

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

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

QUARTER ENDED DECEMBER 31, 2008

INDEPENDENT AUDITORS' REPORT

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

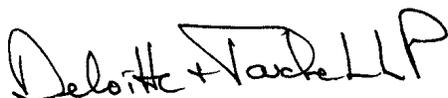
We have audited the accompanying schedule of cash drawdowns and expenditures of U.S. Department of the Interior programs administered by the State of Chuuk (the State) for the quarter ended December 31, 2008. This schedule is the responsibility of the State's management. Our responsibility is to express 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 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 audit provides a reasonable basis for our opinion.

The accompanying schedule of cash drawdowns and expenditures of U.S. Department of the Interior programs administered by the State 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. Department of the Interior programs administered by the State for the quarter ended December 31, 2008, on the basis of accounting described in note 2.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 12, 2009, 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 12, 2009

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Cash Drawdowns and Expenditures of U.S. Department of the Interior Programs
Administered by the State of Chuuk
Quarter Ended December 31, 2008

Program	CFDA #	Cash drawdowns	Expenditures
Compact Sector Grants:			
Education	15.875	\$ 1,502,000	\$ 1,707,681
Health	15.875	2,425,000	1,352,497
Capacity Building in the Public Sector	15.875	50,000	316,201
Environment	15.875	-	23,681
Private Sector Development	15.875	-	46,018
Supplemental Education Grant	15.875	144,000	674,064
Total Compact Sector Grants Fund		<u>4,121,000</u>	<u>4,120,142</u>
U.S. DEPARTMENT OF THE INTERIOR TOTAL		<u>\$ 4,121,000</u>	<u>\$ 4,120,142</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. Department of the Interior 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. Department of the Interior Programs
Administered by the State of Chuuk
Quarter Ended December 31, 2008

(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. Department of the Interior 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. Department of the Interior programs administered by the State of Chuuk (the State) for the quarter ended December 31, 2008, and have issued our report thereon dated February 12, 2009, 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 as items 2009-01-A through 2009-04-A 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.

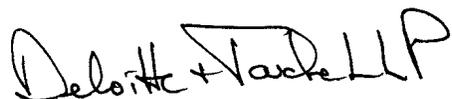
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiencies described above in items 2009-01-A through 2009-03-A 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 2009-01-A through 2009-04-A.

The State's response 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 response and, accordingly, we express no opinion on it.

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.

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

February 12, 2009

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Quarter Ended December 31, 2008

Finding No.: 2009-01-A
Grantor: U.S. Department of the Interior
CFDA No.: 15.875
Program Name: Compact Sector Grants
Requirement: Allowable Costs/Cost Principles
Questioned Costs: \$66,387

Criteria: In accordance with applicable allowable costs/cost principles requirements, non-payroll expenditures should be supported by underlying documentation validating the expenditure. Furthermore, such should be kept on file and be available for audit purposes.

Conditions:

1. For 1 (or 2%) of 63 transactions tested, no distribution or receiving report was provided to substantiate that food supplies, such as rice, were actually received by the intended school.

<u>FUNDORG</u>	<u>Oblig.#</u>	Transaction <u>Amount</u>
10	17723	\$39,389

2. For 1 (or 2%) of 63 transactions tested, no documentation was available with respect to tracking the usage of fuel purchased in bulk.

<u>FUNDORG</u>	<u>Oblig.#</u>	Transaction <u>Amount</u>
10	17925	\$26,998

Cause: There appears to be weak controls over ensuring that expenditures are supported by underlying supporting documentation validating the expenditure.

Effect: The condition may result in potential noncompliance with applicable compliance requirements and potential misstatement of expenditures may exist.

Recommendation: The State should strengthen internal controls over ensuring compliance with the criteria.

Auditee Response and Corrective Action Plan: Management concurs that transfers of food supplies from inventory and usage of bulk fuel purchases need to be supported by valid and sufficient documentation such as internal receiving reports and available for audit purchases. We note the following concerning the two instances cited:

Rice Distribution to Outer Island Schools

Management believes that it is already in substantial compliance with the recommendation and had certain documentation been available to the auditors during their field work the applicable expenditure would not be questioned. The circumstances were as follows:

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended December 31, 2008

Finding No.: 2009-01-A, Continued
Grantor: U.S. Department of the Interior
CFDA No.: 15.875
Program Name: Compact Sector Grants
Requirement: Allowable Costs/Cost Principles
Questioned Costs: \$66,387

The Department of Education purchased 589 sacks of rice; the delivery to Weno of which was evidenced by a receiving report signed by representatives from the Department of Education (DOE), Compact Funds Control Commission (CFCC) and Chuuk State Department of Administrative Services (DAS), Procurement & Supply representatives. 399 sacks of rice were delivered to various outer island schools as per DOE Form 10-17 Supply Transaction Document. This document was signed by the two schools which received the rice, but was not available at the time of the audit fieldwork. The remaining 190 sacks of rice had not been shipped to the Outer Islands at the time of the audit field work, but have since been delivered; signed delivery receipts by Outer Island DOE officials will be provided to DA.

As part of its corrective action plan, DAS will immediately reiterate to DOE officials that internal receiving reports are necessary to support internal deliveries of food supplies from Weno dock to the Outer Island Schools. Documentation not available during the time of field work will be given to the auditors to support removal of this questioned cost.

DOE Usage of Bulk Fuel Purchase

DOE makes large advance payment to local gas stations for vehicle fuel and this fuel is then distributed by the vendor to various DOE vehicles as needed. DOE maintains a log of its internal fuel issuances to track expenditures against the advance. No pre-authorized list of DOE employees receiving the fuel is given the vendor nor does the log indicate the license plate of the receiving vehicle; hence the questioned costs.

Management concurs that controls over local fuel advances are somewhat weak and notes that it is generally not the practice to make advances to local vendors for recurring purchases. DAS will investigate the possibility with DOE and CFCC of using bulk purchase orders with periodic vendor invoice payments to better control DOE vehicle POL purchases. To ensure all fuel usage is properly authorized, DAS will immediately instruct DOE officials to provide the vendor with a list of employees authorized to receive POL and to include all applicable information on its fuel log supporting that fuel issuances are only to authorized employees for government purposes.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Quarter Ended December 31, 2008

Finding No.: 2009-02-A
 Grantor: U.S. Department of the Interior
 CFDA No.: 15.875
 Program Name: Compact Sector Grants
 Requirement: Procurement, Suspension and Debarment
 Questioned Costs: \$52,716

Criteria: Procurement of goods and services should follow applicable federal procurement standards. Furthermore, evidence of procurement procedures undertaken should be kept on file and be available for audit.

Conditions:

1. For 2 (or 3%) of 63 transactions tested, no evidence of price solicitation was documented in the procurement files.

<u>FUND</u>		<u>Oblig. #</u>	<u>Amount</u>
13	Private Sector	15084	\$ 9,610
15	SEG	19357	<u>5,250</u>
Total			\$ <u>14,860</u>

2. For 6 (or 10%) of 63 transactions tested, the underlying procurement rationale does not appear sufficient to document that adequate competition was undertaken.

<u>FUND</u>		<u>Oblig.#</u>	<u>Amount</u>
11	Health	18664	\$ 7,579
15	SEG	16910	9,072
15	SEG	18860	8,302
15	SEG	19233	6,997
15	SEG	19013	<u>5,906</u>
Total			\$ <u>37,856</u>

Cause: There appears to be weak controls over ensuring that underlying documentation is available that complies with applicable procurement standards.

Effect: The condition may result in potential noncompliance with applicable compliance requirements.

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

Auditee Response and Corrective Action Plan: For the two instances of no price solicitation, management believes that additional documentation to be provided the auditors will be sufficient to remove the findings. The following circumstances are pertinent.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended December 31, 2008

Finding No.: 2009-02-A, Continued
Grantor: U.S. Department of the Interior
CFDA No.: 15.875
Program Name: Compact Sector Grants
Requirement: Procurement, Suspension and Debarment
Questioned Costs: \$52,716

1. The \$9,610 was for procurement of printing services for the Chuuk Visitors Bureau. The CVB Managing Director provided a justification for this procurement, and referenced in his letter the solicitations to other vendors and cited the unique ability of the selected vendor to perform the required work. Copies of the price quotations and vendor evaluation were not available for audit review. CVB will provide DAS the documentation from the applicable vendors and submit this information for removal of the finding. DAS management will also immediately request more formal procedures be adopted by CVB in the future when requesting proposals for such services and that documentation be retained for audit purposes.
2. The \$5,250 obligation was for a one-year renewal contract for the SEG consultant heading the Career Ladder Program under the Curriculum and Instruction Division. DOE's justification letter supporting the hiring noted he had formerly been a DOE employee in a similar position and the particular action was to renew the contract that had been effective during fiscal year 2007. Section 8 of his 2007 contract stated "...the terms of his contract shall be for the 12 months...unless sooner *extended* or terminated as provided herein..." This contract will be submitted to the auditor's to support removal of the questioned cost.
3. The six instances of insufficient documentation to support competitive procurement (\$37,856) all pertain to POL purchases. Management believes that documentation available supports the removal of two (2) of the items, as follows:
 - (1) Obligations 18664 (\$7,578) and 18860(\$8,302), pertain to situations in which two or more vendors all quoted the same unit price for POL purchases. For the first two items, a one sentence justification was indicated on the purchase requisition..."best services provided," and "convenience", respectively. Management believes this is sufficient justification in such circumstances, noting that nothing in such selection criteria in contrary to the "full and open competition" provisions of the *Fiscal Procedures Agreement*.

Management believes that one finding should be relegated to an administrative finding, not a questioned cost, because the circumstances do not indicate any impropriety, loss of government funds, or contradiction to the Competition provisions of the *FPA*.

- (2) Obligation 19013 (\$5,906) pertained to a POL purchase in which three vendors quoted same unit price but no justification was provided to support selection of the chosen vendor. Management believes this should be an administrative finding but will immediately instruct DOE officials to always justify the applicable selection even when quoted prices are the same.

Management concurs with two of the findings and will immediately instruct DOE officials to follow competitive procurement practices and ensure all documentation reflects prices quoted by vendors.

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Schedule of Findings and Questioned Costs, Continued
Quarter Ended December 31, 2008

Finding No.: 2009-02-A, Continued
Grantor: U.S. Department of the Interior
CFDA No.: 15.875
Program Name: Compact Sector Grants
Requirement: Procurement, Suspension and Debarment
Questioned Costs: \$52,716

- (3) Obligation 16910 (\$9,072) pertained to an SEG sole source purchase of POL where the only justification indicated that it was the “usual vendor” with whom the department did business.
- (4) The purchase requisition and purchase order supporting obligation 19233 (\$6,997) indicated a higher unit price for a POL purchase than the proforma invoice supporting them.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended December 31, 2008

Finding No.: 2009-03-A
CFDA No.: 15.875
Program Name: Compact Sector Grants
Requirement: Allowable Costs/Cost Principles
Questioned Costs: \$717

Criteria: In accordance with applicable allowable costs/cost principles, 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 be available for audit.

Condition:

1. For 6 (or 6%) of 98 transactions tested, a difference exists in pay rates between the Personal Action Form and the accounting system.

<u>FUND</u>	<u>Date</u>	<u>Employee</u>	<u>Amount</u>
10	11/8/08	40124	\$ 121
10	11/8/08	616982	57
10	11/20/08	19560	174
10	11/20/08	39894	126
11	11/20/08	19735	169
11	12/23/08	31421	70

Cause: There appears to be weak controls over ensuring payroll expenditures are supported by correct pay rates. The condition may also be caused by excessive delays in processing personnel action forms.

Effect: The condition may result in potential noncompliance with applicable compliance requirements. The above results in questioned costs as the projected amounts exceed the \$10,000 threshold.

Recommendation: The State should strengthen controls over ensuring that payroll expenditures are supported by correct pay rates.

Auditee Response and Corrective Action Plan: Management agrees with the finding, but notes that for employees 39894 and 19735, the respective differences represented “underpayments” and would consequently reduce the amount of the questioned costs.

In order to correct this recurring audit finding, DAS management will hire a temporary contractor in March 2009. The scope of work will be to obtain current personnel action forms for all active Chuuk State employees and resolve any wage discrepancies with rates noted in the Fundware payroll system.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended December 31, 2008

Finding No.: 2009-04-A
CFDA No.: 15.875
Program Name: Compact Sector Grants
Requirement: Procurement – 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: For 5 (or 8%) of 63 transactions tested, the underlying contracts lack the applicable contract provisions required by the Fiscal Procedures Agreement.

<u>FUNDORG</u>	<u>Oblig.#</u>	Transaction <u>Amount</u>
11	18359	\$27,266
11	17998	11,249
11	17663	11,249
11	17534	15,000
11	18964	15,000

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 over ensuring that the 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 December 31, 2008

Finding No.: 2009-04-A, Continued
CFDA No.: 15.875
Program Name: Compact Sector Grants
Requirement: Procurement – Contract Provisions
Questioned Costs: \$0

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The Office of the Attorney General and all the applicable respective departments receiving sector funding will be immediately informed as to the inclusion of required applicable contract provisions in all Chuuk State contacts utilizing sector or other U.S. Federal funds.