

CHUUK STATE HEALTH CARE PLAN

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2006 AND 2005

INDEPENDENT AUDITORS' REPORT

The Board of Trustees
Chuuk State Health Care Plan

We have audited the accompanying statements of net assets of the Chuuk State Health Care Plan (the "Plan"), a component unit of the State of Chuuk, as of September 30, 2006 and 2005, and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraphs, we conducted our audits in accordance with auditing standards generally accepted in the United States of America and standards applicable for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Because of the inadequacy of accounting records, we were unable to determine the propriety of outstanding checks, totaling \$37,991, within cash and cash equivalent balances at September 30, 2006.

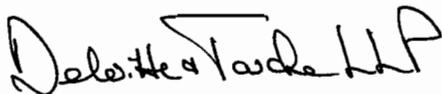
Because of the inadequacy of accounting records, we were unable to form an opinion regarding the amount at which medical claims payable are recorded in the accompanying statement of net assets at September 30, 2005. Medical claims payable enters into the determination of medical claims expense for the year ended September 30, 2005.

Because of the inadequacy of accounting records, underlying supporting documentation evidencing the validity of other operating expenses was not maintained and were not made available for audit. Accordingly, we were not able to satisfy ourselves about the amounts at which other operating expenses are recorded in the accompanying statement of revenues, expenses and changes in net assets for the year ended September 30, 2005.

In our opinion, except for the effects on the financial statements of such adjustments, if any, as might have been determined to be necessary had accounting records concerning outstanding checks at September 30, 2006 been adequate, had accounting records concerning medical claims payable at September 30, 2005 been adequate, and had accounting records supporting other operating expenses for the year ended September 30, 2005 been maintained, as discussed in the third through fifth paragraphs above, such financial statements present fairly, in all material respects, the financial position of the Chuuk State Health Care Plan as of September 30, 2006 and 2005, and changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 8 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Chuuk State Health Care Plan's management. 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 31, 2007, on our consideration of Chuuk State Health Care Plan's 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 audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



August 31, 2007

CHUUK STATE HEALTH CARE PLAN

Management's Discussion and Analysis Year Ended September 30, 2006

This analysis, prepared by the management of the Chuuk State Health Care Plan (the "Plan"), offers readers a narrative overview of the activities of the Plan for the fiscal year ended September 30, 2006. We encourage readers to consider this information in conjunction with the Plan's financial statements, which follow. Fiscal year 2005 comparative information has been included, where appropriate. This information is required by the Governmental Accounting Standards Board, (GASB), which provides guidelines on what must be included and excluded from the analysis.

There are three financial statements presented: the Balance Sheet or Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows.

Financial Highlights

- For the fiscal year ended September 30, 2006, the Chuuk State Health Care Plan increased net assets by \$0.038 million (up 3.7%) from \$1.023 million in the prior year to \$1.061 million. The increase is primarily attributable to increased cash and short-term investments resulting from Plan premiums exceeding payments for medical claims.
- During fiscal year 2006, the Plan had premium revenues of \$0.87 million compared to \$0.78 million in fiscal year 2005. The \$0.09 million increase (or 12%) was the result of new enrollees. Medical claim expenses were \$0.64 million in fiscal year 2006 compared to \$0.23 million in fiscal year 2005 (up 179.4%). The disproportionate increase in expenses results from greater plan utilization by enrollees and higher claims expense per patient.
- During fiscal year 2006, the Plan's total net earnings of \$0.038 million were down \$0.392 million (or 91%) from net earnings in fiscal year 2005 of \$0.43 million.

The Statement of Net Assets

The Statement of Net Assets presents the assets, liabilities and net assets of the Plan as of the fiscal year end and represents a "snapshot" financial statement. The Statement of Net Assets presents end-of-year data concerning assets (current and noncurrent), liabilities (current and noncurrent), and net assets (assets minus liabilities). The difference between current and noncurrent assets and liabilities will be discussed in the footnotes to the financial statements.

From the data presented, readers of the Statement of Net Assets are able to determine the assets available to continue the operations of the Plan. They are also able to determine how much the Plan owes vendors and others. Finally, the Statement of Net Assets provides a picture of the net assets (assets minus liabilities) that the Plan has available for future expenditures by the Plan.

CHUUK STATE HEALTH CARE PLAN

Management's Discussion and Analysis
Year Ended September 30, 2006

Net assets are divided into two major categories. The first category, invested in capital assets, net of related debt, provides the institution's equity in property, plant and equipment owned by the Plan. The next asset category is restricted net assets, which is divided into two categories, nonexpendable and expendable. The corpus of nonexpendable restricted net assets is only available for investment purposes; the Plan has no nonexpendable restricted net assets. Expendable restricted net assets are available for expenditures by the Plan but must be spent for purposes determined by donors and/or external entities that have place, time or purpose restrictions on the use of the assets. All the Plan assets that are not otherwise invested in capital assets are restricted by law to be used for health care services.

SUMMARY BALANCE SHEETS

(In'000's)

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Assets:			
Current assets	\$ 1,105	\$ 1,021	\$ 586
Capital assets, net	<u>23</u>	<u>29</u>	<u>19</u>
Total assets	\$ <u>1,128</u>	\$ <u>1,050</u>	\$ <u>605</u>
Liabilities:			
Current liabilities	\$ 67	\$ 27	\$ 12
Non-current liabilities	<u>-</u>	<u>-</u>	<u>-</u>
Total liabilities	<u>67</u>	<u>27</u>	<u>12</u>
Net Assets:			
Invested in capital assets	\$ 23	\$ 29	\$ 19
Restricted	<u>1,038</u>	<u>994</u>	<u>574</u>
Total net assets	<u>1,061</u>	<u>1,023</u>	<u>593</u>
Total liabilities and net assets	\$ <u>1,128</u>	\$ <u>1,050</u>	\$ <u>605</u>

The total assets at the end of fiscal year 2006 of \$1,128 thousand exceed the total liabilities of \$67 thousand, resulting in net assets of \$1,061 thousand. Of the total net assets, \$1,069 thousand are held in cash, cash equivalents or short-term investments, indicating the ability of the Plan to readily meet any liabilities it may incur. Moreover, the 16:1 ratio of current assets to current liabilities at September 30, 2006 further demonstrates the liquidity of the Plan's financial position. The Plan's low level of liabilities reflects management's policy of paying for medical claims and other operating expenses immediately upon receipt of provider or vendor invoices.

CHUUK STATE HEALTH CARE PLAN

Management's Discussion and Analysis
Year Ended September 30, 2006

Statement of Revenues, Expenses, and Changes in Net Assets

Changes in total net assets are based on the activity presented in the Statement of Revenues, Expenses, and Changes in Net Assets. The purpose of the statement is to present the revenues received by the Plan, both operating and non-operating, and the expenses paid by the institution, operating and non-operating.

Generally speaking, operating revenues are received from income provided by collecting health care premiums from Plan members. Other non-operating revenues are for interest income earning from short-term investments of Plan assets. Operating expenses can be classified as of two types: (i) medical service expenditures provided to eligible enrollees by accredited health care providers, and (ii) other operating expenses necessary to administer the Plan.

SUMMARY STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS In '000's

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Revenues:			
Premiums	\$ 872	\$ 781	\$ 740
Interest	<u>34</u>	<u>14</u>	<u>2</u>
Total revenues	<u>906</u>	<u>795</u>	<u>742</u>
Expenses:			
Claims expenses	639	229	188
Other operating expenses	<u>229</u>	<u>136</u>	<u>108</u>
Total expenses	<u>868</u>	<u>365</u>	<u>296</u>
Net earnings	38	430	446
Net assets at beginning of year	<u>1,023</u>	<u>593</u>	<u>147</u>
Net assets at end of year	\$ <u>1,061</u>	\$ <u>1,023</u>	\$ <u>593</u>

The Statement of Revenues, Expenses, and Changes in Net Assets reflects positive years for both fiscal years 2006 and 2005, with overall increases in net assets equal to the amount of net earnings of approximately \$38 and \$430 thousand, respectively. Some highlights of the information presented on the Statement of Revenues, Expenses, and Changes in Net Assets are as follows:

- Premium revenues represent receipts from Plan enrollees. The following table indicates premium revenue activity for fiscal years 2006 and 2005 for both primary members and their dependents:

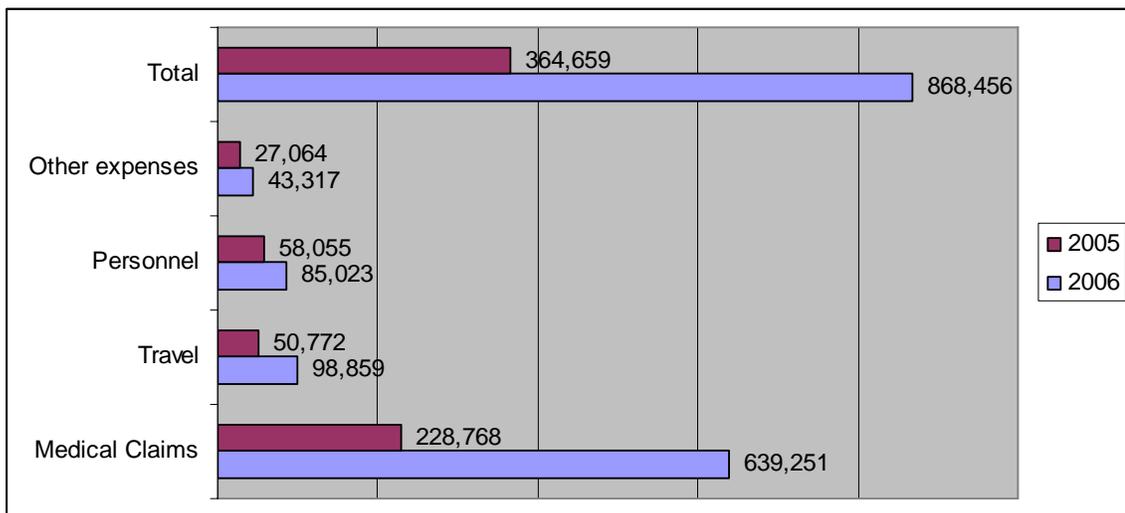
CHUUK STATE HEALTH CARE PLAN

Management's Discussion and Analysis Year Ended September 30, 2006

MEMBER COMPOSITION	FY- 2006 # ENROLLED @ 9-30-06	2006 PREMIUMS PAID (000's)	FY- 2005 # ENROLLED @ 9-30-05	2005 PREMIUMS PAID (000's)
Public Sector	21,495	\$ 845	12,509	\$ 765
Private Sector	1,084	27	970	16
TOTALS	22,579	\$ 872	13,479	\$ 781

% INCREASE FROM PRIOR YEAR 67% 12%

- The major components of Plan expenses during fiscal year 2006 and 2005 are highlighted by the following graph:



Medical claim expenses increased \$0.41 million (or 179%) during fiscal year 2006 from fiscal year 2005, and comprise an increasingly large portion of Plan premiums. In fiscal year 2006, medical claim expenses of \$639 thousand represented 73% of premium revenues. This is comparable to fiscal year 2005, where medical claim expenses of \$229 thousand were only 29% of premium revenues. This higher payout ratio reflects increased utilization of Plan services from increased enrollees. Moreover, the 67% increase in enrollees in fiscal year 2006 has resulted primarily from an increasing number of dependents under each primary member, but only marginal increases in Plan premiums.

Similarly, travel expenses in fiscal year 2006 increased \$48 thousand (or 95%); from \$51 thousand in fiscal year 2005 to \$99 thousand in fiscal year 2006. This increase signifies the increased number of clients being treated in the Philippines.

Personnel expenses, comprising both salaries and coordinator fees, increased to \$85 thousand in fiscal year 2006 from the prior year's \$58 thousand. This 47% increase is the result of the Plan hiring a Controller and another patient service representative.

CHUUK STATE HEALTH CARE PLAN

Management's Discussion and Analysis
Year Ended September 30, 2006

Statement of Cash Flows

The final statements presented by the Chuuk State Health Care Plan is the Statement of Cash Flows. The Statement of Cash Flows presents detailed information about the cash activity during the year. The statement is divided into four parts. The first part deals with operating cash flows from noncapital financing activities of the Plan. The second section reflects cash flows from capital and related financing activities. This section deals with the cash used for the acquisition and construction of capital and related items. The third section reflects the cash flows from investing activities and shows the purchases, proceeds and interest received from investing activities. The fourth section reconciles the net cash used in operating activities to operating income or loss reflected on the Statement of Revenues, Expenses, and Changes in Net Assets.

SUMMARY STATEMENT OF CASH FLOWS (In '000's)

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Cash provided by (used in):			
Operating activities	\$ 96	\$ 439	\$ 503
Capital and related financing activities	-	(18)	(3)
Investing activities	<u>(199)</u>	<u>(501)</u>	<u>2</u>
Net change in cash and cash equivalents	<u>(103)</u>	<u>(80)</u>	<u>502</u>
Cash and cash equivalents, beginning of year	<u>472</u>	<u>552</u>	<u>50</u>
Cash and cash equivalents, end of year	\$ <u><u>369</u></u>	\$ <u><u>472</u></u>	\$ <u><u>552</u></u>

The Plan's cash and cash equivalent resources declined by \$103 thousand (or 22%) in fiscal year 2006, from \$472 thousand in the prior year to \$369 thousand. This decrease in cash resources was the result of eroding cash positions from operating activities as the result of both escalating medical claims and other operating expenses.

Capital Asset and Debt Administration

The Plan's investment in capital assets amounted to \$62 thousand in fiscal year 2006, net of accumulated depreciation of \$35 thousand, leaving a book value of \$27 thousand. This represents a decrease of two thousand (or 6.9%) from the \$29 thousand reported for fiscal year 2005.

The Plan has no debt and there are no foreseen circumstances that would affect the Plan's access to future capital financing.

Further information on the Plan's capital assets can be found in note 4 to the accompanying financial statements.

CHUUK STATE HEALTH CARE PLAN

Management's Discussion and Analysis Year Ended September 30, 2006

Management's Discussion and Analysis for the year ended September 30, 2005 is set forth in the Plan's report on the audit of financial statements, which is dated June 10, 2006. That Discussion and Analysis explains the major factors impacting the 2005 financial statements and can be obtained via the Office of the Public Auditor's website at www.fsmpublicauditor.fm.

Economic Outlook

Two challenges confront the Plan management in fiscal year 2007 and beyond. The first is the ability to collect delinquent premiums for public sector enrollees. Because of Chuuk State's deteriorating fiscal condition, employee allotments due the Plan have become seriously in arrears. At May 25, 2007, \$115,000 of past-due allotments had accumulated, representing several months of public sector enrollees' premiums. The second problem is escalating costs resulting from increased member usage of medical services. As noted above, medical claim expenditures now represent 72% of premium revenues and the trend is rising. When coupled with the corresponding increased travel costs, the trend cannot be sustained without wiping out the Plan's profitability and calling into question the viability of Plan operations. Notwithstanding these challenges, the management and Board remain committed to controlling costs with available resources while continuing to provide an essential level of health care to eligible members and their dependents.

Contacting the Chuuk State Health Care Plan's Management

This financial report is designed to provide our citizens, Plan enrollees, accredited health care providers, and other users of our financial information, a general overview of the Plan'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 Executive Director, Chuuk State Health Care Plan; P.O Box 1679; Weno, Chuuk; FM 96942.

CHUUK STATE HEALTH CARE PLAN

Statements of Net Assets September 30, 2006 and 2005

<u>ASSETS</u>	<u>2006</u>	<u>2005</u>
Current assets:		
Cash and cash equivalents	\$ 369,361	\$ 472,260
Short-term investments	700,000	501,198
Premiums receivable	35,644	46,292
Other receivables	-	800
Other assets	403	1,000
Total current assets	1,105,408	1,021,550
Property and equipment, net	22,902	29,341
Total assets	\$ 1,128,310	\$ 1,050,891
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Medical claims and benefits payable	\$ 57,657	\$ 20,024
Accounts payable and accrued expenses	9,451	7,288
Total liabilities	67,108	27,312
Commitment		
Net assets:		
Invested in capital assets	22,902	29,341
Restricted	1,038,300	994,238
Total net assets	1,061,202	1,023,579
Total liabilities and net assets	\$ 1,128,310	\$ 1,050,891

See accompanying notes to financial statements.

CHUUK STATE HEALTH CARE PLAN

Statements of Revenues, Expenses and Changes in Net Assets Years Ended September 30, 2006 and 2005

	2006	2005
Premium and other revenues:		
Premiums	\$ 872,006	\$ 781,370
Interest	34,073	13,772
	906,079	795,142
Benefits paid:		
Claims expenses	639,251	228,768
	266,828	566,374
Other operating expenses:		
Travel	98,859	50,772
Salaries, wages and other benefits	59,373	33,155
Coordinator's fee	25,650	24,900
Rent	8,400	3,600
Depreciation	6,439	7,297
Gasoline and fuel	3,676	1,250
Telephone and telegraph	3,385	2,946
Housing allowance	3,330	2,250
Office/computer supplies	2,654	2,502
Utilities	2,361	1,609
Social security expense	2,250	-
Representation - board luncheon meeting	2,232	2,379
Board allowance	1,800	1,700
Promotional	1,800	700
CSHCP premium and other health care contributions	1,447	96
Miscellaneous	5,549	735
	229,205	135,891
Net earnings	37,623	430,483
Net assets at beginning of year	1,023,579	593,096
Net assets at end of year	\$ 1,061,202	\$ 1,023,579

See accompanying notes to financial statements.

CHUUK STATE HEALTH CARE PLAN

Statements of Cash Flows Years Ended September 30, 2006 and 2005

	2006	2005
Cash flows from operating activities:		
Premiums received	\$ 884,050	\$ 766,412
Interest income received	34,073	13,772
Medical claims and benefits paid	(601,618)	(217,369)
Other expenses paid	(220,602)	(124,050)
	95,903	438,765
Cash flows from capital and related financing activities		
Acquisition of property and equipment	-	(17,793)
	-	(17,793)
Cash flows from investing activities		
Net change in time certificates of deposit	(198,802)	(501,198)
	(198,802)	(501,198)
Net change in cash and cash equivalents	(102,899)	(80,226)
Cash and cash equivalents at beginning of year	472,260	552,486
Cash and cash equivalents at end of year	\$ 369,361	\$ 472,260
Reconciliation of net earnings to net cash provided by operating activities:		
Net earnings	\$ 37,623	\$ 430,483
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	6,439	7,297
Changes in assets and liabilities:		
Decrease (increase) in premiums receivable	10,648	(14,958)
Decrease in other receivables	800	600
Decrease (increase) increase in other assets	597	(400)
Increase in medical claims and benefits payable	37,633	11,399
Increase in accounts payable and accrued expenses	2,163	4,344
	\$ 95,903	\$ 438,765
Net cash provided by operating activities	\$ 95,903	\$ 438,765

CHUUK STATE HEALTH CARE PLAN

Notes to Financial Statements
September 30, 2006 and 2005

(1) Nature of Operations

Commencement of Operations

Chuuk State Health Care Plan (the Plan), a component unit of the State of Chuuk, was originally established under the Chuuk Health Care Plan Act of 1994, providing eligible residents of Chuuk to be enrolled in the Plan. The Plan commenced its operations in September 2003 after final approval from the Board of Trustees, with Chuuk State Hospital (CSH) as the primary health care provider.

Entity's Activities

As per Chuuk State Law No. 2-94-06 (Act No: 2-25), the Plan is dedicated to serve as a financial system to provide universal coverage of an essential level of health care for all eligible enrollees by collecting health care premiums under a plan and ensuring medical services to all members through its accredited health care providers.

Aside from CSH being its primary health provider, the Plan has also accredited two medical clinics in Chuuk – Family Clinic and Sefin Health Clinic, and five hospitals in the Philippines – Cardinal Santos Medical Center, Capitol Medical Center, and Kidney and Transplant Institute, Philippines Heart Center and St. Luke's Hospital to provide medical services to members of the Plan.

The Plan enables all eligible government employees to be eligible as members by contributing health premiums (50% employee share and 50% employer share) so as to claim medical benefits through the accredited health care providers. The Plan was also introduced to the private sector and the Plan has started collecting premiums from several private companies, and offering medical services, accordingly.

(2) Summary of Significant Accounting Policies

The accounting policies of the Plan conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting," requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The Plan has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

The Plan has adopted GASB Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments* (GASB 34), as amended by GASB Statement No. 37, *Basic Financial Statements – Management's Discussion and Analysis-for State and Local Governments: Omnibus* and GASB Statement No. 38, *Certain Financial Statement Note Disclosures* and applied those standards on a retroactive basis. GASB Statement No. 34 establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following four net asset categories:

CHUUK STATE HEALTH CARE PLAN

Notes to Financial Statements
September 30, 2006 and 2005

(2) Summary of Significant Accounting Policies, Continued

- Invested in capital assets, net of related debt:

Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

- Restricted:

- Nonexpendable – Net assets subject to externally imposed stipulations that require the Plan to maintain them permanently. For the years ended September 30, 2006 and 2005, the Plan does not have nonexpendable net assets.
- Expendable – Net assets whose use by the Plan is subject to externally imposed stipulations that can be fulfilled by actions of the Plan pursuant to those stipulations or that expire by the passage of time.

- Unrestricted:

Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action by management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

All of the Plan's net assets that are not otherwise invested in capital assets are restricted by law to be used for health care services.

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statements of net assets. Proprietary fund operating statements present increases and decreases in net total assets. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenditures and expenses during the reporting period. Actual results may differ from those estimates.

Revenue Recognition

Health care premiums from enrolled members of the Plan are reported as revenue in the period such becomes due. The Plan considers health care premium revenues and costs that are directly related to the provision health care to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

CHUUK STATE HEALTH CARE PLAN

Notes to Financial Statements
September 30, 2006 and 2005

(2) Summary of Significant Accounting Policies, Continued

Cash and Cash Equivalents and Time Certificates of Deposit

For purposes of the statements of net assets and cash flows, cash and cash equivalents is defined as amounts in demand deposits as well as short-term investments maturing within three months of the date acquired.

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 Bank or its agent in the Plan'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 Plan'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 Plan'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 Plan'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. The Plan does not have a deposit policy for custodial credit risk.

Cash and cash equivalents include cash in various bank accounts and time certificates of deposits with an original maturity date of ninety days or less. Short-term investments in time certificates of deposit with original maturity dates greater than ninety days are separately classified. As of September 30, 2006 and 2005, the carrying amount of the Plan's cash and cash equivalents and time certificates of deposit were \$1,069,361 and \$973,458, respectively, and the corresponding bank balances were \$1,069,841 and \$1,192,288, respectively. Of the bank balance amounts, \$944,925 and \$945,032, respectively, were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. The remaining amounts of \$124,916 and \$247,256, respectively, represent deposits maintained in Philippine Peso denominated bank accounts. Accordingly, these deposits are exposed to foreign currency risk. As of September 30, 2006 and 2005, bank deposits in the amount of \$200,000 were FDIC insured. The Plan does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

Short-term Investments

Interest-bearing deposits in banks mature within one year and are carried at cost.

CHUUK STATE HEALTH CARE PLAN

Notes to Financial Statements
September 30, 2006 and 2005

(2) Summary of Significant Accounting Policies, Continued

Premiums Receivable

Premiums receivable are primarily due from the Chuuk State Government and are interest free and uncollateralized. The allowance for uncollectible accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on the credit risk of specific customers, historical trends and other information. The allowance is established through a provision for bad debts charged to expense.

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation. Routine repairs and maintenance costs are expensed as incurred. Depreciation is calculated using the straight-line method based on the estimated useful lives of the assets.

The Plan capitalizes equipment with acquisition values of \$250 and above.

New Accounting Standards

During fiscal year 2006, the Plan 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 serviced 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 of 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 Benefits 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 financial statements.

CHUUK STATE HEALTH CARE PLAN

Notes to Financial Statements
September 30, 2006 and 2005

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which 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 Plan.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which 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 Plan.

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 Plan.

Risk Management

The Plan carries workmen's compensation liability insurance for all employees of the Plan; however, the Plan is substantially self-insured for all other risks. Management is of the opinion that no material losses have been sustained as a result of this practice during the past three years.

(3) Short-Term Investments

The Plan has time certificates of deposit with a federally insured bank totaling \$700,000 and \$501,198 as of September 30, 2006 and 2005, respectively. These deposits have initial maturity dates of one year and have interest rates ranging from 2.33% to 3.41%.

CHUUK STATE HEALTH CARE PLAN

Notes to Financial Statements
September 30, 2006 and 2005

(4) Property and Equipment

A summary of the Plan's property and equipment at September 30, 2006 and 2005, is as follows:

	Estimated Useful Lives	Balance at October 1, 2005	Transfers and Additions	Transfers and Deletions	Balance at September 30, 2006
Office furniture and equipment	5 – 10 years	\$ 27,195	\$ -	\$ (11,258)	\$ 15,937
Vehicle	5 years	<u>31,660</u>	<u>-</u>	<u>-</u>	<u>31,660</u>
		58,855	-	-	47,597
Less accumulated depreciation		<u>(29,514)</u>	<u>(6,439)</u>	<u>11,258</u>	<u>(24,695)</u>
Property and equipment, net		\$ <u>29,341</u>	\$ <u>(6,439)</u>	\$ <u>-</u>	\$ <u>22,902</u>
	Estimated Useful Lives	Balance at October 1, 2004	Transfers and Additions	Transfers and Deletions	Balance at September 30, 2005
Office furniture and equipment	5 – 10 years	\$ 25,312	\$ 1,885	\$ -	\$ 27,195
Vehicle	5 years	<u>15,750</u>	<u>15,910</u>	<u>-</u>	<u>31,660</u>
		41,062	17,793	-	58,855
Less accumulated depreciation		<u>(22,217)</u>	<u>(7,297)</u>	<u>-</u>	<u>(29,514)</u>
Property and equipment, net		\$ <u>18,845</u>	\$ <u>10,496</u>	\$ <u>-</u>	\$ <u>29,341</u>

Of the total property and equipment as of September 30, 2005, \$38,199 was acquired through capital contributions from the Chuuk State Government.

(5) Net Assets

Net assets at September 30, 2006 and 2005 includes funds received from Chuuk State Finance in 2002 amounting to \$15,000 and premiums and other consideration received in 2003 totaling \$94,359. The Plan received premiums from Chuuk State employees prior to its formal commencement of operations as of October 1, 2003.

(6) Commitment

Lease Commitment

The Plan leases office space under an operating lease. Rental expense for the years ended September 30, 2006 and 2005 amounted to \$8,400 and \$7,200, respectively, and is included as a component of other operating expenses in the accompanying financial statements. At September 30, 2006, aggregate future minimum lease payments are summarized as follows:

<u>Year ending September 30,</u>	<u>Amount</u>
2008	\$ 8,400
2009	<u>4,900</u>
	\$ <u>13,300</u>

CHUUK STATE HEALTH CARE PLAN

Notes to Financial Statements
September 30, 2006 and 2005

(7) Related Parties

The Plan has outstanding advances to an employee amounting to \$800 at September 30, 2005. It has also paid medical claims and benefits totaling \$86,177 and \$13,702 at September 30, 2006 and 2005, respectively, to Family Clinic and Pharmacy, whose owner is a member of the Referral committee.

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

The Board of Trustees
Chuuk State Health Care Plan:

We have audited the financial statements of the Chuuk State Health Care Plan (the Plan), as of and for the year ended September 30, 2006, and have issued our report thereon dated August 31, 2007, which report was qualified due to our inability to determine the adequacy of accounting records concerning outstanding checks, medical claims payable balances, and other operating expenses. Except as discussed in the preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Plan'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 Plan's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are described in the accompanying Schedule of Findings (pages 21 through 24) as items 2006-1 through 2006-4.

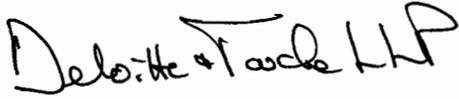
A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being 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, we consider the reportable conditions described above to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Plan'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 audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we have reported to management of the Plan in a separate letter dated August 31, 2007.

This report is intended for the information of the Plan's management and is not intended to be, and should not be, used by anyone other than those specified parties.

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

August 31, 2007

CHUUK STATE HEALTH CARE PLAN

Schedule of Findings
Year Ended September 30, 2006

Finding 2006-01 – Reiteration of Prior Year Findings

Criteria: The Plan should establish policies for asset capitalization and for the liquidation of travel allowances.

Condition: During the 2005 audit, we noted that the following conditions and other control weaknesses that were previously identified still exist and have remained uncorrected in 2006.

- Absence of fixed asset capitalization policy
- Absence of written policy on granting and liquidation of travel allowances

Cause: The cause of this condition is the lack of necessary action to address the cited prior year findings.

Effect: The effect of this condition is noncompliance with the criteria.

Recommendation: We recommend that corrective action be taken to address these deficiencies.

Auditee Response and Corrective Action Plan: We agree with the findings and recommendation. The new set of Board of Trustees and the Management of CSHCP will formulate additional policies and procedures, one of which will be regarding fixed assets capitalization policy. We will also ensure to establish written policies on the propriety of every travel made by either the Board Officers or the Management, the granting of travel allowances, and proper documentation in the liquidation of these travel expenses.

CHUUK STATE HEALTH CARE PLAN

Schedule of Findings, Continued
Year Ended September 30, 2006

Finding 2006-02 - Deficiencies in the Accounting Operations

Criteria: Utilization of an accounting system and adequate monitoring of the accounting process are necessary to carry out day-to-day accounting operations.

Condition: The absence of a formal accounting system was cited as a finding in the 2005 audit. Transactions have been recorded manually in an excel file and no journal entries were prepared to support the recording of transactions, resulting in inadequate controls over maintenance and monitoring of manual account ledgers. Additionally, there appears to be no evidence of segregation of duties. Moreover, in 2006, there was a breakdown of the computer containing the main excel files of the general ledger and subsidiary ledgers. No back-up files were maintained. It appears that the damage can not be repaired, which resulted in a loss of data. For this reason, tests of journal entries were not possible.

Cause: The cause of this condition is the absence of an accounting system and inadequate monitoring of the accounting process.

Effect: The effect of this condition is noncompliance with the criteria.

Recommendation: We reiterate the need to establish a formal accounting system to facilitate the processing of accounting transactions in a systematic manner. Maintenance of back-up files is a standard procedure that should not be disregarded, to ensure recovery in the event of a loss of data files. Additionally, as recommended in the prior year, adequate segregation of duties should exist and all journal entries should be documented and be approved by a higher level of management.

Auditee Response and Corrective Action Plan: We agree with the finding and the recommendation. We are currently implementing an improved formal accounting system. We are also starting the use of an accounting software to do away with the previous manual excel files. Once these are fully and completely implemented, there will be a more systematic manner of recording accounting transactions. This will ensure adequate separation of duties and more correct journal transactions which will be reviewed by the Chief Accountant and approved by the Executive Director.

CHUUK STATE HEALTH CARE PLAN

Schedule of Findings, Continued
Year Ended September 30, 2006

Finding 2006-03 - Deficiencies in Bank Reconciliation Procedures

Criteria: Bank reconciliation statements should be prepared on a timely basis, considering accuracy and proper review of responsible officers.

Condition: As noted in the prior year management letter dated June 10, 2006, inaccurate bank reconciliations have been prepared. We noted outstanding checks totaling \$37,991 that pertain to check disbursements that cleared the bank after September 30, 2006. The bank reconciliation did not consider these as outstanding since the reconciliation was prepared solely based on cleared transactions and did not include uncleared transactions. Therefore, both the books and the bank reconciliation were incorrect.

Cause: The cause of this condition is the inaccurately prepared bank reconciliation statements and inadequate review by responsible officers.

Effect: The effect of this condition is noncompliance with the criteria resulting in an audit qualification of the financial statements.

Recommendation: As this has been a repeat finding, we suggest that preparation of bank reconciliations be revisited and necessary changes be effected to ensure accuracy of reports. The reconciliation should encompass all applicable transactions, should be regularly prepared (i.e. monthly) and should be properly reviewed.

Auditee Response and Corrective Action Plan : We agree with the finding and the recommendation. We will effect the necessary changes to ensure accuracy in the preparation of our bank reconciliations. We have already revised the format of our bank reconciliation and the report is made regularly every month. These are reviewed by the Chief Accountant before the final approval from the Executive Director.

CHUUK STATE HEALTH CARE PLAN

Schedule of Findings, Continued
Year Ended September 30, 2006

Finding 2006-04 - Improper Recording of Adjustments

Criteria: The Plan should maintain on file, evidence supporting posted adjustments and that these be properly approved and documented.

Condition: Beginning net assets per the Plan's final trial balance agrees with the prior year audited balance. However, no details or support were made available to document how prior year adjustments were posted in the general ledger. Additionally, since ledgers and details of journal entries for all accounts were not available, the propriety of the net assets beginning balance, as well as balances of related accounts affected by journal entries, could not be assessed.

Cause: The cause of this condition is the inaccurately prepared bank reconciliation statements and inadequate review by responsible officers.

Effect: The effect of this condition is noncompliance with the criteria.

Recommendation: Posting of adjustments should be documented and approved and evidence supporting such should be maintained on file.

Auditee Response and Corrective Action Plan: Management agrees with the finding and the recommendation. We will document every adjustment we make and keep supporting evidence on file