

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

**SCHEDULE OF CASH DRAWDOWNS AND
EXPENDITURES OF U.S. FEDERAL PROGRAMS
ADMINISTERED BY THE STATE OF CHUUK
AND INDEPENDENT AUDITORS' REPORT**

QUARTER ENDED JUNE 30, 2007

INDEPENDENT AUDITORS' REPORT

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

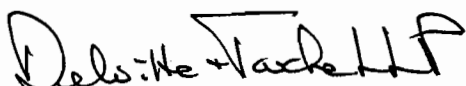
We have audited the accompanying schedule of cash drawdowns and expenditures of U. S. federal programs administered by the State of Chuuk (the State) for the quarter ended June 30, 2007. This schedule is the responsibility of the State's management. Our responsibility is to express an opinion on this schedule based on our audit.

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is 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 State's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The accompanying schedule of cash drawdowns and expenditures of U. S. federal programs is prepared on the modified accrual basis of accounting, as described in note 2, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the aforementioned schedule presents fairly, in all material respects, the cash drawdowns and expenditures of the U. S. federal programs administered by the State for the quarter ended June 30, 2007, on the basis of accounting described in note 2.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 26, 2008, on our consideration of the State'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.



February 26, 2008

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Schedule of Cash Drawdowns and Expenditures of U.S. Federal Programs
Administered by the State of Chuuk
Quarter Ended June 30, 2007

Program	CFDA #	Cash drawdowns	Expenditures
U.S. DEPARTMENT OF AGRICULTURE			
Cooperative Forestry Assistance	10.664	\$ -	\$ 9,059
U.S. DEPARTMENT OF AGRICULTURE TOTAL		-	9,059
U.S. DEPARTMENT OF LABOR			
WIA Cluster	17.255/17.258/17.259/17.260	-	263
U.S. DEPARTMENT OF LABOR TOTAL		-	263
U.S. DEPARTMENT OF HOMELAND SECURITY			
Public Assistance	83.544/97.036	-	(100,871)
U.S. DEPARTMENT OF HOMELAND SECURITY TOTAL		-	(100,871)
U.S. DEPARTMENT OF EDUCATION			
BECLEPS (Bilingual Education)	84.290	-	-
Special Education - Grants to States	84.027B	77,990	160,138
U.S. DEPARTMENT OF EDUCATION TOTAL		77,990	160,138
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES			
Maternal and Child Health Federal Consolidated Programs	93.110	290	289
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	-	12,472
AIDS Activity	93.118	-	1,101
Health Activities	93.203	365	-
Family Planning Services	93.217	3,007	15,525
Substance Abuse and Mental Health Services	93.243	8,155	-
Immunization Grants	93.268	-	47,516
Centers for Disease Control and Prevention - Investigations and Technical Assistance	93.283	-	2,317
HIV Care Formula Grants	93.917	662	4,900
AIDS Prevention	93.940	-	6,950
HIV/AIDS Surveillance	93.944	-	8,260
Block Grants for Prevention and Treatment of Substance Abuse	93.959	-	34,425
System Based Diabetes	93.988	1,163	3,613
MCH Services Block Grant to the States	93.994	5,495	20,691
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES TOTAL		19,137	158,059

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

See accompanying notes to schedule of cash drawdowns and expenditures of U.S. federal programs administered by the State of Chuuk.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Cash Drawdowns and Expenditures of U.S. Federal Programs
Administered by the State of Chuuk
Quarter Ended June 30, 2007

Program	CFDA #	Cash drawdowns	Expenditures
U.S. DEPARTMENT OF THE INTERIOR			
Compact Sector Grants - Education	15.875	\$ 2,427,568	\$ 2,146,473
Compact Sector Grants - Health	15.875	1,648,582	1,307,060
Compact Sector Grants - Capacity Building	15.875	612,648	593,824
Compact Sector Grants - Environment	15.875	133,579	132,226
Compact Sector Grants - Private	15.875	126,733	192,163
Supplemental Education Grant	15.875	<u>2,046,001</u>	<u>850,412</u>
Total Compact Sector Grants Fund		<u>6,995,111</u>	<u>5,222,158</u>
Historic Preservation Fund Grants-In-Aid	15.904	<u>16,663</u>	<u>6,430</u>
U.S. DEPARTMENT OF THE INTERIOR TOTAL		<u>7,011,774</u>	<u>5,228,588</u>
 GRAND TOTAL		 <u>\$ 7,108,901</u>	 <u>\$ 5,455,236</u>

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

See accompanying notes to schedule of cash drawdowns and expenditures of U.S. federal programs administered by the State of Chuuk.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Cash Drawdowns and Expenditures of U. S. Federal Programs
Administered by the State of Chuuk
Quarter Ended June 30, 2007

(1) Organization

The State of Chuuk (the State) is one of the four States of the Federated States of Micronesia. The schedule of cash drawdowns and expenditures of U.S. federal programs administered by the State has been prepared as a result of certain special “high risk” conditions imposed on the State by the U.S. Department of the Interior on January 29, 2007.

(2) Summary of Significant Accounting Principles

Basis of Accounting

The schedule is prepared on the modified accrual basis of accounting. The State’s policy is to recognize cash drawdowns in the accompanying schedule when the requested receipt of cash is physically received in the State’s bank account. Expenditures are recognized when the obligation is incurred on the accrual basis of accounting.

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

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

We have audited the schedule of cash drawdowns and expenditures of U.S. federal programs administered by the State of Chuuk (the State) for the quarter ended June 30, 2007, and have issued our report thereon dated February 26, 2008, which report stated that the schedule was prepared on the modified accrual basis of accounting. 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 State's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statement, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying schedule of findings and questioned costs (pages 7 through 17) as items 2007-01-C, 2007-02-C and 2007-05-C to be significant deficiencies in internal control over financial reporting.

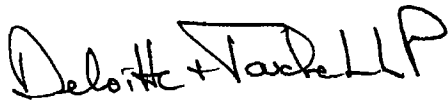
A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe the significant deficiencies described above as items 2007-01-C and 2007-02-C to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's financial statement is 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 instances of noncompliance or other matters 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 2007-01-C through 2007-05-C.

The State's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the State's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management of the State, the Office of the Public Auditor of the Federated States of Micronesia, 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 these specified parties.



February 26, 2008

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Quarter Ended June 30, 2007

Finding No.: 2007-01-C
 CFDA No.: 93.959, 84.027B, 15.875
 Program Name: Block Grants for Prevention and Treatment of Substance Abuse, Special Education—Grants to States, Compact Sector Grants
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$10,116

Criteria: In accordance with applicable allowable costs/cost principles compliance requirements, payroll expenditures should be supported by employee personnel action forms, supporting timesheets and other underlying supporting documentation validating the expenditure. Furthermore, such should be kept on file and made available for examination.

Conditions:

- For 1 (or 50%) of 2 transactions tested for the Block Grants for Prevention and Treatment of Substance Abuse Program, CFDA No. 93.959, we noted a difference in the recalculation of gross pay due to a difference in the number of hours paid as stated per the labor cost and the timesheet.

<u>FundOrg</u>	<u>PP#</u>	<u>Employee</u>	<u>Hours per Labor Cost</u>	<u>Hours per Timesheet</u>	<u>Hours Difference</u>	<u>Gross Pay per Labor Cost</u>	<u>Gross pay Per DTT</u>	<u>Gross pay Difference</u>
417550	11B	30284	232	228	4	\$ 1,229	\$ 1,209	\$ 20

- For 1 (or 33%) of 3 transactions tested for the Special Education Program, CFDA No. 84.027B, we noted a difference in the recalculation of gross pay due to a difference in the number of hours paid as stated per the labor cost and the timesheet.

<u>FundOrg</u>	<u>PP#</u>	<u>Employee</u>	<u>Hours per Labor Cost</u>	<u>Hours per Timesheet</u>	<u>Hours Difference</u>	<u>Gross Pay per Labor Cost</u>	<u>Gross pay Per DTT</u>	<u>Gross pay Difference</u>
303054	11B	42896	160	200	(40)	\$ 819	\$ 1,024	\$ (205)

- For 2 (or 2%) of 117 transactions tested for the Compact Sector Grants, CFDA No. 15.875, no cancelled check was provided and we were unable to determine that the actual payee was as listed in the accounting records.

<u>FundOrg</u>	<u>Fund Description</u>	<u>PP#</u>	<u>Employee</u>	<u>Transaction Amount</u>
741624	Operation	25	38755	\$ 224
771401	SEG	8	22700	1,523
			Total	\$ 1,747

- For 4 (or 3%) of 117 transactions tested for the Compact Sector Grants, CFDA No. 15.875, no timesheet was provided.

<u>FundOrg</u>	<u>Fund Description</u>	<u>PP#</u>	<u>Employee</u>	<u>Transaction Amount</u>
751533	Conservation and Management	10D	25787	\$ 2,100
751533	Conservation and Management	10D	25787	183
761534	Marine Research & Dev.	10D	21879	2,319
761534	Marine Research & Dev.	10D	21879	202
			Total	\$ 4,804

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended June 30, 2007

Finding No.: 2007-01-C, Continued
 CFDA No.: 93.959, 84.027B, 15.875
 Program Name: Block Grants for Prevention and Treatment of Substance Abuse, Special Education—Grants to States, Compact Sector Grants
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$10,116

Conditions, Continued:

5. For 19 (or 16%) of 117 transactions tested for the Compact Sector Grants, CFDA No. 15.875, we noted a difference in the recalculation of gross pay.

a. 10 of 19 transactions resulted in an overpayment of payroll expenditures.

FundOrg	PP#	Employee	Hours	Rate	Rate	Hrs per Timesheet	Gross	Gross	Gross pay Diff
			per Labor Cost	per Register	per PAF		pay per Register	pay Per DTT	
721411	13	54090	302	\$ 2.76	\$ 2.66	302	\$ 994	\$ 957	\$ 38
731206	10	16026	150	\$ 5.84	\$ 5.84	150	\$ 575	\$ 540	35
731206	8	606112	174	\$ 4.21	\$ 3.40	174	\$ 1,310	\$ 444	866
731206	11	75072	636	\$ 3.40	\$ 3.40	126	\$ 532	\$ 272	260
731201	11	57152	200	\$ 12.82	\$12.82	200	\$ 1,518	\$1,415	102
731205	10	40100	72	\$ 4.80	\$ 4.80	72	\$ 1,715	\$ 345	1,370
741624	25	38755	44	\$ 6.30	\$ 6.30	27	\$ 579	\$ 527	52
741621	25	94096	307	\$ 10.10	\$10.82	55	\$ 3,271	\$ 779	2,492
741624	25	38755	44	\$ 6.30	\$ 6.30	43	\$ 579	\$ 527	52
771401	13	23279	186	\$ 4.80	\$ 4.66	186	\$ 892	\$ 867	25
Total									\$ <u>5,292</u>

b. 9 of 19 transactions resulted in an underpayment of payroll expenditures.

FundOrg	PP#	Employee	Hours	Rate	Rate	Hrs per Timesheet	Gross	Gross	Gross pay Diff
			per Labor Cost	per Register	per PAF		pay per Register	pay Per DTT	
721411	7	56367	302	\$ 2.66	\$ 2.76	360	\$ 957	\$ 994	\$ (38)
721411	10	37348	302	\$ 2.66	\$ 2.83	302	\$ 957	\$1,018	(61)
721421	13	606061	176	\$ 1.65	\$ 1.65	520	\$ 291	\$ 859	(568)
721411	13	19752	168	\$ 2.83	\$ 3.00	168	\$ 475	\$ 505	(30)
731201	10	57152	176	\$ 12.82	\$12.82	184	\$ 1,518	\$1,621	(103)
731201	10	57152	176	\$ 12.82	\$12.82	184	\$ 1,518	\$1,621	(103)
771401	12	54278	366	\$ 3.40	\$ 3.61	366	\$ 1,243	\$1,322	(79)
771401	11	56414	168	\$ 6.14	\$ 6.14	200	\$ 1,032	\$1,228	(196)
771401	13C	618783	1,040	\$ 1.25	\$ 1.56	1,040	\$ 1,300	\$1,625	(325)
Total									\$ <u>(1,503)</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended June 30, 2007

Finding No.: 2007-01-C, Continued
 CFDA No.: 93.959, 84.027B, 15.875
 Program Name: Block Grants for Prevention and Treatment of Substance Abuse, Special Education—Grants to States, Compact Sector Grants
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$10,116

Conditions, Continued:

6. For 28 (or 24%) or 117 transactions tested for the Compact Sector Grants, CFDA No. 15.875, we noted a difference between the FundOrg per the system and per the personnel action form.

<u>Employee</u>	<u>PP</u>	<u>Rate</u>	<u>Effective Date</u>	<u>FundOrg Per PAF</u>	<u>FundOrg Per System</u>
74948	25	\$ 3.00	04/15/03	101400	721411
54090	13	\$ 2.66	10/01/94	1411	721411
54200	13	\$ 3.00	05/30/95	2129	721411
26443	9	\$ 4.49	09/19/97	1421	721411
609603	11	\$ 2.13	03/31/07	none	721411
37348	10	\$ 2.83	10/01/97	1206	721411
13221	25	\$ 5.47	09/19/97	1421	721421
37241	10	\$ 3.84	10/01/03	101421	721421
13221	9	\$ 5.47	09/19/97	1421	721421
29740	7	\$ 3.61	10/01/03	101421	721421
18079	13	\$ 4.21	12/01/00	1411	721411
606061	13	\$ 1.65	10/01/03	101421	721421
55211	10	\$ 1.74	10/01/03	101421	721421
26443	9	\$ 4.49	09/19/97	1421	721411
22503	13	\$ 1.58	01/01/07	731205	731201
26445	9	\$10.06	10/01/99	1201	731201
99888	8	\$13.35	06/20/06	1201	731201
22622	12	\$ 8.03	02/15/07	741101	741131
38755	25	\$ 6.30	10/01/03	101624	741624
25787	10D	\$ 5.47	09/17/03	101633	751533
22456	10D	\$ 4.21	06/03/01	761544	751544
25787	10D	\$ 5.47	09/17/03	101633	751533
21879	10D	\$ 5.47	10/01/03	101534	761534
49019	10D	\$ 2.66	10/01/01	1542	761542
23279	13	\$ 4.66	06/02/07	721401	771401
427751	9	\$17.79	01/01/07	721421	771401
427751	11	\$17.79	01/01/07	721421	771401
618783	13C	\$ 1.56	08/14/05	4112	771401

Cause: There appears to be weak internal controls over ensuring payroll expenditures are supported by timesheets and other underlying supporting documents. Furthermore, there appears to be weak internal controls over record keeping of underlying supporting documents and ensuring that such are made available for examination.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended June 30, 2007

Finding No.: 2007-01-C, Continued
CFDA No.: 93.959, 84.027B, 15.875
Program Name: Block Grants for Prevention and Treatment of Substance Abuse, Special Education—Grants to States, Compact Sector Grants
Requirement: Allowable Costs/Cost Principles
Questioned Costs: \$10,116

Effect: The conditions may result in potential noncompliance with applicable compliance requirements and potential misstatement of expenditures may exist. Although the aggregate amount of all conditions listed above is \$10,155, a total of (\$1,708) from conditions 2 and 5.b represents underpayment of payroll expenditures and do not result in a questioned cost. Additionally, a total of \$1,747 from condition 3 does not result in a questioned cost as such pertains to cancelled checks, and is excluded in determining the final questioned costs amount. Therefore, a total questioned cost of \$10,116 exists.

Recommendation: The State should strengthen internal controls over ensuring payroll expenditures are supported by employee personnel action forms, supporting timesheets and other underlying supporting documentation validating the expenditure. Furthermore, the State should strengthen internal controls over ensuring proper record keeping of underlying supporting documents and that such are made available for examination.

Auditee Response and Corrective Action Plan:

We agree with the recommendation to strengthen internal controls over the payroll process, ensuring better documentation to support payroll expenditures and allow for easier retrieval.

Management believes most of the exceptions noted are the result of failure to provide adequate documentation and not reflective of any underlying irregularities with respect to payroll processing. We implemented a new accounting system, Fundware, and a new process for timesheet entry and review. The process itself, combined with the controls inherent in Fundware, is less prone to transposition errors, and the secondary review will provide assurance that errors will be detected before paychecks are issued. Payroll has also been instructed to retain files of timesheets, cancelled checks, and Personnel Action Forms supporting employees' pay rates and FundOrg. In doing so, management believes that internal controls with respect to payroll processing will be improved.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended June 30, 2007

Finding No.: 2007-02-C
 CFDA No.: 84.027B, 15.875
 Program Name: Special Education-Grants to States, Compact Sector Grants
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Costs: \$369,529

Criteria: In accordance with allowable costs/cost principles and procurement compliance requirements, non-payroll expenditures should be supported by purchase requisitions, purchase orders, vendor invoices, receiving reports, contracts, journal vouchers, competitive procurement documents and other underlying source documents validating the expenditure and procurement method. Furthermore, such documentation should be kept on file and be available for examination.

Conditions:

- For 2 (or 100%) of 2 transactions tested for the Special Education Program, CFDA No. 84.027B, no prior grantor approval or competitive procurement related documents were provided.

<u>FundOrg</u>	<u>Fund Description</u>	<u>APV #</u>	<u>Transaction Date</u>	<u>Transaction Amount</u>
301401	Education Administration	700416101	5252007	\$ 34,894
301401	Education Administration	700482101	6212007	<u>27,642</u>
			Total	\$ <u>62,536</u>

- For 2 (or 4%) of 45 transactions tested for the Compact Sector Grants, CFDA No. 15.875, no vendor invoices or contract were provided.

<u>FundOrg</u>	<u>Fund Description</u>	<u>APV#</u>	<u>Transaction Date</u>	<u>Transaction Amount</u>
731201	Hospital & Management	700464901	6222007	\$ 3,800
771401	SEG	760110001	5242007	<u>2,250</u>
			Total	\$ <u>6,050</u>

- For 1 (or 2%) of 45 transactions tested for the Compact Sector Grants, CFDA No. 15.875, no receiving report or boarding passes were provided.

<u>FundOrg</u>	<u>Fund Description</u>	<u>APV #</u>	<u>Transaction Date</u>	<u>Transaction Amount</u>
741105	ACCOUNTING	760102001	5102007	\$ <u>5,600</u>

- For 8 (or 18%) of 45 transactions tested for the Compact Sector Grants, CFDA No. 15.875, either no or insufficient procurement documentation was provided.

<u>FundOrg</u>	<u>Fund Description</u>	<u>APV #</u>	<u>Transaction Date</u>	<u>Transaction Amount</u>
721421	SECONDARY EDUCATION	700389901	5172007	\$ 105,721
721403	CURRICULUM & INSTRUCTION	700389701	5172007	94,335
721411	ELEMENTARY EDUCATION	700389801	5172007	74,891
731206	NURSING	760112601	6042007	2,886
741105	ACCOUNTING	760102001	5102007	5,600

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended June 30, 2007

Finding No.: 2007-02-C, Continued
 CFDA No.: 84.027B, 15.875
 Program Name: Special Education-Grants to States, Compact Sector Grants
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Costs: \$369,529

Conditions, Continued:

<u>FundOrg</u>	<u>Fund Description</u>	<u>APV #</u>	<u>Transaction Date</u>	<u>Transaction Amount</u>
761780	VISITORS BUREAU	700312901	4052007	\$ 4,360
771401	SEG	700329901	4202007	9,850
771401	SEG	700445701	6112007	<u>3,300</u>
			Total	\$ <u>300,943</u>

Cause: There appears to be weak internal controls over ensuring that expenditures are supported by purchase requisitions, purchase orders, vendor invoices, receiving reports, contracts, journal vouchers, competitive procurement documents and other underlying supporting documentation validating the expenditure or procurement method. Furthermore, there appears to be weak internal controls over record keeping of underlying supporting documents and ensuring that such are made available for examination.

Effect: The condition may result in potential noncompliance with applicable compliance requirements and potential misstatement of expenditures may exist. Although the aggregate amount of all conditions listed above is \$375,129, a total of \$5,600 from condition 4 has already been questioned at condition 3 and will be excluded in determining the final questioned cost amount. Therefore, a total questioned cost of \$369,529 exists.

Recommendation: The State should strengthen internal controls over ensuring expenditures are supported by purchase requisitions, purchase orders, vendor invoices, receiving reports, contracts, journal vouchers, procurement documents and other underlying supporting documentation validating the expenditure. Furthermore, the State should strengthen internal controls over ensuring proper record keeping of underlying supporting documents and that such are made available for review.

Auditee Response and Corrective Action Plan:

We agree with the recommendation to strengthen internal controls with respect to properly documenting all non-payroll procurement expenditures. It is the division of finance's standard policy to require purchase requisitions, purchase orders, vendor invoices, receiving reports, contracts, journal vouchers and other procurement documents to properly validate expenditures before they are incurred. Moreover, procedures are in place to require competitive procurement on all expenditures made from sector or other U.S. federal grant funds.

Management believes most of the exceptions noted are the result of failure to provide adequate documentation and not reflective of any underlying irregularities with respect to procurements from sector or other U.S. federal grants. We closed the Procurement office, and moved the Procurement employees to the Finance office, where we believe that we will be able to better control the Procurement process, and retention of the necessary documents. We are working very closely with the Procurement Supervisor to ensure that the Procurement policies are understood and executed. In doing so, management believes that internal controls with respect to procurement procedures will be improved.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended June 30, 2007

Finding No.: 2007-03-C
CFDA No.: 84.027B
Program Name: Special Education-Grants to States
Requirement: Cash Management
Questioned Costs: Undeterminable

Criteria: In accordance with applicable cash management compliance 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 2 (or 100%) of 2 transactions tested (\$62,536 of the aggregate amount of \$62,536 tested), for the Special Education Program, CFDA No. 84.027B, we were unable to perform required cash management tests as detailed federal draw downs and supporting reimbursements were not made available for examination.

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. At the time of the audit there were several unidentified deposits pertaining to U.S. Federal Grant drawdowns. All of these have now been identified so that verification of grant receipts can now be performed for cash management purposes.

Additionally, in May 2007, the local finance office of the FSM national government (FSMNG) began processing all new expenditures incurred under non-sector U.S. federal grants. Consequently, the delays in receiving drawdowns and making disbursements resulting from Chuuk State's former sub-recipient status with respect to these grants should be eliminated. Documentation pertaining to new obligations incurred in May 2007 and subsequently will be provided by the Chief of the FSMNG local finance office.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended June 30, 2007

Finding No.: 2007-04-C
CFDA No.: 15.875
Program Name: Compact Sector Grants
Requirement: Contract Provisions
Questioned Costs: \$ 0

Criteria: For all contracts the following provisions should be included, as applicable:

- (i) For contracts in excess of \$100,000, administrative, contractual, or legal remedies in instances where contractors violate or breach Contract terms, and the provision of such sanctions and penalties as appropriate;
- (ii) For contracts in excess of \$100,000, termination for cause and for convenience by the Grantee or Sub-Grantee including the manner by which it will be effected and the basis for settlement;
- (iii) Compliance with the local statutes regarding kickbacks and corrupt practices;
- (iv) Access by the Government of the Federated States of Micronesia and its Sub-Grantees, the Government of the United States, or any of their duly authorized representatives to any books, documents, papers, and records of the contractor which are directly pertinent to that specific Contract for the purpose of making audit, examination, excerpts, and transcriptions;
- (v) Retention of all required records for three years after Grantees or Sub-Grantees make final payments and all other pending matters are closed; and
- (vi) Compliance with all applicable standards, orders, or requirements issued under local environmental laws.

Condition: Noncompliance with the criteria occurred in the following contracts tested. The aggregate amount of these contracts was \$286,080.

<u>FundOrg</u>	<u>Transaction No.</u>	<u>Contract Reference No.</u>
721421	700433801	C70152
731201	700455401	C60052
771401	700329901	Lease agreement
771401	700445701	Lease agreement
771401	700340001	Lease agreement

Cause: There appears to be lack of internal control exercised over ensuring that compliance with the criteria occurs.

Effect: The State appears to be in noncompliance with the criteria.

Recommendation: We recommend that the State strengthen its control in ensuring that abovementioned contract provisions and requirements are included, as applicable, in contracts.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended June 30, 2007

Finding No.:	2007-04-C, Continued
CFDA No.:	15.875
Program Name:	Compact Sector Grants
Requirement:	Contract Provisions
Questioned Costs:	\$ 0

Auditee Response and Corrective Action Plan:

We agree with the finding and recommendation to strengthen internal controls with respect to ensuring the compliance with contract provisions.

Management believes most of the exceptions noted are the result of failure to provide adequate documentation and lack of secondary review, and are not reflective of any underlying irregularities with respect to procurements from sector or other U.S. federal grants. We continue to review our Policies and Procedures in order to improve our internal controls.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended June 30, 2007

Finding No.: 2007-05-C
 CFDA No.: 15.875
 Program Name: Compact Sector Grants
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Costs: Undeterminable

Criteria: Underlying documentation should be available to support the legitimacy of the incurred expenditure, its relationship to the program and its compliance with relevant laws and regulations.

Conditions:

1. Employee who worked during a holiday should be paid 8 hours of regular pay and 8 hours of holiday pay at a regular pay rate. However, due to two different pay codes being used for holiday pay, the HO (regular pay) and HL (double pay), in the payroll system, an employee who worked during a holiday gets paid 8 hours of regular pay and 8 hours of holiday pay at twice the regular pay rate.

The amount of the total questioned costs for overpayment of the holiday pay will be determined during the year end FY 2007 Single Audit.

2. In accordance with Chuuk State laws, some employees have 80 default hours, others have 72 hours. However, per examination of the approved timesheet provided by Chuuk State Finance office, the timekeeper input 80 hours for employees who have only 72 default hours. This resulted in some of the differences in the gross pay calculation we noted during the audit.
3. Competitive procurement documents should be obtained prior to vendor selection to determine the lowest price for the acceptable quality. However, the date of the price quotations from two vendors provided by the Chuuk State Finance office appears to have been tampered with.
4. The purpose of procurement policies and procedures are intended to require Chuuk State to acquire goods and services of the requisite quality, at the lowest reasonable costs, within the requisite time frame, utilizing competitive procurement method to the maximum extent possible.

For 2 of 45 transactions tested, the petroleum, oil and lubricants were purchased from vendors other than the primary source who is known to Chuuk State Finance office to have the lowest price.

5. Expenditures should be recorded when incurred, i.e. when goods are received or services are actually performed. For 5 items tested, aggregating \$117,094, the expenditures were incurred subsequent to September 30, 2007.

<u>FundOrg</u>	<u>Fund Description</u>	<u>APV #</u>	<u>Transaction Date</u>	<u>Transaction Amount</u>
721411	ELEMENTARY EDUCATION	700358301	4302007	\$ 4,057
731201	HOSPITAL & MANAGEMENT	700380301	5212007	50,000
741624	OPERATION	700358801	4262007	29,000
741624	OPERATION	700358804	4262007	21,000
741621	ADMINISTRATION -P.S	700358808	4262007	13,037
			Total	\$ <u>117,094</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended June 30, 2007

Finding No.: 2007-05-C, Continued
CFDA No.: 15.875
Program Name: Compact Sector Grants
Requirement: Allowable Costs/Cost Principles and Procurement
Questioned Costs: Undeterminable

Cause: The cause of the above is inadequate documentation supporting the specified transactions. Due to the inadequacy of the documentation, no questioned costs have arisen at this point in time. Each of the above will be subject to re-audit in the September 30, 2007 Single Audit and a questioned cost determination will occur at that time.

Effect: The effect of the above condition is that inadequate documentation currently exists to support the propriety of the referenced transactions

Recommendation: The above matters have been discussed with relevant Chuuk State management and these matters will require resolution in the September 30, 2007 Single Audit.

Auditee Response and Corrective Action Plan:

We agree with the recommendation to strengthen internal controls with respect to ensuring the accuracy of compliance with policy and documenting payroll and non-payroll expenditures.

Management believes most of the exceptions noted are the result of failure to provide adequate documentation and lack of secondary review, and are not reflective of any underlying irregularities with respect to procurements from sector or other U.S. federal grants. We continue to review our Policies and Procedures in order to improve our internal controls.