

July 25, 2007

Honorable Emmanuel Mori
President
Federated States of Micronesia:

In planning and performing our audit of the financial statements of Federated States of Micronesia (FSM) National Government for the year ended September 30, 2006, which collectively comprise the State's basic financial statements (on which we have issued our report dated July 25, 2007), we developed the following recommendations concerning certain matters related to the FSM National Government's internal control and certain observations and recommendations on other accounting, administrative and operating matters. Our principal recommendations are summarized below:

Finding Number 1 - Scholarship Checks

Finding: For 17 of 95 scholarship checks tested, the checks were written out to the student/school instead of to the student and the school. Scholarship checks (or any two-party checks) should be written jointly to the recipient and to the applicable school to ensure that funds are used for designated purposes.

Recommendation: Scholarship checks should be made out jointly to the individual and to the school. If this practice is not feasible, the reasons for the adopted practice should be clearly documented.

Finding Number 2 - Fixed Assets

Finding: For 1 of 39 fixed assets tested, the asset was no longer in working condition and was not located in the National Governments' premises.

For 1 of 7 fixed asset disposals tested, authorization and disposal documents were not locatable.

Recommendation: Disposals should be appropriately authorized, associated documents should be on file and records timely updated.

Finding Number 3 - Untimely Deposits

Finding: Cash collections should be deposited the following business day after collection. The following cash collections were not deposited in a timely manner:

<u>Cash Receipt#</u>	<u>Amount</u>	<u>Date of Cash Collection</u>	<u>Date of Deposit</u>
98317	\$ 100	02/09/06	02/13/06
10014108	385,418	04/28/06	05/03/06
9954301	3,982	03/30/06	04/03/06
100777	14,358	05/22/06	05/30/06
100131	31,973	04/24/06	05/01/06

Recommendation: Existing policies governing the timely deposit of collections should be observed.

Finding Number 4 - Cash Findings

Finding: As of September 30, 2006, no bank statement was provided for the following cash account.

<u>Account Name</u>	<u>Account Number</u>	<u>GL Balance</u>	<u>Bank Balance</u>
ADB – Cash Equivalents	59-187	\$9,360	None provided

The following reconciling items for the income tax bank reconciliation were not provided:

<u>Item</u>	<u>Amount</u>	<u>Outstanding</u>
Uncleared checks unreconciled in FY05	\$ 4,327	No details provided
Bank error	\$ 1,979	No details provided
Supplemental checks	\$18,817	Approval of the check run was not provided

Income tax refund checks were not sequentially utilized. The old income tax check series was still used in the check run in August 2006, and the rationale for this matter was not provided. This condition results in unrecorded transactions, which may impact reported expenditures. Furthermore, non-reconciliation of these accounts may expose the Government to misappropriations. Because of the missing approval for the supplemental tax refund check run, it was not possible to determine if the check run was authorized.

The following reconciling items for Washington D.C. embassy reconciliations indicate missing documentation:

<u>Description</u>	<u>Amount</u>
Unrecorded housing allowance	\$(23,834)
Difference in bank and confirmation	1,000

Recommendation: We recommend that management require monthly reconciliations of all cash accounts and that the reconciliations be reviewed and monitored by a higher level of management. Moreover, there should be approval of all check runs, especially those that occur outside normal procedures. Such approval should be documented in writing. All old, unused checks should be perforated to prevent inappropriate use.

Finding Number 5 - Missing Allotment Forms

Finding: An allotment form is to be signed by the employee to support deductions from gross pay. In one of 28 (3.6%) payroll expenditures tested, (\$780.86 of the aggregate amount of \$26,505), the authorized allotment form could not be located.

<u>Employee #</u>	<u>Org #</u>	<u>PPE</u>	<u>Allotment</u>	<u>Amount</u>
16153	453899	3/18/06	FSMDB	\$110

Recommendation: We recommend that allotments be on file to support payroll deductions.

Finding Number 6 - Withholding Tax Calculations

Finding: Per FSM tax laws, taxes should be withheld at six percent on the first \$11,000 of gross pay and ten percent on the amount over the first \$11,000 of all wages and salaries received. For two of 28 (7.1%) payroll expenditures tested (\$42.09 of the aggregate amount of \$26,505), withholding taxes were not correctly calculated.

<u>Emp#</u>	<u>Fund Org</u>	<u>PPE</u>	<u>DTT W/holding</u>	<u>Entity W/Holding</u>	<u>Diff</u>
33065	453899	1/21/06	\$64.76	\$49.00	\$15.76
29678	453899	1/21/06	91.22	64.89	<u>26.33</u>
					<u>\$42.09</u>

Recommendation: We recommend that correct formulas be used in calculating withholding taxes.

Finding Number 7 - Unsupported Revenue

Finding: Revenue should be supported by cash receipts or other valid documentation. For the following fishing fees and postal revenues, there were no cash receipts issued or documentation to support revenue classification.

JVC0524	\$ 38,297
JVC0524	2,147
JVCI1010	407,407
JVCI017	673,141
JVCI006	1,273,866
JVCI009	1,150,000

Recommendation: We recommend that controls be strengthened to ensure that revenues are supported by cash receipts or other alternative documentation. Validation from the implementing government agency should also occur to support revenue classification.

Finding Number 8 - Overpayment of Holiday Labor

Finding: Employee hours should be recorded in the timesheet and in the payroll register and should reflect actual hours worked. For four of 28 (14.3%) payroll expenditures tested (\$419.40 of the aggregate amount of \$26,505), employee hours worked were not recorded properly in the timesheet and in the payroll register, which resulted in an overpayment.

<u>Emp#</u>	<u>Fund Org</u>	<u>PPE</u>	<u>Hours</u>	<u>Amount</u>
33065	453899	1/21/06	16	\$106.25
29678	453899	1/21/06	16	106.25
10151	453898	11/12/05	16	106.25
74578	453898	11/12/05	16	<u>100.65</u>
				<u>\$419.40</u>

Recommendation: We recommend that timesheets reflect actual hours worked by employees.

Finding Number 9 - Absence of Receiving Report

Finding: Expenditures should be supported by a certified receiving report, where applicable. For one of 93 (1%) non-payroll expenditures (\$7,200 of the aggregate amount of \$3,905,726 tested), no receiving report was on file substantiating that services were received.

<u>Item</u>	<u>Fund Org #</u>	<u>Cost Center</u>	<u>Voucher #</u>	<u>Amount</u>	<u>Check Date</u>	<u>Check #</u>
1	741038	NC503F	JVC86	\$ 7,200	03/28/06	250824

Recommendation: Receiving reports should be on file to support expenditure recognition.

Finding Number 10 - Journal Vouchers

Finding: For the following journal voucher and accounts payable vouchers, subsequent adjustments were recorded in the system. However, the adjustments were not supported by a journal voucher or underlying documentation.

JVC215
 APV# 620575701
 APV#601411101

Additionally, journal voucher number JVC0395 was utilized for two different adjustments.

For the following non-payroll expenditures tested (1 to 6), the transactions were reversed. Although the reversal was appropriate, such was not approved and documented. For item 7, approval of the entry was not documented.

	<u>FundOrg</u>	<u>Cost Center</u>	<u>Reference (APV & JV)</u>	<u>Obl doc #</u>	<u>Tested Amount</u>
1	33 5004	AH 5002	600 673001	CB0167	\$ 32,945
2	33 5004	AH 5002	600 673001	CB0167	(32,945)
3	33 5002	KH 5001	600 477501	CB0166	19,000
4	33 5007	PH 5003	600 497001	CB0166	57,000
5	33 5007	PH 5003	600 497002	CB0166	28,500
6	33 5007	PH 5003	600 497001	CB0166	(57,000)
7	10 517	Na Na	JVC 0516	NA	39,597

Recommendation: We recommend that all recorded adjustments be adequately documented.

Finding Number 11 - Unavailability of Documents

Finding: Bank errors should be timely resolved and collection efforts should be documented in writing and be readily available for review. Receivables from banks are recorded in the amount of \$21,708 based on represented bank errors. It is the entity's representation that inquiry and collection efforts have occurred. However no documentation was provided to substantiate the entity's collection efforts. These balances arose in prior years.

Finding Number 11 - Unavailability of Documents, Continued

Recommendation: We recommend that collection efforts relative to these items be documented and if appropriate, the balances should be expensed.

Finding Number 12 - Annual Leave

Finding: For 2 of 5 (40%) samples, annual leave hours may not have been correctly calculated.

<u>Fund</u>	<u>Empl #</u>	<u>Hours Per FSMNG</u>	<u>Pay rate</u>	<u>Amt</u>	<u>Hours Per Audit</u>	<u>Amount</u>	<u>Variance in hours</u>	<u>Variance in \$</u>
101063	38346	456	\$7.82	\$3,566	440	\$3,441	(16)	\$ (125)
101047	39850	835	5.96	4,977	335	3,888	(501)	(1,089)

For 1 of 5 samples, the approved annual leave form was not available.

<u>Fund</u>	<u>Empl #</u>	<u>Pay rate</u>	<u>Leave Usage per System</u>	<u>Available Annual Leave Form</u>	<u>Unsupported Leave Hours</u>
101047	39850	\$5.96	(108.50)	56.00	(52.50)

The maximum hours an employee can carryover is 280. The maximum hours an employee can earn per pay period are 8. Therefore, the maximum annual leave balance as of September 30, 2006 is 440 hours. The following employees exceeded the maximum allowable annual leave hours as of September 30, 2006.

<u>Emp No</u>	<u>Rate</u>	<u>Hrs</u>	<u>Max Hrs</u>	<u>Excess Hrs</u>	<u>Amount</u>
39850	5.96	835	440	395	\$2,354.60
25037	6.29	464	440	24	150.98
38346	7.82	456	440	16	125.14
902252	5.65	456	440	16	90.42
63731	5.08	456	440	16	81.30
53370	5.96	448	440	8	47.69
700102	5.96	446	440	6	35.77

Recommendation: We recommend that periodic reviews of annual leave occur to determine compliance with personnel policies and regulations.

Finding Number 13 - Encumbrances

Finding: For seven encumbrances tested aggregating \$205,857, contractual commitments arose on or before September 30, 2006. However, the amount was not encumbered as of September 30, 2006.

Finding Number 13 – Encumbrances, Continued

Finding, Continued:

<u>Seln #</u>	<u>Check #</u>	<u>Invoice #</u>	<u>APV #</u>	<u>\$ Amount</u>
1	50857	9302006c009426	7000337	454
2	50872	22029	7000574	11
3	50872	600031	7000569	65,360
4	50872	18006	7000336	2,895
5	51689	600031	7001583	74,513
6	4001427	296600	7500099	4,672
7	56161	2006-04	7006085	57,952

Recommendation: Encumbrances should be recorded in the correct accounting period.

Finding Number 14 - Correct Accounting Period

Finding: Expenditures should be recorded when incurred, i.e. when goods are received or services are actually performed. For 18 items tested, aggregating \$1,132,321, the expenditures were incurred on or before September 30, 2006. However, these items were not accrued as of that date.

<u>Seln #</u>	<u>Check #</u>	<u>Invoice #</u>	<u>APV #</u>	<u>Amount</u>
1	50857	9302006c009426	7000337	\$ 454
2	50872	22029	7000574	11
3	50872	600031	7000569	65,360
4	50872	18006	7000336	2,895
5	51193	Payment certificate # 1	7000809	55,000
6	51360	Application # 8	7000192	63,344
7	51545	Various	7000564	202,412
8	51689	600031	7001583	74,513
9	51789	3	7000266	156,000
10	51999	Progress payment # 3	7000801	94,638
			7001741;	
11	52052	610206; 610227	7001793	25,445
12	4001427	296600	7500099	4,672
13	52725	c06-011,c06-001	7000983	115,378
14	56161	2006-04	7006085	57,952
		Request for reimbursement from Yap State		
15	56752	Finance	7008429	36,892
16	54823	FSMTC memo	7003849	75,000
17	55789	MC7393	7001486	61,484
18	55298	70470	7002869	40,871
		Total		<u>\$1,132,321</u>

Finding Number 14 - Correct Accounting Period, Continued

Finding, Continued:

For 25 of 354 (7%) non-payroll expenditures tested, it appears that expenditures were incurred in prior years but were recorded only in FY 2006.

<u>Fund Org</u>	<u>APV #</u>	<u>CC</u>	<u>Obl Doc</u>	<u>Check #</u>	<u>Transaction Amount</u>
118400	660005701	336165	AR5C009	3012714	\$90,000
118400	660005702	336163	AR5C009	3012714	39,001
102760	600032702	VS4002	MC0488	37898	29,549
101368	600035601	SS5039	MC0264	37962	36,000
101000	600301801	AS1003	TA0513	49604	4,792
303054	600100601	NA5091	CB007501	39219	42,872
303054	600528601	NA2090	T31749	41807	1,373
335004	60022601	AH5002	CB016703	37918	83,941
565601	600347501	n/a	TB0789	40580	1,912
152006	600101401	FS6001	MC0789	38585	3,231
252686	JVC0410	TL3001	N3014802	12392	5,000
525201	600044001	ES1002	MC0633	38343	4,297
525201	600100401	ES1002	L5043701	39215	4,364
373654	600701401	NH2563	TA1852	52779	2,598
303056	600268301	NA5103	MC1484	40247	43,382
303056	600268401	NA5104	MC1482	40247	70,899
303056	600073101	NA5105	MC0431	38775	532
303056	600082201	NA5106	MC0406	38741	560
303056	600144701	NA5107	MB9832	39022	595
303056	600695301	NA5108	MC3696	44226	5,760
303056	600695701	NA5109	MC3692	44230	5,814
303056	600696001	NA5110	MC3689	44233	5,832
303056	600696401	NA5111	MC3685	44237	5,850
303056	600698101	NA5112	MC3683	44241	5,886
335004	60022601	AH5002	CB016703	37918	83,941

Recommendation: Expenditures should be recorded in the correct accounting period.

Finding Number 15 - Accounts Payable Negative Amount

Finding: Payroll allotment accounts have not been reconciled and contain debit balances of \$106,678 as of September 30, 2006. This condition appears to indicate that employee receivables exist in this amount.

Recommendation: The allotment accounts should be subject to periodic reconciliation, at least quarterly, and the above balance should be analyzed and adjusted as appropriate.

Honorable Emmanuel Mori
President
Federated States of Micronesia
July 25, 2007

Page 8

Finding Number 16 - Chuuk CIP Account

Finding: As of September 30, 2006 no reconciliation, per program, has been provided for Chuuk State’s Compact CIP account.

The payable recorded by the National Government for cash it administers on behalf of Chuuk State’s Compact CIP account amounts to \$32,272. The cash account combines IFG, expenses and Compact Capital expenditures related to Chuuk. Thus, the payable to Chuuk State should be the net balance of the accumulated actual receipts deposited to the account less related expenditures.

Recommendation: We understand that a bank reconciliation of the account has been performed. However, two separate funding sources were commingled in the account, hence a reconciliation of those two separate funding sources should occur.

Finding Number 17 - Accounts Payable

Finding: The following accounts had an absence of activity during fiscal year 2006.

<u>Acct</u>	<u>Account Name</u>	<u>Amount</u>
49 -502	DEFERRED RE	\$ 75,358
50 - 506	NOTES PAYAB	(2,840)
47 -572	POHNPEI DRA	(207)
50 - 571	KOSRAE DRAW	7,604
50 - 574	YAP DRAWDOW	1,851
59 -500	VOUCHER PAY	15,519
10 - 514	FSM ADB LOAN PAYMENT-REV. SHAR	<u>50,535</u>
		<u>\$147,820</u>

Recommendation: The above accounts should be subject to periodic reconciliation and should be investigated as to their validity.

Finding Number 18 - Accounts Payable

Finding: There is untimely reconciliation of travel related accounts payable. This condition resulted in a negative balance being recorded in the general fund. The original travel expenditure occurred in a separate fund. The general fund paid for the expenditure and created a negative payable in the general fund. This negative payable must be reconciled and offset against the payable recorded in the other funds.

Recommendation: Travel related accounts payable should be periodically reconciled and offsets should occur as required.

* * * * *

We have also communicated certain matters noted during our audit of financial statements of the FSM National Government for the year ended September 30, 2006, which we considered to be reportable conditions in our report dated July 25, 2007.

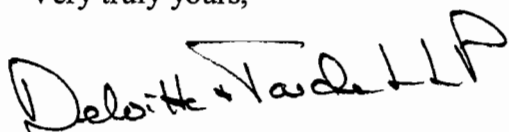
Honorable Emmanuel Mori
President
Federated States of Micronesia
July 25, 2007

Page 9

This report is intended solely for the information and use of management and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

We would like to thank the accounting staff and management for their assistance during the course of our audit. Should you have any questions regarding the matters discussed herein, please contact our office at your convenience.

Very truly yours,

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