

**CHUUK STATE HEALTH CARE PLAN  
(A COMPONENT UNIT OF THE STATE OF CHUUK)**

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**FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITORS' REPORT**

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**YEARS ENDED SEPTEMBER 30, 2007 AND 2006**

## 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, 2007 and 2006, 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.

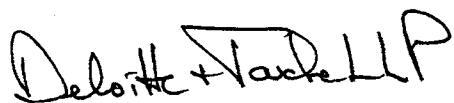
Except as discussed in the following paragraph, we conducted our audits in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial 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.

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, as discussed in the third paragraph above, such financial statements present fairly, in all material respects, the financial position of the Chuuk State Health Care Plan as of September 30, 2007 and 2006, and the 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 June 6, 2008, 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.

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

June 6, 2008

# CHUUK STATE HEALTH CARE PLAN

## Management's Discussion and Analysis Year Ended September 30, 2007

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, 2007. We encourage readers to consider this information in conjunction with the Plan's financial statements, which follow. Fiscal year 2006 and 2005 comparative information has been included, where appropriate. This information is required by the Government Accounting Standards Board, (GASB), which provides guidelines on what must be included and excluded from the analysis.

There are three financial statements presented: the 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, 2007, the Chuuk State Health Care Plan's net assets decreased by \$0.15 million (down 14%) from \$1.061 million in the prior year to \$0.911 million. The decrease is primarily attributable to decreased premium receipts and increased medical claims expenses.
- During fiscal year 2007 the Plan had premium revenues of \$0.835 million compared to \$0.872 million in fiscal year 2006. The \$0.037 million decrease (or 4.3%) was the result of declining premiums per enrollee. Medical claim expenses were \$0.78 million in fiscal year 2007 compared to \$0.64 million in fiscal year 2006 (up 22%). The disproportionate increase in expenses results from greater plan utilization by enrollees and higher claims expense per patient.
- During fiscal year 2007, the Plan incurred a net loss of \$0.15 million compared to earnings of \$0.038 million in fiscal year 2006. The loss reflected the combination of declining premiums, increased claims expenses and higher general and administrative expenses.

### 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.

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 assets, which is divided into two categories, nonexpendable and expendable. The corpus of nonexpendable restricted assets is only available for investment purposes; the Plan has no nonexpendable restricted 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.

# CHUUK STATE HEALTH CARE PLAN

Management's Discussion and Analysis  
Year Ended September 30, 2007

## SUMMARY STATEMENTS OF NET ASSETS (In'000's)

	<u>2007</u>	<u>2006</u>	<u>2005</u>
<b>ASSETS:</b>			
Current assets	\$ 1,060	\$ 1,105	\$ 1,021
Capital assets, net	<u>26</u>	<u>23</u>	<u>29</u>
Total assets	<u>\$ 1,086</u>	<u>\$ 1,128</u>	<u>\$ 1,050</u>
<b>LIABILITIES:</b>			
Current liabilities	\$ 175	\$ 67	\$ 27
Non-current liabilities	<u>-</u>	<u>-</u>	<u>-</u>
Total liabilities	175	67	27
<b>NET ASSETS</b>			
Invested in capital assets	26	23	29
Restricted	<u>885</u>	<u>1,038</u>	<u>994</u>
Total net assets	<u>911</u>	<u>1,061</u>	<u>1,023</u>
Total liabilities and net assets	<u>\$ 1,086</u>	<u>\$ 1,128</u>	<u>\$ 1,050</u>

The total assets at the end of fiscal year 2007 of \$1,086 thousand exceed the total liabilities of \$175 thousand, resulting in net assets of \$ 911 thousand. Of the total net assets, \$ 773 thousand are held in cash, cash equivalents or short-term investments. Another \$287 thousand are in the form of accounts receivable from plan enrollees. This contrasts to fiscal year 2006 when \$1,069 thousand of the total assets were held in cash, cash equivalents or investments and accounts receivable were negligible. The deteriorating cash position of the Plan in fiscal year 2007 reflects the delayed allotment payments for the public sector employees of the Chuuk State Government. Nevertheless, the Plan's 6:1 ratio of current assets to current liabilities still indicates the ability of the Plan to meet its liabilities without difficulty.

### 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 earned 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.

## CHUUK STATE HEALTH CARE PLAN

Management's Discussion and Analysis  
Year Ended September 30, 2007

### SUMMARY STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

In '000's

	2007	2006	2005
<b>REVENUES</b>			
Premiums	\$ 835	\$ 872	\$ 781
Other Revenues	37	34	14
Total revenues	872	906	795
<b>EXPENSES:</b>			
Claims expenses	780	639	229
Other operating expenses	242	229	136
Total expenses	1,022	868	365
Net earnings (loss)	(150)	38	430
Net assets at beginning of year	1,061	1,023	593
Net assets at end of year	\$ 911	\$ 1,061	\$ 1,023

The Statement of Revenues, Expenses, and Changes in Net Assets reflects a negative year in fiscal year 2007, with the overall decrease in net assets equal to the amount of net loss of \$150 thousand. This contrasts to the fiscal years 2006 and 2005 where net assets increased by the amount of net income. Some highlights of the information presented on the Statement of Revenues, Expenses, and Changes in Net Assets are as follows:

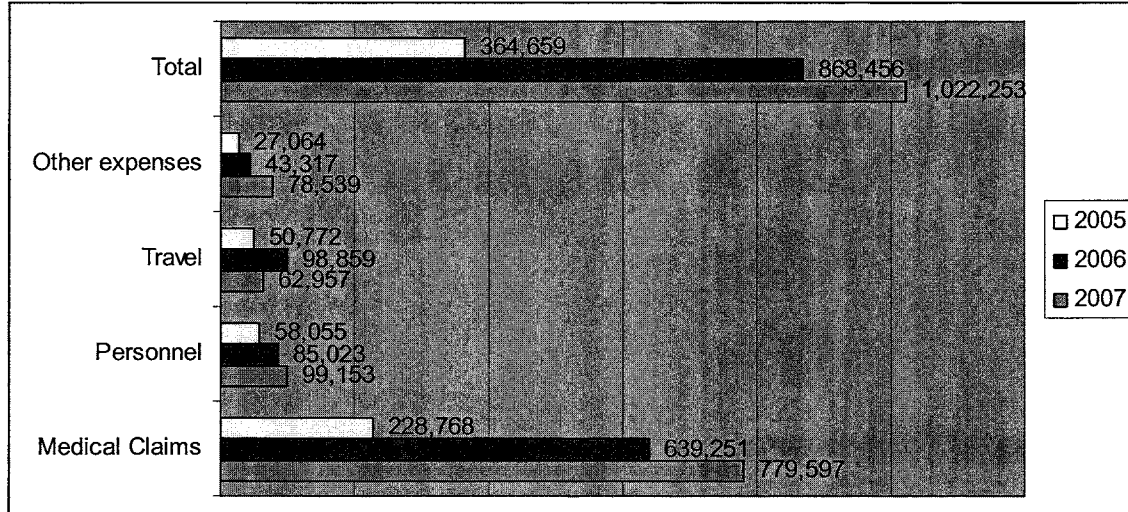
- Premium revenues represent receipts from Plan enrollees. The following table indicates premium revenue activity for fiscal years 2007, 2006 & 2005 for both public and private sector enrollees:

MEMBER COMPOSITION	FY- # ENROLLED	2007 PREMIUMS PAID	FY- # ENROLLED	2006 PREMIUMS PAID	FY- # ENROLLED	2005 PREMIUMS PAID
	@ 9-30-07	(000's)	@ 9-30-06	(000's)	@ 9-30-05	(000's)
Public Sector	22,160	\$ 776	21,495	\$ 845	12,509	\$ 765
Private Sector	1,679	58	1,084	27	970	16
<b>TOTALS</b>	23,839	\$ 834	22,579	\$ 872	13,479	\$ 781

## CHUUK STATE HEALTH CARE PLAN

### Management's Discussion and Analysis Year Ended September 30, 2007

- The major components of Plan expenses during fiscal years 2007, 2006 and 2005 are highlighted by the following graph:



The graph highlights the worrying trend of increasingly higher Plan expenses. Medical claim expenses increased \$ 140 thousand (or 21%) during fiscal year 2007 from fiscal year 2006, and are comprising an increasingly large portion of Plan premiums. Moreover, claim payouts are increasing even as premiums are falling, as disclosed in the table below:

FISCAL YEAR	PREMIUMS	CLAIMS EXPENSE	CLAIMS AS A % OF PREMIUMS
2007	\$ 834,562	\$ 779,597	93%
2006	872,006	639,251	73%
2005	781,370	228,768	29%

Premiums fell \$37 thousand in fiscal year 2007 (or 4.2%) from fiscal year 2006, primarily because of a smaller salary base for public sector employees. The higher payout ratio reflects not only lower premiums but increased utilization of Plan services from the dependents of primary enrollees.

Personnel expenses, comprising both salaries and coordinator fees, increased to \$99 thousand in fiscal year 2007 from the prior year's \$85 thousand (up 7%).

Travel expenses in fiscal year 2007 decreased \$36 thousand (or 37%) ; from \$99 thousand in fiscal year 2006 to \$63 thousand in fiscal year 2007. This decrease reflects the tighter controls management placed on patient, employee and Board of Director travel.

In the category of other expenses, a one-time consultant's fee of \$28,000 in fiscal 2007 was the primary cause of the large \$35 thousand increase (or 81%) from fiscal year's 2006 total.

# CHUUK STATE HEALTH CARE PLAN

Management's Discussion and Analysis  
Year Ended September 30, 2007

## Statement of Cash Flows

The final statement 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 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>2007</u>	<u>2006</u>	<u>2005</u>
Cash provided by (used in):			
Operating activities	\$ (325)	\$ 62	\$ 439
Capital and related financing activities	(9)	-	(18)
Investing Activities	<u>38</u>	<u>(165)</u>	<u>(501)</u>
Net change in cash and cash equivalents	<u>(296)</u>	<u>(103)</u>	<u>(80)</u>
Cash and cash equivalents, beginning of year	<u>369</u>	<u>472</u>	<u>552</u>
Cash and cash equivalents, end of year	<u>\$ 73</u>	<u>\$ 369</u>	<u>\$ 472</u>

The Plan's cash and cash equivalent resources declined by \$296 thousand (or 80%) in fiscal year 2007, from \$369 thousand in the prior year to \$73 thousand. This decrease in cash resources was the result of eroding cash positions from operating activities primarily as the result of delinquent allotment payments of the Chuuk State Government. As cash decreased, accounts receivables increased. Premium receivables in fiscal year 2007, virtually all from the State government, increased by \$201 thousand from \$36 thousand in fiscal year 2006. Moreover, the Plan was required to pay \$50,000 to the State following the Governor's emergency declaration for the utility crisis.

## Capital Asset and Debt Administration

The Plan's investment in capital assets amounted to \$56 thousand in fiscal year 2007, net of accumulated depreciation of \$30 thousand, leaving a book value of \$26 thousand. This represents an increase of three thousand (or 13%) from the \$23 thousand reported for fiscal year 2006.

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 financial statements.

Management's Discussion and Analysis for the year ended September 30, 2006 is set forth in the Plan's report on the audit of financial statements, which is dated August 31, 2007. That Discussion and Analysis explains the major factors impacting the 2006 financial statements and can be obtained via the Office of the Public Auditor's website at [www.fsmpublicauditor.fm](http://www.fsmpublicauditor.fm).



# **CHUUK STATE HEALTH CARE PLAN**

Management's Discussion and Analysis  
Year Ended September 30, 2007

## **Economic Outlook**

In fiscal year 2008, the Chuuk State Government (State) partially paid its liabilities to the Plan, remitting \$92 thousand of approximately \$201 thousand due for outstanding allotments. As the State government makes further efforts to increase its debt relief funds, management is confident that the State will pay its remaining liabilities. On the other hand, the State took major steps to reduce its workforce (RIF) in fiscal year 2008; a move that will have significant impact on public sector premiums, projected to decline from \$90-120 thousand once the total RIF effects are factored into the State's wage bill. Because 93% of its enrollees are public sector employees, the Plan will have little choice but to take concerted action to reduce the erosion of its cash position by implementing firm cost control measures. Rigorous adherence to referral policies, better controls on claims reviews and settlement, cost containment on general and administrative expenses, and increased efforts to enroll more private sector employees will be necessary measures to operate the Plan effectively.

The management and Board of the Chuuk State Health Care Plan accept the challenges of controlling costs within 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, 2007 and 2006

<u>ASSETS</u>	<u>2007</u>	<u>2006</u>
Current assets:		
Cash and cash equivalents	\$ 73,116	\$ 369,361
Short-term investments	700,000	700,000
Premiums receivable	237,056	35,644
Other receivables	50,000	-
Other assets	446	403
Total current assets	<u>1,060,618</u>	<u>1,105,408</u>
Property and equipment, net	<u>25,743</u>	<u>22,902</u>
Total assets	<u><u>\$ 1,086,361</u></u>	<u><u>\$ 1,128,310</u></u>
 <u>LIABILITIES AND NET ASSETS</u>  		
Current liabilities:		
Medical claims and benefits payable	\$ 165,708	\$ 57,657
Accounts payable and accrued expenses	<u>9,441</u>	<u>9,451</u>
Total liabilities	<u>175,149</u>	<u>67,108</u>
Commitment		
Net assets:		
Invested in capital assets	25,743	22,902
Restricted	<u>885,469</u>	<u>1,038,300</u>
Total net assets	<u>911,212</u>	<u>1,061,202</u>
Total liabilities and net assets	<u><u>\$ 1,086,361</u></u>	<u><u>\$ 1,128,310</u></u>

See accompanying notes to financial statements.

## CHUUK STATE HEALTH CARE PLAN

### Statements of Revenues, Expenses and Changes in Net Assets Years Ended September 30, 2007 and 2006

	2007	2006
Revenues:		
Premiums	\$ 834,562	\$ 872,006
Benefits paid:		
Claims expenses	779,597	639,251
	54,965	232,755
Other operating expenses:		
Salaries, wages and other benefits	80,253	59,373
Travel	62,957	98,859
Consultant fee	28,000	-
Coordinator's fee	18,900	25,650
Rent	8,400	8,400
Housing allowance	5,850	3,330
Depreciation	5,786	6,439
Office/computer supplies	4,831	2,654
Promotional	4,825	1,800
Social security expense	4,479	2,250
Board allowance	3,260	1,800
Representation - board luncheon meeting	2,929	2,232
Telephone and telegraph	2,633	3,385
Gasoline and fuel	2,105	3,676
CSHCP premium and other health care contributions	1,932	1,447
Utilities	1,392	2,361
Miscellaneous	4,124	5,549
Total other operating expenses	242,656	229,205
Net (loss) income from operations	(187,691)	3,550
Interest income	37,701	34,073
Net (loss) income	(149,990)	37,623
Net assets at beginning of year	1,061,202	1,023,579
Net assets at end of year	\$ 911,212	\$ 1,061,202

See accompanying notes to financial statements.

## CHUUK STATE HEALTH CARE PLAN

### Statements of Cash Flows Years Ended September 30, 2007 and 2006

	2007	2006
Cash flows from operating activities:		
Premiums received	\$ 633,150	\$ 884,050
Medical claims and benefits paid	(671,546)	(601,618)
Advances and other prepayments	(50,043)	-
Other expenses paid	(236,880)	(220,602)
Net cash (used in) provided by operating activities	(325,319)	61,830
Cash flows from capital and related financing activities		
Acquisition of property and equipment	(8,627)	-
Net cash used in capital and related financing activities	(8,627)	-
Cash flows from investing activities		
Net change in time certificates of deposit	-	(198,802)
Interest income received	37,701	34,073
Net cash provided by (used in) investing activities	37,701	(164,729)
Net change in cash and cash equivalents	(296,245)	(102,899)
Cash and cash equivalents at beginning of year	369,361	472,260
Cash and cash equivalents at end of year	\$ 73,116	\$ 369,361
Reconciliation of net (loss) income from operations to net cash (used in) provided by operating activities:		
Net (loss) income from operations	\$ (187,691)	\$ 3,550
Adjustments to reconcile net (loss) income from operations to net cash (used in) provided by operating activities:		
Depreciation	5,786	6,439
Changes in assets and liabilities:		
(Increase) decrease in premiums receivable	(201,412)	10,648
(Increase) decrease in other receivables	(50,000)	800
(Increase) decrease in other assets	(43)	597
Increase in medical claims and benefits payable	108,051	37,633
(Decrease) increase in accounts payable and accrued expenses	(10)	2,163
Net cash (used in) provided by operating activities	\$ (325,319)	\$ 61,830

See accompanying notes to financial statements.

# CHUUK STATE HEALTH CARE PLAN

Notes to Financial Statements  
September 30, 2007 and 2006

## (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 has also been extended to the private sector employers and employees.

## (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, 2007 and 2006

## (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, 2007 and 2006, 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 become 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.

### Medical Claims and Benefits Payable

Medical claims and benefits payable represent the actual liability on claims reported to the Plan. The liabilities for claims are determined based on actual billings received from accredited hospitals and clinics, representing medical procedures performed for members through the financial statement date.

## CHUUK STATE HEALTH CARE PLAN

Notes to Financial Statements  
September 30, 2007 and 2006

### (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 financial institution 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, 2007 and 2006, the carrying amount of the Plan's cash and cash equivalents and time certificates of deposit were \$773,116 and \$1,069,361, respectively, and the corresponding bank balances were \$789,717 and \$1,069,841, respectively. Of the bank balance amounts, \$771,080 and \$944,925, respectively, were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. The remaining amounts of \$18,638 and \$124,916, respectively, represent deposits maintained in dollar and Philippine Peso denominated bank accounts maintained offshore. Accordingly, these deposits are exposed to foreign currency risk. As of September 30, 2007 and 2006, 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.

# CHUUK STATE HEALTH CARE PLAN

Notes to Financial Statements  
September 30, 2007 and 2006

## (2) Summary of Significant Accounting Policies, Continued

### Short-Term Investments

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

### 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

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments. The provisions of this statement are effective for periods beginning after December 15, 2006. 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*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other postemployment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this statement are effective for periods beginning after December 15, 2007. 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.



# CHUUK STATE HEALTH CARE PLAN

Notes to Financial Statements  
September 30, 2007 and 2006

## (2) Summary of Significant Accounting Policies, Continued

### New Accounting Standards

In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. 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 May 2007, GASB issued Statement No. 50, *Pension Disclosures an amendment of GASB Statements No. 25 and 27*. GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits. The provisions of this statement are effective for periods beginning after June 15, 2007. Management does not believe the implementation of this statement will have a material effect on the financial statements of the Plan.

In June 2007, GASB issued statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. 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 of \$700,000 as of September 30, 2007 and 2006. These deposits have initial maturity dates of one year and have interest rates ranging from 2.33% to 4.42%.

## (4) Property and Equipment

A summary of the Plan's property and equipment at September 30, 2007 and 2006, is as follows:

	Estimated Useful Lives	Balance at October 1, 2006	Transfers and Additions	Transfers and Deletions	Balance at September 30, 2007
Office furniture and equipment	5 - 10 years	\$ 15,937	\$ 8,627	\$ -	\$ 24,564
Vehicle	6 - 15 years	<u>31,660</u>	<u>-</u>	<u>-</u>	<u>31,660</u>
		47,597	8,627	-	56,224
Less accumulated depreciation		<u>(24,695)</u>	<u>(5,786)</u>	<u>-</u>	<u>(30,481)</u>
Property and equipment, net		\$ <u>22,902</u>	\$ <u>2,841</u>	\$ <u>-</u>	\$ <u>25,743</u>

## CHUUK STATE HEALTH CARE PLAN

### Notes to Financial Statements September 30, 2007 and 2006

#### (4) Property and Equipment

	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>

#### (5) Commitment

##### Lease Commitment

The Plan leases office space under an operating lease. Rental expense for the years ended September 30, 2007 and 2006 amounted to \$8,400 and is included as a component of other operating expenses in the accompanying financial statements. At September 30, 2007, 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>

#### (6) Related Parties

As of September 30, 2007 and 2006, premium receivables from Chuuk State Government amounted to \$234,639 and \$33,588, respectively, and related premium revenue earned amounted to \$781,253 and \$840,858, respectively. Additionally, as of September 30, 2007, the Plan has an outstanding receivable of \$50,000 from the Chuuk State Government, representing advances made to a component unit of the State.

The Plan paid medical claims and benefits totaling \$86,177 during the year ended September 30, 2006 to Family Clinic and Pharmacy, whose owner was a member of the Referral committee during 2006.

**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, 2007, and have issued our report thereon dated June 6, 2008. 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 as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Plan'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 generally accepted accounting principles 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 Responses (pages 20 through 23) as items 2007-1 through 2007-3 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 the 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 the 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 that the significant deficiencies described above are material weaknesses.

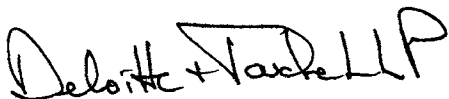
#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Plan's basic 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 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 June 6, 2008.

The Plan's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. We did not audit the Plan's responses and, accordingly, we express no opinion on them.

This report is intended for the information of the management and Board of Trustees of the Plan, 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 those specified parties.

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

June 6, 2008

## CHUUK STATE HEALTH CARE PLAN

Schedule of Findings and Responses  
Year Ended September 30, 2007

### Finding 2007-01 – Reiteration of Prior Year Finding

Criteria: The Plan should establish a capital asset capitalization threshold.

Condition: We note the absence of capital asset capitalization policy that was previously recommended during the 2006 and 2005 audits, and this matter has remained uncorrected in 2007.

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

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

Recommendation: We recommend that corrective action be taken to address this deficiency.

Auditee Response and Corrective Action Plan: We agree with the recommendation of the auditors. For fiscal year 2007, the Plan was adopting the same procedures utilized by the government with regards to its capital asset capitalization threshold. However, we will come up with the Plan's own set of fixed assets capitalization policies, and we will see to it that the Board of Trustees will formulate, adopt and approve such set of standards.

## CHUUK STATE HEALTH CARE PLAN

### Schedule of Findings and Responses, Continued Year Ended September 30, 2007

#### Finding 2007-02 - Deficiencies in the Accounting System

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 2006 and 2005 audits and this finding has remained uncorrected. Transactions have continued to be recorded manually in an excel file and there is an absence of complete journal entries prepared to support the recording of transactions, resulting in inadequate controls over maintenance and monitoring of manual account ledgers. Additionally, as noted in prior years, the issue concerning segregation of duties has remained unresolved. Further, in 2007, the excel files supporting certain journal entries were corrupted and were not recovered. As no back-up files were maintained, tests of journal entries were not possible. Corrective action on the prior year recommendation for the need to maintain back-up files has not been taken.

Cause: The cause of this condition is the lack of management action to address the recurring identified condition.

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

Recommendation: We reiterate the need for management to be actively involved in addressing this matter. As recommended in prior years, the need to establish a formal accounting system should be considered to facilitate the processing of accounting transactions in a systematic manner. Maintenance of back-up files is a standard procedure that should be utilized to assist in 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 recommendation to implement a formal accounting system. We are already in the process of installing and putting up the Quickbooks System. We will just complete some training modules and then launch the full implementation of the system. With regards to the maintenance of back-up files, we are currently using measures to prevent possible loss of data in case of computer breakdowns. Moreover, as recommended in the prior audit, segregation of duties is adequately enforced and journal entries are accordingly recorded, documented and approved by a higher level of management.

## CHUUK STATE HEALTH CARE PLAN

### Schedule of Findings and Responses, Continued Year Ended September 30, 2007

Finding 2007-03 - Absence of Strict Monitoring of Travel Expenses

Criteria: Travel expenses should be monitored and be supported by required documents (i.e., trip reports).

Condition:

In the prior year, a finding relative to travel expenses was reported. For the year ended September 30, 2007, travel expenses of \$62,957 approximate 26% of total general and administrative expenses. While we understand the need for travel to occur, we bring to your attention certain matters that appear to indicate that excessive travel costs may have occurred.

Date of Travel	Amount (Airfare and Per diem)	Check no.	Particulars
November 2-7, 2006	\$7,805	1897	Travel for four people to Hawaii for the purpose of executing an agreement with a prospective coordinator. The travel was not supported by a trip report and the subject agreement, that was the purpose of the trip, could not be produced for audit inspection.
December 2-12, 2006	\$4,795	1923	Travel for five people to the Philippines to personally meet with one coordinator and to discuss banking transactions with a local bank. Travel was not supported by a trip report.
January 14-17, 2007	\$5,839	1975	Travel for five people to Hawaii to again meet with the prospective coordinator and to review the report, which summarizes unfavorable results of a feasibility study findings that no hospitals in Hawaii accepted the Plan's offer for accreditation.
January 14-17, 2007	\$2,585	1971	Travel for one Board member to Hawaii to again meet with the prospective coordinator and to review his report which summarizes unfavorable results. Additionally, one of the signatories for the check reimbursement is also the payee and the travel authorization was approved by the traveler.
August 18-26, 2007	\$5,484	2158	Travel for four people to the Philippines for the purpose of closing a bank account maintained with a local bank.

## CHUUK STATE HEALTH CARE PLAN

### Schedule of Findings and Responses, Continued Year Ended September 30, 2007

#### Finding 2007-03 - Absence of Strict Monitoring of Travel Expenses, Continued

Cause: The cause of this condition is the lack of cost benefit analysis of the undertaken travel.

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

Recommendation: We reiterate the need to monitor travel expenses. The Plan should perform cost-benefit analyses. We understand that a new travel policy has been implemented and we recommend adherence to that policy.

Auditee Response and Corrective Action Plan: We agree with the recommendation of the auditors. In fact, effective fiscal year 2008, the Management and Board officers have already adopted and approved its new set of Travel Policies wherein a trip report is required to be submitted after each trip. A cost-benefit analysis is also being considered before any trip is undertaken thereby ensuring that trips are necessary and not excessive. The present management and Board of Trustees are trying their best to cut down costs of travel expenses and have successfully trimmed down the costs in comparison with those in the previous years.