricted by enabling legislation.

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

C. Fund Financial Statements

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

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

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

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting

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

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

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

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

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

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(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 - for State and Local Governments: 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, 2006

(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. Investments

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.

H. 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".

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

H. Receivables, Continued

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.

I. 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.

J. 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.

K. 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 \$72,165 and \$4,967,835, respectively. Furthermore, investments recorded in the Compact Trust Fund of \$7,232,484 are restricted in that they are not available to be used in current operations.

L. 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.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

L. Capital Assets, Continued

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

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

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

M. 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.

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

During the year ended September 30, 2006, the State made a one-time transfer in the amount of \$6,400,000 from the Compact Capital Projects Fund to the General Fund to assist in the elimination of the operating fund deficit.

N. Deferred Revenue

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

STATE OF CHUUK
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Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

O. 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.

P. 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, 2006, is represented by the following assets:

	General	Special Revenue		Capital	Permanent	Other	Totals
		U.S. Federal Grants	Compact Sector Grants	Compact Capital Projects	Compact Trust	Governmental Funds	
Investments	\$ 259,600	\$ -	\$ -	\$ 3,675,505	\$ -	\$ -	\$ 3,935,105
Due from other funds	-	-	-	-	-	3,603,109	3,603,109
Receivables:							
FSM National Government	-	-	-	37,272	-	-	37,272
Prepayments	-	-	1,518,002	-	-	-	1,518,002
Restricted assets:							
Cash and cash equivalents	72,565	-	-	-	-	-	72,565
Investments	4,967,835	-	-	-	7,232,484	-	12,200,319
	<u>\$ 5,300,000</u>	<u>\$ -</u>	<u>\$ 1,518,002</u>	<u>\$ 3,712,777</u>	<u>\$ 7,232,484</u>	<u>\$ 3,603,109</u>	<u>\$21,366,372</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.

Q. Risk Financing

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

STATE OF CHUUK
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Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

R. Estimates

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

S. Restatement of Primary Government Net Assets

Net assets, as previously reported at September 30, 2005	\$ 59,505,244
Understatement of capital assets, net of accumulated depreciation, previously reported for governmental activities	<u>2,278,389</u>
Net assets, as restated at September 30, 2005	\$ <u>61,783,633</u>

T. New Accounting Standards

During fiscal year 2006, the State implemented the following pronouncements:

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes standards for impairment of capital assets when its service utility has declined significantly and unexpectedly.
- GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment to NCGA Statement 1*, which 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. 46, *Net Assets Restricted by Enabling Legislation (an amendment to GASB Statement No. 34)*, which requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets.
- GASB Statement No. 47, *Accounting for Termination Benefits*, which establishes guidance for state and local governmental employers on accounting and financial reporting for termination of benefits.
- GASB Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefit Expenditures/Expense and Liabilities by Cost-Sharing Employers*, which 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.

The implementation of these pronouncements did not have a material impact on the accompanying 2006 financial statements.

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.

STATE OF CHUUK
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Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

T. New Accounting Standards, Continued

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other post employment 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 September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*. GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. The Statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. The provisions of this Statement are effective for periods beginning after December 15, 2006. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of the State.

(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:

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(2) Deposits and Investments, Continued

- 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.

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.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(2) Deposits and Investments, Continued

As of September 30, 2006, the carrying amount of the primary government's total cash and cash equivalents were \$351,652 and the corresponding bank balances were \$726,340, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2006, 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, 2006, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit were \$1,476,820 and the corresponding bank balances were \$1,091,794. Of the bank balance amounts, \$966,878 is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. The remaining amount of \$124,916 represents deposits maintained in Philippine Peso denominated bank accounts. Accordingly, these deposits are subject to foreign currency risk. As of September 30, 2006, bank deposits in the amount of \$221,953 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.

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, 2006, the State's investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ <u>1,429,852</u>
Other investments:	
Domestic equities	3,364,674
Money market funds	173,310
Cash management account	<u>10,673,230</u>
	<u>14,211,214</u>
	\$ <u>15,641,066</u>

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(2) Deposits and Investments, Continued

B. Investments, Continued

As of September 30, 2006, the Compact Capital Projects Fund holds 16% of the shares of the Bank of the Federated States of Micronesia in the amount of \$1,500,000, 4.8% 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, 1% of the shares of the FSM Development Bank in the amount of \$300,000, and 0.01% of the shares of the Bank of Guam in the amount of \$423,500. As the fair market value of these investments is not readily available, such have been recorded at cost.

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, 2006.

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, 2006, 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, 2006, the State's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

	Credit Ratings	Less Than 1	Investment Maturities (In Years)			Fair Value
			1 to 5	6 to 10	Greater Than 10	
U.S. government obligations	Aaa	\$ -	\$ 77,307	\$ 108,372	\$ 140,586	\$ 326,265
U.S. government agency obligations	Aaa	44,539	214,587	25,835	491,150	776,111
Corporate notes and bonds	Aaa	-	59,132	-	14,665	73,797
Corporate notes and bonds	Aa1	-	16,018	-	-	16,018
Corporate notes and bonds	Aa2	-	-	7,536	-	7,536
Corporate notes and bonds	A1	-	-	-	29,504	29,504
Corporate notes and bonds	A2	-	36,773	53,999	17,008	107,780
Corporate notes and bonds	A3	-	10,506	-	-	10,506
Corporate notes and bonds	Baa1	-	8,996	13,783	-	22,779
Corporate notes and bonds	Baa2	-	-	7,056	-	7,056
Corporate notes and bonds	Not rated	-	19,308	-	33,192	52,500
		\$ 44,539	\$ 442,627	\$ 216,581	\$ 726,105	\$ 1,429,852

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(3) Receivables

Receivables as of September 30, 2006, 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	\$ 787,817	\$ 766,989	\$ 562,511	\$ 37,272	\$ -	\$ 1,128,381	\$ 3,282,970
Other	<u>148,606</u>	-	-	-	-	-	<u>148,606</u>
	936,423	766,989	-	37,272	-	-	3,431,576
Less: allowance for uncollectible accounts	<u>(224,056)</u>	-	-	-	-	(1,128,381)	<u>(1,352,437)</u>
Net receivables	<u>\$ 712,367</u>	<u>\$ 766,989</u>	<u>\$ 562,511</u>	<u>\$ 37,272</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,079,139</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, 2006, are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Compact Sector Grants	\$ 8,767
General	Nonmajor governmental funds	25,485
U.S. Federal Grants	General	444,192
Compact Sector Grants	General	2,367,345
Compact Capital Projects	General	2,644,698
Nonmajor governmental funds	General	<u>5,262,777</u>
		<u>\$ 10,753,264</u>

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

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Nonmajor governmental funds:		
Chuuk Airport Authority	General	\$ 1,128,381
Compact Other Grants	General	1,346,945
Compact Special Block Section 221(b)	General	<u>1,127,783</u>
		<u>\$ 3,603,109</u>

STATE OF CHUUK
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Notes to Financial Statements
September 30, 2006

(5) Fixed Assets

Capital asset activities of the primary government for the year ended September 30, 2006, are as follows:

	Balance October 1, 2005	<u>Additions</u>	<u>Retirements</u>	Balance September 30, 2006
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 24,129,857	\$ -	\$ -	\$ 24,129,857
Capital assets, being depreciated:				
Airport facilities	29,906,300	-	-	29,906,300
Buildings	9,439,947	-	-	9,439,947
Seaport facilities	6,815,794	328,293	-	7,144,087
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>56,788,285</u>	<u>328,293</u>	<u>-</u>	<u>57,116,578</u>
Less accumulated depreciation for:				
Airport facilities	(4,898,718)	(702,657)	-	(5,601,375)
Buildings	(4,778,817)	(130,558)	-	(4,909,375)
Seaport facilities	(1,942,551)	(273,636)	-	(2,216,187)
Vehicles	(189,327)	(22,276)	-	(211,603)
Infrastructure	<u>(3,044,278)</u>	<u>(410,280)</u>	<u>-</u>	<u>(3,454,558)</u>
	<u>(14,853,691)</u>	<u>(1,539,407)</u>	<u>-</u>	<u>(16,393,099)</u>
Total capital assets, being depreciated, net	<u>41,934,594</u>	<u>(1,211,114)</u>	<u>-</u>	<u>40,723,480</u>
Governmental activities capital assets, net	<u>\$ 66,064,451</u>	<u>\$ (1,211,114)</u>	<u>\$ -</u>	<u>\$ 64,853,337</u>

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

General government	\$ 67,263
Health services	50,628
Education	6,000
Public safety	5,078
Public works and transportation	1,403,771
Community affairs	<u>6,667</u>
	<u>\$ 1,539,407</u>

Capital asset activities of the discretely presently component units for the year ended September 30, 2006, are as follows:

	Balance October 1, 2005	<u>Additions</u>	<u>Retirements</u>	Balance September 30, 2006
Capital assets, being depreciated:				
Electric plant facilities	\$ 15,370,780	\$ 5,899	\$ -	\$ 15,376,679
Water and sewer plant facilities	10,088,112	-	-	10,088,112
Machinery and equipment	292,640	-	(11,258)	302,840
Other	<u>599,798</u>	<u>10,200</u>	<u>-</u>	<u>588,540</u>
Total capital assets, being depreciated	26,351,330	16,099	-	26,356,171
Less accumulated depreciation	<u>(20,057,427)</u>	<u>(1,183,498)</u>	<u>(11,258)</u>	<u>(21,229,667)</u>
	<u>\$ 6,293,903</u>	<u>\$ (1,167,399)</u>	<u>\$ -</u>	<u>\$ 5,126,504</u>

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(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. \$ 1,324,106

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

\$ 1,653,285

No changes in this debt occurred during the year ended September 30, 2006.

(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, 2006. As of September 30, 2006, 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 \$4,967,835 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, 2006

(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, 2006, 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, 2006, the amount outstanding against this loan was \$183,363.

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

Year ending September 30,	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ -	\$ 59,415	\$ 59,415
2008	106,000	59,415	165,415
2009	136,629	61,563	198,192
2010	136,629	60,044	196,673
2012 – 2016	136,629	58,524	195,153
2017 – 2021	769,720	268,849	1,038,569
2022 – 2026	1,081,833	221,129	1,302,962
2027 – 2031	1,222,797	156,314	1,379,111
2032 – 2036	1,079,302	95,834	1,175,136
2032 – 2036	1,060,000	42,400	1,102,400
2037	212,000	2,120	214,120
	<u>\$5,941,539</u>	<u>\$1,085,607</u>	<u>\$7,027,146</u>

During the year ended September 30, 2006, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net assets:

	Balance October 1, 2005	<u>Additions</u>	<u>Reductions</u>	Balance September 30, 2006	<u>Due Within One Year</u>
Loan payable:					
ADB loans	\$ 5,780,160	\$ 161,379	\$ -	\$ 5,941,539	\$ -
Other:					
Compensated absences	939,075	276,818	(199,576)	1,016,317	379,436
	<u>\$ 6,719,235</u>	<u>\$ 438,197</u>	<u>\$ (199,576)</u>	<u>\$ 6,957,856</u>	<u>\$ 379,436</u>

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(7) Long-term Obligations, Continued

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

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>
2007	\$ 711,124	\$ 300,066	\$ 1,011,190
2008	59,737	189,113	248,850
2009	59,737	185,039	244,776
2010	59,737	180,965	240,702
2011	59,737	176,891	236,628
2012-2016	298,685	823,340	1,122,025
2017-2021	746,804	660,366	1,407,170
2022-2026	796,595	390,425	1,187,020
2027-2031	<u>1,350,833</u>	<u>121,583</u>	<u>1,472,416</u>
	\$ <u>4,142,989</u>	\$ <u>3,027,788</u>	\$ <u>7,170,777</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, 2006 is \$3,396,836.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(8) Contingencies, Continued

Insurance Coverage

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

Federal Grants

The State participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of \$9,423,929 relating to fiscal years 1999 through 2006 have been set forth in the State's Single Audit Report for the year ended September 30, 2006. 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 land lease cases and other claims against the State exist at September 30, 2006 in the amount of approximately \$14.5 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, 2006, the loan balance is \$3,461,734.

General Fund Financial Position

The State's General Fund has sustained recurring operating deficits and has an unreserved fund deficit of \$27,639,954 at September 30, 2006. In addition, at September 30, 2006, the primary government's current liabilities exceed current assets by \$17,871,868.

Management of the State has entered into a memorandum of understanding with the FSM National Government to outline reform measures to address the deficit. The plan includes the following:

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(8) Contingencies, Continued

General Fund Financial Position, Continued

- Chuuk State will sell off its stock holdings or investments.
- Chuuk State will sell the Chuuk State Medical Referral House in Honolulu.
- Chuuk State will adopt measures to control the General Fund expenditures for the remainder of the FY07. Such include moratorium of hiring, salary increases and other spending, such as travel.
- Chuuk State agreed to before the end of FY07, shall work to balance its proposed FY08 budget and to include a provision to reduce the budget deficit by \$1M.
- Chuuk State agreed to eliminate 400 positions from its operations budget. The elimination will involve two phases: 200 positions by March 31, 2008, and the other 200 by March 31, 2009.
- Chuuk State will work to restructure its state government to include restructuring the Chuuk Legislature into a unicameral legislature. The State agreed to make sure voting on the Legislature restructuring constitutional amendment is on the March 2009 General Ballot.
- Chuuk State will develop a public awareness program to educate the Chuukese people about the imminent need for reform.

Management of the State believes that the actions above will provide the State the opportunity to commence the process of reducing the General Fund deficit position.

(9) Individual Deficit Fund Balances

Specific individual funds which had significant individual deficit fund balances as at September 30, 2006, are as follows:

Major Governmental Funds

General Fund	\$ <u>18,533,096</u>
U.S. Federal Grants	\$ <u>269,998</u>

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2006

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Schedule of Revenues, Expenditures and Changes in Deficit
Budget and Actual - General Fund
Year Ended September 30, 2006

	Budgeted Amounts		Actual - Budgetary Basis (see Note 1)	Variance with Final Budget - Positive (Negative)
	Original	Final		
Revenues:				
Local revenues	\$ 6,377,926	\$ 5,800,968	\$ 6,926,849	\$ 1,125,881
Net increase in the fair value of investments	-	-	788,228	788,228
Total revenues	6,377,926	5,800,968	7,715,077	1,914,109
Expenditures:				
Current:				
General government	4,185,919	4,105,856	4,094,865	10,991
Health services	10,000	15,000	-	15,000
Education	-	-	(12,023)	12,023
Economic development	-	-	132	(132)
Public safety	259,976	282,173	339,187	(57,014)
Public works and transportation	1,073,371	1,205,929	1,237,280	(31,351)
Community affairs	-	-	280,242	(280,242)
Boards and commissions	191,825	191,825	185,681	6,144
Judiciary	213,588	213,558	159,860	53,698
Payments to component units	65,000	65,000	102,433	(37,433)
Municipal affairs	6,592,946	6,540,231	4,335,285	2,204,946
Other	3,792,017	3,188,112	2,369,869	818,243
Total expenditures	16,384,642	15,807,684	13,092,811	2,714,873
Deficiency of revenues under expenditures	(10,006,716)	(10,006,716)	(5,377,734)	4,628,982
Other financing sources:				
Loan proceeds	-	-	161,379	161,379
Transfers in from other funds	-	-	6,400,000	6,400,000
Total other financing sources	-	-	6,561,379	6,561,379
Net change in deficit	(10,006,716)	(10,006,716)	1,183,645	11,190,361
Other changes in unreserved deficit				
Decrease in reserve for continuing appropriations	-	-	(2,040,969)	(2,040,969)
Unreserved deficit at the beginning of the year	(26,782,630)	(26,782,630)	(26,782,630)	-
Unreserved deficit at the end of the year	\$ (36,789,346)	\$ (36,789,346)	\$ (27,639,954)	\$ 9,149,392

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, 2006

(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.

For the year ended September 30, 2006, expenditures of the General Fund exceeded budget at the program area level (i.e., legal level of budgetary control as follows:

<u>Program Area</u>	<u>Excess</u>
Economic Development	\$ 132
Public Safety	\$ 57,014
Public Works and Transportation	\$ 31,351
Community Affairs	\$ 280,242
Payments to Component Unites	\$ 37,433

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2006

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

GENERAL FUND

September 30, 2006

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, 2006
(with comparative totals for the year ended September 30, 2005)

	<u>2006</u>	<u>2005</u>
Revenues:		
FSM revenue sharing	2,926,387	2,828,658
Excise taxes:		
Sales tax	1,182,811	1,231,063
Hotel	137,255	137,259
Tobacco	86,023	73,201
Alcoholic beverages	123,014	105,135
Delinquent tax collections	53,926	27,989
Other excise taxes	147,254	166,212
	<u>1,730,283</u>	<u>1,740,859</u>
Fees and charges:		
Licenses and permits	158,829	178,494
Leases and other rentals	29,641	10,169
	<u>188,470</u>	<u>188,663</u>
Departmental charges:		
Transportation collections	489,961	514,977
Net increase in the fair value of investments	788,228	2,200,242
Other revenues	1,591,748	59,670
Total revenues	<u>7,715,077</u>	<u>7,533,069</u>
Expenditures:		
Current:		
General government:		
Office of the Governor	752,582	648,901
State Legislature	3,205,914	3,193,218
Department of Treasury	151,412	346,063
	<u>4,109,908</u>	<u>4,188,182</u>
Education:		
Department of Education	-	12,294
Economic Development:		
Department of Agriculture	-	1,491
Department of Commerce and Industry	-	49,737
Department of Marine Resources	992	7,985
	<u>992</u>	<u>59,213</u>

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, 2006
(with comparative totals for the year ended September 30, 2005)

	2006	2005
Expenditures, continued:		
Current, continued:		
Public Safety:		
Office of the Attorney General	201,259	9,062
Department of Public Safety	136,467	91,864
	337,726	100,926
Public Works and Transportation:		
Department of Transportation	1,237,222	1,416,659
Community Affairs:		
Department of Public Affairs	280,905	270,089
Boards and Commissions:		
Chuuk Recreation Board	58,753	75,020
Environmental Protection Agency	99	6,099
Election Commission	95,136	316,741
Mortlocks Commission	24,990	18,750
Faichuk Commission	19,841	19,974
	198,819	436,584
Judiciary:		
State Court	159,860	3,523
Payments to component units:		
Chuuk Coconut Authority	50,255	64,940
Chuuk State Housing Authority	52,178	85,074
	102,433	150,014
Municipal Affairs:		
Payments to municipalities	4,176,643	1,042,459
Other:		
Small Business Development Center	1,688	(5,189)
Farmers Home Administration	50,525	47,165
Land lease and acquisition	-	527,481
Disaster assistance	19,108	173,424
Legal services	10,000	40,000
Red Cross	21,987	32,222
Peace Corps	7,575	10,800
Other	2,265,287	1,828,587
	2,376,170	2,654,490
Total expenditures	12,980,678	10,334,433
Deficiency of revenues under expenditures	(5,265,601)	(2,801,364)
Other financing sources:		
Loan proceeds	161,379	480,160
Transfers in from other funds	6,400,000	-
Total other financing sources	6,561,379	480,160
Net change in deficit	1,295,778	(2,321,204)
Deficit at the beginning of the year	(19,828,874)	(17,507,670)
Deficit at the end of the year	\$ (18,533,096)	\$ (19,828,874)

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, 2006

	Budgeted Amounts		Actual Budgetary Basis (see Note 1)	Variance with Final Budget Positive(Negative)
	Original	Final		
Revenues:				
Local revenues	\$ 6,377,926	\$ 5,800,968	\$ 6,926,849	\$ 1,125,881
Net increase in the fair value of investments	-	-	788,228	788,228
Total revenues	6,377,926	5,800,968	7,715,077	1,914,109
Expenditures:				
Current:				
General government:				
Office of the Governor	680,200	632,048	756,176	(124,128)
State Legislature	3,144,275	3,128,128	3,187,277	(59,149)
Department of Treasury	361,444	345,680	151,412	194,268
	<u>4,185,919</u>	<u>4,105,856</u>	<u>4,094,865</u>	<u>10,991</u>
Health Services:				
Department of Health Services	10,000	15,000	-	15,000
Education:				
Department of Education	-	-	(12,023)	12,023
Economic Development:				
Department of Marine Resources	-	-	992	(992)
Department of Commerce and Industry	-	-	(860)	860
	<u>-</u>	<u>-</u>	<u>132</u>	<u>(132)</u>
Public Safety:				
Office of Attorney General	179,976	179,978	202,720	(22,742)
Department of Public Safety	80,000	102,195	136,467	(34,272)
	<u>259,976</u>	<u>282,173</u>	<u>339,187</u>	<u>(57,014)</u>
Public Works and Transportation:				
Department of Transportation	1,073,371	1,205,929	1,237,280	(31,351)
Community Affairs:				
Department of Public Affairs	-	-	280,242	(280,242)
Boards and Commissions:				
Chuuk Recreation Board	54,783	54,783	53,884	899
Education board	-	-	99	(99)
Election Commission	87,042	87,042	86,867	175
Mortlocks Commission	25,000	25,000	24,990	10
Faichuk Commission	25,000	25,000	19,841	5,159
	<u>191,825</u>	<u>191,825</u>	<u>185,681</u>	<u>6,144</u>
Judiciary:				
State Court	213,588	213,558	159,860	53,698
Payments to component units:				
Chuuk Coconut Authority	20,000	20,000	50,255	(30,255)
Chuuk State Housing Authority	45,000	45,000	52,178	(7,178)
	<u>65,000</u>	<u>65,000</u>	<u>102,433</u>	<u>(37,433)</u>
Municipal Affairs:				
Payments to municipalities	6,592,946	6,540,231	4,335,285	2,204,946
Other:				
Small Business Development Center	-	-	1,688	(1,688)
Claims and Judgements	1,800,000	1,675,000	-	1,675,000
Farmers Home Administration	47,500	47,500	50,525	(3,025)
Disaster assistance	-	-	19,108	(19,108)
Legal services	-	-	10,000	(10,000)
Red Cross	25,000	25,000	24,646	354
Peace Corps	10,800	10,800	7,575	3,225
Other	1,908,717	1,429,812	2,256,327	(826,515)
	<u>3,792,017</u>	<u>3,188,112</u>	<u>2,369,869</u>	<u>818,243</u>
Total expenditures	16,384,642	15,807,684	13,092,811	2,714,873
Deficiency of revenues under expenditures	(10,006,716)	(10,006,716)	(5,377,734)	4,628,982
Other financing sources:				
Loan proceeds	-	-	161,379	161,379
Transfers in from other funds	-	-	6,400,000	6,400,000
Total other financing sources	-	-	6,561,379	6,561,379
Net change in deficit	(10,006,716)	(10,006,716)	1,183,645	11,190,361
Other changes in unreserved deficit:				
Increase in reserve for continuing appropriations	-	-	(2,040,969)	(2,040,969)
Unreserved deficit at the beginning of the year	(26,782,630)	(26,782,630)	(26,782,630)	-
Unreserved deficit at the end of the year	\$ (36,789,346)	\$ (36,789,346)	\$ (27,639,954)	\$ 9,149,392

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS - SPECIAL REVENUE FUNDS

September 30, 2006

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, 2006, follows:

Chuuk Airport Authority Fund

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

CFSM Grants Fund

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

Compact Other Grants Fund

This fund accounts for the following funds received under the Compact of Free Association:

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, 2006

	<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	\$ 1,132,673	\$ -	\$ 1,438,358	\$ 2,691,746	\$ 5,262,777
Total assets	<u>\$ 1,132,673</u>	<u>\$ -</u>	<u>\$ 1,438,358</u>	<u>\$ 2,691,746</u>	<u>\$ 5,262,777</u>
<u>LIABILITIES AND FUND BALANCES</u>					
Liabilities:					
Accounts payable	\$ 4,292	\$ 19,113	\$ 91,413	\$ 1,563,963	\$ 1,678,781
Due to other funds	-	25,485	-	-	25,485
Total liabilities	<u>4,292</u>	<u>44,598</u>	<u>91,413</u>	<u>1,563,963</u>	<u>1,704,266</u>
Fund balances:					
Reserved for:					
Related assets	1,128,381	-	1,346,945	1,127,783	3,603,109
Encumbrances	-	4,528	1,089	9,140	14,758
Unreserved (deficit)	<u>-</u>	<u>(49,126)</u>	<u>(1,089)</u>	<u>(9,140)</u>	<u>(59,355)</u>
Total fund balances	<u>1,128,381</u>	<u>(44,598)</u>	<u>1,346,945</u>	<u>1,127,783</u>	<u>3,558,511</u>
Total liabilities and fund balances	<u>\$ 1,132,673</u>	<u>\$ -</u>	<u>\$ 1,438,358</u>	<u>\$ 2,691,746</u>	<u>\$ 5,262,777</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, 2006

	Chuuk Airport Authority	CFSM Grants	Compact Other Grants	Compact Special Block Section 221(b)	Total
Revenues:					
Fees and charges	\$ 61,020	\$ -	\$ -	\$ -	\$ 61,020
Total revenues	<u>61,020</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>61,020</u>
Expenditures by function:					
Current:					
Public Safety	-	44,598	-	-	44,598
Total expenditures	<u>-</u>	<u>44,598</u>	<u>-</u>	<u>-</u>	<u>44,598</u>
Net change in fund balances (deficits)	61,020	(44,598)	-	-	16,422
Fund balances at the beginning 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>
Fund balances (deficit) at the end of the year	<u>\$ 1,128,381</u>	<u>\$ (44,598)</u>	<u>\$ 1,346,945</u>	<u>\$ 1,127,783</u>	<u>\$ 3,558,511</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, 2006

	<u>Education Sector</u>	<u>Health Sector</u>	<u>Capacity Building Sector</u>	<u>Environment Sector</u>	<u>Private Sector Development</u>	<u>Supplemental Education</u>	<u>Total</u>
<u>ASSETS</u>							
Due from other funds	\$ 1,178,601	\$ 252,826	\$ -	\$ 111,842	\$ 25,011	\$ 799,065	\$ 2,367,345
Receivables	122,366	161,517	125,198	80,959	72,471	-	562,511
Prepayments	<u>1,370,806</u>	<u>67,697</u>	<u>16,844</u>	<u>62,655</u>	<u>-</u>	<u>-</u>	<u>1,518,002</u>
	<u>\$ 2,671,773</u>	<u>\$ 482,040</u>	<u>\$ 142,042</u>	<u>\$ 255,456</u>	<u>\$ 97,482</u>	<u>\$ 799,065</u>	<u>\$ 4,447,858</u>
<u>LIABILITIES AND FUND BALANCES (DEFICITS)</u>							
Liabilities:							
Accounts payable	\$ 1,300,967	\$ 414,343	\$ 116,431	\$ 192,801	\$ 97,482	\$ 179,281	\$ 2,301,305
Deferred revenue	-	-	-	-	-	619,784	619,784
Due to other funds	<u>-</u>	<u>-</u>	<u>8,767</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,767</u>
Total liabilities	<u>1,300,967</u>	<u>414,343</u>	<u>125,198</u>	<u>192,801</u>	<u>97,482</u>	<u>799,065</u>	<u>2,929,856</u>
Fund balances:							
Reserved for:							
Related assets	<u>1,370,806</u>	<u>67,697</u>	<u>16,844</u>	<u>62,655</u>	<u>-</u>	<u>-</u>	<u>1,518,002</u>
Total fund balances	<u>1,370,806</u>	<u>67,697</u>	<u>16,844</u>	<u>62,655</u>	<u>-</u>	<u>-</u>	<u>1,518,002</u>
Total liabilities and fund balances	<u>\$ 2,671,773</u>	<u>\$ 482,040</u>	<u>\$ 142,042</u>	<u>\$ 255,456</u>	<u>\$ 97,482</u>	<u>\$ 799,065</u>	<u>\$ 4,447,858</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, 2006

	Education Sector	Health Sector	Capacity Building Sector	Environment Sector	Private Sector Development	Supplemental Education	Total
Revenues:							
Compact funding	\$ 8,303,649	\$ 5,297,670	\$ 2,329,252	\$ 634,506	\$ 1,277,650	\$ 2,915,342	\$ 20,758,069
	<u>8,303,649</u>	<u>5,297,670</u>	<u>2,329,252</u>	<u>634,506</u>	<u>1,277,650</u>	<u>2,915,342</u>	<u>\$ 20,758,069</u>
Expenditures by function:							
Current:							
General government	-	-	1,130,930	-	-	-	1,130,930
Health services	-	5,341,948	-	-	-	-	5,341,948
Education	7,271,484	-	-	-	-	2,915,342	10,186,826
Economic development	-	-	-	162,092	924,696	-	1,086,788
Public safety	-	-	900,460	-	-	-	900,460
Boards and commissions	5,374	-	-	441,277	142,854	-	589,505
Payment to component units	-	-	-	-	172,874	-	172,874
Judiciary	-	-	381,818	-	-	-	381,818
Other	-	-	-	11,482	97,101	-	108,583
Total expenditures	<u>7,276,858</u>	<u>5,341,948</u>	<u>2,413,208</u>	<u>614,851</u>	<u>1,337,525</u>	<u>2,915,342</u>	<u>19,899,732</u>
Net change in fund balances	1,026,791	(44,278)	(83,956)	19,655	(59,875)	-	858,337
Fund balances at the beginning of the year	<u>344,015</u>	<u>111,975</u>	<u>100,800</u>	<u>43,000</u>	<u>59,875</u>	<u>-</u>	<u>659,665</u>
Fund balances at the end of the year	<u>\$ 1,370,806</u>	<u>\$ 67,697</u>	<u>\$ 16,844</u>	<u>\$ 62,655</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,518,002</u>

See Accompanying Independent Auditors' Report.

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER
MATTERS BASED UPON THE ENGAGEMENT TO AUDIT FINANCIAL STATEMENTS
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, 2006, which collectively comprise the State's basic financial statements. Our report dated July 18, 2007, 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 and other claims 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 land acquisitions payable and the associated expenditure/expense recorded for the governmental activities and the General Fund; 6) our inability to determine the propriety of fixed assets, related accumulated depreciation and depreciation expense for the governmental activities; 7) our inability to determine the propriety of cash and cash equivalents, receivables, capital assets, accounts payable, and other liabilities and accruals of the Chuuk Public Utilities Corporation; and 8) the inclusion of unaudited financial statements of the Chuuk State Housing Authority.

Internal Control Over Financial Reporting

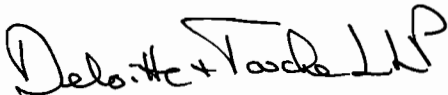
In planning our audit, we considered the State's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted 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 initiate, record, process, 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 68 through 128) as items 2006-14 through 2006-31.

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 2006-14 through 2006-31 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 2006-01 through 2006-13.

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". The signature is written in a cursive, stylized font.

July 18, 2007

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133 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, 2006. 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 68 through 128). 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 2006-01 through 2006-13 and 2006-26 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; matching, level of effort, earmarking; cash management; eligibility; and equipment and real property management that are applicable to its major federal programs as described in the Federal Award Findings and Questioned Cost Section of the accompanying Schedule Findings and Questioned Costs. 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, 2006.

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 2006-01 through 2006-13 and 2006-26.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 2006-01 through 2006-13 and 2006-26 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, 2006. Our report dated July 18, 2007, 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 and other claims 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 land acquisitions payable and the associated expenditure/expense recorded for the governmental activities and the General Fund; 6) our inability to determine the propriety of fixed assets, related accumulated depreciation and depreciation expense for the governmental activities; 7) our inability to determine the propriety of cash and cash equivalents, receivables, capital assets, accounts payable, and other liabilities and accruals of the Chuuk Public Utilities Corporation; and 8) the inclusion of unaudited financial statements of the Chuuk State Housing Authority. The accompanying Schedule of Expenditures of Federal Awards (pages 58 through 64) is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the basic 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.

Deloitte + Touche LLP

July 18, 2007

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Summary Schedule of Expenditures of Federal Awards, by Grantor
Year Ended September 30, 2006

Agency/Program	Expenditures
U.S. Department of Agriculture	\$ 61,286
U.S. Department of the Interior	20,032,579
U.S. Department of Labor	2,046,561
U.S. Department of Homeland Security	756,797
U.S. Department of Education	1,243,797
U.S. Department of Health and Human Services	<u>573,549</u>
GRAND TOTAL	<u>\$ 24,714,569</u>
Reconciliation to the basic financial statements:	
U.S. Federal Grants Fund	\$ 4,783,495
Less: WHO Grant - Non-U.S. Federal Grants	<u>(3,156)</u> \$ 4,780,339
Compact Sector Grants Fund	19,899,732
Compact Capital Projects Fund	<u>34,498</u>
	<u>\$ 24,714,569</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, 2006

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF AGRICULTURE		
Urban & Com. Forestry Prog.	10.675	\$ 35,574
Forest Stewardship	10.675	<u>25,712</u>
U.S. DEPARTMENT OF AGRICULTURE TOTAL		<u>\$ 61,286</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, 2006

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	\$ <u>34,498</u>
Compact Sector Grants - Capacity Build		2,413,208
Compact Sector Grants - Education		7,276,858
Supplemental Education Grant		2,915,342
Compact Sector Grants - Environment		614,851
Compact Sector Grants - Health		5,341,948
Compact Sector Grants - Private		<u>1,337,525</u>
Total Compact Sector Grants Fund	15.875	<u>19,899,732</u>
Law Enforcement Grant	15.875	25,000
Historic Preservation	15.904	<u>73,349</u>
U.S. DEPARTMENT OF THE INTERIOR TOTAL		\$ <u><u>20,032,579</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, 2006

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF LABOR		
WIA Administration	17.255	\$ 35,078
WIA Adult Program	17.258	265,152
WIA Youth Activities	17.259	125,337
WIA Dislocated Workers	17.260	438,153
WIA National Emergency/TS Chat	17.260	<u>1,182,841</u>
U.S. DEPARTMENT OF LABOR TOTAL		<u>\$ 2,046,561</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, 2006

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF HOMELAND SECURITY		
Public Assistance Project 1504	83.544	\$ 1,679
FEMA 1449 DR-FM PA (Pongsona)	83.544	574,912
FEMA 1427 DR-FM PA (Chaatan)	83.544	8,665
FEMA 1427 Sub-Grantee Admin	83.544	1,803
El Nino/ Drought Public Assistance	83.544	1,556
Hazard Mitigation#8 Agriculture Mitigation	83.544	147,580
Hazard Mitigation#13 Management Cost	83.544	<u>20,602</u>
U.S. DEPARTMENT OF HOMELAND SECURITY TOTAL		<u>\$ 756,797</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, 2006

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF EDUCATION		
School Improvement Project (SIP)	84.256A	\$ 105,933
BECLEPS (Bilingual Education)	84.290	251,438
Vocational Education Improvement Project	84.994	12,478
FY05 Special Education	84.027B	232,479
FY06 Special Education	84.027B	<u>641,469</u>
U.S. DEPARTMENT OF EDUCATION TOTAL		<u>\$ 1,243,797</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 # 84.256A, CFDA # 84.290, and CFDA # 84.994.

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, 2006

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES		
Children's Oral Care	93.110	3,322
T.B. Elimination	93.116	36,021
Family Planning	93.217	72,440
Immunization	93.268	127,319
Tobacco Prevention	93.283	5,039
H.I.V. Care	93.917	16,201
AIDS Prevention	93.940	46,830
AIDS Surveillance	93.944	11,232
Substance Abuse Mental Health	93.959	125,298
System Based Diabetes	93.988	19,260
Community Health Promotion	93.991	2,595
MCH Programs	93.994	<u>107,992</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES TOTAL		<u>\$ 573,549</u>
GRAND TOTAL		<u>\$ 24,714,569</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**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2006

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.

E. CFDA #15.875

CFDA #15.875 represents the Office of Insular Affairs (OIA), U. S. Department of the Interior. Funding from this source is subject to varying rules and regulations since OIA administers the Compact of Free Association, which is a treaty, and is not a federal program. The Compact is comprised of various funded programs, each with separate compliance requirements. To maximize audit coverage of OIA funding, the OIG has recommended that programs administered under CFDA #15.875 be grouped by like compliance requirements and such groupings be separately evaluated as major programs.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2006

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 2006 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 2006 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, 2006

<u>Grantor Program Title</u>	<u>CFDA No.</u>	<u>2006 Fiscal Year Expenditures</u>
<u>U.S. Department of the Interior</u> Compact of Free Association: Sector Grants	15.875	\$ 19,899,732
<u>U.S. Department of Labor</u> WIA Cluster	17.255/17.258/ 17.259/17.260	2,046,561
<u>U.S. Department of Education</u> Special Education – Grants to States	84.027	873,948
<u>U.S. Department of Homeland Security</u> Federal Emergency Management Agency: Public Assistance Grants	83.544/97.036	<u>756,797</u>
Total U.S. Federal program expenditures selected		\$ <u>23,577,038</u>
Total U.S. Federal program expenditures		\$ <u>24,714,569</u>
% of total U.S. Federal expenditures covered by major programs		<u>95%</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2006

Part I - Summary of Auditors' Results

1. The Independent Auditors' Report on the basic financial statements disclaimed an opinion on those financial statements due to: 1) our inability to obtain sufficient evidence regarding the State's investment in Chuuk Fresh Tuna, Inc.; 2) obligations for land leases and other claims 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 land acquisitions payable and the associated expenditure/expense recorded for the governmental activities and the General Fund; 6) our inability to determine the propriety of fixed assets, related accumulated depreciation and depreciation expense for the governmental activities; 7) our inability to determine the propriety of cash and cash equivalents, receivables, capital assets, accounts payable, and other liabilities and accruals of the Chuuk Public Utilities Corporation; and 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 basic financial statements were disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal award programs were identified, some of which are considered to be material weaknesses.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. The State's major programs were:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
U.S. Department of the Interior – Compact of Free Association, Sector Grants	15.875
U.S. Department of Education – Special Education	84.027
U.S. Department of Labor – WIA Cluster	17.255/17.258/ 17.259/17.260
U.S. Department of Homeland Security – FEMA Public Assistance Grant	83.544/97.036

8. A threshold of \$741,437 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, 2006

Part II - Financial Statement Findings Section

<u>Reference Number</u>	<u>Findings</u>
2006-14	Cash
2006-15	Accounts Receivable
2006-16	Accounts Payable
2006-17	Supporting Documents – Search for Unreconciled Liabilities
2006-18	Recording – Search for Unreconciled Liabilities
2006-19	Travel Advances
2006-20	Encumbrances
2006-21	Recording – Expenditures
2006-22	Expenditures
2006-23	Annual Leave
2006-24	Employee Ceiling
2006-25	Revenue
2006-26	Implementation of Fixed Assets for GASB Statement No. 34
2006-27	Compact Capital Debt Remaining Unpaid
2006-28	Accounting System Access
2006-29	Investment Balance Reconciliations
2006-30	Land Acquisition Payables
2006-31	Appropriations

Part III - Federal Award Findings and Questioned Cost Section

<u>Reference Number</u>	<u>CDFA Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
2006-01	15.875	Allowable Costs/Cost Principles and Procurement	\$267,429
2006-02	15.875	Allowable Costs/Cost Principles	\$121,272
2006-03	17.255/17.258/ 17.259/17.260	Eligibility	\$ 23,144
2006-04	17.255/17.258/ 17.259/17.260	Allowable Costs/Cost Principles and Procurement	\$103,081
2006-05	17.255/17.258/ 17.259/17.260	Cash Management	Undeterminable
2006-06	17.255/17.258/ 17.259/17.260	Allowable Costs/Cost Principles	\$125,171
2006-07	83.544/97.036	Allowable Costs/Cost Principles and Procurement	\$66,102
2006-08	83.544/97.036	Matching Requirement	\$187,900
2006-09	83.544/97.036	Cash Management	Undeterminable
2006-10	83.544/97.036	Allowable Costs/Cost Principles	\$1,154
2006-11	84.027	Cash Management	Undeterminable
2006-12	84.027	Allowable Costs/Cost Principles and Procurement	\$42,020
2006-13	84.027	Allowable Costs/Cost Principles	\$21,714
2006-26	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, 2006

Finding No.: 2006-01
 CFDA#: 15.875
 Agency: U.S. Department of the Interior, Office of Insular Affairs
 Grant: Compact Sector Grants
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Cost: \$267,429

Criteria: In accordance with applicable Allowable Costs/Cost Principles, expenditures should be necessary and reasonable for program needs and should be executed in accordance with program objectives. Additionally, in accordance with applicable procurement requirements, the grantee shall maintain sufficient documentation to detail the significant history of the procurement, including the rationale for the method of procurement, selection of contract type, contractor selection or rejection and the basis for the contract price. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

Conditions:

1. For 24 (or 26%) of 93 non-payroll expenditures (\$155,980 of the aggregate amount of \$2,174,951 tested), no financial records (purchase order, vendor invoices, receiving reports, competitive procurement documentation, etc.) were on file to substantiate the expenditure and its relationship to the program.

Fund Acct	Fund Description	Acct	APV	Transaction Amount	Support Needed
721401	Education Administration	8311	JVC72013	\$ 28,350	Vendor Invoice, Receiving Report
731201	Hospital & Management	8314	60016960	12,118	Receiving Report
731201	Hospital & Management	8311	60083010	14,987	Vendor Invoice, Receiving Report
751159	Environmental Protection Agency	8110	66028480	5,671	Trip Report, Boarding Passes, Expense Receipts
761503	C&I Investment & Economic Research Grant	8201	60040800	15,000	Vendor Invoice, Receiving Report
771401	Supplemental Education Grant	8405	JVL60029	500	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Procurement Documents
771401	Supplemental Education Grant	8405	JVL60029	200	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Procurement Documents
771401	Supplemental Education Grant	8405	JVL60030	692	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Procurement Documents
771401	Supplemental Education Grant	8405	JVL60036	808	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Procurement Documents
771401	Supplemental Education Grant	8405	JVL60036	525	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Procurement Documents
771401	Supplemental Education Grant	8405	JVL60029	18,778	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Procurement Documents
721411	Elementary Education	8303	60116770	19,166	P.O., Purchase Requisition, Vendor Invoice, Receiving Report,
731201	Hospital & Management	8314	60041300	10,584	Vendor Invoice, Receiving Report,
771401	Supplemental Education Grant	8405	JVL60040	17,501	P.O., Purchase Requisition, Vendor Invoice, Receiving Report
771401	Supplemental Education Grant	8405	JVL60022	<u>11,000</u>	P.O., Purchase Requisition, Vendor Invoice, Receiving Report
Total				<u>\$155,980</u>	

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-01, Continued
 CFDA#: 15.875
 Agency: U.S. Department of the Interior, Office of Insular Affairs
 Grant: Compact Sector Grants
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Cost: \$267,429

Conditions, Continued

2. For 2 (or 2%) of 87 non-payroll expenditures (\$39,475 of the aggregate amount of \$2,079,699 tested), a specific brand name was specified on the request for quotations. The request did not include "or equivalent" to allow a broader range of responses and therefore, the manner in which the request occurred appears to have limited competition without adequate explanation.

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>APV</u>	<u>Transaction Amount</u>
751159	Environmental Protection Agency	8210	60004390	\$24,475
761503	C&I Investment & Economic Research	8201	60040800	<u>15,000</u>
				<u>\$39,475</u>

3. For 17 (or 20%) of 87 non-payroll expenditures (\$92,645 of the aggregate amount of \$2,079,699 tested), no evidence supporting that competitive procurement procedures occurred was provided.

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>APV</u>	<u>Transaction Amount</u>
721411	Elementary Education	8304	60075210	\$30,777
731201	Hospital & Management	8405	60048300	14,963
741121	Tax & Revenue	8110	66010830	2,680
751159	Environmental Protection Agency	8110	66028480	5,671
761955	CSBDC	8110	66030340	4,945
771401	Supplemental Education Grant	8302	60053900	19,700
771401	Supplemental Education Grant	8303	60079450	9,660
771401	Supplemental Education Grant	8110	66008000	<u>4,249</u>
			Total	<u>\$92,645</u>

4. For 6 (or 7%) of 87 non-payroll expenditures (\$144,047 of the aggregate amount of \$2,079,699 tested), no rationale for vendor selection was documented on file. Based on our understanding of the program and the surrounding conditions, it appears reasonable for the selection of the vendor; however, there is no documented rationale of such.

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>APV</u>	<u>Transaction Amount</u>
721401	Education Administration	8302	60050070	\$ 27,261
721421	Secondary Education	8405	60100110	30,151
731201	Hospital & Management	8311	60100720	25,129
731201	Hospital & Management	8311	60083010	14,987
771401	Supplemental Education Grant	8405	60084860	23,896
771401	Supplemental Education Grant	8405	60084810	<u>22,623</u>
			Total	<u>\$144,047</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-01, Continued
CFDA#: 15.875
Agency: U.S. Department of the Interior, Office of Insular Affairs
Grant: Compact Sector Grants
Requirement: Allowable Costs/Cost Principles and Procurement
Questioned Cost: \$267,429

Cause: There appears to be a lack of internal controls over record keeping and ensuring that program expenditures are substantiated by such financial records as vendor invoices, and receiving reports, etc., and that applicable procurement requirements are properly applied.

Effect: The State appears to be in noncompliance with applicable allowable costs/cost principles and competitive procurement requirements. Although the aggregate amount of all the conditions listed above is \$432,147, a total of \$15,000 from condition two (APV 60040800) and a total of \$5,671 from condition three (APV 66028480) have already been questioned at condition one above and will be excluded in determining the final questioned cost amount. Additionally a total of \$144,047 from condition four does not result in a questioned cost and will be excluded in determining the final questioned cost. Therefore, a total questioned cost of \$267,429 exists.

Prior Year Status: The above conditions are reiterative of conditions identified in our prior year audit of the program.

Recommendation: The State should comply with the criteria.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Chuuk State Finance acknowledges its problems with internal controls over recordkeeping and filing. We believe these problems do not represent substantive program non-compliance but rather failure to adequately file supporting documents for easy retrieval. We note that documentation for all sector expenditures had been approved by the Chuuk Financial Control Commission (CFCC) prior to making the expenditures. Chuuk State Finance will change its filing system to allow for document retention of the complete package pertaining to an expenditure. These will include all documents evidencing competitive procurement, bid awards and vendor selection. These procedures will be in place by December 2007

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-02
 CFDA#: 15.875
 Agency: U.S. Department of the Interior, Office of Insular Affairs
 Grant: Compact Sector Grants
 Requirement: Allowable Costs/Cost Principles
 Questioned Cost: \$121,272

Criteria: In accordance with applicable Allowable Costs/Cost Principles, expenditures should be in 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.

Conditions:

- For 59 (or 34%) of 174 payroll expenditures (\$71,255 of the aggregate amount of \$6,946,815 tested), no financial records (personnel action form, timesheet and/or pay register) were on file to substantiate the expenditure and its relationship to the program.

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>APV</u>	<u>Employee</u>	<u>Transaction Amount</u>	<u>Support Needed</u>
721411	ELEMENTARY EDUCATION	8010	7	611149	\$ 2,083	Personnel Action Form
721411	ELEMENTARY EDUCATION	8010	18	24104	1,235	Personnel Action Form
721411	ELEMENTARY EDUCATION	8010	8	24104	647	Personnel Action Form
721411	ELEMENTARY EDUCATION	8010	23	41338	788	Personnel Action Form
721411	ELEMENTARY EDUCATION	8010	10	32586	421	Personnel Action Form
721411	ELEMENTARY EDUCATION	8010	20	41203	923	Personnel Action Form
721411	ELEMENTARY EDUCATION	8010	15	18083	909	Personnel Action Form
721421	SECONDARY EDUCATION	8010	9	22422	970	Personnel Action Form
721421	SECONDARY EDUCATION	8010	1	40151	1,018	Personnel Action Form
721421	SECONDARY EDUCATION	8010	19	22422	970	Personnel Action Form
721421	SECONDARY EDUCATION	8010	6	35101	1,880	Personnel Action Form
721421	SECONDARY EDUCATION	8010	12	13221	788	Personnel Action Form
721421	SECONDARY EDUCATION	8010	17	51040	692	Personnel Action Form
721421	SECONDARY EDUCATION	8010	18	24269	691	Personnel Action Form
721421	SECONDARY EDUCATION	8010	13	22422	647	Personnel Action Form
721411	ELEMENTARY EDUCATION	8010	1	31477	554	Personnel Action Form
721411	ELEMENTARY EDUCATION	8010	26	18085	410	Personnel Action Form
721411	ELEMENTARY EDUCATION	8010	8	22573	611	Personnel Action Form
721411	ELEMENTARY EDUCATION	8010	16	609552	437	Personnel Action Form
721411	ELEMENTARY EDUCATION	8010	10	32882	421	Personnel Action Form
731206	NURSING	8010	21	15190	505	Personnel Action Form
741951	JUDICIARY	8010	26	1011	8,631	Personnel Action Form
741624	OPERATION	8010	6	63189	663	Personnel Action Form
741624	OPERATION	8010	26	33981	345	Personnel Action Form
751159	ENVIRON.PROTECTION AGENCY	8010	25	99711	6,923	Personnel Action Form
751159	ENVIRON.PROTECTION AGENCY	8010	15	99711	1,538	Personnel Action Form
761152	LAND COMMISSION	8010	18	21856	519	Personnel Action Form

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-02, Continued
 CFDA#: 15.875
 Agency: U.S. Department of the Interior, Office of Insular Affairs
 Grant: Compact Sector Grants
 Requirement: Allowable Costs/Cost Principles
 Questioned Cost: \$121,272

Conditions, Continued:

Fund Acct	Fund Description	Acct	APV	Employee	Transaction Amount	Support Needed
761152	LAND COMMISSION	8010	21	18195	323	Personnel Action Form
761152	LAND COMMISSION	8010	3	13718	623	Personnel Action Form
721411	ELEMENTARY EDUCATION	8010	11	55465	1,274	Personnel Action Form & Timesheet
721421	SECONDARY EDUCATION	8010	24B	53421	489	Personnel Action Form & Timesheet
721411	ELEMENTARY EDUCATION	8010	3	608256	891	Personnel Action Form & Timesheet
721411	ELEMENTARY EDUCATION	8010	2	63021	884	Personnel Action Form & Timesheet
771401	SEG	8010	23B	22519	2,769	Personnel Action Form & Timesheet
771401	SEG	8010	14E	19663	120	Personnel Action Form & Timesheet
721411	ELEMENTARY EDUCATION	8010	24B	31432	1,955	Timesheet
721411	ELEMENTARY EDUCATION	8010	3	49198	1,382	Timesheet
721411	ELEMENTARY EDUCATION	8010	1	8908	562	Timesheet
721411	ELEMENTARY EDUCATION	8010	2	18084	1,107	Timesheet
721421	SECONDARY EDUCATION	8010	3	13221	788	Timesheet
721421	SECONDARY EDUCATION	8010	23	25792	691	Timesheet
721421	SECONDARY EDUCATION	8010	2	604428	1,229	Timesheet
721421	SECONDARY EDUCATION	8010	21	40141	1,413	Timesheet
731201	HOSPITAL & MANAGEMENT	8010	21	603666	749	Timesheet
731201	HOSPITAL & MANAGEMENT	8010	1	619540	2,008	Timesheet
771401	SEG	8010	23B	23025	2,885	Timesheet
771401	SEG	8010	25B	10161	1,538	Timesheet
771401	SEG	8010	4	67402	4,149	Timesheet
771401	SEG	8010	1	33550	1,385	Timesheet
771401	SEG	8010	6	26424	846	Timesheet
731206	NURSING	8012	9	1241	2,616	Personnel Action Form
741061	BUDGET	8012	06C	610810	1,569	Timesheet
721411	ELEMENTARY EDUCATION	8014	25	28656	67	Personnel Action Form
721411	ELEMENTARY EDUCATION	8014	7	611149	179	Personnel Action Form
721411	ELEMENTARY EDUCATION	8014	16	32882	41	Personnel Action Form
721411	ELEMENTARY EDUCATION	8014	4	31458	68	Personnel Action Form
761152	LAND COMMISSION	8014	20	21856	88	Personnel Action Form
721411	ELEMENTARY EDUCATION	8014	3	49198	123	Timesheet
771401	SEG	8014	23B	31227	225	Timesheet
					<u>\$71,255</u>	

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-02, Continued
 CFDA#: 15.875
 Agency: U.S. Department of the Interior, Office of Insular Affairs
 Grant: Compact Sector Grants
 Requirement: Allowable Costs/Cost Principles
 Questioned Cost: \$121,272

Conditions, Continued:

2. For 65 (or 37%) of 174 payroll expenditures (\$50,017 of the aggregate amount of \$6,946,815 tested), we noted a difference in the recalculation of gross pay.

Fund Acct	Fund Description	Acct	APV	Employee	Hours Per Labor Cost	Hours per Timesheet	Hours Difference	Gross Pay per Labor Cost	Gross Pay per DTT Recalculation	Gross Pay Difference
721411	ELEMENTARY EDUCATION	8010	6	56448	864	904	40	\$ 1,295	\$ 1,355	\$ 60
721411	ELEMENTARY EDUCATION	8010	17	56015	144	432	288	433	1,298	865
721411	ELEMENTARY EDUCATION	8010	4	8749	112	112	0	537	1,237	700
721411	ELEMENTARY EDUCATION	8010	13	31402	72	72	0	786	171	615
721411	ELEMENTARY EDUCATION	8010	14	8908	72	72	0	562	506	56
721411	ELEMENTARY EDUCATION	8010	22	49102	144	144	0	489	460	29
721411	ELEMENTARY EDUCATION	8010	5	8908	72	72	0	562	506	56
721411	ELEMENTARY EDUCATION	8010	7	18076	432	432	0	1,661	1,571	90
721411	ELEMENTARY EDUCATION	8014	26	49122	72	72	0	69	277	208
721421	SECONDARY EDUCATION	8010	11	703611	1,224	1,288	64	2,612	2,749	137
721421	SECONDARY EDUCATION	8010	25	29692	336	272	64	799	647	152
731201	HOSPITAL & MANAGEMENT	8010	20	52239	80	168	88	5,693	1,565	4,128
731201	HOSPITAL & MANAGEMENT	8010	19	619364	160	240	80	970	1,925	955
731201	HOSPITAL & MANAGEMENT	8010	23	601104	288	160	128	1,745	1,944	199
731201	HOSPITAL & MANAGEMENT	8010	11	29737	144	216	72	1,080	2,145	1,065
731201	HOSPITAL & MANAGEMENT	8010	18	99888	464	232	232	4,808	2,431	2,377
731201	HOSPITAL & MANAGEMENT	8010	16	606719	144	216	72	997	2,200	1,203
731201	HOSPITAL & MANAGEMENT	8010	5	99888	264	352	88	1,558	4,259	2,701
731201	HOSPITAL & MANAGEMENT	8010	26	22626	144	72	72	442	369	73
731201	HOSPITAL & MANAGEMENT	8010	8	99888	160	240	80	1,154	2,546	1,392
731201	HOSPITAL & MANAGEMENT	8010	7	99888	160	240	80	1,154	2,546	1,392

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-02, Continued
 CFDA#: 15.875
 Agency: U.S. Department of the Interior, Office of Insular Affairs
 Grant: Compact Sector Grants
 Requirement: Allowable Costs/Cost Principles
 Questioned Cost: \$121,272

Conditions, Continued:

Fund Acct	Fund Description	Acct	APV	Employee	Hours Per Labor Cost	Hours per Timesheet	Hours Difference	Gross Pay per Labor Cost	Gross Pay per DTT Recalculation	Gross Pay Difference
731201	HOSPITAL & MANAGEMENT	8010	6	611368	160	240	80	1,292	2,852	1,560
731201	HOSPITAL & MANAGEMENT	8010	14	72249	144	216	72	997	2,200	1,203
731201	HOSPITAL & MANAGEMENT	8010	22	26421	72	88	16	727	963	236
731201	HOSPITAL & MANAGEMENT	8010	2	611368	160	240	80	1,292	2,852	1,560
731201	HOSPITAL & MANAGEMENT	8010	3	50974	216	288	72	2,132	3,629	1,497
731201	HOSPITAL & MANAGEMENT	8010	12	68850	144	216	72	997	2,200	1,203
731201	HOSPITAL & MANAGEMENT	8010	20	55495	144	216	72	4,956	2,200	2,756
731201	HOSPITAL & MANAGEMENT	8014	4	68850	176	144	32	167	2,000	1,833
731201	HOSPITAL & MANAGEMENT	8010	4	24287	176	176	0	1,988	1,884	104
731201	HOSPITAL & MANAGEMENT	8010	25	56461	654	654	0	7,455	8,974	1,519
731201	HOSPITAL & MANAGEMENT	8010	10	52239	168	168	0	1,284	2,528	1,244
731201	HOSPITAL & MANAGEMENT	8010	24	611368	376	376	0	4,200	5,056	856
731201	HOSPITAL & MANAGEMENT	8010	17	99888	464	464	0	4,808	5,787	979
731201	HOSPITAL & MANAGEMENT	8010	13	49219	144	144	0	997	1,200	203
731201	HOSPITAL & MANAGEMENT	8010	15	74486	144	144	0	997	1,200	203
731201	HOSPITAL & MANAGEMENT	8010	9	27960	144	144	0	1,142	1,904	762
731201	HOSPITAL & MANAGEMENT	8010	20	24287	144	144	0	4,555	1,375	3,180
731201	HOSPITAL & MANAGEMENT	8014	18	57152	144	144	0	178	2,000	1,822
731201	HOSPITAL & MANAGEMENT	8014	10	57152	152	152	0	193	2,111	1,918
731206	NURSING	8010	10	1241	88	90	2	811	676	135
731206	NURSING	8010	22	28715	134	80	54	561	467	94
731206	NURSING	8012	20	607171	314	166	148	836	299	537
731206	NURSING	8010	25	53125	88	88	0	607	514	93
741624	OPERATION	8010	3	60007	182	236	54	418	428	10

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-02, Continued
 CFDA#: 15.875
 Agency: U.S. Department of the Interior, Office of Insular Affairs
 Grant: Compact Sector Grants
 Requirement: Allowable Costs/Cost Principles
 Questioned Cost: \$121,272

Conditions, Continued:

Fund Acct	Fund Description	Acct	APV	Employee	Hours Per Labor Cost	Hours per Timesheet	Hours Difference	Gross Pay per Labor Cost	Gross Pay per DTT Recalculation	Gross Pay Difference
741624	OPERATION	8010	15	73800	360	380	20	729	769	40
741624	OPERATION	8010	23	38755	144	206	62	907	1,190	283
741624	OPERATION	8010	5	14494	126	180	54	316	484	168
741624	OPERATION	8010	7	601951	126	180	54	289	369	80
741624	OPERATION	8014	20	38755	126	72	54	69	416	347
741624	OPERATION	8010	1	38755	108	108	0	674	624	50
741624	OPERATION	8010	20	64064	262	262	0	574	696	122
741624	OPERATION	8010	17	45898	112	112	0	265	380	115
741624	OPERATION	8010	22	58864	72	72	0	216	191	25
741624	OPERATION	8010	4	33981	112	112	0	374	300	74
741624	OPERATION	8010	10	601951	72	72	0	260	198	62
741624	OPERATION	8010	2	42773	72	72	0	394	191	203
741624	OPERATION	8010	8	64191	72	72	0	284	323	39
741624	OPERATION ENVIRON.PROTECTION	8014	3	29679	136	136	0	35	122	87
751159	AGENCY LAND	8010	10	26475	210	72	138	4,038	1,385	2,653
761152	COMMISSION	8010	25	75007	72	72	0	162	176	14
771401	SEG	8010	18	54036	144	160	16	647	719	72
771401	SEG	8010	3	23025	72	80	8	865	962	97
771401	SEG	8010	19	23279	128	136	8	614	652	38
771401	SEG	8010	15	41362	72	80	8	623	775	152
771401	SEG	8010	9	67596	80	80	0	1,846	450	<u>1,396</u>
										<u>\$50,017</u>

Cause: There appears to be a lack of internal controls over record keeping and ensuring that program expenditures are substantiated by such financial records as personnel action forms and timesheets.

Effect: The State appears to be in noncompliance with applicable allowable costs/cost principles and a questioned cost of \$121,272 exists.

Prior Year Status: The above condition is reiterative of conditions identified in our prior year audit of the program.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.:	2006-02, Continued
CFDA#:	15.875
Agency:	U.S. Department of the Interior, Office of Insular Affairs
Grant:	Compact Sector Grants
Requirement:	Allowable Costs/Cost Principles
Questioned Cost:	\$121,272

Recommendation: The State should comply with the criteria.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The Chuuk State Personnel Office and Chuuk State Finance have failed to maintain a system to allow for proper filing of personnel action forms and timesheets. In some cases, irregularities in employee payments have resulted. Chuuk State Finance will obtain all current personnel action forms for active employees, maintain for easy retrieval all department timesheets, and review its editing procedures to ensure all payroll charges are supported by timesheets and properly approved personnel action forms. These procedures will be in place by December, 2007.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-03
 CFDA#: 17.255/17.258/17.259/17.260
 Agency: U.S. Department of Labor
 Grant: WIA Cluster
 Requirement: Eligibility
 Questioned Cost: \$23,144

Criteria: In accordance with applicable eligibility requirements, such documents as Eligibility Review and Verification Forms should be maintained on file to substantiate the eligibility determinations.

Conditions:

1. For 32 (or 71%) of 45 WIA participants, no form of identification (birth certificate, passport, social security card, etc.) was on file to substantiate that the participant was authorized to work in the Chuuk. The grant award from the FSM National Government, states that only eligible individuals residing in the service delivery area may be served. However, the grant award does not specifically state that copies of the applicable identification must be kept on file. Furthermore, we were unable to verify that the participants were in fact, individuals of the service delivery area. However, based on review of the participant data, the surname appears to be of Chuukese descent. Therefore, no questioned costs have resulted from this matter.
2. For 12 (or 27%) of 45 WIA participants (\$9,624 of the aggregate amount of \$62,237 tested), we noted no documentation to support that at least one intensive service was provided prior to the applicant receiving training.

<u>Selection No.</u>	<u>Implementation Date</u>	<u>Cost</u>	<u>Type of Program</u>
3	09/11/05	\$1,102	Dislocated
4	11/13/05	80	Dislocated
11	09/11/05	1,723	Dislocated
17	11/13/05	80	Dislocated
19	05/22/05	1,300	Adult
23	09/11/05	1,102	Dislocated
26	11/13/05	80	Dislocated
27	09/11/05	1,102	Dislocated
30	09/11/05	1,723	Dislocated
35	11/13/05	80	Dislocated
41	07/03/05	1,172	Adult
42	11/13/05	<u>80</u>	Dislocated
Total		<u>\$9,624</u>	

3. For 12 (or 27%) of 45 WIA participants (\$14,782 of the aggregate amount of \$62,237 tested), no documentation was on file to support that a career strategy plan was performed for the applicant.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-03, Continued
 CFDA#: 17.255/17.258/17.259/17.260
 Agency: U.S. Department of Labor
 Grant: WIA Cluster
 Requirement: Eligibility
 Questioned Cost: \$23,144

Conditions:

<u>Selection No.</u>	<u>Implementation Date</u>	<u>Cost</u>	<u>Type of Program</u>
1	10/02/05	\$ 1,300	Dislocated
4	11/13/05	80	Dislocated
9	12/11/05	1,300	Dislocated
18	11/13/05	1,625	Dislocated
27	09/11/05	1,102	Dislocated
32	10/31/05	1,625	Dislocated
35	11/13/05	80	Dislocated
36	10/02/05	1,300	Dislocated
37	10/26/05	1,723	Adult
38	08/14/05	1,625	Adult
39	11/28/05	1,300	Dislocated
45	03/12/06	<u>1,722</u>	Dislocated
	Total	<u>\$14,782</u>	

4. For 2 (or 4%) of 45 WIA participants (\$3,022 of the aggregate amount of \$62,237 tested), we could not locate evidence that the Career Training Plan was approved by the WIA administrator. Additionally, no training contract was documented on file.

<u>Selection No.</u>	<u>Implementation Date</u>	<u>Cost</u>	<u>Type of Program</u>
19	05/22/05	\$1,300	Adult
45	03/12/06	<u>1,722</u>	Dislocated
	Total	<u>\$3,022</u>	

Cause: There appears to be weak internal controls over ensuring compliance with applicable eligibility requirements.

Effect: The State is in noncompliance with applicable eligibility requirements. Although the aggregate amount of all the conditions listed above is \$27,428, a total of \$1,262 from condition three (selection nos. 4, 27, 35) and a total of \$3,022 from condition four (selection nos. 19, and 45) have already been questioned at conditions two and three above and will be excluded in determining the final questioned cost amount. Therefore, a total questioned cost of \$23,144 exists.

Recommendation: The State should comply with the criteria.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.:	2006-03, Continued
CFDA#:	17.255/17.258/17.259/17.260
Agency:	U.S. Department of Labor
Grant:	WIA Cluster
Requirement:	Eligibility
Questioned Cost:	\$23,144

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Chuuk State Finance will work with the WIA Coordinator to ensure WIA eligibility is properly documented, intensive service properly approved prior to participant training, career strategy plans are performed and documented, Career Training Plans are approved by the WIA coordinator, and all training contracts are on file. These procedures will be in place by December 2007.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-04
 CFDA#: 17.255/17.258/17.259/17.260
 Agency: U.S. Department of Labor
 Grant: WIA Cluster
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Cost: \$103,081

Criteria: In accordance with applicable Allowable Costs/Cost Principles, expenditures should be necessary and reasonable for program needs and should be executed in accordance with program objectives. Additionally, in accordance with applicable procurement requirements, the grantee shall maintain sufficient to detail the significant history of procurement, including the rationale for the method of procurement, selection of contract type, contractor selection or rejection and the basis for the contract price. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

Conditions:

1. For 20 (or 43%) of 46 non-payroll expenditures (\$48,799 of the aggregate amount of \$1,131,253 tested), no financial records (purchase order, vendor invoices, receiving reports, competitive procurement documentation, etc.) were on file to substantiate the expenditure and its relationship to the program.

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>APV</u>	<u>Transaction Amount</u>	<u>Support Needed</u>
301001	Governor's Office/Disaster Office	8455	60030460	\$ 70	Contract
301001	Governor's Office/Disaster Office	8455	JVF06017	850	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents
301001	Governor's Office/Disaster Office	8405	60017240	53	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents
301001	Governor's Office/Disaster Office	8405	JVF06016	11,200	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents
301001	Governor's Office/Disaster Office	8405	JVF06016	300	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents
301001	Governor's Office/Disaster Office	8405	JVF06016	1,400	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents
301001	Governor's Office/Disaster Office	8401	JVF06029	125	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents
301001	Governor's Office/Disaster Office	8401	JFV03023	8,849	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents
301001	Governor's Office/Disaster Office	8401	JVF06010	72	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-04, Continued
 CFDA#: 17.255/17.258/17.259/17.260
 Agency: U.S. Department of Labor
 Grant: WIA Cluster
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Cost: \$103,081

Conditions, Continued:

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>APV</u>	<u>Transaction Amount</u>	<u>Support Needed</u>
301001	Governor's Office/Disaster Office	8401	JVF06016	1,440	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents
301001	Governor's Office/Disaster Office	8401	JVF06018	144	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents
301001	Governor's Office/Disaster Office	8401	JVF06011	240	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents
301001	Governor's Office/Disaster Office	8401	JVF06029	2,080	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents
301001	Governor's Office/Disaster Office	8401	JVF06020	2,080	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents
301001	Governor's Office/Disaster Office	8401	JVF06010	1,200	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents
301001	Governor's Office/Disaster Office	8401	JVF06016	1,400	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents
301001	Governor's Office/Disaster Office	8401	JVF06016	1,440	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents
301001	Governor's Office/Disaster Office	8401	JVF06018	2,400	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents
301001	Governor's Office/Disaster Office	8301	60046100	9,860	Vendor Invoice, Receiving Report
301001	Governor's Office/Disaster Office	8101	66020100	3,596	P.O., Purchase Requisition, Vendor Invoice, Receiving Report, Contract, Procurement Documents
			Total	\$ <u>48,799</u>	

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-04, Continued
 CFDA#: 17.255/17.258/17.259/17.260
 Agency: U.S. Department of Labor
 Grant: WIA Cluster
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Cost: \$103,081

Conditions, Continued:

2. For 8 (or 17%) of 46 non-payroll expenditures tested (\$37,930 of the aggregate amount of \$1,131,253 tested), no certification from a training instructor was on file certifying the attendance of the instructor and attendees was on file to substantiate the expenditure.

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>APV</u>	<u>Transaction Amount</u>
301001	Governor's Office/Disaster Office	8455	60030460	\$ 70
301001	Governor's Office/Disaster Office	8455	60019470	300
301001	Governor's Office/Disaster Office	8455	60027290	300
301001	Governor's Office/Disaster Office	8401	60052330	150
301001	Governor's Office/Disaster Office	8401	60058940	36,400
301001	Governor's Office/Disaster Office	8401	60083510	80
301001	Governor's Office/Disaster Office	8401	60060970	150
301001	Governor's Office/Disaster Office	8401	60043920	480
Total				<u>\$37,930</u>

3. For 19 (or 41%) of 46 non-payroll expenditures (\$54,352 of the aggregate amount of \$1,131,253 tested), no evidence in support of competitive procurement activities was provided. The State's procedures do not comply with federal requirements and are not enforced. Therefore, the State has not implemented competitive procurement requirements that are in compliance with federal requirements.

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>APV</u>	<u>Transaction Amount</u>
301001	Governor's Office/Disaster Office	8455	60030460	\$ 70
301001	Governor's Office/Disaster Office	8455	60019470	300
301001	Governor's Office/Disaster Office	8455	60027290	300
301001	Governor's Office/Disaster Office	8455	60028410	300
301001	Governor's Office/Disaster Office	8455	60019650	480
301001	Governor's Office/Disaster Office	8455	60012050	2,106
301001	Governor's Office/Disaster Office	8401	60052330	150
301001	Governor's Office/Disaster Office	8401	60055720	150
301001	Governor's Office/Disaster Office	8401	60050840	520
301001	Governor's Office/Disaster Office	8401	60050940	1,315
301001	Governor's Office/Disaster Office	8401	60058940	36,400
301001	Governor's Office/Disaster Office	8401	60083510	80
301001	Governor's Office/Disaster Office	8401	60060970	150
301001	Governor's Office/Disaster Office	8401	60060630	225
301001	Governor's Office/Disaster Office	8401	60073920	480

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-04, Continued
 CFDA#: 17.255/17.258/17.259/17.260
 Agency: U.S. Department of Labor
 Grant: WIA Cluster
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Cost: \$103,081

Conditions, Continued:

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>APV</u>	<u>Transaction Amount</u>
301001	Governor's Office/Disaster Office	8401	60107080	9,360
301001	Governor's Office/Disaster Office	8110	66003880	676
301001	Governor's Office/Disaster Office	8101	66087300	1,008
301001	Governor's Office/Disaster Office	8101	66008600	<u>282</u>
			Total	<u>\$54,352</u>

Cause: There appears to be a lack of internal controls over record keeping and ensuring that program expenditures are substantiated by such financial records as vendor invoices, and receiving reports, etc., and that applicable procurement requirements are properly applied.

Effect: The State appears to be in noncompliance with applicable allowable costs/cost principles and competitive procurement requirements. Although the aggregate amount of all the conditions listed above is \$141,081, a total of \$70 from condition two (APV 60030460) and a total of \$37,930 from condition three (APV's 60030460, 60019470, 60027290, 60052330, 60058940, 60083510, 60060970 and 60043920) have already been questioned at conditions one and two above and will be excluded in determining the final questioned cost amount. Therefore, a total questioned cost of \$103,081 exists.

Recommendation: The State should comply with the criteria.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Chuuk State Finance acknowledges its prior deficiencies in maintaining an adequate filing system to support WIA program expenditures but believes these problems do not represent substantive program non-compliance but rather failures to retain supporting documents to evidence such. In May 2007, authority over WIA program expenditures were transferred to the local finance office of the FSM National Government. Additionally, Chuuk State Finance will work with the Disaster Office to better document and support WIA program compliance. These procedures will be in place by December 2007.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-05
CFDA#: 17.255/17.258/17.259/17.260
Agency: U.S. Department of Labor
Grant: WIA Cluster
Requirement: Cash Management
Questioned Cost: Undeterminable

Criteria: In accordance with applicable cash management requirements, the time elapsed between the receipt of Federal funds and the clearance of disbursed checks should be minimized. The specified clearance pattern for Chuuk is three days. Furthermore, any amount of interest from advances over \$100 should be returned to the Federal government.

Condition: For 46 (or 100%) of 46 non-payroll expenditures (\$1,131,253 of the aggregate amount of \$1,131,253 tested), we were unable to perform required cash management tests as the detailed federal draw downs and supporting reimbursements were not made available for review.

Cause: There appears to be weak internal controls over ensuring compliance with applicable cash management requirements.

Effect: The State appears to be in noncompliance with applicable cash management requirements.

Recommendation: The State should comply with the criteria.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Whereas it is true a cash management study has not been performed on WIA drawdowns and payments, Chuuk State Finance notes that WIA drawdowns were previously done on a reimbursement basis through a pass-through arrangement with the FSM National Government. In May 2007, the FSM National government became responsible for WIA disbursements. This arrangement, it is felt, will better allow for an adequate cash management study to be performed.

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FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-06
 CFDA#: 17.255/17.258/17.259/17.260
 Agency: U.S. Department of Labor
 Grant: WIA Cluster
 Requirement: Allowable Costs/Cost Principles
 Questioned Cost: \$125,171

Criteria: In accordance with applicable Allowable Costs/Cost Principles, 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 115 (or 88%) of 131 payroll expenditures tested (\$125,171 of the aggregate amount of \$142,931 tested), no financial records (personnel action form, timesheet and/or pay register) were on file to substantiate the expenditure and its relationship to the program.

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>APV</u>	<u>Employee</u>	<u>Transaction Amount</u>	<u>Support Needed</u>
301001	GOVERNOR'S OFFICE/DISASTER OFF	8014	4	602981	\$ 12	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	24A	615620	500	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8014	03B	602982	60	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8014	05D	600945	84	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8014	07D	611208	86	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8014	07D	18019	86	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8014	10M	916754	96	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8014	10M	604150	115	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	4	64032	240	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	4	69811	200	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	4	619300	108	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	4	69811	200	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	20A	53016	2,080	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	20A	601881	1,040	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	20A	704039	2,080	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	16C	619983	2,080	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	16B	18288	160	Personnel Action Form & Timesheet

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-06, Continued
 CFDA#: 17.255/17.258/17.259/17.260
 Agency: U.S. Department of Labor
 Grant: WIA Cluster
 Requirement: Allowable Costs/Cost Principles
 Questioned Cost: \$125,171

Condition, Continued:

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>APV</u>	<u>Employee</u>	<u>Transaction Amount</u>	<u>Support Needed</u>
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	16B	58763	720	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	16B	68815	2,080	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	16B	600594	1,280	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	16B	619367	2,080	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	03B	31391	1,000	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	03B	45617	1,000	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	03B	56327	800	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	03B	612605	1,000	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	03B	612964	800	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	03B	53135	1,000	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	03B	51221	1,000	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	03B	64032	1,200	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	03B	72036	1,200	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	05D	1858	1,120	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	05D	4827	1,120	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	05D	14267	1,120	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	05D	18013	1,120	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	05D	18170	1,120	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	05D	20962	1,120	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	05D	28616	1,400	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	05D	43769	1,400	Personnel Action Form & Timesheet

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-06, Continued
 CFDA#: 17.255/17.258/17.259/17.260
 Agency: U.S. Department of Labor
 Grant: WIA Cluster
 Requirement: Allowable Costs/Cost Principles
 Questioned Cost: \$125,171

Condition, Continued:

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>APV</u>	<u>Employee</u>	<u>Transaction Amount</u>	<u>Support Needed</u>
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	05D	600945	1,400	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	05D	619440	1,400	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	05D	619750	1,120	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	05D	611883	1,120	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	05D	613134	1,120	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	05D	610561	11,200	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07D	907918	1,440	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07D	914478	1,440	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07D	651318	1,440	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07D	618195	320	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07D	615467	1,440	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07D	610022	1,440	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07D	610116	1,440	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07D	51221	400	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07D	53104	1,440	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07D	53443	1,440	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07D	46425	1,440	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07D	58848	320	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07D	614018	1,440	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07D	614726	1,440	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07D	615343	1,440	Personnel Action Form & Timesheet

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-06, Continued
 CFDA#: 17.255/17.258/17.259/17.260
 Agency: U.S. Department of Labor
 Grant: WIA Cluster
 Requirement: Allowable Costs/Cost Principles
 Questioned Cost: \$125,171

Condition, Continued:

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>APV</u>	<u>Employee</u>	<u>Transaction Amount</u>	<u>Support Needed</u>
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07D	42654	1,800	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10B	18013	480	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10B	21821	480	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10B	33494	2,400	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10B	32572	1,440	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10B	42654	600	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10B	613955	540	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10B	614762	540	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10B	40063	1,600	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10B	53001	1,760	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10B	48524	1,600	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10B	51200	1,600	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10B	60081	1,600	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10B	69771	1,616	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10B	85552	1,600	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10B	600543	1,600	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10B	609688	1,600	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10M	33494	2,400	Personnel Action Form & Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	11B	608651	308	Personnel Action Form
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	20B	608651	277	Personnel Action Form
301001	GOVERNOR'S OFFICE/DISASTER OFF	8014	21A	609628	56	Timesheet

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-06, Continued
 CFDA#: 17.255/17.258/17.259/17.260
 Agency: U.S. Department of Labor
 Grant: WIA Cluster
 Requirement: Allowable Costs/Cost Principles
 Questioned Cost: \$125,171

Condition, Continued:

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>APV</u>	<u>Employee</u>	<u>Transaction Amount</u>	<u>Support Needed</u>
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	02C	603181	1,000	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	02B	76513	1,080	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	02B	60984	175	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07C	602030	125	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	26C	607993	600	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	02B	616665	250	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	02B	77407	146	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	02B	77407	146	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	02B	619032	375	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	02B	610414	313	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	24A	7047	525	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	24A	619115	938	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	03B	513936	250	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	05B	615910	250	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	24A	616614	500	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	01B	609427	875	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	01B	619515	313	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	09B	38652	1,063	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	01B	16545	313	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07C	618632	1,250	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07C	618632	1,250	Timesheet

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-06, Continued
 CFDA#: 17.255/17.258/17.259/17.260
 Agency: U.S. Department of Labor
 Grant: WIA Cluster
 Requirement: Allowable Costs/Cost Principles
 Questioned Cost: \$125,171

Condition, Continued:

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>APV</u>	<u>Employee</u>	<u>Transaction Amount</u>	<u>Support Needed</u>
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	05B	609192	960	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	21A	42772	1,437	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	07C	618632	1,250	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	26C	33550	5,469	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	26B	611862	625	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	03B	619191	750	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	21A	617559	938	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	22A	614239	875	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	25B	614944	813	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	16B	32514	713	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	03B	62182	1,200	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	03B	32514	1,000	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	03B	62182	1,200	Timesheet
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	10B	62182	<u>720</u>	Timesheet
					<u>\$ 125,171</u>	

Cause: There appears to be a lack of internal controls over record keeping and ensuring that program expenditures are substantiated by such financial records as personnel action forms and timesheets.

Effect: The State appears to be in noncompliance with applicable allowable costs/cost principles and a questioned cost of \$125,171 exists.

Recommendation: The State should comply with the criteria.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.:	2006-06, Continued
CFDA#:	17.255/17.258/17.259/17.260
Agency:	U.S. Department of Labor
Grant:	WIA Cluster
Requirement:	Allowable Costs/Cost Principles
Questioned Cost:	\$125,171

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. In May 2007, the FSM National Government was given responsibility over WIA payroll to better ensure adequate documentation of WIA payroll expenditures with properly approved timesheets and personnel action forms.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-07
 CFDA#: 83.544/97.036
 Agency: U.S. Department of Homeland Security
 Grant: Public Assistance Grants
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Cost: \$66,102

Criteria: In accordance with applicable Allowable Costs/Cost Principles, expenditures should be necessary and reasonable for program needs and should be executed in accordance with program objectives. Additionally, in accordance with applicable procurement requirements, the grantee shall maintain sufficient documentation to detail the significant history of the procurement, including the rationale for the method of procurement, selection of contract type, contractor selection or rejection and the basis for the contract price. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

Conditions:

1. For 3 (or 6%) of 48 non-payroll expenditures (\$4,561 of the aggregate amount of \$1,105,341 tested), no financial records (purchase order, vendor invoices, receiving reports, competitive procurement documentation, etc.) were on file to substantiate the expenditure and its relationship to the program.

<u>FundAcct</u>	<u>Acct</u>	<u>APV</u>	<u>Transaction Amount</u>	<u>Support Needed</u>
301037	8405	6008513	\$ 56	P.O., Purchase Requisition, Vendor Invoice, Receiving Report
301037	8405	6004635	250	P.O., Purchase Requisition, Vendor Invoice, Receiving Report
301037	8301	6011086	<u>4,255</u>	Vendor Invoice, Receiving Report
		Total	<u>\$4,561</u>	

2. For 2 (or 4%) of 48 non-payroll expenditures (\$5,255 of the aggregate amount of \$1,105,341 tested), the purchase order was approved subsequent to the purchase and receipt of goods.

<u>Fund Acct</u>	<u>Acct</u>	<u>APV</u>	<u>Transaction Amount</u>
301037	8301	6011485	\$1,000
301037	8301	6011086	<u>4,255</u>
		Total	<u>\$5,255</u>

3. For 26 (or 54%) of 48 non-payroll expenditures (\$66,102 of the aggregate amount of \$1,105,341 tested), no evidence supporting that competitive procurement procedures occurred was provided.

<u>Fund Acct</u>	<u>Acct</u>	<u>APV</u>	<u>Transaction Amount</u>
301036	8405	6004365	\$250
301037	8405	6008513	56
301037	8405	6004860	90
301037	8405	6004779	110
301037	8405	6001309	125

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-07, Continued
 CFDA#: 83.544/97.036
 Agency: U.S. Department of Homeland Security
 Grant: Public Assistance Grants
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Cost: \$66,102

Conditions, Continued:

<u>Fund Acct</u>	<u>Acct</u>	<u>APV</u>	<u>Transaction Amount</u>
301037	8405	6002919	194
301037	8405	6004635	250
301037	8405	6008514	603
301037	8405	6011536	1,000
301037	8405	6007606	10,480
301001	8302	6000990	183
301001	8302	6001022	302
301001	8302	6007604	2,055
301001	8302	6009249	7,000
301001	8302	6004675	14,000
301001	8302	6004676	14,000
301036	8302	6600564	625
301037	8302	6009389	2,400
301001	8301	6008807	820
301001	8301	6008806	1,660
301037	8301	6006052	350
301037	8301	6000956	441
301037	8301	6006475	520
301037	8301	6011485	1,000
301037	8301	6006475	3,333
301037	8301	6011086	<u>4,255</u>
		Total	<u>\$66,102</u>

Cause: There appears to be a lack of internal controls over record keeping and ensuring that program expenditures are substantiated by such financial records as vendor invoices, and receiving reports, etc., and that applicable procurement requirements are properly applied.

Effect: The State appears to be in noncompliance with applicable allowable costs/cost principles and competitive procurement requirements. Although the aggregate amount of all the conditions listed above is \$75,918 a total of \$4,561 from condition three (APV's 6008513, 6004635, 6011485 and 6011086) have already been questioned at conditions one and two above and will be excluded in determining the final questioned cost amount. Additionally, a total of \$5,255 from condition two does not result in a questioned cost. Therefore, a total questioned cost of \$66,102 exists.

Prior Year Status: The above conditions are reiterative of conditions identified in our prior year audit of the program.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.:	2006-07, Continued
CFDA#:	83.544/97.036
Agency:	U.S. Department of Homeland Security
Grant:	Public Assistance Grants
Requirement:	Allowable Costs/Cost Principles and Procurement
Questioned Cost:	\$66,102

Recommendation: The State should comply with the criteria.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Chuuk State Finance acknowledges its prior deficiencies in maintaining an adequate filing system to support Department of Homeland Security program expenditures but believes these problems do not represent substantive program non-compliance but rather failures to retain supporting documents to evidence such. In May 2007, authority over FEMA program expenditures were transferred to the local finance office of the FSM National Government. Additionally, Chuuk State Finance will work with the Disaster Office to better document and support WIA program compliance. These procedures will be in place by December 2007.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-08
 CFDA#: 83.544/97.036
 Agency: U.S. Department of Homeland Security
 Grant: Public Assistance Grants
 Requirement: Matching Requirement
 Questioned Cost: \$187,900

Criteria: In accordance with applicable matching requirements as specified in the FEMA-Chuuk State agreement - Chata'an Disaster, the maximum Federal share of the eligible cost cannot exceed 90%, FEMA-Chuuk State agreement - Pongsona Disaster, the maximum Federal share of the eligible cost cannot exceed 75% and the HMGP-Chuuk State Agreement states the maximum Federal share of the eligible cost cannot exceed 75%.

Condition: For 37 (or 77%) of 48 non-payroll expenditures (\$531,767 of the aggregate amount of \$1,105,341 tested), we were unable to determine if the specified matching requirements were applied or recorded as we could find no record of the match within the State's financial statements. Furthermore, based on review of the total expenditures, we recalculated the matching requirement as follows.

Fund Acct	Cost Center	Fund Description	Expenditures	Matching Requirement %	Estimated Matching Requirement \$
301036	TX7203	FEMA 1427 CHAATAN	\$ 7,932	10%	\$ 793
301036	TX7204	FEMA 1427 CHAATAN	733	10%	73
301037	TX7301	FEMA 1449 PONGSANA	564,342	25%	141,086
301037	TX7302	FEMA 1449 PONGSANA	10,570	25%	2,643
301037	TX7404	O.I. STORAGE TANKS	1,556	25%	389
301037	TX7405	1427 HMGP #2,SUBGRANTEE ADMIN.	1,803	25%	451
301001	TX7406	AGRI MITIGATION HMGP#8	6,898	25%	1,725
301001	TX7408	AGRI MITIGATION HMGP#8	140,681	25%	35,170
301001	TX7410	HMGP#13 MGT COST	20,602	25%	5,151
301001	TX7501	PA PROJECT 1504	<u>1,679</u>	25%	<u>420</u>
Total			<u>\$756,796</u>		<u>\$187,900</u>

Cause: There appears to be weak internal controls over ensuring compliance with applicable matching requirements.

Effect: The State appears to be in noncompliance with applicable matching requirements and a questioned cost of \$187,900 exists.

Recommendation: The State should comply with the criteria.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. We note, that although program matching amounts were appropriated by the Chuuk State Legislature, Chuuk State Finance did not establish the appropriate accounts in the general fund to document compliance with the requirements for typhoon Chaatan and Pongsana. This problem will be corrected in Fiscal Year 2007.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-09
CFDA#: 83.544/97.036
Agency: U.S. Department of Homeland Security
Grant: Public Assistance Grants
Requirement: Cash Management
Questioned Cost: Undeterminable

Criteria: In accordance with applicable cash management requirements, the time elapsed between the receipt of Federal funds and the clearance of disbursed checks should be minimized. The clearance pattern for Chuuk is understood to generally be three days. Furthermore, any amount of interest from advances over \$100 should be returned to the Federal government.

Condition: For 48 (or 100%) of 48 non-payroll expenditures (\$1,105,341 of the aggregate amount of \$1,105,341 tested), we were unable to perform required cash management tests as the detailed federal draw downs and supporting reimbursements were not made available for review.

Cause: There appears to be weak internal controls over ensuring compliance with applicable cash management requirements.

Effect: The State appears to be in noncompliance with applicable cash management requirements.

Recommendation: The State should comply with the criteria.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Whereas it is true a cash management study has not been performed on Department of Homeland Security drawdowns and payments, Chuuk State Finance notes that Homeland Security drawdowns were previously done on a reimbursement basis through a pass-through arrangement with the FSM National Government. In May 2007, the FSM National government became responsible for these disbursements. This arrangement, it is felt, will better allow for an adequate cash management study to be performed.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-10
 CFDA#: 83.544/97.036
 Agency: U.S. Department of Homeland Security
 Grant: Public Assistance Grants
 Requirement: Allowable Costs/Cost Principles
 Questioned Cost: \$1,154

Criteria: In accordance with applicable Allowable Costs/Cost Principles, 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 2 (or 100%) of 2 payroll expenditures (\$1,154 of the aggregate amount of \$1,154 tested), no timesheet was on file to substantiate the expenditure and its relationship to the program.

Fund <u>Acct</u>	<u>Fund Description</u>	<u>Acct</u>	Pay <u>Period</u>	<u>Employee</u>	Transaction <u>Amount</u>
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	20A	29684	\$ 577
301001	GOVERNOR'S OFFICE/DISASTER OFF	8010	06A	29684	<u>577</u>
				Total	<u>\$1,154</u>

Cause: There appears to be a lack of internal controls over record keeping and ensuring that program expenditures are substantiated by such financial records as personnel action forms and timesheets.

Effect: The State appears to be in noncompliance with applicable allowable costs/cost principles and a questioned cost of \$1,154 exists. Although the actual questioned cost is less than \$10,000, this finding is considered reportable because the total projected questioned cost exceeds the threshold.

Prior Year Status: The above conditions are reiterative of conditions identified in our prior year audit of the program.

Recommendation: The State should comply with the criteria.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Beginning May 2007, Department of Homeland Security payrolls are being processed by the local finance office of the FSM National Government. It is felt this procedure will better allow for the retention of timesheets supporting payroll charges for the program. Additionally, Chuuk State Finance will obtain all current personnel action forms for active employees, maintain for easy retrieval all department timesheets, and review its editing procedures to ensure all payroll charges are supported by timesheets and properly approved personnel action forms. These procedures will be in place by December, 2007.

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FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-11
CFDA#: 84.027
Agency: U.S. Department of Education
Grant: Special Education
Requirement: Cash Management
Questioned Cost: Undeterminable

Criteria: In accordance with applicable cash management requirements, the time elapsed between the receipt of Federal funds and the clearance of disbursed checks should be minimized. The specified clearance pattern for Chuuk is three days. Furthermore, any amount of interest from advances over \$100 should be returned to the Federal government.

Condition: For 42 (or 93%) of 45 non-payroll expenditures (\$128,897 of the aggregate amount of \$140,216 tested), we were unable to perform required cash management tests as the detailed federal draw downs and supporting reimbursements were not available for review.

Cause: There appears to be weak internal controls over ensuring compliance with applicable cash management requirements.

Effect: The State may be in noncompliance with applicable cash management requirements.

Recommendation: The State should comply with the criteria.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Whereas it is true a cash management study has not been performed on Special Education drawdowns and payments, Chuuk State Finance notes that SEPIIE drawdowns were previously done on a reimbursement basis through a pass-through arrangement with the FSM National Government. That is, the State first spent its local revenues before requesting through the FSM reimbursement from the US Federal government. In May 2007, the FSM National government became responsible for special Education disbursements. This arrangement, it is felt, will better allow for an adequate cash management study to be performed.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-12
 CFDA#: 84.027
 Agency: U.S. Department of Education
 Grant: Special Education
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Costs: \$42,020

Criteria: In accordance with applicable Allowable Costs/Cost Principles, expenditures should be necessary and reasonable for program needs and should be executed in accordance with program objectives. Additionally, in accordance with applicable procurement requirements, the grantee shall maintain sufficient to detail the significant history of procurement, including the rationale for the method of procurement, selection of contract type, contractor selection or rejection and the basis for the contract price. Furthermore, financial and programmatic records should be maintained on file for at least 3 years.

Conditions:

1. For 6 (or 13%) of 45 non-payroll expenditures (\$14,846 of the aggregate amount of \$140,216 tested), there were either partial or no financial and/or programmatic records (contract, receiving report, boarding pass, etc.) were on file to substantiate the following transactions.

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct No</u>	<u>APV</u>	<u>Transaction Amount</u>	<u>Support Needed</u>
301401	Education Administration	8110	660127901	\$ 2,830	Trip Report, Boarding Passes, Expense Receipts
301401	Education Administration	8303	601271501	2,250	Vendor Invoice, Receiving Report
301401	Education Administration	8303	601271502	2,200	Vendor Invoice, Receiving Report
301401	Education Administration	8303	601301104	1,613	Vendor Invoice, Receiving Report
301401	Education Administration	8405	601193001	2,250	Contract does not specify dollar amount.
301401	Education Administration	8455	JVF06035	<u>3,703</u>	Trip Report, Boarding Passes, Expense Receipts
Total				<u>\$14,846</u>	

2. For 12 (or 27%) of 45 non-payroll expenditures (\$34,007 of the aggregate amount of \$140,216 tested), no evidence supporting that competitive procurement procedures occurred was provided.

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct No</u>	<u>APV</u>	<u>Transaction Amount</u>
301401	Education Administration	8101	660110101	\$ 3,184
301401	Education Administration	8101	660090901	3,063
301401	Education Administration	8101	660093102	2,260
301401	Education Administration	8110	660127901	2,830
301401	Education Administration	8110	660128201	2,830
301401	Education Administration	8110	660093602	1,882
301401	Education Administration	8301	600358201	2,550

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FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-12, Continued
 CFDA#: 84.027
 Agency: U.S. Department of Education
 Grant: Special Education
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Costs: \$42,020

Conditions, Continued:

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct No</u>	<u>APV</u>	<u>Transaction Amount</u>
301401	Education Administration	8301	600509801	2,550
301401	Education Administration	8405	660294301	3,749
301401	Education Administration	8405	601193001	2,250
301401	Education Administration	8455	JVF06035	3,703
301401	Education Administration	8455	JVF06031	<u>3,156</u>
Total				<u>\$ 34,007</u>

3. For 1 (or 2%) of 45 non-payroll expenditures tested, the price quotation submitted by one vendor for three units of computers appears to have been altered from \$2,050 to \$2,550 per unit.

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct No</u>	<u>APV</u>	<u>Original Amount</u>	<u>Altered amount</u>	<u>Quantity purchased</u>	<u>Questioned Cost</u>
301401	Education Administration	8201	601216901	\$2,050	\$2,550	3 units	\$1,500

4. For 1 (or 2%) of 45 non-payroll expenditures tested, the grantee did not select the lowest bidder and justification for such selection was not documented in the bidding documents. The lowest bid for 50 boxes of short duplicating paper was \$56 per box. However, the papers were purchased at \$65 per box.

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct No</u>	<u>APV</u>	<u>Purchase price</u>	<u>Lowest bid</u>	<u>Quantity purchased</u>	<u>Questioned cost</u>
301401	Education Administration	8303	601217302	\$65	\$56	50 boxes	\$450

5. For 1 (or 2%) of 45 non-payroll expenditures tested, the price quotation submitted by the vendor for 250 units of story books was only \$4.95 per unit. However, the books were purchased at \$6.45 per unit.

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct No</u>	<u>APV</u>	<u>Purchase price</u>	<u>Price quoted</u>	<u>Quantity purchased</u>	<u>Questioned cost</u>
301401	Education Administration	8303	601301104	\$6.45	\$4.95	250 units	\$375

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-12, Continued
 CFDA#: 84.027
 Agency: U.S. Department of Education
 Grant: Special Education
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Costs: \$42,020

Conditions, Continued:

6. For 1 (or 2%) of 45 non-payroll expenditures tested (\$5,437 of the aggregate amount of \$140,216 tested), no rationale for vendor selection was documented on file. Based on our understanding of the program and the surrounding conditions, it appears reasonable for the selection of the vendor however there is no documented rationale of such.

<u>Fund</u> <u>Acct</u>	<u>Fund Description</u>	<u>Acct</u> <u>No</u>	<u>APV</u>	<u>Transaction</u> <u>Amount</u>
301401	Education Administration	8101	601160301	\$5,437

Cause: There appears to be a lack of internal controls over record keeping and ensuring that program expenditures are substantiated by such financial records as vendor invoices, and receiving reports, etc., and that applicable procurement requirements are properly applied.

Effect: The State appears to be in noncompliance with applicable allowable costs/cost principles and competitive procurement requirements. Although the aggregate amount of all the conditions listed above is \$56,615, a total of \$8,783 from condition two (APV's 660127901, 601193001 and JVF06035) and a total of \$375 from condition five (APV 601301104) have already been questioned at condition one above and will be excluded in determining the final questioned cost amount. Additionally, a total of \$5,437 from condition six does not result in a questioned cost. Therefore, a total questioned cost of \$42,020 exists.

Prior Year Status: The above conditions are reiterative of conditions identified in our prior year audit of the program.

Recommendation: The State should comply with the criteria.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. While acknowledging previous problems regarding internal controls over documenting expenditures, Chuuk State Finance believes the problems to not represent substantive non-compliance with Special Education policies but rather pertain more to failure to retain supporting documentation in a manner that facilitates easy retrieval. It is true that competitive procurement was not obtained for off-island travel but Chuuk State is serviced by only one airline and itineraries have previously been sole sourced through this carrier; the audit requirement for obtaining additional quotes for travel outside Micronesia is new. In May 2007, the FSM National government was given authority to process expenditures pertaining to the Special Education program and we believe this will better facilitate document retention to support Special Education procurement and expenditures.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-13
 CFDA#: 84.027
 Agency: U.S. Department of Education
 Grant: Special Education
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$21,714

Criteria: In accordance with applicable Allowable Costs/Cost Principles, 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 and approved personnel action forms and timesheets should reflect balances contained in the payroll register.

Conditions:

1. For 20 (or 26%) of 76 payroll expenditures (\$17,000 of the aggregate amount of \$59,324 tested), there were either partial or no financial and/or programmatic records (timesheet, personnel action form, etc.) were on file to substantiate the following transactions.

<u>Fund Acct</u>	<u>Fund Description</u>	<u>Acct</u>	<u>APV</u>	<u>Employee</u>	<u>Transaction Amount</u>	<u>Support Needed</u>
301401	Education Administration	8010	26B	63049	\$ 1,262	Personnel Action Form & Timesheet
301401	Education Administration	8010	26B	34443	1,248	Personnel Action Form & Timesheet
301401	Education Administration	8014	26B	63049	149	Personnel Action Form & Timesheet
301401	Education Administration	8010	03B	16447	562	Personnel Action Form
301401	Education Administration	8010	06B	72050	438	Personnel Action Form
301401	Education Administration	8010	11B	16447	1,124	Personnel Action Form
301401	Education Administration	8010	13B	86067	310	Personnel Action Form
301401	Education Administration	8010	19B	609607	184	Personnel Action Form
301401	Education Administration	8010	23B	16447	1,124	Personnel Action Form
301401	Education Administration	8010	24B	58671	180	Personnel Action Form
301401	Education Administration	8014	23B	16447	148	Personnel Action Form
301401	Education Administration	8010	09B	607449	360	Timesheet
301401	Education Administration	8010	09B	1369	359	Timesheet
301401	Education Administration	8010	15B	5357	3,131	Timesheet
301401	Education Administration	8010	15B	1369	2,264	Timesheet
301401	Education Administration	8010	15B	76060	438	Timesheet
301401	Education Administration	8010	21A	26424	846	Timesheet
301401	Education Administration	8010	26B	23280	2,453	Timesheet
301401	Education Administration	8014	15B	5357	272	Timesheet
301401	Education Administration	8014	21A	26424	148	Timesheet
					<u>\$17,000</u>	

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-13, Continued
CFDA#: 84.027
Agency: U.S. Department of Education
Grant: Special Education
Requirement: Allowable Costs/Cost Principles
Questioned Costs: \$21,714

Conditions, Continued:

2. For 15 (or 20%) of 76 payroll expenditures (\$4,714 of the aggregate amount of \$59,324 tested), we noted a difference in the recalculation of gross pay.

Fund Acct	Fund Description	Acct	APV	Employee	Hours Per Labor Cost	Hours Per Timesheet	Hours Difference	Gross Pay per Labor Cost	Gross Pay per DTT Recalculation	Gross Pay Difference
301401	EDUCATION ADMINISTRATION	8010	04B	42896	256	76	180	\$ 1,311	\$ 389	\$ 922
301401	EDUCATION ADMINISTRATION	8010	04B	41951	280	88	192	1,104	347	757
301401	EDUCATION ADMINISTRATION	8010	04B	49499	280	88	192	1,104	347	757
301401	EDUCATION ADMINISTRATION	8010	23B	23280	160	168	8	1,582	1,662	80
301401	EDUCATION ADMINISTRATION	8010	24B	58707	80	160	80	180	360	180
301401	EDUCATION ADMINISTRATION	8010	25B	69058	242	80	162	545	180	365
301401	EDUCATION ADMINISTRATION	8014	04B	42896	256	76	180	1,311	389	922
301401	EDUCATION ADMINISTRATION	8010	02B	23861	160	160	0	1,140	875	265
301401	EDUCATION ADMINISTRATION	8010	02B	35900	160	160	0	935	875	60
301401	EDUCATION ADMINISTRATION	8010	05B	35900	160	160	0	935	875	60
301401	EDUCATION ADMINISTRATION	8010	05B	605014	160	160	0	935	819	116
301401	EDUCATION ADMINISTRATION	8010	05B	51452	160	160	0	875	819	56
301401	EDUCATION ADMINISTRATION	8010	06B	76060	80	80	0	438	410	28
301401	EDUCATION ADMINISTRATION	8010	08B	23861	80	80	0	570	438	132
301401	EDUCATION ADMINISTRATION	8010	25B	608723	80	80	0	162	176	<u>14</u>
										<u>\$4,714</u>

Cause: There appears to be a lack of internal controls over record keeping and ensuring that program expenditures are substantiated by such financial records as personnel action forms and timesheets.

Effect: The State appears to be in noncompliance with applicable allowable costs/cost principles and a questioned cost of \$21,714 exists.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.:	2006-13, Continued
CFDA#:	84.027
Agency:	U.S. Department of Education
Grant:	Special Education
Requirement:	Allowable Costs/Cost Principles
Questioned Costs:	\$21,714

Prior Year Status: The above condition is reiterative of conditions identified in our prior year audit of the program.

Recommendation: The State should comply with the criteria.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. In May 2007 the FSM National Government was given responsibility to process Special Education program payrolls to better ensure adequate documentation of Special Education payroll expenditures with properly approved timesheets and personnel action forms.

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FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-14 - Cash

Criteria: Cash accounts should be reconciled in a timely manner. Additionally, the reconciliation should be available for review.

Conditions:

1. For the following accounts, no bank reconciliation was available for review.

<u>Account No.</u>	<u>Amount</u>
10-102	\$100
10-105	(2)
10-121	714

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

<u>Account No.</u>	<u>Amount</u>
10-129	\$21,427

3. For the following accounts, we noted numerous un-reconciled differences located on the bank reconciliation.

<u>Account No.</u>	<u>Amount</u>
10-108	\$ 30,946
10-125	89,236
10-126	318,589
10-129	545,853
10-130	313,063
10-135	(10)
10-140	(528)
10-144	89,417
10-145	(36)
10-600	105,726

4. For the following accounts, we noted the following amounts of stale dated checks.

<u>Account No.</u>	<u>Amount</u>
10-108	\$166,718
10-125	980,232
10-126	16,011
10-135	1,984
10-144	61,688
10-145	729
66-600	120,949

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-14 – Cash, Continued

Conditions, Continued:

5. For the following account, we noted an outstanding check that has not cleared the bank; however, is not located on the outstanding check listing at fiscal year end.

<u>Account No.</u>	<u>Amount</u>
10-108	\$20,000

6. The State does not reconcile bank accounts in a timely manner as requested bank reconciliations were not provided until eight months after the fiscal year ended.

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

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

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

Recommendation: The State should strengthen internal controls to ensure that monthly bank reconciliations are performed in a timely manner and that reconciling items are resolved and corrected in the following month.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Although progress has been made in writing off old reconciling items, Chuuk Finance continues to have problems in performing timely bank reconciliations. Additional staff will be assigned to assist with becoming current on bank reconciliations and identifying unreconciled differences between bank and book balances. New bank reconciliation software will be implemented in October 2007 to better assist in obtaining an automated outstanding check file. Procedures will be in place by December 2007 to become current on bank reconciliations.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-15 – Accounts Receivable

Criteria: Accounts receivables should be supported by aged detailed sub-ledgers and should be monitored for receivable validity. Additionally, all invalid receivables should be written off. Furthermore, documentation in support of the reconciliations should be maintained on file and be 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	267	\$55,525
64	263	(93,081)
Federal Grants Fund		
37	262	41,959
Other Governmental Funds		
40	262	70,503

2. For Fund 10, Account 280, Travel Advances, \$268,781 or 88% of the total accounts receivable of \$304,587, is aged greater than ninety days.
3. Fund 60, Account 250, represents funds administered by the FSM National Government on behalf of Chuuk State. No reconciliations or monitoring of the account appears to have been performed.

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

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

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

Recommendation: The State should strengthen internal controls to ensure that accounts receivable are supported by detailed sub-ledgers and are monitored for receivable validity. Invalid receivables should be written-off and supporting sub-ledgers should be maintained on file and be available for review.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. All accounts receivables will be analyzed and those not supported by a sub-ledger will be written off. These procedures will be reflected in the audit for fiscal year 2007.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-16 – Accounts Payable

Criteria: Detailed aged accounts payable sub-ledgers should be reconciled with the general ledger. Furthermore, the detailed aged accounts payable sub-ledgers should be available for inspection.

Conditions:

1. For the following accounts, 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	\$ 664,731	\$1,231,795	\$567,054
10	800	8,886,764	9,375,781	489,017
61	800	181,146	121,616	(59,530)
Federal Grants				
30	800	1,410,235	1,499,509	89,274
37	800	70,943	52,418	(18,526)
Capital Projects Funds				
60	800	1,150,807	1,210,792	59,985
Other Governmental Funds				
20	800	1,563,964	1,496,675	(67,289)
25	800	91,411	87,525	(3,885)
40	800	19,112	18,665	(447)

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

<u>Fund</u>	<u>Account No.</u>	<u>Account Name</u>	<u>Amount</u>
10	873	PAYABLES-	\$ (13,600)
10	874	PAYABLES-OT	259,787
66	601	INCOMETAX	(55,430)
66	603	SOCIALSECU	(75,762)
66	604	GHI	(13,113)
66	606	CHUUKHEALT	(36,312)
66	607	SUPP/INS.&	(16,566)
66	608	BANKOFGUA	(40,825)
66	609	BANKOFFSM	(94,161)
66	611	KUCHUACU	(25)
66	613	EDCU	(244)
66	614	PACBASINI	(16)
66	615	MOCHMUNI	(22)

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-16 – Accounts Payable, Continued

Conditions, Continued:

<u>Fund</u>	<u>Account No.</u>	<u>Account Name</u>	<u>Amount</u>
66	617	HPG	(646)
66	618	HSREHABLF	(2,126)
66	619	PISMCU	(71)
66	620	TRUKDEV	(305)
66	621	KIOMASA	(4,568)
66	622	VIN	(145)
66	623	ROROCU	(10)
66	624	EDLFCHUUK	(1,300)
66	625	SHIGETO	(591)
66	626	M.O.TAXIS	(1)
66	627	REGENCYTRA	(377)
66	628	CHRISTOPHER	(344)
66	629	TTU	(1,293)
66	631	MOENHR	(1,498)
66	632	PAATAHR	(1,325)
66	634	CHUUKCU	(13,221)
66	635	T&S	(171)
66	636	WENO	5,366
66	637	TRUKTRANS	(831)
66	638	HOUSINGAUT	(1,207)
66	639	TRUKTRADIN	(12,057)
66	640	J&RSTORE	(175)
66	641	M&SSTORE	(323)
66	642	ANNASTORE	(1,363)
66	643	FSMTELECOM	(2,703)
66	644	CARMENSS	(2,109)
66	645	BSDIST	(913)
66	646	DEALFAIR	(43,524)
66	647	CHUUKFHA	(3,785)
66	649	BEALBANK1	(115)
66	650	LJMORI	(7,806)
66	651	STCECELIA	(1,411)
66	652	SARAMENCK	(1,241)
66	653	CHEEYOUNG	(2,178)
66	654	CHUUKUTILI	(408)
66	657	FSMINSURAN	(40)
66	658	KURASSASTO	(8,485)

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-16 – Accounts Payable, Continued

Conditions, Continued:

Account			
<u>Fund</u>	<u>No.</u>	<u>Account Name</u>	<u>Amount</u>
66	659	FEFANHOUSE	(100)
66	661	SBAADMINCO	(1,204)
66	664	KUCHUCU	(110)
66	670	CARINS	(1,129)
66	672	MOYLAN'SIN	(3,188)
66	673	NATIONALWE	(200)
66	674	ETTENCU	(25)
66	679	MORIASTORE	(591)
66	680	ALLOTMENTC	(1,134)
66	682	HRT'S	(2,729)
66	683	TONASRURAL	(281)
66	684	NET-TO-BANK	(2,594)
66	691	CHUUKMEDIC	(80)
66	693	DJ'SSTORE	(775)
66	698	TRAVELADVA	662
66	699	PAYROLLACCTO	(148,946)

3. We noted a \$77,375 difference in the general fund payables that arose from FY 2007 expenditures inappropriately accrued in FY 2006.

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

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

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

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

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. All accounts payable accounts will be supported by detailed sub-ledgers when Chuuk State finance converts to a new FMIS on October 1, 2007.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-17 – Supporting Documents – Search for Unreconciled Liabilities

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

Condition: For 44 fiscal year 2007 expenditures tested, aggregating \$673,701, the underlying documentation, i.e. vendor's invoices, contracts, receiving reports or other supporting documents were not provided or locatable.

Cause: There appear to be weak internal controls over ensuring that expenditures are supported by vendor invoices, contracts, receiving reports or other relevant documents.

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

Recommendation: The State should strengthen its internal controls to ensure that expenditures are supported by vendor invoices, contracts, receiving reports and other relevant documents.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Chuuk Finance will review its filing procedures to ensure documentation is available to support the accrual for unrecorded liabilities. These procedures will be in effect for the fiscal year 2007 audit.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-18 – Recording – Search for Unreconciled Liabilities

Criteria: Per accounting principles generally accepted in the United States of America (GAAP), expenditures should be recorded when incurred, i.e. when goods are received or services performed.

Conditions:

1. For 40 items tested, aggregating \$1,115,737, it appears that expenditures were improperly recorded before goods or services were actually received or performed.
2. For 8 items tested, aggregating \$85,851, it appears that expenditures were not correctly accrued.

Cause: There appears to be a lack of understanding of GAAP.

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

Recommendation: The State should ensure adherence to the criteria.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. A review of all open advances to vendors will be made as of September 20, 2007 to ensure expenditures are recorded in the proper period. Moreover, expenditures made in fiscal year 2008 where the good and service were received in fiscal year 2007 will be properly accrued at fiscal year end.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-19 – Travel Advances

Criteria: In accordance with State travel advance policy, 80% of the allowed per diem and other non-special allowance and non-flight costs can be advanced. Furthermore, such advances should be cleared within 10 days upon return and all supporting travel advance forms and clearance documents should be available for review.

Conditions:

1. For 5 travel advances tested, aggregating \$20,591, no travel advance file was provided.
2. For 6 travel advances tested, aggregating \$23,695, the travel advances were not cleared in a timely manner.

Cause: There appears to be weak internal controls over ensuring that travel advance clearance is performed and that all supporting travel documents are kept on file and are available for review.

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

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

Recommendation: The State should strengthen internals over compliance with the criteria.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Finance management will implement procedures to only process travel advances when a properly approved travel authorization form is prepared. Moreover, procedures will be implemented to ensure timely filing of travel advances.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-20 – Encumbrances

Criteria: Encumbrances per the general ledger should be reconciled to the supporting sub-ledgers. Furthermore, the sub-ledger should be reviewed to ensure encumbrance validity and to ensure that encumbrances are supported by available purchase orders, contracts and agreements.

Condition: For 83 encumbrances tested, aggregating \$1,818,907, no supporting purchase order, contract, agreement or other supporting documents were provided.

Cause: There appears to be weak internal controls over ensuring that general ledger encumbrance balances are reconciled to supporting sub-ledgers. Furthermore, there is no documented review of sub-ledgers to determine encumbrance validity and to ensure that detailed encumbrances are supported by purchase orders, contracts and agreements.

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

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

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

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. All open encumbrances will be supported by detailed sub-ledgers when Chuuk State finance converts to a new FMIS on October 1, 2007. Invalid and inactive encumbrances will be cancelled. Procedures will be implemented to ensure that open encumbrances can be supported by copies of obligating documents.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-21 – Recording - Expenditures

Criteria: Expenditures should only be recognized when goods or services have been received or performed.

Condition: Chuuk State recorded expenditures, aggregating \$817,022 in fiscal year 2006 when the goods or services had not been received or performed.

Cause: There appears to be weak internal controls over ensuring that expenditures are recorded in the correct period.

Effect: The condition results in a misstatement of expenditures and prepaid expenses. Adjustments were proposed through the audit process to adjust this matter.

Recommendation: The State should strengthen internal controls to ensure that expenditures are recorded in the correct period.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. A review of all open advance to vendors will be made as of September 20, 2007 to ensure expenditures are recorded in the proper period. Moreover, procedures will be developed to utilize an advance to vendor account on a regular basis with proper clearing to expenditures when the goods or services are received.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-22 – Expenditures

Criteria: All expenditures should be supported by purchase requisitions, purchase orders, vendor invoices, receiving reports, timesheets, personnel action forms and other supporting documents validating the expenditures. Furthermore, such should be reviewed and approved, be kept on file and be available for review.

Conditions:

1. For 2 expenditure transactions tested aggregating \$7,552, we noted travel and rental car dates per the travel authorization did not agree with the actual travel and rental car dates submitted by the traveler as evidenced in the boarding passes and rental car invoice. Furthermore, no amended travel authorization was provided.
2. For 2 expenditures tested aggregating \$6,380, we noted the per diem paid to the traveler did not agree with a recalculation based on the actual dates traveled per review of the boarding passes and the per diem rates per established policy. Additionally, the amount advanced to the traveler exceeded the amount per the approved travel authorization.
3. For one expenditure tested aggregating \$3,100, we noted insufficient documentation for Per Diem - Special Allowance.
4. For 19 expenditures tested aggregating \$558,640, no vendor invoice, purchase order, purchase requisition, receiving report, travel authorization or journal voucher were provided.
5. For 69 expenditures tested aggregating \$493,897, no cancelled check was provided.
6. For 1 expenditure tested aggregating \$11,800, no receiving report was provided.
7. For 30 expenditures tested aggregating \$28,568, no personnel action form or supporting timesheets were provided.
8. For 22 expenditures tested aggregating \$39,022, no personnel action form was provided.
9. For 14 expenditures tested aggregating \$10,374, no supporting timesheet was provided.
10. For 5 expenditures tested aggregating \$2,906, we noted the employee contract or personnel action form was not signed and approved.
11. For 4 expenditures tested aggregating \$1,708, we noted variances in the recalculation of gross pay compared with the gross pay per the Labor Cost Report.
12. For 2 expenditures tested aggregating \$1,290, no trip expense report and boarding pass were provided.

Cause: There appears to be weak internal controls over ensuring that expenditures are supported by purchase requisitions, purchase orders, vendor invoices, receiving reports, timesheets, personnel action forms and other validating documents.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-22 – Expenditures, Continued

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

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

Recommendation: The State should strengthen internal controls to ensure that expenditures are supported by purchase requisitions, purchase orders, vendor invoices, receiving reports, timesheets, personnel action forms and other validating documents.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Chuuk State Finance is in the process of reviewing its internal controls over documentation and filing and will implement procedures by December 2007 to ensure all expenditures are adequately supported by documentation that can be easily retrieved for audit review.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-23 – Annual Leave

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

Condition: For seven annual leave balances tested aggregating \$12,549, no supporting personnel action form was provided.

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

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

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

Recommendation: The State should strengthen internal controls to ensure that annual leave calculations are supported by personnel action forms.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Payroll staff will be instructed to pay annual leave hours only at the rate supported by a Personnel Action Form, effective September 2007.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-24 – Employee Ceiling

Criteria: The maximum number of positions funded from the General Fund shall not exceed the positions as stated per Public Law No.8-07.

Condition: The number of positions for the following departments appears to have exceeded the maximum number allowed per public law.

<u>Department</u>	<u>Dept. Total</u>	<u>Per PL</u>	<u>Excess</u>
Education	1244	1082	162
Governor's Office	79	16	63
Administrative Services	184	147	37
EPA	17	10	7
Visitor's Bureau	4	0	4
Attorney General	13	12	1

Cause: There appears to be weak internal controls over ensuring that the Government is in compliance with the criteria.

Effect: The condition may result in the unauthorized hiring of employees.

Recommendation: The State should strengthen internal controls to ensure that the government is in compliance with the criteria.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. As part of the August 2007 reform measures to rationalize the size of the Chuuk State government, the Chuuk State Finance will work with the Personnel Office to reduce force levels stipulated by Chuuk State Law.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-25 – Revenue

Criteria: Revenues should be supported by and agree with underlying billings, cash receipts, bank validated deposit slips, contracts/leases and other valid documentation. Additionally, such should be kept on file and be available for review. Furthermore, cash collections should be deposited in a timely manner.

Conditions:

1. For one revenue item tested aggregating \$7,786, no supporting billing or cash receipt was provided.
2. The airport leases space to an airline for \$1,600 per month. However, the signed supporting lease agreement/contract was not available for review.
3. The Chuuk State Government charges a departure fee of \$15 per person for all departing passengers. We obtained confirmation of the total number of departed passengers from October 1, 2005 to September 30, 2006 from the airline that services the island. We noted a difference as follows:

Number of Passengers Departed from Chuuk	18,387
	x
Airport Departure Fee	<u>\$15.00</u>
Expected Revenues	\$275,805
Revenues Per GL (Acct 10-7512)	<u>265,073</u>
Difference	<u>\$ 10,732</u>

4. For 32 revenue transactions tested aggregating \$2,132,599, the cash collections were not deposited in a timely manner.

Cause: There appears to be weak internal controls over ensuring that revenues are supported by and agree with underlying billings, cash receipts, bank validated deposit slips, contracts/leases and other valid documentation and that such are kept on file and are available for review and that cash collections are deposited in a timely manner.

Effect: The conditions may result in a potential misstatement of revenues and a potential for cash on hand to be diverted for other uses.

Recommendation: The State should strengthen internal controls over ensuring that revenues are supported by and agree with underlying billings, cash receipts, bank validated deposit slips, contracts/leases and other valid documentation. The supporting documents should be kept on file and be available for review. Furthermore, cash collections should be deposited in a timely manner.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. In May 2007 a new supervisor was hired for the Revenue and Tax division of Chuuk State Finance. All issues mentioned in the audit finding will be addressed by the supervisor as he insures that Chuuk State government collects and properly documents all revenues due and owing to the government.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-26 – Implementation of Fixed Assets for GASB Statement No. 34

Criteria: The provisions of GASB Statement No. 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 made minimal progress during the year ended September 30, 2006 in expanding its inventory of capital assets, inclusive of infrastructure, to allow for the financial statement presentation required by GASB 34. 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: There appears to be weak internal controls over ensuring that the State completes its duties and responsibilities associated with compliance with GASB 34 requirements.

Effect: The condition results in a potential misstatement of fixed assets and inability to conform to the GASB 34 presentation and disclosure requirements.

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

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

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Chuuk Finance staff responsible for maintaining fixed asset records have been instructed to continue improving the fixed asset records to ensure full compliance with GASB 34.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-27 – 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 therefore 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 agree with the finding and recommendation. The Attorney General's office will be consulted to determine if the \$329,179 Notes Payable can be written-off.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-28 – Accounting System Access

Criteria: The State should ensure that access to the accounting system is restricted based on the employee position, title and division as approved by management.

Condition: The State does not restrict access to the accounting system

Cause: There appears to be weak internal controls over ensuring that restrictions are in place.

Effect: The condition may result in potential unauthorized use or editing of accounting information and records.

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

Recommendation: The State should strengthen internal control over ensuring that appropriate restrictions are imposed over accounting system users

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The implementation of the new FMIS in October 2007 will allow for securitization at both the employee and functional level. Proper security for all Chuuk Finance employees will be set up at this time.

STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-29 – Investment Balance Reconciliations

Criteria: Investment balances should be reconciled in a timely manner.

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

Cause: There appears to be weak internal controls over ensuring investments are periodically reconciled.

Effect: The condition may result in a potential misstatement of investments and revenues as the State does not have knowledge as to the status of its investments or the related impact on its revenues until substantially after the fiscal year end.

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

Recommendation: The State should strengthen internal controls to ensure proper reconciliations of its investments are performed 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. Chuuk Finance will consult with responsible employees at the FSMNG Investment division for the proper procedures to reconcile its investments using reports from the money managers.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-30 – Land Acquisition Payables

Criteria: Detailed aging land acquisition payables sub-ledgers should be reconciled with the land acquisition payables balance per the general ledger. Furthermore, the underlying supporting acquisition documents and authorization of source of funds for payments should be made available for review to substantiate the acquisitions and payments.

Conditions:

1. The State does not reconcile its land acquisition payables sub-ledger in a timely manner. Furthermore, we were provided a revised land acquisition payables sub-ledger on July 30, 2007 in which there were additional acquisitions of \$560,923 that appear to have been acquired in prior fiscal years but not included in the initial sub-ledger provided.
2. The State made \$560,923 of payments in FY2006 for land acquisitions payable. It was represented that the source of the funds includes the General Fund and Compact Capital Funds transferred to the General Fund. Based on Public Law 13-51, Compact Capital Funds transferred to the General Fund are restricted for Chuuk State Municipalities. The underlying Chuuk State authorization for use of Compact Capital Funds transferred to the General Fund for unrestricted use has not been provided.

Cause: There appears to be weak internal controls over ensuring that the land acquisition payables sub-ledger is periodically reconciled and that land payments are made in accordance with applicable established laws.

Effect: The conditions may result in a potential misstatement of payables and expenditures.

Recommendation: The State should strengthen internal controls to ensure reconciliations of land acquisition payables are performed on a monthly basis and that land payments occur in accordance with applicable laws.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. At September 30, 2006, an adjustment was made to the general ledger to record land acquisition payables to agree with the most recent worksheet copy of a sub-ledger that has been maintained off the books. This balance will be further reconciled in 2007. It is the policy of Chuuk State government to utilize Compact CIP funds only for municipal projects and the referenced land payment in 2006 was sourced only from general fund revenues.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No. 2006-31 – Appropriations

Criteria: Appropriations in the accounting system should agree with underlying public laws. Additionally, detailed reconciliations of current year appropriations and prior year carryover encumbrances should be available for review.

Condition: A detailed schedule of appropriations, extracted from the accounting system, by governmental department was provided. Additionally, a summary schedule of appropriations by governmental department which referenced the underlying public laws that established the appropriation was provided. The schedules did not agree. Furthermore, appropriations per the system and per the summary schedule did not agree with underlying public laws. The differences may be attributed to the prior year carryover encumbrances being included in the accounting system. However, no detailed reconciliation of current year appropriations and carryover encumbrances was provided.

Cause: There appear to be weak internal controls over ensuring that appropriations per the accounting system agree with underlying public laws and reconciliations of appropriations and prior year carryover encumbrances occur.

Effect: The condition may result in a potential misstatement of appropriations and in unauthorized expenditures.

Recommendation: The State should strengthen internal controls to ensure that appropriations per the accounting system agree with underlying public laws and that reconciliation of the appropriations and prior year carryover encumbrances are documented and available.

Auditee Response and Corrective Action Plan: We agree with, the finding and recommendation. The budget department is responsible for entering allotments into the financial management system and ensuring they agree with the appropriation laws. As indicated, no reconciliation has been performed to indicate the discrepancies between the two sources. The Budget department will be requested to reconcile the general fund system allotments with the appropriation laws for as of September 30, 2007.

**STATE OF CHUUK
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Resolution of Prior Years' Findings and Questioned Costs
Year Ended September 30, 2006

For the year ended September 30, 2006, the following questioned costs were noted and prior questioned costs resolved:

	Questioned Costs Set Forth in Prior Audit Report <u>2005</u>	Questioned Costs Resolved for Fiscal Year <u>2005</u>	Questioned Costs at <u>September 30, 2006</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	1,728,813	-	1,728,813
Unresolved Questioned Costs FY 06	<u>-</u>	<u>-</u>	<u>958,987</u>
	\$ <u>8,464,942</u>	\$ <u>-</u>	\$ <u>9,423,929</u>