

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

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2009 AND 2008

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, 2009 and 2008, 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.

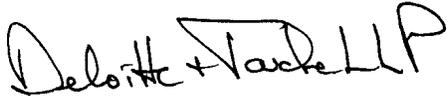
We conducted our audits in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and 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 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 audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Chuuk State Health Care Plan as of September 30, 2009 and 2008, 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.

As stated in note 6, the Plan carries a receivable of \$50,000 from the State of Chuuk and it is not possible to predict when this balance will be collected.

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 4, 2010, 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 + Tuckers LLP". The signature is written in a cursive, stylized font.

June 4, 2010

CHUUK STATE HEALTH CARE PLAN

Management's Discussion and Analysis Year Ended September 30, 2009

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, 2009. We encourage readers to consider this information in conjunction with the Plan's financial statements, which follow. Fiscal year 2008 and 2007 comparative information has been included, where appropriate. This information is required by the Governmental Accounting Standards Board, (GASB), which provides guidelines on what must be included and excluded from the analysis.

There are three financial statements presented: the Balance Sheet; 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, 2009, the Chuuk State Health Care Plan's net assets decreased by \$0.084 million (down 12.3%) from \$0.686 million in the prior year to \$0.602 million. The decrease occurred because net revenues after claims expenses are covered were not sufficient to cover all operating expenses.
- During fiscal year 2009, the Plan had premium revenues of \$0.837 million compared to \$0.775 million in fiscal year 2008. The \$0.062 million increase (or 8%) was the result of management's rigorous collection of all Plan premiums and new premiums from private sector enrollees. Medical claims expenses of \$0.76 million in fiscal year 2009 were virtually unchanged from the prior year. This represents a marked improvement in the Plan's control of claims expenditures. Claims expenses as a percentage of Plan premiums were 90% in fiscal year 2009 compared to 98% in the prior year. This was the first year since the Plan's inception in 2004 that claims expenditures as a portion of premiums have fallen.
- During fiscal year 2009, the Plan incurred a net loss of \$0.084 million compared with a net loss of \$0.225 million in fiscal year 2008 (down 63%). The declining loss resulted from management's aggressive control of medical claims expenditures in the Philippines and strict control of travel and other operating expenditures. In spite of this, net revenues are still insufficient to cover all 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.

CHUUK STATE HEALTH CARE PLAN

Management's Discussion and Analysis Year Ended September 30, 2009

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.

SUMMARY STATEMENT OF NET ASSETS (In '000's)

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Assets:			
Current and other assets	\$ 652	\$ 763	\$ 1,060
Capital assets, net	<u>25</u>	<u>35</u>	<u>26</u>
Total assets	\$ <u>677</u>	\$ <u>798</u>	\$ <u>1,086</u>
Liabilities:			
Current liabilities	\$ 75	\$ 112	\$ 175
Non-current liabilities	<u>-</u>	<u>-</u>	<u>-</u>
Total liabilities	<u>75</u>	<u>112</u>	<u>175</u>
Net assets:			
Invested in capital assets	25	35	26
Restricted	<u>577</u>	<u>651</u>	<u>885</u>
Total net assets	<u>602</u>	<u>686</u>	<u>911</u>
Total liabilities and net assets	\$ <u>677</u>	\$ <u>798</u>	\$ <u>1,086</u>

The total assets at the end of fiscal year 2009 of \$0.677 million exceed the total liabilities of \$0.75 million, resulting in net assets of \$0.602 million. Of the total assets, \$0.564 million are held in cash, cash equivalents or short-term investments. Another \$0.87 million are in the form of accounts receivable. This contrasts to fiscal year 2008 when \$0.613 million of the total assets were held in cash or investment equivalents and accounts receivables were \$0.149 million. Liabilities of \$0.075 million in fiscal year 2009 compare favorably with the \$0.112 million in fiscal year 2008; down \$0.037 million (or 33%). Nevertheless, in spite of positive trends in accounts receivable collections and liquidation of liabilities, the cash and investment position of the Plan continue to worsen as the Plan uses cash reserves accumulated in prior years to meet current year expenses. Management's plan to turnaround this fiscal condition are noted below.

CHUUK STATE HEALTH CARE PLAN

Management's Discussion and Analysis
Year Ended September 30, 2009

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 earning 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.

SUMMARY STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (In '000's)

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Revenues:			
Premiums	\$ 837	\$ 775	\$ 835
Other Revenues	5	7	10
Provisions for Premium losses	-	(31)	-
Claims expenses	<u>(756)</u>	<u>(758)</u>	<u>(780)</u>
Total net revenues	<u>86</u>	<u>(7)</u>	<u>65</u>
Expenses:			
Other operating expenses	<u>180</u>	<u>234</u>	<u>242</u>
Net earnings (loss)	<u>(94)</u>	<u>(242)</u>	<u>(178)</u>
Interest income	10	17	28
Net assets at beginning of year	<u>686</u>	<u>911</u>	<u>1,061</u>
Net assets at end of year	\$ <u>602</u>	\$ <u>686</u>	\$ <u>911</u>

In fiscal year 2009, for the third consecutive year, the Statement of Revenues, Expenses, and Changes in Net Assets reflects declining net assets, with an overall \$0.084 million decrease (or 12.3%) in net assets from the prior year. This decline, however, is partially offset by several positive changes in 2009 reflecting management's efforts to rationalize the operations of the Plan; an increase in premium revenues of \$0.062 million (or 8%); a marginal reduction in premium expenses demonstrating tight control of referrals and third-party coordinator expenses; and, a \$0.054 million reduction in other operating expenses (down 23%) showing management's line-item attention over Plan expenses. 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 2009, 2008 and 2007 for both public and private sector enrollees:

CHUUK STATE HEALTH CARE PLAN

Management's Discussion and Analysis Year Ended September 30, 2009

MEMBER COMPOSITION	FY- 2009		FY- 2008		FY- 2007	
	# ENROLLED	PREMIUMS PAID	# ENROLLED	PREMIUMS PAID	# ENROLLED	PREMIUMS PAID
	@ 9-30-09	(000's)	@ 9-30-08	(000's)	@ 9-30-07	(000's)
Public Sector	10,177	\$ 761	11,886	\$ 715	22,160	\$ 776
Private Sector	2,469	76	1,844	60	1,679	59
TOTALS	12,646	\$ 837	13,730	\$ 775	23,839	\$ 835

The chart shows that the 8% increase in premiums collected was accomplished with an 8% decline in total Plan enrollees in fiscal year 2009, declining from 13,730 in fiscal year 2008 to 12,646 in fiscal year 2009. This positive trend is indicative of management strictly enforcing the number of Plan beneficiaries of each primary enrollee and closing all loopholes that previously resulted in unpaid premiums. The uptick in private sector enrollees is also an encouraging trend. Private sector enrollees increased by 625 to 2,469 in fiscal year 2009; up 25% from 1,844 in fiscal year 2008.

Management's control of premium expenses also reflected a positive turnaround in fiscal year 2009. The recurring problem from prior years of medical claims expenses comprising ever larger ratio of Plan premiums, leaving little leftover to cover general and administrative expenses, was partially abated in FY-09 as disclosed in the table below:

<u>Fiscal Year</u>	<u>Premiums</u>	<u>Claims Expense</u>	<u>Claims as a % of Premiums</u>
2009	\$ 837,430	\$ 756,292	90%
2008	775,114	758,062	98%
2007	834,562	779,597	93%
2006	872,006	639,251	73%
2005	781,370	228,768	29%

Management will work to bring this critical ratio lower as it endeavors to increase Plan premiums while holding medical claims expenses in line.

The marked \$0.054 million decrease in other operating expenses in fiscal year 2009, from \$0.234 million in FY-08 to \$0.180 million in fiscal year 2009 (down 23%) was accomplished by significant declines in two categories related to medical referrals to the Philippines: travel expenses declined \$0.023 million (down 57%) in fiscal year 2009; dropping from \$0.041 million in fiscal year 2008 to \$0.018 million. Medical Coordinator and consultant's expense similarly declined \$0.023 million (down 55%) in fiscal year 2009; falling from \$0.043 million to \$0.020 million in the same time period.

CHUUK STATE HEALTH CARE PLAN

Management's Discussion and Analysis
Year Ended September 30, 2009

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 from noncapital financing activities 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>2009</u>	<u>2008</u>	<u>2007</u>
Cash provided by (used in):			
Operating activities	\$ (59)	\$ (155)	\$ (287)
Capital and related financing activities	-	(22)	(9)
Investing activities	<u>207</u>	<u>267</u>	<u>-</u>
Net change in cash and cash equivalents	148	90	(296)
Cash and cash equivalents, beginning of year	<u>163</u>	<u>73</u>	<u>369</u>
Cash and cash equivalents, end of year	\$ <u>311</u>	\$ <u>163</u>	\$ <u>73</u>

Although the chart indicates an improvement in cash and equivalents, the increase in cash was obtained by cashing in one of the Plan's TCD investments. Combined cash and TCD investments in fiscal year 2009 of \$0.563 showed a decline of \$0.04 million (down 7%) from \$0.613 million in fiscal year 2008. In spite of the improvements in collecting accounts receivable, reducing liabilities, controlling medical claim and other expenses, and increasing premiums, the overall net loss from Plan operations in fiscal year 2009 resulted in an erosion of its cash and investment assets.

Capital Asset and Debt Administration

The Plan's net investment in capital assets totaled \$25 thousand in fiscal year 2009, a decrease of \$10 thousand (or 28%) from fiscal year 2008.

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.

CHUUK STATE HEALTH CARE PLAN

Management's Discussion and Analysis Year Ended September 30, 2009

Management's Discussion and Analysis for the year ended September 30, 2008 is set forth in the Plan's report on the audit of financial statements, which is dated June 29, 2009. That Discussion and Analysis explains the major factors impacting the 2008 financial statements and can be obtained via the Office of the Public Auditor's website at www.fsmopa.fm.

Economic Outlook

In fiscal year 2010, Plan management will continue focusing on increasing premiums, reducing medical claim expenses and keeping general and administrative costs low. Although public sector premiums are not expected to grow appreciatively, construction activity in the private sector ongoing since 2009, promises increased premiums from that sector. Additionally, the Plan will actively seek subsidies from FSM Congress for those travel expenses not fully supported by premiums. Sector grant funding has also been secured to hire a Controller and purchase needed computer equipment and software. In fiscal year 2010, the Plan will automate its accounting system; a necessity to ensure management has the necessary data and reports to continue the positive changes began in fiscal year 2009.

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, 2009 and 2008

<u>ASSETS</u>	<u>2009</u>	<u>2008</u>
Current assets:		
Cash and cash equivalents	\$ 310,849	\$ 162,816
Short-term investments	252,677	450,000
Premiums receivable, net of an allowance for doubtful premium of \$47,110 and \$31,407 in 2009 and 2008, respectively	37,284	99,594
Other receivables	-	50,000
Other assets	842	350
Total current assets	601,652	762,760
Due from the State of Chuuk	50,000	-
Property and equipment, net	25,090	34,915
Total assets	\$ 676,742	\$ 797,675
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Medical claims and benefits payable	\$ 67,518	\$ 101,292
Accounts payable and accrued expenses	7,243	10,235
Total liabilities	74,761	111,527
Commitment		
Net assets:		
Invested in capital assets	25,090	34,915
Restricted	576,891	651,233
Total net assets	601,981	686,148
Total liabilities and net assets	\$ 676,742	\$ 797,675

See accompanying notes to financial statements.

CHUUK STATE HEALTH CARE PLAN

Statements of Revenues, Expenses and Changes in Net Assets Years Ended September 30, 2009 and 2008

	2009	2008
Revenues:		
Premiums	\$ 837,430	\$ 775,114
Others	4,773	6,574
	842,203	781,688
Benefits paid:		
Claims expenses	756,292	758,062
Net revenues	85,911	23,626
Provision for premium losses	-	31,407
Net revenues (losses), after provision for premium losses	85,911	(7,781)
Other operating expenses:		
Salaries, wages and other benefits	88,363	91,428
Coordinator's fee	19,200	22,550
Travel	17,548	40,663
Housing allowance	12,800	9,550
Depreciation	9,418	13,278
Rent	8,400	8,400
Social security expense	6,908	4,635
Telephone and telegraph	4,264	5,159
Gasoline and fuel	3,600	2,350
Office/computer supplies	2,791	5,283
Representation - board luncheon meeting	1,376	2,942
Board allowance	1,140	2,160
Utilities	665	1,349
Promotional	255	1,310
Consultant fee	-	20,000
CSHCP premium and other health care contributions	-	2,158
Miscellaneous	3,627	1,111
Total other operating expenses	180,355	234,326
Net loss from operations	(94,444)	(242,107)
Investment and interest income	10,277	17,043
Net loss	(84,167)	(225,064)
Net assets at beginning of year	686,148	911,212
Net assets at end of year	\$ 601,981	\$ 686,148

See accompanying notes to financial statements.

CHUUK STATE HEALTH CARE PLAN

Statements of Cash Flows Years Ended September 30, 2009 and 2008

	2009	2008
Cash flows from operating activities:		
Premiums received	\$ 904,513	\$ 887,743
Medical claims and benefits paid	(790,066)	(822,478)
Cash paid to employees and vendors	(173,846)	(220,157)
	(59,399)	(154,892)
Cash flows from capital and related financing activities:		
Acquisition of property and equipment	(168)	(22,450)
	(168)	(22,450)
Cash flows from investing activities:		
Net change in time certificates of deposit	250,000	250,000
Purchase of investment securities	(50,000)	-
Interest income received	7,600	17,042
	207,600	267,042
Net change in cash and cash equivalents	148,033	89,700
Cash and cash equivalents at beginning of year	162,816	73,116
Cash and cash equivalents at end of year	\$ 310,849	\$ 162,816
Reconciliation of net loss from operations to net cash used in operating activities:		
Net loss from operations	\$ (94,443)	\$ (242,107)
Adjustments to reconcile net loss from operations to net cash used in operating activities:		
Depreciation	9,418	13,278
Provision for premium losses	-	31,407
Changes in assets and liabilities:		
Decrease in premiums receivable	62,310	106,055
Decrease in other assets	82	96
Decrease in medical claims and benefits payable	(33,774)	(64,416)
Increase (decrease) in accounts payable and accrued expenses	(2,992)	795
	\$ (59,399)	\$ (154,892)

See accompanying notes to financial statements.

CHUUK STATE HEALTH CARE PLAN

Notes to Financial Statements
September 30, 2009 and 2008

(1) Nature of Operations

Commencement of Operations

Chuuk State Health Care Plan (the “Plan” or “CSHCP”), a component unit of the State of Chuuk, was originally established under the Chuuk Health Care Plan Act of 1994 to provide eligible residents of Chuuk State with quality health care. The Plan commenced operations in September 2003 after final approval from the Board of Trustees, with Chuuk State Hospital (CSH) as the primary health care provider. The Board of Trustees comprises of five voting members appointed by the Governor of Chuuk, with the advice and consent of the Chuuk State Legislature, and the Executive Director as a non-voting member.

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 six hospitals in the Philippines – Cardinal Santos Medical Center, Medical City, Capitol Medical Center, 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 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 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*. 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, 2009 and 2008

(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, 2009 and 2008, 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 Trustees 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. 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 and Expense 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, 2009 and 2008

(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 deposit with an original maturity dates 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, 2009 and 2008, the carrying amount of the Plan's cash and cash equivalents and time certificates of deposit was \$510,849 and \$612,816, respectively, and the corresponding bank balances were \$511,310 and \$612,810, respectively. Of the bank balance amounts, \$510,303 and \$611,803, respectively, were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. The remaining amounts of \$1,007 each year represent deposits maintained in dollar and Philippine Peso denominated bank accounts maintained offshore. Accordingly, these deposits are exposed to foreign currency exchange risk. As of September 30, 2009 and 2008, bank deposits in the amount of \$462,768 and \$200,000, respectively, 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.

Short-Term Investments

Interest-bearing deposits in banks mature within one year and are carried at cost. Investments in common stock are carried at fair value with unrealized gains and losses recognized in earnings.

CHUUK STATE HEALTH CARE PLAN

Notes to Financial Statements
September 30, 2009 and 2008

(2) Summary of Significant Accounting Policies, Continued

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 generally capitalizes equipment with acquisition values of \$250 and above but has not established a specific policy.

New Accounting Standards

During fiscal year 2009, CSHCP implemented the following pronouncements:

- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation.
- GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, which improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income.
- GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which improves financial reporting by contributing to the GASB's efforts to codify all GAAP for state and local governments so that they derive from a single source.
- GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, which incorporates accounting and financial reporting guidance previously only contained in the American Institute of Certified Public Accountants (AICPA) auditing literature into the GASB's accounting and financial reporting literature for state and local governments, and addresses three issues from the AICPA's literature - related party transactions, going concern considerations, and subsequent events.

The implementation of these pronouncements did not have a material effect on the accompanying financial statements.

CHUUK STATE HEALTH CARE PLAN

Notes to Financial Statements
September 30, 2009 and 2008

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2007, GASB issued statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which 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 CSHCP.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. 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 CSHCP.

In December 2008, GASB issued Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*, which clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, for calculating the annual required contribution (ARC) adjustment. The provisions of this statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CSHCP.

In March 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The provisions of this statement are effective for periods beginning after June 15, 2010. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CSHCP.

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 federally insured banks of \$200,000 and \$450,000 as of September 30, 2009 and 2008, respectively. These deposits have initial maturity dates of one year and have interest rates ranging from 2.25% to 4.42%.

GASB Statement No. 3 previously required government entities to present investment risks in terms of whether the investments fell into the following categories:

- Category 1 Investments that are insured or registered, or securities held by CSHCP or its agent in CSHCP's name;
- Category 2 Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in CSHCP's name; or

CHUUK STATE HEALTH CARE PLAN

Notes to Financial Statements
September 30, 2009 and 2008

(3) Short-Term Investments, Continued

Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in CSHCP's name.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for investments falling into categories 1 and 2, and provided for disclosure requirements addressing other common risks of investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. GASB Statement No. 40 did retain and expand the element of custodial credit risk in GASB Statement No. 3.

In 2009, short-term investments also comprise the following:

Common stock	\$ 50,926
Cash	<u>1,751</u>
	\$ <u>52,677</u>

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, CSHCP will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. CSHCP's investments are held and administered by trustees. Accordingly, these investments are exposed to custodial credit risk. Based on negotiated trust and custody contracts, all of these investments were held in CSHCP's name by CSHCP's custodial financial institutions at September 30, 2009 and 2008.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for CSHCP. As of September 30, 2009, there was no concentration of credit risk for CSHCP's investments.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. CSHCP does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

(4) Property and Equipment

A summary of the Plan's property and equipment at September 30, 2009 and 2008, is as follows:

	Estimated Useful <u>Lives</u>	Balance at October 1, <u>2008</u>	Transfers and <u>Additions</u>	Transfers and <u>Deletions</u>	Balance at September <u>30, 2009</u>
Office furniture and equipment	5 - 10 years	\$ 22,194	\$ 168	\$ (575)	\$ 21,787
Vehicle	5 years	<u>49,660</u>	-	-	<u>49,660</u>
		71,854	168	(575)	71,447
Less accumulated depreciation		<u>(36,939)</u>	<u>(9,418)</u>	-	<u>(46,357)</u>
Property and equipment, net		\$ <u>34,915</u>	\$ <u>(9,250)</u>	\$ <u>(575)</u>	\$ <u>25,090</u>

CHUUK STATE HEALTH CARE PLAN

Notes to Financial Statements
September 30, 2009 and 2008

(4) Property and Equipment, Continued

	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2007</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Balance at September 30, 2008</u>
Office furniture and equipment	5 - 10 years	\$ 24,564	\$ 4,450	\$ (6,820)	\$ 22,194
Vehicle	5 years	<u>31,660</u>	<u>18,000</u>	<u>-</u>	<u>49,660</u>
		56,224	22,450	(6,820)	71,854
Less accumulated depreciation		<u>(30,481)</u>	<u>(13,278)</u>	<u>6,820</u>	<u>(36,939)</u>
Property and equipment, net		\$ <u>25,743</u>	\$ <u>9,172</u>	\$ <u>-</u>	\$ <u>34,915</u>

(5) Commitment

Lease Commitment

The Plan leases office space under an operating lease. Rental expense for the years ended September 30, 2009 and 2008 amounted to \$8,400 and is included as a component of other operating expenses in the accompanying financial statements. At September 30, 2009, aggregate future minimum lease payments are summarized as follows:

<u>Year ending September 30,</u>	<u>Amount</u>
2010	\$ 4,900

Management intends to vacate its current location and move to accommodations at the State hospital at the end of May 2010.

(6) Related Parties

As of September 30, 2009 and 2008, premium receivables from Chuuk State Government amounted to \$30,462 and \$95,165, respectively, and related premium revenue earned for the years then ended amounted to \$731,274 and \$682,451, respectively. Additionally, as of September 30, 2009 and 2008, the Plan has an outstanding receivable of \$50,000 from the Chuuk State Government, representing advances made to a component unit of the State. Management cannot assess when the State will be able to repay this advance and has accordingly, in 2009, reflected the balance as noncurrent.

The Plan paid medical claims and benefits, totaling \$97,097 and \$94,029, respectively, during the years ended September 30, 2009 and 2008 to Family Clinic and Pharmacy, whose part-owner is a current member of the Board of Trustees. Additionally, outstanding premiums receivable from the same clinic amounted to \$40 and \$8,616 as of September 30, 2009 and 2008, respectively.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS 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, 2009, and have issued our report thereon dated June 4, 2010. 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 21 and 22) as items 2009-1 and 2009-2 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.

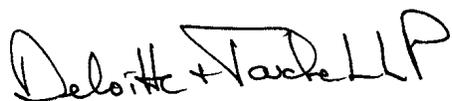
Compliance and Other Matters

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 4, 2010.

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 4, 2010

CHUUK STATE HEALTH CARE PLAN

Schedule of Findings and Responses Year Ended September 30, 2009

Finding 2009-01 – Reiteration of Prior Year Finding

Criteria: The Plan should establish policies governing asset capitalization.

Condition: The issue of an absence of a fixed asset capitalization policy was previously identified during the 2005 to 2009 audits and has remained uncorrected in 2009.

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 matter.

Auditee Response and Corrective Action Plan: During its July 2009 meeting the Plan Board of Directors agreed to the following capitalization thresholds, consistent with other FSM government entities:

Buildings	\$100,000
Equipment	50,000
Vehicles & Boats	All

The accounting staff of the Plan will be advised to follow this policy when recording fixed asset purchases.

CHUUK STATE HEALTH CARE PLAN

Schedule of Findings and Responses Year Ended September 30, 2009

Finding 2009-02 – Reiteration of Prior Year Finding

Criteria: Utilization of an accounting system and adequate monitoring of the accounting process is necessary to carry out day-to-day accounting operations. Additionally, financial statements should be timely prepared and reviewed.

Condition: The absence of a formal accounting system was cited as a finding in the 2005 to 2008 audits and in spite of repeated recommendations, substantial correction has yet to occur. After fiscal year end, it appears that corrective action has been planned once the move to the Hospital office occurs. Transactions have continued to be recorded in an EXCEL file and no formal journal entries are prepared to support the recording of transactions. This results in inadequate controls over maintenance and monitoring of account ledgers and in the non-timely preparation of financial statements. Additionally, as noted in prior years, the issue of segregation of entry with respect to account ledgers and financial statement preparation issues appears to be pending implementation of the new system.

Cause: The cause of this condition is the lack of an adequate accounting system.

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

Recommendation: We recommend that management address this matter at the earliest. As can be seen in the financial statements, the Plan is operating at a loss and timely financial information will be required to assist the Plan in continuing its turnaround efforts. Therefore, this matter appears critical to the continued operations of the Plan and we recommend that it be addressed at the earliest.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Implementation of the Peachtree accounting software will begin in June, 2010. Beginning balances for fiscal year 2010 will be established based on the audited FY-09 results and all fiscal year 2010 transactions heretofore maintained in excel worksheets will be re-entered so that a full set of automated reports will be available to management by September 30, 2010.