

**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 MARCH 31, 2009

INDEPENDENT AUDITORS' REPORT

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

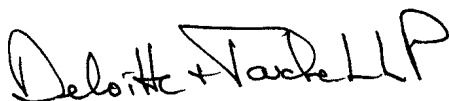
We have audited the accompanying schedule of cash drawdowns and expenditures of U.S. Department of the Interior programs administered by the State of Chuuk (the State) for the quarter ended March 31, 2009. This schedule is the responsibility of the State's management. Our responsibility is to express 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. 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 March 31, 2009, on the basis of accounting described in note 2.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 21, 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.



May 21, 2009

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 March 31, 2009

(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 March 31, 2009, and have issued our report thereon dated May 21, 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-B through 2009-03-B 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.

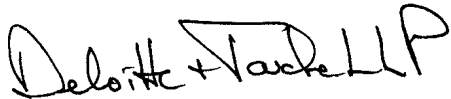
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiencies described above in items 2009-01-B, 2009-02-B and 2009-03-B 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-B through 2009-03-B.

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 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.

May 21, 2009

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Quarter Ended March 31, 2009

Finding No.: 2009-01-B
 CFDA No.: 15.875
 Program Name: Compact Sector Grants
 Requirement: Allowable Costs/Cost Principles/Contract Provisions
 Questioned Costs: \$51,374

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

Condition:

- For 1 (or 1%) of 104 transactions tested, no documentation was available with respect to verification that the payee (scholarship recipient) was still attending school.

<u>Date</u>	<u>Amount</u>	<u>Oblig. #</u>
1/8/2009	\$ <u>1,000</u>	19869

- For 1 (or 1%) of 104 transactions tested, no documentation was available to track the usage of fuel purchased in bulk.

<u>Date</u>	<u>Description</u>	<u>Amount</u>	<u>Ref 1</u>
1/13/2009	MICRO ENTERPRISES	\$ <u>12,526</u>	19899

- For 3 (or 3%) of 104 transactions tested, the underlying contract lacks applicable contract provisions required by the Fiscal Procedures Agreement (No questioned cost results from this matter).

<u>Date</u>	<u>Description</u>	<u>Amount</u>	<u>Ref 1</u>
3/11/2009	KURASSA STORE	\$ 33,345	21843
1/7/2009	MCRAFFY ESTEPA	9,986	17534
2/4/2009	MEDPHARM	<u>40,508</u>	20619
		\$ <u>83,839</u>	

- For 1 (or 1%) of 104 transactions tested, the expenditure charged to Compact Sector Grant funds was actually a transfer of cash from the Compact Sector checking account to the Chuuk House Honolulu checking account for housing allowances for Chuuk State Government employees in Hawaii. The Chuuk House Honolulu bank account does not appear to be included in the trial balance. Actual disbursements to landlords and the underlying supporting invoices were not available for inspection.

<u>Date</u>	<u>Description</u>	<u>Amount</u>	<u>Ref 1</u>
1/20/2009	CHUUK HOUSE HONOLULU	\$ <u>30,000</u>	20185

- For 1 (or 1%) of 104 transactions tested, no vendor invoice was available for inspection.

<u>Date</u>	<u>Description</u>	<u>Amount</u>	<u>Ref 1</u>
2/4/2009	FSM PETROLEUM CORPORATION	\$ <u>7,848</u>	20625

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended March 31, 2009

Finding No.: 2009-01-B, Continued
CFDA No.: 15.875
Program Name: Compact Sector Grants
Requirement: Allowable Costs/Cost Principles
Questioned Costs: \$51,374

Cause: There appears to be weak internal controls over ensuring that expenditures are supported by underlying documentation that validates expenditures and that required provisions are contained in contracts.

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

Recommendation: The State should strengthen controls over ensuring compliance with applicable Compact Fiscal Procedures.

Auditee Response and Corrective Action Plan:

1. The stated obligation was a scholarship grant award for Stephen Ismael. Copy of communications by email to and from school/payee and Scholarship Student Coordinator confirming that scholarship recipient is not enrolled for SY 2008-2009, were available and sent to the auditor for review. As soon as the returned check is received, the check will be voided in support of clearing this questioned cost.
2. The supporting documentations such as ledger for usage of purchased fuel as well as requested invoices are now available and will be provided the auditors to support removal of this audit finding.
3. We agree with the findings and recommendations. The Office of the Attorney General and all concerned departments were already advised as to the necessary inclusion of applicable contract provisions in all contracts utilizing sector or Federal funds as mandated by the Fiscal Procedure Agreement.
4. We agree with the finding. The Department of Health has been notified and requested to provide the necessary invoices of the actual disbursements to landlords, including Chuuk House Honolulu office. When DAS obtains these invoices they will be submitted to clear this audit finding.
5. The invoice is now available for inspection to clear this item.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended March 31, 2009

Finding No.: 2009-02-B
CFDA No.: 15.875
Program Name: Compact Sector Grants
Requirement: Procurement
Questioned Costs: \$122,802

Criteria: Procurement of goods and services should follow applicable federal procurement standards. Furthermore, such should be kept on file and be available for examination.

Condition:

1. For 3 (or 3%) of 104 transactions tested, no evidence of competitive bidding was documented in the procurement files.

Transaction		Transaction	
<u>Date</u>	<u>Description</u>	<u>Amount</u>	<u>Oblig. #</u>
2/5/2009	COMFSM	\$ 58,880	20205
1/8/2009	COMFSM	30,000	19733
1/8/2009	COMFSM	<u>26,518</u>	19733
		<u>\$115,398</u>	

2. For 1 (or 1%) of 104 transactions tested, there was no evidence of price solicitation.

Transaction		Transaction	
<u>Date</u>	<u>Description</u>	<u>Amount</u>	<u>Oblig. #</u>
1/7/2009	Xavier High School	<u>\$7,404</u>	19424

Cause: There appears to be inadequate controls over ensuring that underlying supporting documentation is available to evidence compliance with applicable procurement standards.

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

Recommendation: The State should strengthen controls over ensuring compliance with federal procurement standards.

Auditee Response and Corrective Action Plan: Management concurs with the finding but sole sourcing the teacher training through COM is a practice approved by the grantor agency because of the special needs required for these services. In that regard, justification was made available for examination on the underlying rationale why to have training/education contracts with College of Micronesia. It was stated that the DOE has been for years working with COM to provide the required training/ education courses for staffs and teachers to attain their Associate of Arts or Sciences degrees in education. Further stated, that to change the institution to other institutions will cause great problem considering the fact of the need to establish new teacher's records and new courses to be taken by the teachers. Specific approval by OIA will be obtained to remove this audit finding.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Quarter Ended March 31, 2009

Finding No.: 2009-02-B, Continued
CFDA No.: 15.875
Program Name: Compact Sector Grants
Requirement: Procurement
Questioned Costs: \$122,802

Auditee Response and Corrective Action Plan, Continued:

Likewise, justification was made available for examination on why Xavier and Berea were chosen for COMET summer training sites. It was noted that opportunities were given to all high schools to participate in the program but only Xavier and Berea School responded thereby were given the challenge to train the teachers for a short summer. In addition, an approval from the grant manager will also be obtained to support removal of the questioned cost.

**STATE OF CHUUK
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Schedule of Findings and Questioned Costs, Continued
Quarter Ended March 31, 2009

Finding No.: 2009-03-B
CFDA No.: 15.875
Program Name: Compact Sector Grants
Requirement: Cut-Off
Questioned Costs: \$0

Criteria: A functioning internal control system requires that under the modified accrual basis of accounting expenditures be accrued in the correct fiscal year.

Condition: For 4 (or 4%) of 104 transactions tested, fiscal year 2008 expenditures were recorded in fiscal year 2009.

Cause: The cause of this condition is that vendor invoices are only recorded as expenditures when a check is issued.

Effect: An internal control weakness relating to cut-off resulted from the condition.

Recommendation: We recommend that Chuuk State accrue invoices in its accounting system upon the receipt of underlying goods and services.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Chuuk DAS will closely monitor its cut-off procedures at fiscal year-end to ensure applicable accruals are made in the correct fiscal and grant year. In those cases where the prior grant year is closed, DAS will get permission from OIA to use current grant year funds to pay the invoice.