

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

**REPORT ON THE AUDIT OF
FINANCIAL STATEMENTS IN ACCORDANCE
WITH THE UNIFORM GUIDANCE**

YEAR ENDED SEPTEMBER 30, 2016

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2016

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**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2016

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**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

**INDEPENDENT AUDITORS' REPORT,
FINANCIAL STATEMENTS
AND ADDITIONAL INFORMATION**

YEAR ENDED SEPTEMBER 30, 2016

INDEPENDENT AUDITORS' REPORT

Honorable Johnson Elimo
Governor, State of Chuuk
Federated States of Micronesia:

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Chuuk (the State) as of and for the year ended September 30, 2016, and the related notes to the financial statements, which collectively comprise the State's basic financial statements as set forth in Section III of the foregoing table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements 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 statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinions.

Summary of Opinions

Opinion Unit	Type of Opinion
Governmental Activities	Qualified
Aggregate Discretely Presented Component Units	Unmodified
General Fund	Qualified
Grants Assistance Fund	Unmodified
Compact Trust Fund	Unmodified
Aggregate Remaining Fund Information	Unmodified

Basis for Qualified Opinions on Governmental Activities and General Fund

As discussed in Note 12 to the financial statements, the State has not recorded a liability for land leases and related claims payable in the governmental activities and the General Fund and, accordingly, has not recorded an expenditure/expense for the current period change in that liability. Accounting principles generally accepted in the United States of America require that liabilities incurred attributable to services already rendered and that are not contingent upon a specific event that is outside of the control of the State be accrued as liabilities and expenditures/expenses, which would increase the liabilities, decrease net position, and change the expenses of the governmental activities and increase the liabilities, increase fund deficit, and change the expenditures of the General Fund. The amount by which this departure would affect the liabilities, net position and expenses of the governmental activities and the liabilities, fund deficit, and expenditures of the General Fund is not reasonably determinable.

Qualified Opinions

In our opinion, except for the matters described in the "Basis for Qualified Opinions on Governmental Activities and General Fund" paragraph, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the General Fund of the State of Chuuk as of September 30, 2016, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Unmodified Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the aggregate discretely presented component units, the Grants Assistance Fund, the Compact Trust Fund, and the aggregate remaining fund information of the State of Chuuk as of September 30, 2016, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matter

New Accounting Pronouncements

As described in Note 1 to the financial statements, the State adopted Governmental Accounting Standards Board (GASB) Statement No. 72, *Fair Value Measurement and Application*, effective October 1, 2015. As a result, the State has elected to restate the beginning net position of the governmental activities and the beginning fund deficit of the General Fund for the effect of adopting this accounting pronouncement.

Receivables from the FSM National Government

As discussed in Note 3 to the financial statements, the State is in discussions with the FSM National Government to determine the ultimate collectability of certain receivables due from the FSM National Government in consultation with federal grantor agencies arising from Compact sector grant transactions.

Our opinion is not modified with respect to these matters.

Other Matters

Required Supplementary Information

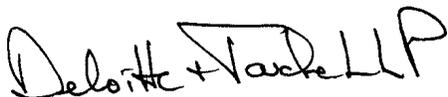
Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 10 as well as the Schedule of Revenues, Expenditures, and Changes in Fund Deficit – Budget and Actual – General Fund and notes thereto, on pages 49 and 50, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the GASB who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State's basic financial statements. The combining and individual fund financial statements as set forth in Section V of the foregoing table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual fund financial statements are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining and individual fund financial statements are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 30, 2017, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the State's internal control over financial reporting and compliance.



June 30, 2017

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2016

This analysis, prepared by the Department of Administrative Services, Division of Treasury, offers readers of the Chuuk State Government's (Chuuk State) financial statements a narrative overview of the activities of the government for the fiscal year ended September 30, 2016. We encourage readers to consider this information in conjunction with Chuuk State's financial statements, which follow. Fiscal year 2015 comparative information has been included, where appropriate. This analysis is required by the Governmental Accounting Standards Board (GASB) which provides guidelines on what must be included and excluded from this analysis.

FINANCIAL HIGHLIGHTS

- For the fiscal year ended September 30, 2016, Chuuk State's total net position increased by \$0.259 million (or 0.65 %) from \$39.605 million, as restated, in the prior year to \$39.864 million.
- During fiscal year 2016, both revenues and expenses increased from fiscal year 2015. Chuuk State's revenues of \$38.812 million increased by \$1.645 million from \$37.167 million, as restated, in fiscal year 2015. The increase in revenue was primarily attributable to increased operating grants, revenue sharing, local taxes and fees and write-off of stale dated checks. Expenses in fiscal year 2016 of \$38.553 million increased by \$1.535 million (or 4.15%) from \$37.018 million in fiscal year 2015. The increase is due to increases in expenses for education sector, health, general government, public safety, public works and payment to component units.
- The General Fund deficit decreased by \$0.504 million in fiscal year 2016, decreasing from \$5.681 million, as restated, in the prior year to \$5.177 million. The write-off of stale dated checks of \$0.423 million contributed to the deficit decrease.

Restatement

The beginning net position of the governmental activities and the beginning fund balance of the General Fund have been restated as the State adopted GASB Statement No. 72, *Fair Value Measurement and Application*, effective October 1, 2015 as described in Note 1 to the financial statements.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to Chuuk State's basic financial statements. Chuuk State's basic financial statements comprise three components: 1) governmental-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains additional required supplementary information in the form of budgetary schedules, which are prepared on the budgetary basis of accounting, and other optional supplementary information, in addition to the basic financial statements themselves, which includes combining statements for governmental funds and component units.

Government-Wide Financial Statements

The government-wide statements report information about Chuuk State as a whole using accounting methods similar to those used by private-sector companies. It provides both long-term and short-term information about Chuuk State's financial status.

The statement of net position includes all the government's assets and liabilities. The difference in the two is called net position. Over time, increases or decreases in Chuuk State's net position serves as an indicator to measure Chuuk State's financial position.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis, Continued
September 30, 2016

The statement of activities, on the other hand, account for Chuuk State's current year's revenues and expenses regardless of when cash is received or paid.

The government-wide financial statements of Chuuk State are divided into two categories:

- **Governmental Activities** - Most of Chuuk State's basic services are included here, such as education, health, special appropriations, finance, judiciary, and general administration. Compact sector and other federal grants finance most of these activities.
- **Component Units** - Chuuk State includes the operating results of the Chuuk State Health Care Plan, the Chuuk Public Utility Corporation, and the Chuuk State Housing Authority in its report. Although legally separate, these "component units" are important because Chuuk State is financially accountable for them.

Fund Financial Statements

The fund financial statements provide more detailed information about Chuuk State's significant funds. Funds are accounting devices that Chuuk State uses to keep track of specific sources of funding and spending for particular services. The State uses fund accounting to comply with financial and related legal requirements. The fund financial statements present a balance sheet and a statement of revenues, expenditures, and changes in fund balances for its major and aggregated non-major funds.

Most of Chuuk State's basic services are included in governmental funds, which focus on (1) how cash and other financial assets that can be readily converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance Chuuk State programs. Because this information does not encompass the additional long-term focus of the government-wide statements, we provide additional information at the bottom of the governmental funds statements, or on the subsequent page, that explains and reconciles the relationship (or differences) between them.

Chuuk State maintains individual governmental funds, which are categorized as major and non-major. The major funds comprise the General Fund, the Grants Assistance Fund, and the permanent Compact Trust Fund.

FINANCIAL ANALYSIS OF CHUUK STATE AS A WHOLE

Net position may serve over time as a useful indicator of a government's financial position. At the end of fiscal year 2016, Chuuk State's assets exceeded liabilities by \$39.864 million. However, all net position is restricted as to the purposes they can be used for or is invested in capital assets. Chuuk State uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although Chuuk State's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. The following summary of Chuuk State's net position as of September 30, 2016, with comparable balances for fiscal year 2015, discloses this relationship.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis, Continued
September 30, 2016

	Governmental Activities			
	2016	(As Restated) 2015	Change	%
Current and other assets	\$ 24,366,090	\$ 22,872,162	\$ 1,493,928	6.53
Capital assets	<u>39,100,174</u>	<u>40,760,163</u>	<u>(1,659,989)</u>	(4.07)
Total assets	\$ <u>63,466,264</u>	\$ <u>63,632,325</u>	\$ <u>(166,061)</u>	(0.26)
Current and other liabilities	14,658,655	14,666,438	(7,783)	(0.05)
Long-term debt	<u>8,943,673</u>	<u>9,361,128</u>	<u>(417,455)</u>	(4.07)
Total liabilities	<u>23,602,328</u>	<u>24,027,566</u>	<u>(425,238)</u>	(1.77)
Net position:				
Net investment in capital assets	39,100,174	40,760,163	(1,659,989)	(4.07)
Restricted	21,636,297	21,061,630	574,667	2.73
Unrestricted	<u>(20,872,535)</u>	<u>(22,217,034)</u>	<u>1,344,499</u>	(6.05)
Total net position	<u>39,863,936</u>	<u>39,604,759</u>	<u>259,177</u>	0.65
Total liabilities and net position	\$ <u>63,466,264</u>	\$ <u>63,632,325</u>	\$ <u>(166,058)</u>	(0.26)

At the end of fiscal year 2016, Chuuk State's unrestricted net position showed a deficit of \$20.873 million, a decrease of \$1.344 million (6.05%) from the prior year \$22.217 million. This deficit is the result of having current and long-term commitments that are greater than currently available resources. Chuuk State did not include in past annual budgets the full amounts needed to finance its current liabilities to vendors and others or its long-term liabilities arising from Asian Development Bank (ADB) loans, unused employee leave balances, and claims and judgements payable. Chuuk State will include these amounts in future years' budgets as funding permits.

Net position increased by \$0.259 million (or 0.65%) from the prior year. Key elements of the increase and the differences from the prior year are shown in the following schedule:

	Governmental Activities			
	2016	(As Restated) 2015	Change	%
Revenues:				
Program revenues:				
Charges for services	\$ 2,286,421	\$ 2,126,370	\$ 160,051	7.53
Operating grants and contributions	<u>28,329,839</u>	<u>27,521,317</u>	<u>808,522</u>	2.94
	<u>30,616,260</u>	<u>29,647,687</u>	<u>968,573</u>	3.27
General revenues:				
Taxes	6,453,810	5,564,123	889,687	15.99
Unrestricted investment earnings	(144,209)	192,765	(336,974)	(174.81)
Other	<u>721,433</u>	<u>648,571</u>	<u>72,862</u>	11.23
	<u>7,031,034</u>	<u>6,405,459</u>	<u>625,575</u>	9.77
Total revenues	37,647,294	36,053,146	1,594,148	4.42
Special item-SDR foreign exchange gain	51,520	1,698,067	(1,646,547)	(96.97)
Contributions to permanent fund	<u>1,112,947</u>	<u>(584,472)</u>	<u>1,697,419</u>	(290.42)
	<u>38,811,761</u>	<u>37,166,741</u>	<u>1,645,020</u>	4.43

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis, Continued
September 30, 2016

	Governmental Activities			
	2016	(As Restated) 2015	Change	%
Expenses:				
General government	6,415,438	5,967,351	448,087	7.51
Health services	10,805,290	9,924,455	880,835	8.88
Education	15,442,223	14,523,690	918,533	6.32
Economic development	1,051,991	1,448,648	(396,657)	(27.38)
Public safety	1,322,886	944,911	377,975	40.00
Public works and transportation	1,551,817	1,462,102	89,715	6.14
Community affairs	143,061	146,168	(3,107)	(2.13)
Boards and commissions	718,894	836,015	(117,121)	(14.01)
Judiciary	481,475	515,629	(34,154)	(6.62)
Payments to component units	114,001	53,905	60,096	111.49
Municipal affairs	413,757	414,772	(1,015)	(0.24)
Unallocated interest on long-term debt	51,179	120,709	(69,530)	(57.60)
Other	40,572	659,394	(618,822)	(93.85)
Total expenses	<u>38,552,584</u>	<u>37,017,749</u>	<u>1,534,835</u>	4.15
Change in net position	259,177	148,992	110,185	72.95
Net position at the beginning of the year	<u>39,604,759</u>	<u>39,455,767</u>	<u>148,992</u>	.38
Net position at the end of the year	\$ <u>39,863,936</u>	\$ <u>39,604,759</u>	\$ <u>259,177</u>	0.65

The detail indicates the increases in both revenues and expenses in fiscal year 2016, and the marginal increase in overall net position of \$0.259 million.

Revenues and special items and contributions of \$38.812 million increased by \$1.645 million (or 4.43%) from the prior year's \$37.167 million. The key elements of the increase were due to an increase in program revenues as more grant drawdowns from higher utilization of sector grants occurred and improved local tax collections compared with prior year.

The following table shows a comparison of each revenue component's contribution to total revenues:

<u>SOURCES OF REVENUE</u>	<u>2016</u>	<u>2015</u>
Compact funding	67%	71%
Investments	3%	0%
Revenue sharing	9%	8%
Federal and other grants	6%	6%
Taxes and fees	13%	13%
Other	<u>2%</u>	<u>2%</u>
	<u>100%</u>	<u>100%</u>

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Management's Discussion and Analysis, Continued
September 30, 2016

Notwithstanding the increases in both revenue shares passed through to the State and local taxes that reduce dependency on Compact funding, the preponderance of sector funding as 67% of the total revenue highlights the importance of maximizing Compact sector grant utilization.

Total expenses increased by \$1.535 million (or 4.15%) from \$37.018 million in the prior fiscal year to \$38.553 million in fiscal year 2016. The most notable increases in fiscal year 2016 were in the education sector \$0.919 million, health sector \$0.881 million, general government \$0.448 million, public safety \$0.378 million and public works and transportation \$0.090 million. The major decreases of expenses were in economic development \$0.397 million, boards and commissions \$0.117 million, and other government agencies \$0.720 million offset the increase.

FINANCIAL ANALYSIS OF CHUUK STATE'S FUNDS

As noted earlier, Chuuk State uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. As of the end of fiscal year 2016, Chuuk State's governmental funds reported a combined fund balance of \$11.979 million, which represents a \$1.509 million increase (14.41%) from the restated \$10.471 million fund balance recorded at the end of fiscal 2015. Of this total combined fund balance, \$13.988 million is non-spendable because it is legally restricted to other purposes and \$8.150 million is restricted to fund specific fund-related activities. These non-spendable and restricted fund balances are off-set by combined unassigned fund deficit of \$10.159 million.

General Fund

Most of the basic current operational services are recorded, reported, and accounted for in the General Fund, except for Health, Education, Environment, Private Sector Development, Capacity Building, ERA and IMF which are reported and accounted for in the Grant Assistance Fund. As shown in the accompanying financial statements, at the end of fiscal year 2016, the General Fund recorded total revenues of \$9.222 million with total expenditures of \$8.210 million resulted an excess of \$1.012 million even after repayment of ADB loans principal and interest of \$0.417 million. At the end of the year, General Fund deficit decreased by \$0.504 million decreasing from \$5.681 million, as restated, in the prior year to \$5.177 million, which included a local match transfer out to IMF Grants Assistance Fund of \$0.507 million. The State needs to continue to develop strategies to increase revenues and reduce expenditures in order to sustainably eliminate the fund balance deficit over the next few years.

Grants Assistance Fund

The Grants Assistance Fund consists of funding provided through the amended Compact of Free Association Sector Grants; US Federal Grants, and other Non-US grants. As shown in the accompanying financial statements, at the end of fiscal year 2016, the Grant Assistance Fund had total revenues of \$28.330 million and total expenditures of \$28.919 million. This resulted in a deficit of \$0.590 million. Nevertheless, a total of \$0.507 million operating transfers-in to finance infrastructure maintenance programs were recorded, which effectuated a net change in fund balance deficit of \$0.082 million. This brings a total overall fund balance of \$4.677 million. As shown in the above numbers, this is indicative of well spending in the Grant Assistance Fund and management will ensure that internal controls are in place.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis, Continued
September 30, 2016

Compact Trust Fund

The Trust Fund was established to account for Chuuk State's share of the Compact Trust Fund. The Fund is managed by the FSM National Government and is a long-term restricted Fund. At the end of fiscal year 2016, the fund recorded net change in the fair value of its investments of \$1.113 million, which increases the fund balance at the end of the year to \$12.369 million.

Other Governmental Funds

This fund is established to account and report on fees collected for services at the hospital. At the end of fiscal year 2016, total revenues collected were \$0.095 million and at the same time total expenditures were \$0.122 million. This resulted in a deficit of revenues under expenditures of \$0.027 million.

Note 9 of the financial statements gives further details of the fund balance components of Chuuk State.

GENERAL FUND BUDGETARY HIGHLIGHTS

In fiscal year 2016, actual revenues of \$9.222 million exceeded the budgeted revenues of \$7.923 million by \$1.299 million. Actual budgetary expenditures of \$8.580 million were greater than budgetary appropriations of \$7.965 million by \$0.615 million, resulting in an overall excess of revenues over expenditures of \$0.643 million. When combined with the transfer out to other fund (\$0.508 million), the net change in unreserved fund deficit on a budgetary basis was a positive \$0.135 million. In accordance with the principles of budgetary accounting, the deficit includes encumbrances for which goods or services had not been received of \$0.369 million, the net change in unreserved fund deficit on a budgetary basis was a positive of \$0.592 million.

Chuuk State retains a balanced operating budget but debt service activities of the State that are not budgeted have negative impact on overall State operations. In fiscal year 2016, principal and debt service charges on ADB loans of \$0.417 million contributed to the deficiency.

CAPITAL ASSET AND DEBT ADMINISTRATION

Chuuk State's investment in capital assets for the primary government as of September 30, 2016, amounted to \$123.125 million, net of accumulated depreciation of \$84.025 million, leaving a net book value of \$39.1 million. This represents a net decrease of \$1.66 million (or 4.07%) from fiscal year 2015. Chuuk State recorded major additions of \$0.633 million in 2016 related to buildings of \$0.308 million and vehicles and other equipments of \$0.355 million, but current year depreciation charges of \$2.323 million resulted in the net decrease. The table below summarizes Chuuk State's net capital assets:

	Governmental Activities			
	<u>2016</u>	<u>2015</u>	<u>Change</u>	<u>%</u>
Land	\$ 17,954,462	\$ 17,954,462	\$ -	-
Airport Facilities	6,863,836	7,816,523	(952,686)	(12.19)
Buildings	7,650,381	7,605,894	44,486	0.58
Seaport Facilities	3,977,582	4,640,512	(1,173,832)	(14.29)
Vehicles / Equipment	2,653,913	2,742,772	422,043	(3.24)
	<u>\$ 39,100,174</u>	<u>\$ 40,760,163</u>	<u>\$ (1,659,989)</u>	<u>(4.07)</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis, Continued
September 30, 2016

Additional information on Chuuk State's capital assets can be found in Note 5 to the accompanying financial statements.

Long -Term Debt

The following schedule shows Chuuk State's summarized long-term debt for fiscal year 2016 and comparable amounts for fiscal year 2015.

	Governmental Activities			
	<u>2016</u>	<u>2015</u>	<u>Change</u>	<u>%</u>
ADB Water Supply Loan (1459)	\$ 3,163,851	\$ 3,259,280	\$ (95,429)	(2.93)
ADB Early Retirement Loan (1520)	4,363,469	4,484,498	(121,029)	(2.70)
ADB Basic Social Services Program Loan (1816)	223,067	328,470	(105,403)	(32.09)
ADB Private Sector Reform Program Loan (1873)	365,015	405,304	(40,289)	(9.94)
ADB Private Sector Reform Program Loan (1874)	<u>828,271</u>	<u>883,576</u>	<u>(55,305)</u>	<u>(6.26)</u>
	<u>\$ 8,943,673</u>	<u>\$ 9,361,128</u>	<u>\$ (417,455)</u>	<u>(4.46)</u>

Long-term debt decreased by \$0.417 million (or 4.46%) in fiscal year 2016 as the result of loan repayments with an SDR adjustment resulting in gradual debt reductions.

Additional information on Chuuk State's long-term debt obligations can be found in Notes 6 and 7 to the accompanying financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

Chuuk State local revenue collections are showing growth in fiscal year 2017 with revenue collections trending is expected to have marginal growth from prior year. As a result, State policymakers have cautiously kept General Fund budgets capped within actual revenue collections, both in fiscal years 2017 and for the 2018 annual appropriation act. Revenue collections in excess of these fiscal ceilings will be used for debt relief payments of Chuuk's old liabilities.

CONTACTING CHUUK STATE'S FINANCIAL MANAGEMENT

The financial report is designed to provide our citizens, taxpayers, customers, and investments and creditors, a general overview of Chuuk State'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 Director, Office of Administrative Services, P.O. Box 849, Weno, Chuuk FM 9694

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Statement of Net Position
September 30, 2016

	<u>Primary Government</u>	<u>Component Units</u>
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 653,148	\$ 2,050,042
Time certificates of deposit	-	200,000
Equity interest in internal investment pool	33,264	435,453
Receivables, net of allowance for uncollectibles	3,687,080	1,274,611
Inventories	-	1,204,956
Prepayments	893,195	-
Restricted assets:		
Cash and cash equivalents	<u>1,976,911</u>	<u>-</u>
Total current assets	<u>7,243,598</u>	<u>5,165,062</u>
Noncurrent assets:		
Restricted assets:		
Investments	16,001,840	-
Investments	570,652	-
Other assets	550,000	1,220,031
Capital assets:		
Nondepreciable capital assets	17,954,462	6,372,278
Capital assets, net of accumulated depreciation	<u>21,145,712</u>	<u>12,987,249</u>
Total noncurrent assets	<u>56,222,666</u>	<u>20,579,558</u>
Total assets	<u>\$ 63,466,264</u>	<u>\$ 25,744,620</u>
<u>LIABILITIES</u>		
Current liabilities:		
Current portion of long-term debt	\$ 365,553	\$ 243,529
Accounts payable	1,162,489	424,622
Land acquisition payable	8,591,745	-
Compensated absences payable	337,596	-
Other liabilities and accruals	889,476	1,268,042
Unearned revenues	<u>1,742,912</u>	<u>89,351</u>
Total current liabilities	<u>13,089,771</u>	<u>2,025,544</u>
Noncurrent liabilities:		
Accrued annual leave, net of current portion	-	32,781
Noncurrent portion of long-term obligations	8,578,120	4,699,308
Compensated absences payable, net of current portion	1,031,832	-
Claims and judgments payable	<u>902,605</u>	<u>-</u>
Total noncurrent liabilities	<u>10,512,557</u>	<u>4,732,089</u>
Total liabilities	<u>23,602,328</u>	<u>6,757,633</u>
<u>NET POSITION</u>		
Net investment in capital assets	39,100,174	14,402,618
Restricted for:		
Nonexpendable:		
Future operations	12,369,336	-
Expendable:		
Compact related	5,523,851	-
Debt service	3,632,504	-
Other purposes	110,606	551,551
Unrestricted	<u>(20,872,535)</u>	<u>4,032,818</u>
Total net position	<u>39,863,936</u>	<u>18,986,987</u>
Total liabilities and net position	<u>\$ 63,466,264</u>	<u>\$ 25,744,620</u>

See accompanying notes to financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Statement of Activities
Year Ended September 30, 2016

Functions/Programs	Program Revenues				Net (Expenses) Revenues and Changes in Net Position	
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government	Component Units
Primary government:						
Governmental activities:						
General government	\$ 6,415,438	\$ 1,372,217	\$ 3,433,241	\$ -	\$ (1,609,980)	\$ -
Health services	10,805,290	95,048	9,272,950	-	(1,437,292)	-
Education	15,442,223	-	14,623,170	-	(819,053)	-
Economic development	1,051,991	-	1,000,478	-	(51,513)	-
Public safety	1,322,886	92,281	-	-	(1,230,605)	-
Public works and transportation	1,551,817	726,875	-	-	(824,942)	-
Community affairs	143,061	-	-	-	(143,061)	-
Boards, commissions and other	718,894	-	-	-	(718,894)	-
Judiciary	481,475	-	-	-	(481,475)	-
Payments to component units	114,001	-	-	-	(114,001)	-
Municipal affairs	413,757	-	-	-	(413,757)	-
Unallocated interest on long-term debt	51,179	-	-	-	(51,179)	-
Other	40,572	-	-	-	(40,572)	-
Total primary government	<u>38,552,584</u>	<u>2,286,421</u>	<u>28,329,839</u>	<u>-</u>	<u>(7,936,324)</u>	<u>-</u>
Component units:						
Chuuk State Health Care Plan	1,411,121	1,518,926	-	-	-	107,805
Chuuk Public Utility Corporation	6,103,626	5,641,727	-	7,038,970	-	6,577,071
Chuuk State Housing Authority	170,466	218,642	-	-	-	48,176
Total component units	<u>\$ 7,685,213</u>	<u>\$ 7,379,295</u>	<u>\$ -</u>	<u>\$ 7,038,970</u>	<u>-</u>	<u>6,733,052</u>
General revenues:						
Taxes:						
FSM revenue sharing:						
Gross revenue taxes					1,280,809	-
Import taxes					1,170,790	-
Income taxes					1,051,538	-
Other taxes					131,270	-
State taxes:						
Sales tax					2,238,850	-
Other excise taxes					580,553	-
Unrestricted investment income					(144,209)	834,681
Other					721,433	-
Total general revenues					<u>7,031,034</u>	<u>834,681</u>
Special item - gain on SDR foreign exchange					51,520	-
Contributions to permanent fund					<u>1,112,947</u>	<u>-</u>
Total general revenues, special item and contributions					<u>8,195,501</u>	<u>834,681</u>
Change in net position					<u>259,177</u>	<u>7,567,733</u>
Net position at the beginning of the year, as previously reported					39,320,662	11,419,254
Implementation of GASB 72 (Note 1)					284,097	-
Net position at the beginning of the year, as restated					<u>39,604,759</u>	<u>11,419,254</u>
Net position at the end of the year					<u>\$ 39,863,936</u>	<u>\$ 18,986,987</u>

See accompanying notes to financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Balance Sheet
Governmental Funds
September 30, 2016

		<u>Special Revenue</u>	<u>Permanent</u>	<u>Other Governmental Funds</u>	<u>Total</u>
	<u>General</u>	<u>Grants Assistance</u>	<u>Compact Trust</u>		
<u>ASSETS</u>					
Cash and cash equivalents	\$ 653,148	\$ -	\$ -	\$ -	\$ 653,148
Equity interest in internal investment pool	33,264	-	-	-	33,264
Investments	570,652	-	-	-	570,652
Receivables, net	523,294	3,148,566	-	15,220	3,687,080
Prepayments	229,156	609,358	-	54,681	893,195
Due from other funds	2,715,575	6,452,130	-	43,947	9,211,652
Other assets	550,000	-	-	-	550,000
Restricted assets:					
Cash and cash equivalents	1,976,911	-	-	-	1,976,911
Investments	<u>3,632,504</u>	<u>-</u>	<u>12,369,336</u>	<u>-</u>	<u>16,001,840</u>
Total assets	<u>\$ 10,884,504</u>	<u>\$ 10,210,054</u>	<u>\$ 12,369,336</u>	<u>\$ 113,848</u>	<u>\$ 33,577,742</u>
<u>LIABILITIES AND FUND BALANCES (DEFICIT)</u>					
Liabilities:					
Accounts payable	\$ 766,999	\$ 392,281	\$ -	\$ 3,209	\$ 1,162,489
Accrued liabilities	206,271	682,649	-	556	889,476
Land acquisition payable	8,591,745	-	-	-	8,591,745
Unearned revenues	-	1,742,912	-	-	1,742,912
Due to other funds	<u>6,496,077</u>	<u>2,715,575</u>	<u>-</u>	<u>-</u>	<u>9,211,652</u>
Total liabilities	<u>16,061,092</u>	<u>5,533,417</u>	<u>-</u>	<u>3,765</u>	<u>21,598,274</u>
Fund balances (deficit):					
Nonspendable	1,349,808	269,095	12,369,336	-	13,988,239
Restricted	3,632,504	4,407,542	-	110,083	8,150,129
Unassigned:					
General fund	<u>(10,158,900)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(10,158,900)</u>
Total fund balances (deficit)	<u>(5,176,588)</u>	<u>4,676,637</u>	<u>12,369,336</u>	<u>110,083</u>	<u>11,979,468</u>
Total liabilities and fund balances	<u>\$ 10,884,504</u>	<u>\$ 10,210,054</u>	<u>\$ 12,369,336</u>	<u>\$ 113,848</u>	
Amounts reported for governmental activities in the statement of net position are different because:					
Capital assets used in governmental activities are not financial resources and, therefore, are reported in the funds 39,100,174					
Long-term liabilities, including loans payable, are not due and payable in the current period and, therefore, are not reported in the funds. The liabilities include:					
Long-term obligations (8,943,673)					
Compensated absences (1,369,428)					
Claims and judgements payable <u>(902,605)</u>					
<u>(11,215,706)</u>					
Net position of governmental activities <u>\$ 39,863,936</u>					

See accompanying notes to financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficit)
Governmental Funds
Year Ended September 30, 2016

	General	Special Revenue Grants Assistance	Permanent Compact Trust	Other Governmental Funds	Total
Revenues:					
Compact funding	\$ -	\$ 25,997,091	\$ -	\$ -	\$ 25,997,091
Net change in the fair value of investments	(144,209)	-	1,112,947	-	968,738
Federal contributions and other grants	-	2,332,748	-	-	2,332,748
FSM revenue sharing	3,634,407	-	-	-	3,634,407
State taxes	2,819,403	-	-	-	2,819,403
Fees and charges	2,191,373	-	-	95,048	2,286,421
Other	721,433	-	-	-	721,433
Total revenues	<u>9,222,407</u>	<u>28,329,839</u>	<u>1,112,947</u>	<u>95,048</u>	<u>38,760,241</u>
Expenditures:					
Current:					
General government	3,805,549	1,451,833	-	-	5,257,382
Health services	85,953	10,730,045	-	121,836	10,937,834
Education	-	15,455,727	-	-	15,455,727
Economic development	52,795	1,003,452	-	-	1,056,247
Public safety	1,049,676	278,422	-	-	1,328,098
Public works and transportation	888,635	-	-	-	888,635
Community affairs	143,061	-	-	-	143,061
Boards, commissions and other	718,017	-	-	-	718,017
Judiciary	481,286	-	-	-	481,286
Payments to component units	114,001	-	-	-	114,001
Municipal affairs	413,757	-	-	-	413,757
Other	40,572	-	-	-	40,572
Debt service	417,114	-	-	-	417,114
Total expenditures	<u>8,210,416</u>	<u>28,919,479</u>	<u>-</u>	<u>121,836</u>	<u>37,251,731</u>
Excess (deficiency) of revenues over (under) expenditures	<u>1,011,991</u>	<u>(589,640)</u>	<u>1,112,947</u>	<u>(26,788)</u>	<u>1,508,510</u>
Other financing sources (uses):					
Operating transfers in	-	507,600	-	-	507,600
Operating transfers out	(507,600)	-	-	-	(507,600)
Total other financing sources (uses), net	<u>(507,600)</u>	<u>507,600</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net change in fund balances (deficit)	<u>504,391</u>	<u>(82,040)</u>	<u>1,112,947</u>	<u>(26,788)</u>	<u>1,508,510</u>
Fund balances (deficit) at the beginning of the year, as previously reported	(5,965,076)	4,758,677	11,256,389	136,871	10,186,861
Implementation of GASB 72 (Note 1)	284,097	-	-	-	284,097
Fund balances (deficit) at the beginning of the year, as restated	<u>(5,680,979)</u>	<u>4,758,677</u>	<u>11,256,389</u>	<u>136,871</u>	<u>10,470,958</u>
Fund balances (deficit) at the end of the year	<u>\$ (5,176,588)</u>	<u>\$ 4,676,637</u>	<u>\$ 12,369,336</u>	<u>\$ 110,083</u>	<u>\$ 11,979,468</u>

See accompanying notes to financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Reconciliation of the Statement of Revenues, Expenditures,
and Changes in Fund Balances of Governmental Funds
to the Statement of Activities
Year Ended September 30, 2016

Amounts reported for governmental activities in the statement of activities are different from changes in fund balances because:

Net change in fund balances - total governmental funds	\$ 1,508,510
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation (\$2,323,094) exceeded capital outlays (\$663,105) in the current period.	(1,659,989)
Special item associated with gain on SDR foreign exchange adjustment.	51,520
The incurrence of long-term debt (e.g. bonds, leases) provides current financial resources to governmental funds, while the repayment of principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction has any effect on net position. For the current year, these amounts consist of:	
Repayment of ADB loans	365,935
Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds. For the current year, these activities consist of:	
Change in compensated absences payable	<u>(6,799)</u>
Change in net position of governmental activities	\$ <u>259,177</u>

See accompanying notes to financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

DISCRETELY PRESENTED COMPONENT UNITS
Combining Statement of Net Position
September 30, 2016

<u>ASSETS</u>	Chuuk State Health Care Plan	Chuuk Public Utility Corporation	Chuuk State Housing Authority	Total
Current assets:				
Cash and cash equivalents	\$ 471,432	\$ 1,445,550	\$ 133,060	\$ 2,050,042
Time certificates of deposit	200,000	-	-	200,000
Investments	435,453	-	-	435,453
Receivables, net	394,227	470,195	410,189	1,274,611
Inventories	-	1,204,956	-	1,204,956
	<u>1,501,112</u>	<u>3,120,701</u>	<u>543,249</u>	<u>5,165,062</u>
Total current assets				
Noncurrent assets:				
Deposits	43,750	1,176,281	-	1,220,031
Capital assets:				
Nondepreciable capital assets	-	6,372,278	-	6,372,278
Capital assets, net of accumulated depreciation	6,640	12,966,537	14,072	12,987,249
	<u>1,551,502</u>	<u>23,635,797</u>	<u>557,321</u>	<u>25,744,620</u>
Total assets				
	<u>\$ 1,551,502</u>	<u>\$ 23,635,797</u>	<u>\$ 557,321</u>	<u>\$ 25,744,620</u>
<u>LIABILITIES AND NET POSITION</u>				
Current liabilities:				
Current portion of long-term debt	\$ -	\$ 243,529	\$ -	\$ 243,529
Accounts payable	40,009	376,933	7,680	424,622
Accrued liabilities	12,823	1,170,981	84,238	1,268,042
Unearned income	-	89,351	-	89,351
	<u>52,832</u>	<u>1,880,794</u>	<u>91,918</u>	<u>2,025,544</u>
Total current liabilities				
Noncurrent liabilities:				
Accrued annual leave, net of current portion	-	32,781	-	32,781
Noncurrent portion of long-term debt	-	4,699,308	-	4,699,308
	<u>52,832</u>	<u>6,612,883</u>	<u>91,918</u>	<u>6,757,633</u>
Total liabilities				
Net position:				
Net investment in capital assets	6,640	14,395,978	-	14,402,618
Restricted	-	551,551	-	551,551
Unrestricted	1,492,030	2,075,385	465,403	4,032,818
	<u>1,498,670</u>	<u>17,022,914</u>	<u>465,403</u>	<u>18,986,987</u>
Total net position				
Total liabilities and net position	<u>\$ 1,551,502</u>	<u>\$ 23,635,797</u>	<u>\$ 557,321</u>	<u>\$ 25,744,620</u>

See accompanying notes to financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

DISCRETELY PRESENTED COMPONENT UNITS
Combining Statement of Revenues, Expenses, and Changes in Net Position
Year Ended September 30, 2016

	Chuuk State Health Care Plan	Chuuk Public Utility Corporation	Chuuk State Housing Authority	Total
Operating revenues:				
Charges for services	\$ 1,505,119	\$ 5,180,875	\$ -	\$ 6,685,994
Other	<u>13,807</u>	<u>460,852</u>	<u>218,642</u>	<u>693,301</u>
Total operating revenues	<u>1,518,926</u>	<u>5,641,727</u>	<u>218,642</u>	<u>7,379,295</u>
Operating expenses:				
Cost of services	1,124,400	2,695,490	-	3,819,890
Depreciation	12,731	665,240	3,415	681,386
Administration and general	<u>273,990</u>	<u>2,742,896</u>	<u>167,051</u>	<u>3,183,937</u>
Total operating expenses	<u>1,411,121</u>	<u>6,103,626</u>	<u>170,466</u>	<u>7,685,213</u>
Operating (loss) income	<u>107,805</u>	<u>(461,899)</u>	<u>48,176</u>	<u>(305,918)</u>
Nonoperating revenues (expenses):				
Other income (loss)	38,486	121,996	-	160,482
Operating grants	<u>-</u>	<u>674,199</u>	<u>-</u>	<u>674,199</u>
Total nonoperating revenues, net	<u>38,486</u>	<u>796,195</u>	<u>-</u>	<u>834,681</u>
Net income before capital contributions	146,291	334,296	48,176	528,763
Capital contributions	<u>-</u>	<u>7,038,970</u>	<u>-</u>	<u>7,038,970</u>
Change in net position	146,291	7,373,266	48,176	7,567,733
Net position at the beginning of the year	<u>1,352,379</u>	<u>9,649,648</u>	<u>417,227</u>	<u>11,419,254</u>
Net position at the end of the year	<u>\$ 1,498,670</u>	<u>\$ 17,022,914</u>	<u>\$ 465,403</u>	<u>\$ 18,986,987</u>

See accompanying notes to financial statements.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2016

(1) Summary of Significant Accounting Policies

The State of Chuuk (the State) was constituted on October 1, 1984, under the provisions of the Chuuk State Constitution (the Constitution) as approved by the people of Chuuk. The Constitution provides for the separation of powers of the executive, legislative, and judicial branches of the government.

The accompanying financial statements of the State have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the State's accounting policies are described below.

A. Reporting Entity

The State is one of the four states that make up the Federated States of Micronesia (FSM), along with the states of Kosrae, Pohnpei and Yap. The State is a constitutional government comprised of three branches: the Legislative Branch, consisting of the Senate (10 members elected for a term of four years by qualified voters of their respective election districts with the President of the Senate as its highest officer) and the House of Representatives (28 members elected for a term of two years by qualified voters of their respective election districts with the Speaker as its highest officer); the Executive Branch, headed by the Governor and Lt. Governor who are primarily responsible for executing the laws and administering state government services; and the Judiciary Branch made up of the State Supreme Court, which consists of a Chief Justice and four Associate Justices, such inferior courts that may be created by law, and the municipal courts.

For financial reporting purposes, the State has included all funds, organizations, agencies, boards, commissions and institutions. The State has also considered all potential component units for which it is financially accountable as well as other entities for which the nature and significance of their relationship with the State are such that exclusion would cause the State's financial statements to be misleading or incomplete. The criteria to be considered in determining financial accountability include whether the State, as the primary government, has appointed a voting majority of an organization's governing body and either has the ability to impose its will on that organization or there is potential for the organization to provide specific financial benefits to or impose specific financial burdens on the State. Financial accountability also exists if an organization is determined to be fiscally dependent on the primary government, although the primary government does not appoint a voting majority of the organization's governing board.

Each blended and discretely presented component unit of the State has a September 30 year-end.

Once financial accountability has been determined for a potential component unit, that component unit is either blended into the primary government or discretely presented from the primary government. Potential component units that do not meet the financial accountability criteria, but where a voting majority of the governing board is appointed by the State, are deemed to be related organizations. The nature and relationship of the State's component units and related organizations are disclosed in the following section.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

Blended component units are entities that are legally separate from the State, but are so related to the State that they are, in substance, the same as the State or entities providing services entirely or almost entirely to the State. The State has not identified any entities that should be so blended.

i. Discretely Presented Component Units

Discretely presented component units are entities which are legally separate from the State, but are financially accountable to the State, or whose relationships with the State are such that exclusion would cause the State's basic financial statements to be misleading or incomplete. The component units' column of the basic financial statements includes the financial data of the following major component units:

Chuuk State Housing Authority (CSHA): CSHA was created by Chuuk State Law (CSL) No. 3-30 and is responsible for monitoring the U.S. Department of Housing and Urban Development Section 8 and CDBG housing renovation loan programs. Additionally, CSHA monitors the GLF loan fund of the State which provides low cost housing loans to the general public. CSHA is governed by a five-member Board of Directors appointed by the Governor subject to the advice and consent of the Legislature. The State has the ability to impose its will on CSHA.

Chuuk Public Utility Corporation (CPUC): CPUC was created by CSL No. 3-97-05 and is responsible for providing electrical services to the public through the operation and the maintenance of the State's electrical power system. CPUC is governed by a five-member Board of Directors appointed by the Governor subject to the advice and consent of the Legislature. The State has the ability to impose its will on CPUC.

Chuuk State Health Care Plan (CSHCP): CSHCP was established under CSL No. 2-94-06 for the purpose of establishing a financial system to provide universal coverage of an essential level of health care for all eligible enrollees and to create a means for collection of health care premiums for additional coverage. The State has the ability to impose its will on CSHCP.

The State's component units, departments, and funds that are separately audited issue their own financial statements. These statements may be obtained by directly contacting the various entities or obtaining them directly from the Office of the Public Auditor at the following address:

P.O. Box 760
Weno, Chuuk, FSM 96942

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

ii. Omitted Governmental Funds

The following funds are considered to be nonmajor governmental funds of the State but are not included in the accompanying basic financial statements due to absence of account balances and financial activities. The omission of these funds is not considered material to either the nonmajor other governmental funds or the governmental activities reporting units:

Development Authorities - The Northern Namoneas Economic Development Authority, the Southern Namoneas Development Authority, the Inner Faichuk Social and Economic Development Authority, the Outer Faichuk Development Authority, the Faichuk Transportation and Economic Development Authority, the Hall Islands Economic Development Authority, the Pattiw Islands Development Authority, and the Witto Resources and Development Authority. These development authorities were established to identify the development needs and promote economic development within the various municipalities, in coordination and cooperation with the State and the FSM National Government.

Chuuk Visitors Bureau (CVB) Fund - This fund was created by CSL No. 6-39 and is responsible for improving and developing the State's tourism industry. CVB is governed by a nine-member Board of Directors, five of whom are appointed by the Governor subject to the advice and consent of the Legislature and the remaining four of whom are appointed by the President and Speaker of the Legislature.

Representation Fund: This fund was established under CSL No. 3-95-09 for the use of members of the State Legislature to provide assistance to constituents' legitimate emergencies, educational, and civic needs not met by other appropriations.

Chuuk State Legislature Entertainment Fund: This fund was established under Title 21, Section 751 of the Truk District Code (TDC), for the use by the Legislature to entertain guests or other distinguished persons living in or visiting the State.

Legislature Emergency Fund: This fund was established under Truk District Law (TDL) No. 21-1 to defray salaries of personnel of the Legislature and office expenses of the Legislature during a period of time between the close of a fiscal year and the signing into law of an appropriation for salaries and expenses of the Legislature office and staff for the next succeeding fiscal year.

Chuuk State Travel Fund: This fund was established under TDL No. 22-27 to enable members of the Legislature, Magistrates of municipalities, members of municipal councils, and other leaders in the State to travel outside of the State for the purposes of attending functions prescribed by the enabling legislation.

Association of Pacific Island Legislatures Fund: This fund was established under TDL No. 24-9 for the purpose of funding donations or membership fees to the Association of Pacific Island Legislatures.

Municipal Operations and Projects Fund: This fund was established under TDL No. 25-23 for the purpose of funding operational expenses of municipalities in the State, and providing funds for municipal projects and programs.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

ii. Omitted Governmental Funds, Continued

Fire Disaster Relief Fund: This fund was established under 7 TDC Section 51 for the purpose of providing relief to persons suffering loss or damage to homes or furnishings as a result of accidental fires.

Economic Development Loan Fund: This fund was established under 13 TDC Section 1 for the purpose of providing loans to any private citizen of the State or any Chuukese corporation or cooperative, wishing to begin, operate, or improve business operations in the State.

Chuuk Farmers', Fishermen's, and Handicrafts Fair Fund: This fund was established under TDL No. 23-28 for the purpose of paying for supplies, materials, prizes and other expenses incurred in the preparation for and holding of the Chuuk Farmers', Fishermen and Handicrafts Fair.

Chuuk State Local Farmers Revolving Fund: This fund was established under TDL No. 21-25 for the purpose of purchasing agricultural supplies, livestock, feeds, assorted tools and other materials, for the use of local farmers in the State.

Chuuk State Hospital Transportation Fund: This fund was established under TDL No. 22-32 for the purpose of transporting patients of the State, who require periodic medical treatment and care, to the Chuuk State Hospital, to provide return transportation to their homes after treatment at the Chuuk State Hospital, and to provide for each of these patients a one dollar and fifty cents (\$1.50) noon meal during such travel, treatment and care.

iii. Omitted Component Units

The following component units have been omitted from the basic financial statements due to the lack of available financial information. The omission of these component units is not considered material to the aggregate discretely presented component unit reporting unit:

Chuuk State Coconut Authority (CSCA): CSCA was created by TSL No. 1-1-12 and is responsible for the manufacturing, processing, buying, collecting, marketing, selling, exporting and dealing with, in general, all products derived from the coconut tree. CSCA is governed by a five-member Board of Directors appointed by the Governor subject to the advice and consent of the Legislature. The State has the ability to impose its will on CSCA.

Chuuk Public Fisheries Corporation (CPFC): CPFC was created by CSL No. 5-99-22 and is responsible for promoting the development of pelagic fisheries and related industries for the economic benefit of the people of the State. CPFC is governed by a five-member Board of Directors, which comprises of the Director of the Department of Marine Resources, the Director of the Department of Commerce and Industry, one member who is appointed by the Governor representing the Chamber of Commerce, and two members who are appointed by the President and the Speaker. The State has the ability to impose its will on CPFC.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements

The Statement of Net Position and the Statement of Activities report financial information on all of the non-fiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been eliminated from these statements except for other charges between the primary government and the discretely presented component units. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Primary government activities are defined as either governmental or business-type activities. Governmental activities, which normally are supported by taxes, intergovernmental revenues and other non-exchange revenues, are reported separately from business-type activities, which rely to a significant extent on fees charged to external parties for goods or services. As such, business-type activities account for operations similarly to a for-profit business. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable. Discretely presented component unit activities are presented with their business-type focus.

The Statement of Net Position presents all of the reporting entity's non-fiduciary assets and deferred outflows of resources, and liabilities and deferred inflows of resources with the difference reported as net position. Net position is reported in the following categories:

- Net investment in capital assets consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets.
- Restricted net position - nonexpendable consists of permanent funds in which donors or other outside sources have stipulated that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to the principal.
- Restricted net position - expendable consists of resources in which the State is legally or contractually obligated to spend resources in accordance with restrictions either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.
- Unrestricted net position consists of net position, which does not meet the definition of the two preceding categories. Unrestricted net position often is designated, (for example, internally restricted), to indicate that management does not consider such to be available for general operations.

The government-wide Statement of Net Position reports \$21,636,297 of restricted net position, of which none is restricted by enabling legislation.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

The Statement of Activities demonstrates the degree to which the direct expenses of given functions or segments are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function or segment. Program revenues include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not meeting the definition of program revenues are, instead, reported as general revenue.

C. Fund Financial Statements

The fund financial statements present a balance sheet and a statement of revenues, expenditures, and changes in fund balances for its major and aggregated non-major funds. Major individual governmental funds are reported as separate columns in the fund financial statements pursuant to GASB reporting standards, with nonmajor governmental funds being combined into a single column.

The State reports its financial position and results of operations in funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures/expenses. Transactions between funds within a fund type, if any, have not been eliminated.

D. Measurement Focus and Basis of Accounting

Government-Wide Financial Statements:

The government-wide financial statements are reported using the economic resources management focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Amounts reported as program revenue include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources are reported as general revenues rather than as program revenues. General revenue is derived from taxation, investment income and other fees that are not allocated to specific programs.

Governmental Fund Financial Statements:

Governmental fund financial statements account for the general governmental activities of the State and are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become susceptible to accrual; generally when they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For the purpose, the State considers revenues to be available if they are collected within 60 days of the end of the current fiscal period.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Governmental Fund Financial Statements, Continued:

Significant revenues susceptible to accrual include income and gross revenue taxes, federal grants, federal reimbursements and other reimbursements for use of materials and services. Miscellaneous revenues from other financing sources are recognized when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned, since they are both measurable and available. Expenditures generally are recorded in the period in which the related fund liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Component Unit Financial Statements:

Discretely presented component units distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a discretely presented component unit's principal ongoing operations. All other revenues are reported as nonoperating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Fund Accounting:

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments: Omnibus*, sets forth minimum criteria (percentage of the assets, liabilities, revenues or expenditures/expenses for either fund category or the governmental and enterprise combined) for the determination of major funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The nonmajor funds are combined in a column in the fund financial statements and detailed in the combining statements. The State reports the following major funds:

General Fund - this fund is the primary operating fund of the State. It is used to account for all governmental transactions, except those required to be accounted for in another fund.

Grants Assistance Fund - a Special Revenue Fund that accounts for funds received under sector grants pursuant to the amended Compact of Free Association; all financial transactions of federally assisted funds, which are subgranted to the State, as well as other direct federal grants that the State received from the United States government, and foreign assistance grants.

Section 215 Compact Trust Fund - a Permanent Fund that accounts for the State's contributions to the Trust Fund established in accordance with Section 215 of the Compact of Free Association, as amended, to provide for an additional source of revenue for the government budget that will be needed to substitute for the absence of Compact of Free Association funding.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

E. Cash and Cash Equivalents and Time Certificates of Deposit

Cash and cash equivalents of the primary government and the discretely presented component units include cash held in demand accounts as well as short-term investments with maturity dates within three months of the date acquired by the State. Deposits maintained in time certificates of deposit with original maturity dates greater than ninety days are separately classified on the statement of net position/balance sheet.

F. Investments

Investments and related investment earnings of the primary government and the discretely presented component units are recorded at fair value using quoted market prices. Fair value is the price that would be received to sell an asset or paid to transfer a liability (ie., the exit price) in an orderly transaction between market participants at the date as of which the fair value of an asset or liability is determined.

The State categorizes its fair value measurements within the fair value hierarchy established by GAAP. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs. In certain instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy is based on the lowest level of input that is significant to the fair measurement. Investments not categorized under the fair value hierarchy are shown at either Net Asset Value (NAV) or amortized cost.

G. Receivables

In general, tax revenue is recognized on the government-wide financial statements when assessed or levied and on the governmental fund financial statements to the extent that it is both measurable and available. Receivables are stated net of estimated allowances for uncollectible accounts. Federal receivables include those funds which are earned, primarily from FSM National Government administered federal grants, which have yet to be reimbursed by the applicable grantor.

Receivables of the primary government and the discretely presented component units are primarily due from businesses and individuals residing in the State. The State establishes an allowance for doubtful accounts receivable based on the credit risk of specific customers, historical trends and other information.

H. Inventories

Inventories of the discretely presented component units are valued at the lower of cost (FIFO) or market.

I. Prepaid Items

Certain payments made to vendors or persons for services reflect costs applicable to future accounting periods and are recorded as prepaid items in both the government-wide and governmental fund financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

J. Interfund Receivables/Payables

During the course of its operations, the State records transactions between individual funds for goods provided or services rendered. Receivables and payables resulting from transactions between funds are classified as "due from other funds" or "due to other funds" on the governmental fund balance sheet.

These balances result from the time lag between the dates that 1) interfund goods and services are provided or reimbursable expenditures occur, 2) transactions are recorded in the accounting system, and 3) payments between funds are made, and are scheduled to be collected in the subsequent year.

K. Restricted Assets

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through loan agreements or enabling legislation. Specifically, the State has collateralized Asian Development Bank loan proceeds and earnings for the Chuuk State Early Retirement Scheme with investments recorded in the General Fund of \$3,632,504. Furthermore, investments recorded in the Compact Trust Fund of \$12,369,336 are restricted in that they are not available to be used in current operations.

As of September 30, 2016, cash and cash equivalents of the primary government were restricted for the following uses:

Savings account established in accordance with Section 211(d)(2) of the Compact of Free Association, as amended, for the purpose of funding the State's infrastructure maintenance plan	\$ 1,384,236
Deposit account established for the purpose of federal grants program activities	6,266
Deposit accounts established for the purpose of receiving payments pursuant to the Compact of Free Association, as amended	<u>586,409</u>
	\$ <u>1,976,911</u>

L. Other Assets

The State holds approximately 3.3% of the outstanding shares of Pacific Islands Development Bank with a carrying value of \$250,000 and 7% of the outstanding shares of the FSM Development Bank with a carrying value of \$300,000. These equity interests do not meet the definition of an investment as the assets are held primarily for economic development and are presented as other assets in the accompanying financial statements.

M. Capital Assets

Capital assets, which include property, plant, equipment and infrastructure (e.g. roads, bridges, ramps and other similar items), are reported in the governmental activity column of the government-wide financial statements. Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair market value at the date of donation.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

M. Capital Assets, Continued

The State currently holds no title to land. Singular pieces of machinery and equipment, other than vehicles, that equal or exceed \$50,000 are capitalized. Buildings and infrastructure projects with a cost that equals or exceeds \$100,000 are capitalized. The costs of normal maintenance and repairs that do not add to the value of assets or materially extend asset lives are not capitalized.

Capital assets of the primary government and the discretely presented component units are depreciated using the straight-line method over their estimated useful lives, with a full year's depreciation charged in the year of acquisition and disposal, regardless of date. Estimated useful lives are as follows:

Buildings	40 - 50 years
Infrastructure	25 - 50 years
Facilities	3 - 40 years
Machinery and equipment	3 - 25 years
Furniture and fixtures	3 - 10 years

N. Deferred Outflows of Resources

In addition to assets, the statements of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. The State has no items that qualify for reporting in this category.

O. Compensated Absences

It is the government's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since the government does not have a policy to pay any amounts when employees separate from service with the government. All vacation pay is accrued when incurred in the government-wide financial statements. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements. Annual leave accumulates at the rate of one working day per bi-weekly pay period.

P. Unearned Revenues

In the government-wide financial statements, unearned revenue is recognized when cash, receivables or other assets are recorded prior to their being earned. In the governmental fund financial statements, unearned revenue represents monies received or revenues accrued which have not been earned or do not meet the "available" criterion for revenue recognition under the modified accrual basis of accounting. The unearned revenue in the governmental fund financial statements has primarily resulted as federal funds are received in advance of eligible expenditures.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

Q. Deferred Inflows of Resources

In addition to liabilities, the statements of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. The State has no items that qualify for reporting in this category.

R. Fund Balance

Fund balance classifications are based on the extent to which the State is bound to honor constraints on the specific purposes for which amounts in those funds can be spent and are reported under the following fund balance classifications:

- Non-spendable - includes fund balance amounts that cannot be spent either because it is not in spendable form or because of legal or contractual constraints.
- Restricted - includes fund balance amounts that are constrained for specific purposes which are externally imposed by providers, such as creditors or amounts constrained due to constitutional provisions or enabling legislation.
- Committed - includes fund balance amounts that are constrained for specific purposes that are internally imposed by the government through formal action of the highest level of decision making authority and does not lapse at year-end.
- Assigned - includes fund balance amounts that are intended to be used for specific purposes that are neither considered restricted or committed.
- Unassigned - includes negative fund balances in other governmental funds.

The State has a general policy to first use restricted resources for expenditures incurred for which both restricted and unrestricted (committed, assigned, and unassigned) resources are available. When expenditures are incurred for which only unrestricted resources are available, the general policy of the State is to use committed resources first, followed by assigned, and then unassigned. The use of restricted/committed resources may be deferred based on a review of the specific transaction.

A formal minimum fund balance policy has not been adopted.

S. Interfund/Intrafund Transactions

As a general rule, the effect of interfund activity has been eliminated in the government-wide financial statements. Exceptions to this rule are: 1) activities between funds reported as governmental activities and funds reported as business-type activities and 2) activities between funds that are reported in different functional categories in either the governmental or business-type activities column. Elimination of these activities would distort the direct costs and program revenues for the functions concerned.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

T. New Accounting Standards

During fiscal year 2016, the State implemented the following pronouncements:

- GASB Statement No. 72, *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements and requires entities to expand their fair value disclosures by determining major categories of debt and equity securities within the fair value hierarchy on the basis of the nature and risk of the investment. The implementation of this statement required additional disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques. Additionally, the implementation resulted in the re-measurement of equity investment from cost-basis to the net asset value (NAV), as cost-basis measurement is no longer an allowable measurable method for equity investment. Such implementation had a material effect on the accompanying financial statements resulting in the restatement of the State's beginning net position/fund balance. Net position for governmental activities and fund balance for the General Fund as of October 1, 2015 increased by \$284,097 as a result of the implementation of GASB Statement No. 72. Refer to Note 2B for more information regarding the State's investments.
- GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which eliminates two of the four categories of authoritative GAAP that exist under the existing hierarchy prescribed by Statement No. 55. The two categories that will remain under the new standard are (1) GASB Statements and (2) GASB technical bulletins and implementation guides in addition to AICPA guidance that the GASB clears. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, addresses for certain external investment pools and their participants the accounting and financial reporting implications that result from changes in the regulatory provisions referenced by previous accounting and financial reporting standards. Those provisions were based on the Investment Company Act of 1940, Rule 2a7. Rule 2a7 contains the Securities and Exchange Commission's regulations that apply to money market funds and were significantly amended in 2014. The implementation of this statement did not have a material effect on the accompanying financial statements.

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements No. 67 and No. 68 with the reporting requirements in Statement No. 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

T. New Accounting Standards, Continued

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, as amended*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB). The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, as amended*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements. The provisions in Statement No. 77 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In December 2015, GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, which addresses a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The provisions in Statement No. 78 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units. The provisions in Statement No. 80 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(1) Summary of Significant Accounting Policies, Continued

T. New Accounting Standards, Continued

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The provisions in Statement No. 81 are effective for fiscal years beginning after December 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The provisions in Statement No. 82 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

U. Risk Financing

The State is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. It is the policy of the primary government not to purchase commercial insurance for the risks of loss to which it is exposed. Instead, the State management believes it is more economical to manage its risks internally. In the event of claim settlements and judgments, the State reports all of its risk management activities in its General Fund. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. No losses have occurred as a result of these risks in any of the past three fiscal years.

V. Estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and deferred outflows of resources, liabilities and deferred inflows of resources, and disclosures 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 could differ from those estimates.

W. Total Columns

Total columns are presented primarily to facilitate financial analysis. The Management's Discussion and Analysis includes certain prior year summarized comparative information in total. Such information does not include sufficient detail to constitute a full comparative presentation. Accordingly, such information should be read in conjunction with the State's financial statements for the year ended September 30, 2015 from which summarized information was derived.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2016

(2) Deposits and Investments

The deposit and investment policies of the State are governed by State legislation. The Treasurer is responsible for ensuring that deposits of the General Fund are maintained in commercial checking or savings accounts of any financial institution whose assets are at least \$1 billion and whose deposits are subject to Federal Deposit Insurance Corporation (FDIC) insurance. The Governor is responsible for the investment of any monies of the State that are deemed not necessary for immediate use.

The Federated Development Authority has selected investment managers who are given authority to buy and sell securities. These investment managers may invest in stocks, bonds and cash equivalents, for which minimum standards of quality of such investments at the time of purchase shall be as follows:

- i. Cash equivalents - the investment manager may engage in all normally accepted short-term investment practices including, but not limited to U.S. Treasury and government agency securities, bankers acceptances, certificates of deposit, commercial paper and repurchase agreements using any of the foregoing as collateral. The following restrictions apply: (1) Commercial paper must be rated A-1/P-1 or higher by Standard & Poor Corporation and Moody's Investor Services; and (2) Certificates of deposit must be from FDIC insured banks or FSLIC insured savings and loan associations, both of which must have assets in excess of \$2 billion. Deposits in smaller institutions are acceptable, but must not exceed the amount of the insurance, unless collateralized by U.S. Treasury obligations at 102%.
- ii. Stocks - A "B" rating by a national rating service. Non-rated stocks, such as banks or insurance companies, must be equal in quality or higher.
- iii. Bonds - Confined to issues rated "A" or higher by a national rating service, except in the case of U.S. Treasury or government agency obligations which are not rated.

The equity portfolio shall be diversified among issues and industry classifications. No more than 25% of the equity portfolio may be invested in any single classification, as described by the Standard and Poor 500 Index, unless prior approval is received from the Secretary of Finance.

No investment may be made in a single corporate entity which exceeds 5% of the total assets of the fund at the time of purchase without prior approval of the Secretary of Finance.

The Secretary of Administration and Finance shall be responsible for investment of all public funds collected or appropriated for use by the State. Funds under this arrangement shall include all appropriations from the State, whether funds are appropriated from the State Treasury or funds from other sources. Any funds in excess of the amount necessary for the operation of the State shall be deposited or invested to earn the safest optimum interest. The Secretary shall determine the amount to be invested with the consideration that such amount should not cause disruption of any government service due to low or lack of funds in the operational budget. The Secretary shall cause all investments to be made into financially secure institutions in Chuuk or abroad as determined by the financial institution paying the highest rate of interest on savings when the investment is made.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2016

(2) Deposits and Investments, Continued

The investment policy for the Compact Trust Fund (the Trust Fund), which was adopted by the Trust Fund Committee on September 15, 2010 and amended through December 17, 2013 requires the Trust Fund to allocate its managed investment portfolios among domestic and foreign equity and fixed income securities. All or a portion of the Trust Fund may be invested in exchange traded funds ("ETFs"), mutual funds, real estate investment trusts ("REITs"), separate accounts and common trust funds (commingled vehicles), hedge funds, private equity funds, and other pooled investment vehicles ("pooled vehicles"). A common trust fund is similar to an open-ended investment company or mutual fund, but participation is limited to investors with trust accounts. Commingled and pooled vehicles that invest exclusively in marketable fixed income securities are considered to be fixed income securities for the purpose of compliance with the Trust Fund's investment policy.

The fair values of ETFs, mutual funds, and common trust funds are generally determined by the fair value of the underlying marketable equity and debt securities owned, which are principally common stocks and bonds, respectively. Publicly traded ETFs, mutual funds, and similar vehicles may trade at prices above or below the fair values of the underlying investments held; therefore the fair value of such investments may differ from the sum of the fair values of the underlying investments owned. The core fixed income portfolios may be invested in debt securities issued by the U.S. government and government agencies, foreign governments, domestic and international corporate securities, including asset-backed and mortgage-backed obligations. The fixed income portfolio may invest in convertible and high yield debt securities; however the average quality of the fixed income portfolio must be rated "investment grade" by at least one nationally recognized rating agency at the time of purchase. The Trust Fund's fixed income investment objective is for each portfolio to achieve total return similar to a relevant index, such as Barclays Capital Aggregate Index and the Bank of America Merrill Lynch Global High Yield Index.

The Trust Fund's equity investment objective is for its various portfolios to achieve total returns similar to their benchmark equity indices. Benchmark indices include the Russell 3000, the S&P 500 and the MSCI EAFE.

Private equity funds are a form of pooled investment vehicle, typically limited partnerships controlled by a private equity firm that acts as general partner. The general partner seeks to obtain specific dollar commitments from qualified institutional and accredited investors to invest capital in the fund as limited partners. The passive limited partners fund pro rata portions of their commitments when the general partner has identified an appropriate opportunity, which may be venture capital in the form of equity securities, convertible debt securities, or real estate for which no active markets exist. Venture capital is often used to finance new products and technologies, expand working capital, make acquisitions, or finance leveraged buyouts. A typical private equity fund could make between 15 and 25 separate investments over a ten-year life, with no single investment exceeding 10% of the total capital commitment. The fair values of the underlying investments held by each private equity fund are generally determined by management of the equity investee or as determined by the general partner or manager of the private equity fund and is based upon the Trust Fund's percentage ownership of the underlying investments. Investments in private equity funds generally tend to be illiquid for significant periods of time.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2016

(2) Deposits and Investments, Continued

Hedge funds are a form of pooled investment vehicle, generally a limited partnership or a foreign (off-shore) investment corporation, that seeks to maximize absolute returns whose offering memorandum allows for the fund to take both long and short positions, use leverage and derivatives, and invest in many markets. Hedge funds often take large risks using a broad range of speculative strategies, including investing in unconventional and illiquid investments. The fair value of the Trust Fund's investment in a hedge fund is determined by the hedge fund manager and is based upon the Trust Fund's percentage ownership of the underlying investments.

Commingled separate accounts invested in real estate and related assets are carried at fair value of the underlying investments. The fair value of separate account investments in real property real estate partnerships are generally determined based on independent appraisals obtained no less frequently than annually. The fair value of separate account investments in real estate partnerships are generally determined based upon the equity method of accounting, and the fair value of underlying investments in real estate loans and mortgages are generally determined through the use of cash flow forecasting or other models by management of the insurance company that manages the separate account.

Derivatives, options and future contracts are permitted investments for the purpose of reducing risk and efficient portfolio management. Derivatives, options and futures may not be used for speculative purposes.

A. Deposits

Custodial credit risk is the risk that in the event of a bank failure, the State'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 State does not have a deposit policy for custodial credit risk or foreign currency risk.

As of September 30, 2016, the carrying amount of the primary government's total cash and cash equivalents were \$2,630,059 and the corresponding bank balances were \$4,328,023, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2016, bank deposits in the amount of \$500,000 were FDIC insured. The State does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

As of September 30, 2016, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit was \$2,250,042 and the corresponding bank balances were \$2,255,939, which were maintained in financial institutions subject to FDIC insurance. As of September 30, 2016, bank deposits in the amount of \$883,062 were FDIC insured. The component units do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Therefore, these deposits are exposed to custodial credit risk.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2016

(2) Deposits and Investments, Continued

B. Investments

Primary Government

As of September 30, 2016, the State's investments are as follows:

General Fund:

Fixed income	\$ 1,684,041
Domestic equities	570,652
Common equities	1,948,463
Cash management account	<u>33,264</u>
	<u>4,236,420</u>

Compact Trust Fund:

Common trust funds:	
Domestic Equity	3,377,578
International Equity	3,187,741
Fixed Income	2,358,633
Private Equity	915,572
Hedge Fund	1,080,090
Real Estate	1,402,191
Money market funds	<u>47,531</u>
	<u>12,369,336</u>
	\$ <u>16,605,756</u>

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. With the exception of investments in U.S. government securities, which are explicitly or implicitly guaranteed by the United States government, all other investments must be rated in accordance with the State's investment policy.

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the State will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The State's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the State's name by the State's custodial financial institutions at September 30, 2016.

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 the State. As of September 30, 2016, the State did not hold an investment in any one issuer that represented more than 5% of the State's total investments.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. The State 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.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

The Trust Fund's fixed income allocation consists of a Mercer Investment Management Opportunistic Fixed Income mutual fund ("MIM OFI") and a Mercer Investment Management Core Fixed Income Fund ("MIM CFI"); the performance of these funds is expected to closely replicate the performance of 50% of the JP Morgan Government Bond Index Emerging Market Global Diversified Index and 50% Bank of America/Merrill Lynch Global High Yield and the Barclays Capital U.S. Aggregate Bond Index, respectively. The bonds held by MIM CFI vary in credit quality with an average overall rating of "Aa3" as rated by Moody's as of September 30, 2016. High yield debt receiving a credit rating below "A" comprises approximately 32.2% of the MIM CFI fixed income portfolio as rated by Moody's at September 30, 2016. At September 30, 2016, the weighted average maturity of the bonds comprising MIM CFI is 8.23 years.

The bonds held by MIM OFI vary in credit quality with an average overall rating of "BB" as rated by Moody's as of September 30, 2016. High yield debt receiving a credit rating below "A" comprises approximately 83.6% of the MIM OFI fixed income portfolio as rated by Moody's at September 30, 2016. At September 30, 2016, the weighted average maturity of the bonds comprising MIM OFI is 3.70 years.

The Trust Fund's investment policy does not require direct investment in fixed maturity securities ("Bonds") as a means of managing its exposure to loss of principal due to increasing interest rates. The Trust Fund's investment policy requires the performance of each investment class to be periodically compared with an associated benchmark. Bonds and bond funds generally decrease in value in response to rising interest rates. Bonds, however, have a fixed date of maturity and do not have exposure to loss of principal from rising interest rates, whereas shares of a common trust fund, ETF, or similar investment vehicle have no maturity date.

The Trust Fund's exposure to foreign currency risk is derived from its investment in common trust funds, ETFs and REITs that hold investments in securities of foreign issuers and sovereigns. Foreign currency risk is the risk that changes in foreign exchange rates will adversely affect the fair values of an investment or deposit. At September 30, 2016, the Trust Fund held approximately \$4,012,000 in securities of foreign issuers held in common trust funds. Of this amount, approximately \$865,000 was held in securities whose functional currency is the Euro, \$477,000 whose functional currency is the British pound, \$443,000 whose functional currency is the Japanese yen, and \$2,227,000 in functional currencies of 35 other countries. Foreign currency exposure data is not available for the Trust Fund's investment in the Hedge Funds and its investments in Global Private Equity Funds, which comprise 16.4% of invested assets at September 30, 2016.

The Trust Fund's investment in hedge funds includes ownership of the Mercer Hedge Fund Series A ("Mercer Hedge Fund") and the Blackstone Partners Offshore Fund Ltd. Mercer Hedge Funds Investors SPC, who incorporated the Mercer Hedge Fund, and the Blackstone Partners Offshore Fund Ltd. are registered under the Mutual Funds Law of the Cayman Islands. The fair value of the Trust Fund's position in the hedge fund pools are equivalent to the value of the pool shares.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

The State owns 25,000 shares of the outstanding common stock of the Bank of the Federated States of Micronesia, which engages in commercial banking services in the FSM. An equity investment in the common stock of the Bank of the Federated States of Micronesia (investee) is stated at the net asset value (NAV). The NAV is used as a practical expedient to estimate fair value. The NAV is determined based on the total shareholders' equities reported by the investee.

As of September 30, 2016, the State's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

Investment Type	Rating Type	Maturity (in years)				Total
		Less than 1	1-5	6-10	Over	
U.S. Treasury Notes and Bonds	AAA	\$ 98,111	\$171,611	\$111,301	\$ 10,402	\$ 391,425
U.S. Treasury Notes and Bonds	Aaa	163,521	-	-	-	163,521
U.S. Government Agencies Obligations:						
Federal Home Loan Mortgage Corporation	AAA	51,982	2,463	-	17,499	71,944
Federal National Mortgage Association	AAA	-	50,623	-	27,743	78,366
Federal Home Loan Bank	AAA	62,864	-	-	-	62,864
Government National Mortgage Assoc.	AAA	-	-	-	942	942
NCUA Guaranteed Notes	AAA	14,165	-	-	-	14,165
Overseas Private Inv	AAA	-	-	84,000	-	84,000
Tennessee Valley Authority	AAA	-	-	15,710	-	15,710
Private Export Funding	AAA	-	-	29,757	-	29,757
AID-Tunisia	AAA	-	28,301	-	-	28,301
U.S Agency	Aa2	17,215	-	-	-	17,215
Securitized Mortgage-backed	Aa1	97,570	-	-	-	97,570
Securitized Assets - backed	Aa3	16,964	-	-	-	16,964
Municipal Obligations	Aa1	-	16,924	-	5,158	22,082
Municipal Obligations	Aa2	-	18,452	7,274	7,828	33,554
Corporate Bonds	Aaa/AAA	23,809	23,576	16,343	-	63,728
Corporate Bonds	Aa/AA	42,005	107,323	-	-	149,328
Corporate Bonds	A	-	26,733	15,709	59,566	102,008
Corporate Bonds	Baa/BBB	-	11,415	12,091	-	23,506
Corporate Bonds	Baa1	102,639	-	-	-	102,639
Corporate Bonds	Baa1	66,402	-	-	-	66,402
Corporate Bonds	A2	17,466	-	-	-	17,466
Corporate Bonds	Baa1	7,027	-	-	-	7,027
Corporate Bonds	A2	13,100	-	-	-	13,100
Corporate Bonds	No rating	-	-	-	10,457	10,457
		<u>\$794,840</u>	<u>\$457,421</u>	<u>\$292,185</u>	<u>\$139,595</u>	<u>\$1,684,041</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(2) Deposits and Investments, Continued

B. Investments, Continued

The State has the following recurring fair value measurements as of September 30, 2016:

General Fund:

	<u>Total</u>	<u>Fair Value Measurements Using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments by fair value level:				
Fixed income:				
U.S. Treasury obligations	\$ 554,946	\$ -	\$ 554,946	\$ -
U.S. Government Agencies	403,264	-	403,264	-
Municipal obligations	170,170	-	170,170	-
Corporate notes	<u>555,661</u>	-	<u>555,661</u>	-
Total fixed income	1,684,041	-	<u>1,684,041</u>	-
Equity securities:				
U.S. equities	<u>1,948,463</u>	<u>1,948,463</u>	-	-
Total investments at fair value	3,632,504	\$ <u>1,948,463</u>	\$ <u>1,684,041</u>	\$ -
Investments measured at NAV:				
Equity investment in the Bank of the FSM	570,652			
Investments measured at amortized cost:				
Cash management account	<u>33,264</u>			
	\$ <u>4,236,420</u>			

Compact Trust Fund:

	<u>Total</u>	<u>Fair Value Measurements Using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments by fair value level:				
Common trust funds:				
Domestic Equity	\$ 3,377,578	\$ 3,377,578	\$ -	\$ -
International Equity	3,187,741	3,187,741	-	-
Fixed Income	2,358,633	2,358,633	-	-
Private Equity	<u>915,572</u>	-	-	<u>915,572</u>
Total investments at fair value	9,839,524	\$ <u>8,923,952</u>	\$ -	\$ <u>915,572</u>
Investments measured at NAV:				
Hedge Fund	1,080,090			
Real Estate	1,402,191			
Investments measured at amortized cost:				
Money market funds	<u>47,531</u>			
	\$ <u>12,369,336</u>			

Discretely Presented Component Units

As of September 30, 2016, investments comprise the following:

Chuuk State Health Care Plan (CSHCP):

Fixed income securities:	
Fixed income	\$ 11,518
Other investments:	
Common equities	296,879
Mutual funds	70,785
Money market funds	<u>56,271</u>
	\$ <u>435,453</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units, Continued

Chuuk State Health Care Plan (CSHCP), Continued

As of September 30, 2016, CSHCP's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

<u>Investment Type</u>	<u>Investment Maturities (In Years)</u>		
	<u>Fair Value</u>	<u>1-5</u>	<u>Credit Ratings</u>
U.S. Treasury Notes and Bonds	\$ 31,733	\$ 31,733	AAA
Federal National Mortgage Association	<u>39,052</u>	<u>39,052</u>	AAA
	<u>\$ 70,785</u>	<u>\$ 70,785</u>	

(3) Receivables

Primary Government

Receivables as of September 30, 2016, for the primary government's individual major funds and nonmajor funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	<u>General</u>	<u>Grants Assistance</u>	<u>Compact Trust</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Receivables:					
General receivables	\$ 1,203,390	\$ 129,386	\$ -	\$ 15,220	\$ 1,347,996
FSM National Government	<u>555,364</u>	<u>3,019,180</u>	<u>-</u>	<u>-</u>	<u>3,574,544</u>
	1,758,754	3,148,566	-	15,220	4,922,540
Less: allowance for uncollectible accounts	<u>(1,235,460)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,235,460)</u>
Net receivables	<u>\$ 523,294</u>	<u>\$ 3,148,566</u>	<u>\$ -</u>	<u>\$ 15,220</u>	<u>\$ 3,687,080</u>

The final settlement of receivables due from the FSM National Government arising from Compact sector grant transactions can be determined only by final action of the FSM National Government in consultation with the grantor agency. Management is of the opinion that collection efforts will be favorable and thus no allowance for uncollectible accounts is considered necessary.

Presented Component Units

Receivables as of September 30, 2016, for the discretely presented component units in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	<u>Chuuk State Health Care Plan</u>	<u>Chuuk Public Utility Corporation</u>	<u>Chuuk State Housing Authority</u>	<u>Total</u>
Receivables:				
General	\$ 437,099	\$ 739,787	\$ 2,930,023	\$ 4,106,909
Other	<u>-</u>	<u>28,032</u>	<u>-</u>	<u>28,032</u>
	437,099	767,819	2,930,023	4,134,941
Allowance for uncollectable accounts	<u>(42,872)</u>	<u>(297,624)</u>	<u>(2,519,834)</u>	<u>(2,860,330)</u>
	<u>\$ 394,227</u>	<u>\$ 470,195</u>	<u>\$ 410,189</u>	<u>\$ 1,274,611</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(4) Interfund Receivables and Payables

Receivables and payables between funds reflected as due to/from other funds in the combined balance sheet at September 30, 2016, are summarized as follows:

Receivable Fund	Payable Fund	Amount
Grants Assistance	General	\$ 6,452,130
General	Grants Assistance	2,715,575
Nonmajor governmental funds	General	<u>43,947</u>
		<u>\$ 9,211,652</u>

(5) Capital Assets

Capital asset activities for the year ended September 30, 2016, are as follows:

Primary Government

	Balance October <u>1, 2015</u>	<u>Additions</u>	<u>Retirements</u>	Balance September <u>30, 2016</u>
Governmental activities:				
Depreciable assets:				
Airport facilities	\$ 38,107,415	\$ -	\$ -	\$ 38,107,415
Buildings	14,682,069	308,322	-	14,990,391
Seaport facilities	26,517,208	-	-	26,517,208
Vehicles and other equipment	10,365,586	354,783	-	10,720,369
Infrastructure	<u>14,835,315</u>	<u>-</u>	<u>-</u>	<u>14,835,315</u>
	<u>104,507,593</u>	<u>663,105</u>	<u>-</u>	<u>105,170,698</u>
Less accumulated depreciation for:				
Airport facilities	(30,290,892)	(952,687)	-	(31,243,579)
Buildings	(7,076,175)	(263,835)	-	(7,340,010)
Seaport facilities	(21,876,696)	(662,930)	-	(22,539,626)
Vehicles and other equipment	(7,622,814)	(443,642)	-	(8,066,456)
Infrastructure	<u>(14,835,315)</u>	<u>-</u>	<u>-</u>	<u>(14,835,315)</u>
	<u>(81,701,892)</u>	<u>(2,323,094)</u>	<u>-</u>	<u>(84,024,986)</u>
	22,805,701	(1,659,989)	-	21,145,712
Nondepreciable assets:				
Land	<u>17,954,462</u>	<u>-</u>	<u>-</u>	<u>17,954,462</u>
	<u>\$ 40,760,163</u>	<u>\$ (1,659,989)</u>	<u>\$ -</u>	<u>\$ 39,100,174</u>

Depreciation expense was charged to functions/programs of the primary government's governmental activities as follows:

General government	\$ 1,225,598
Health services	218,599
Education	202,033
Public safety	13,934
Public works and transportation	<u>662,930</u>
	<u>\$ 2,323,094</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(5) Capital Assets, Continued

Discretely Presented Component Units

	Balance October 1, 2015	<u>Addition</u>	<u>Retirements</u>	Balance September 30, 2016
Depreciable assets:				
Buildings	\$ 415,089	\$ -	\$ -	\$ 415,089
Utility plant	29,045,896	5,787,342	(10,428,604)	24,404,634
Machinery, equipment, others	<u>284,478</u>	<u>1,023</u>	<u>-</u>	<u>285,501</u>
	29,745,463	5,788,365	(10,428,604)	25,105,224
Less accumulated depreciation	<u>(21,675,293)</u>	<u>(671,722)</u>	<u>10,229,040</u>	<u>(12,117,975)</u>
	8,070,170	5,116,643	(199,564)	12,987,249
Nondepreciable assets:				
Construction work-in-progress	<u>4,155,661</u>	<u>7,818,585</u>	<u>(5,601,968)</u>	<u>6,372,278</u>
	<u>\$ 12,225,831</u>	<u>\$ 12,935,228</u>	<u>\$ (5,801,532)</u>	<u>\$ 19,359,527</u>

(6) Long-Term Obligations

Primary Government

The State implemented an Early Retirement Scheme (ERS) in which employees holding certain nonessential positions as identified by the State were retired early with a payout of the equivalent of two-years' wages. This ERS program is funded by a \$5,300,000 loan from the Asian Development Bank (ADB) (Loan Number 1520 (SF)) through the FSM National Government, non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The activities of the ERS Program are recorded in the General Fund.

The ADB loan has a grace period of ten years with the first payment due in February 2008 and the last payment in August 2037. However, pursuant to the terms of the Financing Agreement between the State and the FSM National Government, the State is required to deposit into the ERS Trust account held in the name of the State within the FSM National Government investment portfolio, 100% of the outstanding principal balance by September 30, 2002.

Funds for the repayment of the ADB loan are expected to be derived from the annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The Financing Agreement requires the State to continue to appropriate salaries for the abolished positions and deposit the appropriated funds into the ERS Trust Account. These funds had not been deposited to the Trust Account as of September 30, 2016. As of September 30, 2016, the amount outstanding against this loan was \$4,363,469. Of the required \$5,300,000 identified for future debt service payments, \$3,632,504 is deposited in an investment account held jointly with the FSM National Government. That investment account is restricted for the repayment of this debt and other ADB related debt set forth below.

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Program Loan with ADB (Loan Number 1816 FSM (SF)) for the purpose of funding the Basic Social Services Project, with interest at 1% to 1.5% per annum. Principal payments shall be made semiannually commencing February 1, 2009, with a maturity date of August 1, 2032. As of September 30, 2016, the balance payable on this loan amounted to \$223,067.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(6) Long-Term Obligations, Continued

Primary Government, Continued

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Program Loans with ADB (Loan Number 1873 (SF) and Loan Number 1874 FSM (SF)) for the purpose of promoting private sector development in Chuuk, with interest at 1% to 1.5% per annum. Principal payments shall be made in 32 equal semi-annual payments with the first payment due on May 15, 2010 and the last payment on November 15, 2025. As of September 30, 2016, the related principal balances were \$365,015 and \$828,271, respectively.

On December 21, 2010, the Chuuk Public Utilities Corporation (CPUC) and the State agreed through memorandum of understanding to offset certain claims and transferred certain debt between CPUC and the State. The transferred debt was the FSM National Government Program Loan with ADB (Loan Number 1459 (SF)), totaling \$3,868,102, for water wells and electric construction purposes, with interest at 1% to 1.5% per annum. Principal payments shall be made semiannually commencing August 1, 2007, with a maturity date of August 1, 2036. As of September 30, 2016, the balance payable on this loan amounted to \$3,163,851.

Annual debt service requirements to maturity for principal and interest are as follows:

<u>Year Ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ 365,553	\$ 96,518	\$ 462,071
2018	472,345	90,227	562,572
2019	472,345	87,139	559,484
2020	472,345	81,916	554,261
2021	472,345	76,692	549,037
2022-2026	2,341,217	305,107	2,646,324
2027-2031	2,168,962	181,838	2,350,800
2032-2036	1,979,942	68,515	2,048,457
2037	<u>198,619</u>	<u>1,986</u>	<u>200,605</u>
	\$ <u>8,943,673</u>	\$ <u>989,938</u>	\$ <u>9,933,611</u>

Discretely Presented Component Units

Chuuk Public Utility Corporation:

Loan payable to the State, facilitated by an ADB loan (Loan Number 2099-FSM) to the FSM National Government, original amount of \$1,800,000 due in semi-annual installments of \$85,883 from January 15, 2013 to July 15, 2036. Interest is payable at 1% per annum during the grace period and at 1.5% per annum thereafter. Proceeds were used for infrastructure projects: power distribution upgrades, decommissioning and environmental remediation of the existing power station, and institutional strengthening. \$ 2,195,038

Loan payable to the State, facilitated by an ADB loan (Loan Number 2100-FSM) to the FSM National Government, original amount of \$2,800,000, due in semi-annual installments of varying amounts through January 15, 2019. Interest is payable at LIBOR plus 0.6% per annum (2.1% at September 30, 2016). Proceeds were used for the purchase of two generator sets and related costs. 2,561,395

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(6) Long-Term Obligations, Continued

Discretely Presented Component Units, Continued

Chuuk Public Utility Corporation, Continued:

A \$207,000 loan with the FSM Development Bank, bearing interest fixed at 7% per annum, payable over 60 monthly installments of \$4,099, maturing in February 2021. The loan is collateralized by a security interest in the fixed assets. Proceed was used to pay off an existing outstanding payable.

186,404
\$ 4,942,837

Principal payments for subsequent years ending September 30 and applicable interest due are as follows:

<u>Year Ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ 243,529	\$ 109,623	\$ 353,152
2018	258,427	97,740	356,167
2019	274,273	92,938	367,211
2020	293,177	87,803	380,980
2021	283,916	81,687	365,603
2022-2026	1,621,873	259,660	1,881,533
2027-2031	1,546,530	98,018	1,644,548
2032-2035	<u>421,112</u>	<u>10,077</u>	<u>431,189</u>
	\$ <u>4,942,837</u>	\$ <u>837,546</u>	\$ <u>5,780,383</u>

(7) Changes in Long-Term Obligations

Primary Government

Long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2016, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net position:

	Balance October 1, 2015	<u>Additions</u>	<u>Reductions</u>	Balance September 30, 2016	Due Within One Year
Loans payable:					
ADB loans:					
Loan 1459	\$ 3,259,280	\$ -	\$ (95,429)	\$ 3,163,851	\$ 158,735
Loan 1520	4,484,498	-	(121,029)	4,363,469	106,791
Loan 1816	328,470	-	(105,403)	223,067	13,986
Loan 1873	405,304	-	(40,289)	365,015	38,552
Loan 1874	<u>883,576</u>	<u>-</u>	<u>(55,305)</u>	<u>828,271</u>	<u>47,489</u>
	9,361,128	-	(417,455)	8,943,673	365,553
Other:					
Claims and judgments	902,605	-	-	902,605	-
Compensated absences	<u>1,362,629</u>	<u>401,939</u>	<u>(395,140)</u>	<u>1,369,428</u>	<u>337,596</u>
	\$ <u>11,626,362</u>	\$ <u>401,939</u>	\$ <u>(812,595)</u>	\$ <u>11,215,706</u>	\$ <u>703,149</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(7) Changes in Long-Term Obligations, Continued

Primary Government, Continued

When the ADB extends credit to a particular country, the loan is booked in Special Drawing Rights (SDRs) but the actual loan is delivered in the currency of the borrower, at the current exchange rate between the currency and the SDR. The value of the SDR is subject to periodic review by the International Monetary Fund, which may result in the recognition of a foreign exchange gain or loss. During the year ended September 30, 2016, the State recognized a foreign exchange gain of \$51,520 associated with valuation of the SDR, which is presented as a special item in the accompanying financial statements, and which results in a reduction in ADB loans payable.

Discretely Presented Component Units

During the year ended September 30, 2016, the following changes occurred in long-term obligations of the discretely presented component units:

	Balance October 1, 2015	Additions	Reductions	Balance September 30, 2016	Due Within One Year
Long-term debt	\$ 4,756,700	\$ 325,306	\$ (139,169)	\$ 4,942,837	\$ 243,529
Accrued annual leave	<u>45,789</u>	<u>-</u>	<u>(5,649)</u>	<u>40,140</u>	<u>7,359</u>
	<u>\$ 4,802,489</u>	<u>\$ 325,306</u>	<u>\$ (144,818)</u>	<u>\$ 4,982,977</u>	<u>\$ 250,888</u>

(8) Interfund/Intrafund Transactions

Operating transfers in/out for each major governmental fund and nonmajor governmental funds in the aggregate, for the year ended September 30, 2016, are as follows:

	<u>Transfers Out</u>	<u>Transfers In</u>
General Fund:		
Grants Assistance Fund	\$ 507,600	\$ -
Grants Assistance Fund:		
General Fund	<u>-</u>	<u>507,600</u>
	<u>\$ 507,600</u>	<u>\$ 507,600</u>

Transfers are used to 1) move revenues from the fund that enabling legislation or budget requires to collect them to the fund that enabling legislation or budget requires to expend them, 2) use unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations, and 3) record reductions in interfund loans for amounts that are not expected to be repaid. Specifically, the State transferred \$507,600 from the General Fund to the Grants Assistance Fund to primarily finance infrastructure maintenance programs.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(9) Fund Balance

Classifications of fund balances comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. The following table enumerates the fund balance classifications:

	General Fund	Grants Assistance Fund	Compact Trust Fund	Nonmajor Funds	Total Governmental Funds
Non-spendable:					
General government	\$ 53,132	\$ 269,095	\$ -	\$ -	\$ 322,227
FSM Development Bank	300,000	-	-	-	300,000
Pacific Islands Development Bank	250,000	-	-	-	250,000
Bank of the FSM	570,652	-	-	-	570,652
Permanent fund principal	-	-	12,369,336	-	12,369,336
Restricted:					
Debt service	3,632,504	-	-	-	3,632,504
Capital projects	-	1,339,347	-	-	1,339,347
General government	-	1,271,934	-	-	1,271,934
Education	-	1,535,120	-	-	1,535,120
Health services	-	98,993	-	110,083	209,076
Other foreign assistance	-	162,148	-	-	162,148
Unassigned	(10,158,900)	-	-	-	(10,158,900)
	<u>\$ (5,176,588)</u>	<u>\$ 4,676,637</u>	<u>\$ 12,369,336</u>	<u>\$ 110,083</u>	<u>\$ 11,979,468</u>

(10) Contingencies

Sick Leave

It is the policy of the State to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave as of September 30, 2016 is \$4,464,924.

Insurance Coverage

The State does not maintain insurance coverage for a significant amount of fixed assets. In the event of a catastrophe, the State may be self-insured to a material extent.

Encumbrances

The State utilizes encumbrance accounting to identify fund obligations. Encumbrances represent commitments related to unperformed contracts for goods. At September 30, 2016, the State has significant encumbrances summarized as follows:

<u>General</u>	<u>Grants Assistance</u>	<u>Compact Trust</u>	<u>Other Governmental Funds</u>	<u>Total</u>
\$ 369,272	\$ 4,014,625	\$ -	\$ 922	\$ 4,384,819

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2016

(10) Contingencies, Continued

Federal Grants

The State participates in a number of federally assisted grant programs and other various U.S. Department of the Interior grants. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs have been set forth in the State's Single Audit Report for the year ended September 30, 2016. In addition, the State is considered to have responsibility for any questioned costs that may result from Single Audits of subgrantees who have not satisfied the audit requirements of OMB Circular A-133 or the Uniform Guidance. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

Litigation

The State is a party to various legal proceedings in which the State's Attorney General indicates that pending land lease cases and other related claims against the State exist at September 30, 2016 in an amount that is material to the financial statements. Due to an inability to predict the ultimate outcome of these matters, no provision for these liabilities has been made in the accompanying financial statements.

Delinquent Taxes

The State is delinquent in remitting certain social security and withholding taxes. Management is of the opinion that no significant penalties or interest will arise from this matter and that if any such changes occur, they will be accounted for prospectively.

General Fund Financial Position

The State's General Fund has sustained recurring operating deficits and has an unassigned fund deficit of \$10,158,900 at September 30, 2016. In addition, at September 30, 2016, the primary government's current liabilities exceed current assets by \$5,846,173.

Management of the State has entered into a memorandum of understanding with the FSM National Government to outline reform measures to address the deficit. The plan includes the following:

- The State will sell off its stock holdings or investments.
- The State is considering the sale of the Chuuk State Medical Referral House in Honolulu.
- The State will adopt measures to control General Fund expenditures. Such include moratorium of hiring, salary increases and other spending, such as travel.
- The State agreed to work to balance its proposed budgets.
- The State will work to restructure its government to include restructuring the Chuuk Legislature into a unicameral legislature.

Management of the State believes that the actions above will provide the State the opportunity to continue the process of reducing the General Fund deficit position.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2016

(11) Budgetary Compliance

For the year ended September 30, 2016, significant over-expenditures exceeding appropriations within the General Fund were as follows:

Office of Governor	\$ 96,791
Department of Administrative Services	\$ 300,830
Debt service	\$ 417,114
Other	\$ 132,918

(12) Land Lease and Related Claims

The State has not recorded a liability for land leases and related claims payable in the governmental activities and the General Fund and, accordingly, has not recorded an expenditure/expense for the current period change in that liability. Accounting principles generally accepted in the United States of America require that liabilities incurred attributable to services already rendered and that are not contingent upon a specific event that is outside of the control of the State be accrued as liabilities and expenditures/expenses, which would increase the liabilities, decrease net position, and change the expenses of the governmental activities and increase the liabilities, increase fund deficit, and change the expenditures of the General Fund. The amount by which this departure would affect the liabilities, net position and expenses of the governmental activities and the liabilities, fund deficit, and expenditures of the General Fund is not reasonably determinable.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2016

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Revenues, Expenditures and Changes in Deficit
Budget and Actual - General Fund
Year Ended September 30, 2016

	<u>Budgeted Amounts</u>		Actual -	Variance with
	<u>Original</u>	<u>Final</u>	Budgetary Basis (see Note 1)	Final Budget - Positive (Negative)
Revenues:				
Local revenues	\$ 7,210,454	\$ 7,922,952	\$ 9,366,616	\$ 1,443,664
Net change in fair value of investments	-	-	(144,209)	(144,209)
Total revenues	<u>7,210,454</u>	<u>7,922,952</u>	<u>9,222,407</u>	<u>1,299,455</u>
Expenditures:				
Current:				
General government	3,375,012	3,755,227	4,074,277	(319,050)
Education	79,367	93,367	93,938	(571)
Economic development	16,396	71,841	54,125	17,716
Public safety	1,104,071	1,109,071	1,054,651	54,420
Public works and transportation	912,596	991,199	933,676	57,523
Community affairs	145,112	154,132	148,109	6,023
Boards and commissions	628,115	715,495	730,041	(14,546)
Judiciary	533,075	533,174	492,517	40,657
Payments to component units	57,071	107,071	114,162	(7,091)
Municipal affairs	434,030	434,030	426,506	7,524
Other	-	-	40,572	(40,572)
Debt service	-	-	417,114	(417,114)
Total expenditures	<u>7,284,845</u>	<u>7,964,607</u>	<u>8,579,688</u>	<u>(615,081)</u>
Excess (deficiency) of revenues over (under) expenditures	(74,391)	(41,655)	642,719	684,374
Other financing uses:				
Operating transfers out	(507,600)	(507,600)	(507,600)	-
Net change in deficit	(581,991)	(549,255)	135,119	684,374
Other changes in fund deficit:				
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary purposes but in the year the supplies are received for financial reporting purposes	461,870	461,870	369,272	(92,598)
Fund deficit at the beginning of the year	<u>(5,680,979)</u>	<u>(5,680,979)</u>	<u>(5,680,979)</u>	-
Fund deficit at the end of the year	<u>\$ (5,801,100)</u>	<u>\$ (5,768,364)</u>	<u>\$ (5,176,588)</u>	<u>\$ 591,776</u>

See accompanying notes to required supplementary information - budgetary reporting.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Required Supplementary Information – Budgetary Reporting
September 30, 2016

(1) Budgetary Information

The Governor shall submit an annual budget to the Legislature at a time prescribed by statute. The budget shall contain a complete plan of proposed expenditures, anticipated revenues, and other monies available to the State for the next fiscal year, and any additional information which the Legislature may require. The Legislature may alter all or any portion of the proposed budget.

An annual appropriated budget is adopted by the State's Legislature for the General Fund and Compact Programs through an Appropriations Act. However, additional appropriations and budget modifications occur throughout the year. The majority of unencumbered appropriations lapse as of year end unless specifically extended by the State's Legislature. Budgets for special revenue funds, except the Compact Program Fund, are not included in the annual Appropriations Act. Accordingly, a budget to actual presentation for special revenue funds, except the Compact Program Fund, is not required or presented. Project-length financial plans are generally adopted for all capital project funds.

Encumbrance accounting is employed in governmental funds. For budgetary purposes, the encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be reappropriated and honored during the subsequent fiscal year.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2016

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Combining Schedule of Expenditures by Account
Governmental Funds
Year Ended September 30, 2016

	<u>General</u>	<u>Special Revenue</u>	<u>Permanent</u>	<u>Other Governmental Funds</u>	<u>Total</u>
		<u>Grants Assistance</u>	<u>Compact Trust</u>		
Expenditures:					
Salaries and wages					
Regular	\$ 4,048,920	\$ 11,788,983	\$ -	\$ -	\$ 15,837,903
Overtime	71,222	404,985	-	-	476,207
Fringe benefits	552,951	1,566,850	-	-	2,119,801
Travel and transportation	530,368	748,362	-	-	1,278,730
Books and library materials	-	17,393	-	-	17,393
Communications	45,921	180,697	-	-	226,618
Dues, membership, and subscription:	24,379	9,024	-	-	33,403
Food stuffs	50,692	452,805	-	-	503,497
Port charges	17,122	76,879	-	-	94,001
Office supplies and materials	114,885	2,073,287	-	-	2,188,172
POL	145,111	591,256	-	-	736,367
Printing and reproduction	3,107	94,968	-	-	98,075
Rental services	9,899	123,753	-	-	133,652
Repairs and maintenance	69,875	609,384	-	-	679,259
Constructional materials	-	5,138	-	-	5,138
Utilities	260,091	904,757	-	-	1,164,848
Goods and services	139,866	70,887	-	-	210,753
Subsidies and contributions	15,600	225,596	-	-	241,196
Medical referrals	-	99,464	-	-	99,464
Medical supplies	-	2,006,342	-	-	2,006,342
Contractual services	500,092	3,055,629	-	121,836	3,677,557
Professional services	-	491,389	-	-	491,389
Housing allowance	57,550	-	-	-	57,550
Compensation non-payroll	10,572	102,149	-	-	112,721
Scholarships and allowances	13,764	426,036	-	-	439,800
Training	1,173	665,673	-	-	666,846
Official allowance	625,932	-	-	-	625,932
Meeting fees and allowance	-	140,518	-	-	140,518
Insurance	-	1,960	-	-	1,960
Leased housing, buildings and land	36,855	639,299	-	-	676,154
Equipment	13,644	911,097	-	-	924,741
Furniture and fixtures	1,908	178,281	-	-	180,189
Vehicles	30,420	256,638	-	-	287,058
Principal repayment	365,935	-	-	-	365,935
Interest payments	51,179	-	-	-	51,179
Miscellaneous	401,383	-	-	-	401,383
	<u>\$ 8,210,416</u>	<u>\$ 28,919,479</u>	<u>\$ -</u>	<u>\$ 121,836</u>	<u>\$ 37,251,731</u>

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

GENERAL FUND

September 30, 2016

The general fund is used to account for resources traditionally associated with government which are not required legally or by sound financial management to be accounted for in another fund. The United States Compact of Free Association current account and inflation adjustment funds associated with the current account are accounted for in this fund in addition to local taxes and other revenues.

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function, and Changes in Deficit
General Fund
Year Ended September 30, 2016
(with comparative totals for the year ended September 30, 2015)

	<u>2016</u>	<u>2015</u>
Revenues:		
FSM revenue sharing:		
Gross revenue taxes	\$ 1,280,809	\$ 1,030,886
Import taxes	1,170,790	818,619
Income taxes	1,051,538	1,029,379
Other taxes	<u>131,270</u>	<u>155,045</u>
FSM revenue sharing	<u>3,634,407</u>	<u>3,033,929</u>
State taxes:		
Sales tax	2,238,850	2,011,013
Other excise taxes	<u>580,553</u>	<u>519,181</u>
	<u>2,819,403</u>	<u>2,530,194</u>
Fees and charges:		
Licenses and permits	1,276,827	1,121,806
Leases and other rentals	<u>187,671</u>	<u>101,319</u>
	<u>1,464,498</u>	<u>1,223,125</u>
Departmental charges:		
Transportation collections	<u>726,875</u>	<u>650,769</u>
Net change in the fair value of investments	<u>(144,209)</u>	<u>192,765</u>
Other revenues	<u>721,433</u>	<u>648,571</u>
Total revenues	<u>9,222,407</u>	<u>8,279,353</u>
Expenditures:		
Current:		
General government:		
Office of the Governor	564,496	739,457
State Legislature	2,383,761	2,397,613
Department of Administrative Services	840,352	580,371
Office of Public Auditor	<u>16,940</u>	<u>-</u>
	<u>3,805,549</u>	<u>3,717,441</u>
Health:		
Department of Health	<u>85,953</u>	<u>86,683</u>
Economic development:		
Department of Marine Resources	52,795	16,511
Historic Preservation Office	-	34,009
Division of Business and Trade	-	16,048
Division of Labor and Manpower	-	23,346
Division of Commerce and Industries	<u>-</u>	<u>8,020</u>
	<u>52,795</u>	<u>97,934</u>
Public safety:		
Office of the Attorney General	239,925	204,233
Department of Public Safety	<u>809,751</u>	<u>719,928</u>
	<u>1,049,676</u>	<u>924,161</u>
Public works and transportation:		
Department of Transportation	<u>888,635</u>	<u>811,029</u>
Community affairs:		
Public Affairs	83,887	86,563
Youth Affairs	24,711	14,167
Broadcast	<u>34,463</u>	<u>45,438</u>
	<u>143,061</u>	<u>146,168</u>

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function, and Changes in Deficit, Continued
General Fund
Year Ended September 30, 2016
(with comparative totals for the year ended September 30, 2015)

	2016	2015
Expenditures, continued:		
Current, continued:		
Boards, commissions and other:		
Land Commission	141,014	127,821
Public Service Commission	150,198	157,519
Election Commission	122,979	233,100
Farmers Home Administration	13,979	19,883
Peace Corps	15,600	13,350
Micronesian Legal Services Corporation	40,000	5,000
Micro Games	34,826	16,364
Youth Constitution Day	25,702	-
Goodwill Games	-	2,500
Land Management	-	52,595
Overseas Development Assistance	34,477	34,061
Political Status Commission	15,900	168,093
Chuuk Women	-	5,000
Solid and Hazardous Waste Management	41,186	-
SEPDIC	91,062	-
Chuuk Small Business Development Center	(8,906)	13,321
	718,017	848,607
Judiciary:		
State Court	481,286	524,488
Payments to component units:		
Chuuk State Housing Authority	114,001	53,905
Municipal affairs:		
Payments to municipalities	413,757	414,772
Other	40,572	659,394
Debt service:		
Principal repayment	365,935	369,782
Interest	51,179	120,739
	417,114	490,521
Total expenditures	8,210,416	8,775,103
Excess (deficiency) of revenues over (under) expenditures	1,011,991	(495,750)
Other financing uses:		
Operating transfers out	(507,600)	(256,004)
Net change in deficit	504,391	(751,754)
Deficit at the beginning of the year	(5,680,979)	(4,929,225)
Deficit at the end of the year	\$ (5,176,588)	\$ (5,680,979)

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures and Changes in Deficit
Budget and Actual - General Fund
Year Ended September 30, 2016

	Budgeted Amounts		Actual Budgetary Basis	Variance with Final Budget Positive/(Negative)
	Original	Final		
Revenues:				
Local revenues	\$ 7,210,454	\$ 7,922,952	\$ 9,366,616	\$ 1,443,664
Net change in fair value of investments	-	-	(144,209)	(144,209)
Total revenues	7,210,454	7,922,952	9,222,407	1,299,455
Expenditures:				
Current:				
General government:				
Office of the Governor	456,479	497,729	594,520	(96,791)
State Legislature	2,466,421	2,671,588	2,594,076	77,512
Department of Administrative Services	434,112	567,910	868,740	(300,830)
Office of Public Auditor	18,000	18,000	16,940	1,060
	<u>3,375,012</u>	<u>3,755,227</u>	<u>4,074,277</u>	<u>(319,050)</u>
Health:				
Department of Health	79,367	93,367	93,938	(571)
Economic development:				
Division of Marine Resources	13,500	37,318	52,795	(15,477)
Historic Preservation Office	-	31,627	-	31,627
Division of Business and Trade	1,170	1,170	503	667
Division of Manpower and Labor	915	915	826	89
Division of Commerce and Industry	811	811	1	810
	<u>16,396</u>	<u>71,841</u>	<u>54,125</u>	<u>17,716</u>
Public safety:				
Office of the Attorney General	268,873	273,873	240,766	33,107
Department of Public Safety	835,198	835,198	813,885	21,313
	<u>1,104,071</u>	<u>1,109,071</u>	<u>1,054,651</u>	<u>54,420</u>
Public works and transportation:				
Department of Transportation	912,596	991,199	933,676	57,523
Community affairs:				
Department of Public Affairs	145,112	154,132	148,109	6,023
Boards, commissions and other:				
Land Commission	157,899	157,899	141,371	16,528
Public Service Commission	162,801	162,801	151,142	11,659
Election Commission	93,086	123,086	123,029	57
Farmers Home Administration	23,346	23,346	13,979	9,367
Peace Corps	15,600	15,600	15,600	-
Micronesia Legal Services Corporation	40,000	40,000	40,000	-
Micro Games	-	-	34,826	(34,826)
Youth Constitution Day	-	-	25,702	(25,702)
Guandong Providence	2,000	2,000	2,000	-
Chuuk EPA	-	37,322	41,186	(3,864)
Land Management	35	35	2,213	(2,178)
Overseas Development Assistance	38,963	38,963	34,672	4,291
Chuuk Small Business Development Center	4,268	4,268	(7,230)	11,498
Political Status Commission	6,817	21,750	20,489	1,261
Economic Policy Development and Implementation	83,300	88,425	91,062	(2,637)
	<u>628,115</u>	<u>715,495</u>	<u>730,041</u>	<u>(14,546)</u>
Judiciary:				
State Court	533,075	533,174	492,517	40,657
Payments to component units:				
Chuuk State Housing Authority	57,071	107,071	114,162	(7,091)
Municipal affairs:				
Payments to municipalities	434,030	434,030	426,506	7,524
Other	-	-	40,572	(40,572)

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures and Changes in Deficit
Budget and Actual - General Fund, Continued
Year Ended September 30, 2016

	<u>Budgeted Amounts</u>		Actual Budgetary Basis	Variance with Final Budget Positive/(Negative)
	<u>Original</u>	<u>Final</u>		
Debt service:				
Principal repayment	-	-	365,935	(365,935)
Interest payments	-	-	51,179	(51,179)
	-	-	417,114	(417,114)
Total expenditures	<u>7,284,845</u>	<u>7,964,607</u>	<u>8,579,688</u>	<u>(615,081)</u>
Excess (deficiency) of revenues over (under) expenditures	(74,391)	(41,655)	642,719	684,374
Other financing uses:				
Operating transfers out	<u>(507,600)</u>	<u>(507,600)</u>	<u>(507,600)</u>	-
Net change in deficit	(581,991)	(549,255)	135,119	684,374
Other changes in fund deficit:				
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary purposes but in the year the supplies are received for financial reporting purposes	461,870	461,870	369,272	(92,598)
Fund deficit at the beginning of the year	<u>(5,680,979)</u>	<u>(5,680,979)</u>	<u>(5,680,979)</u>	-
Fund deficit at the end of the year	<u>\$ (5,801,100)</u>	<u>\$ (5,768,364)</u>	<u>\$ (5,176,588)</u>	<u>\$ 591,776</u>

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

NONMAJOR GOVERNMENTAL FUNDS - SPECIAL REVENUE FUNDS

September 30, 2016

Special revenue funds are used to account for specific revenues that are legally restricted for particular purposes. A brief discussion of the State's Nonmajor Governmental Funds - Special Revenue Funds as of September 30, 2016, follows:

Hospital Revolving Fund

This fund accounts for the operations of the hospital and the purchase of pharmaceutical and medical supplies.

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet
September 30, 2016

	Education Sector	Health Sector	Environment Sector	Private Sector Development	Capacity Building Sector	Supplemental Education	Enhanced Reporting Accountability	Infrastructure Maintenance	U.S. Federal Grants	Foreign Assistance	CFSM Grants	Total
ASSETS												
Receivables:	\$ 2,188,534	\$ -	\$ 95,336	\$ -	\$ -	\$ -	\$ 132,588	\$ -	\$ 351,512	\$ -	\$ 251,210	\$ 3,019,180
Advances	46,327	22,558	7,967	5,092	2,043	33,343	1,168	-	8,417	-	2,471	129,386
Prepayments	339,963	77,868	-	300	11,180	180,047	-	-	-	-	-	609,358
Due from other funds	-	653,246	-	134,421	1,577,369	2,583,013	-	1,339,416	-	164,665	-	6,452,130
	<u>\$ 2,574,824</u>	<u>\$ 753,672</u>	<u>\$ 103,303</u>	<u>\$ 139,813</u>	<u>\$ 1,590,592</u>	<u>\$ 2,796,403</u>	<u>\$ 133,756</u>	<u>\$ 1,339,416</u>	<u>\$ 359,929</u>	<u>\$ 164,665</u>	<u>\$ 253,681</u>	<u>\$ 10,210,054</u>
LIABILITIES AND FUND BALANCES												
Liabilities:												
Accounts payable	\$ 227,630	\$ 137,930	\$ 3,431	\$ 3,842	\$ (23,300)	\$ (2,351)	\$ (6,088)	\$ -	\$ 43,157	\$ 1,779	\$ 6,251	\$ 392,281
Accrued liabilities	318,403	174,191	17,004	18,812	20,459	45,362	25,835	69	61,776	738	-	682,649
Unearned revenues	-	264,690	-	117,159	322,838	1,038,225	-	-	-	-	-	1,742,912
Due to other funds	2,028,791	-	82,868	-	-	-	114,009	-	242,477	-	247,430	2,715,575
Total liabilities	<u>2,574,824</u>	<u>576,811</u>	<u>103,303</u>	<u>139,813</u>	<u>319,997</u>	<u>1,081,236</u>	<u>133,756</u>	<u>69</u>	<u>347,410</u>	<u>2,517</u>	<u>253,681</u>	<u>5,533,417</u>
Fund balances:												
Non-spendable	-	77,868	-	-	11,180	180,047	-	-	-	-	-	269,095
Restricted	-	98,993	-	-	1,259,415	1,535,120	-	1,339,347	12,519	162,148	-	4,407,542
Total fund balances	<u>-</u>	<u>176,861</u>	<u>-</u>	<u>-</u>	<u>1,270,595</u>	<u>1,715,167</u>	<u>-</u>	<u>1,339,347</u>	<u>12,519</u>	<u>162,148</u>	<u>-</u>	<u>4,676,637</u>
Total liabilities and fund balances	<u>\$ 2,574,824</u>	<u>\$ 753,672</u>	<u>\$ 103,303</u>	<u>\$ 139,813</u>	<u>\$ 1,590,592</u>	<u>\$ 2,796,403</u>	<u>\$ 133,756</u>	<u>\$ 1,339,416</u>	<u>\$ 359,929</u>	<u>\$ 164,665</u>	<u>\$ 253,681</u>	<u>\$ 10,210,054</u>

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances
Year Ended September 30, 2016

	Education Sector	Health Sector	Environment Sector	Private Sector Development	Capacity Building Sector	Supplemental Education	Enhanced Reporting Accountability	Infrastructure Maintenance	U.S. Federal Grants	Foreign Assistance	CFSM Grants	Total
Revenues:												
Compact funding	\$ 10,808,360	\$ 9,272,950	\$ 634,517	\$ 365,961	\$ 420,000	\$ 3,814,810	\$ 680,493	\$ -	\$ -	\$ -	\$ -	\$ 25,997,091
Federal and other grants	-	-	-	-	-	-	-	-	2,036,321	18,005	278,422	2,332,748
Total revenues	<u>10,808,360</u>	<u>9,272,950</u>	<u>634,517</u>	<u>365,961</u>	<u>420,000</u>	<u>3,814,810</u>	<u>680,493</u>	<u>-</u>	<u>2,036,321</u>	<u>18,005</u>	<u>278,422</u>	<u>28,329,839</u>
Expenditures by function:												
Current:												
General government	-	-	-	-	765,709	-	680,493	-	-	5,631	-	1,451,833
Health services	-	9,526,281	-	-	-	-	-	-	1,203,764	-	-	10,730,045
Education	10,808,360	-	-	-	-	3,814,810	-	-	832,557	-	-	15,455,727
Economic development	-	-	634,517	365,961	-	-	-	2,974	-	-	-	1,003,452
Public safety	-	-	-	-	-	-	-	-	-	-	278,422	278,422
Total expenditures	<u>10,808,360</u>	<u>9,526,281</u>	<u>634,517</u>	<u>365,961</u>	<u>765,709</u>	<u>3,814,810</u>	<u>680,493</u>	<u>2,974</u>	<u>2,036,321</u>	<u>5,631</u>	<u>278,422</u>	<u>28,919,479</u>
Excess (deficiency) of revenues over (under) expenditures	-	(253,331)	-	-	(345,709)	-	-	(2,974)	-	12,374	-	(589,640)
Other financing sources:												
Operating transfers in	-	-	-	-	-	-	-	507,600	-	-	-	507,600
Net change in fund balances	-	(253,331)	-	-	(345,709)	-	-	504,626	-	12,374	-	(82,040)
Fund balances at the beginning of the year	-	430,192	-	-	1,616,304	1,715,167	-	834,721	12,519	149,774	-	4,758,677
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ 176,861</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,270,595</u>	<u>\$ 1,715,167</u>	<u>\$ -</u>	<u>\$ 1,339,347</u>	<u>\$ 12,519</u>	<u>\$ 162,148</u>	<u>\$ -</u>	<u>\$ 4,676,637</u>

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances
Year Ended September 30, 2016

	Education Sector	Health Sector	Environment Sector	Private Sector Development	Capacity Building Sector	Supplemental Education	Enhanced Reporting Accountability	Infrastructure Maintenance	Infrastructure	U.S. Federal Grants	Foreign Assistance	CFSM Grants	Total
Revenues:													
Compact funding	\$ 10,808,360	\$ 9,272,950	\$ 634,517	\$ 365,961	\$ 420,000	\$ 3,814,810	\$ 680,493	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 25,997,091
Federal and other grants	-	-	-	-	-	-	-	-	-	2,036,321	18,005	278,422	2,332,748
Total revenues	10,808,360	9,272,950	634,517	365,961	420,000	3,814,810	680,493	-	-	2,036,321	18,005	278,422	28,329,839
Expenditures by account:													
Salaries and wages:													
Regular	5,631,149	3,405,103	357,192	156,284	133,604	438,060	455,389	-	-	1,212,435	(683)	450	11,788,983
Overtime	56,741	321,099	1,739	-	5,412	-	19,994	-	-	-	-	-	404,985
Fringe benefits	720,099	471,640	51,044	20,866	27,481	57,811	61,683	283	-	155,003	683	257	1,566,850
Travel and transportation	9,836	169,111	13,681	10,618	67,702	127,076	19,183	-	-	154,201	-	176,954	748,362
Books and library materials	1,835	-	-	-	939	14,619	-	-	-	-	-	-	17,393
Communications	6,469	38,521	8,057	16,513	24,569	56,847	16,292	-	-	12,314	-	1,115	180,697
Dues, memberships, and subscriptions	4,171	1,515	1,025	260	873	1,180	-	-	-	-	-	-	9,024
Food stuffs	118,325	274,271	-	-	-	59,731	-	-	-	26	-	452	452,805
Freight and port charges	27,109	19,757	1,204	1,332	304	26,102	-	-	-	1,071	-	-	76,879
Office supplies and materials	472,232	169,357	27,351	36,953	27,042	1,193,787	46,345	-	-	96,964	1,868	1,388	2,073,287
POL	108,605	221,444	34,778	17,927	10,991	134,070	11,175	-	-	48,430	656	3,180	591,256
Printing and reproduction	-	30,782	-	-	614	50,730	199	-	-	11,076	1,567	-	94,968
Rental services	27,018	30,527	3,654	1,044	2,804	13,532	-	-	-	43,462	1,439	273	123,753
Repairs and maintenance	271,914	141,144	11,648	4,080	2,031	163,786	5,332	-	-	8,745	-	704	609,384
Construction materials	2,335	2,803	-	-	-	-	-	-	-	-	-	-	5,138
Utilities	97,420	616,561	15,044	10,549	20,075	106,428	23,603	-	-	10,000	-	5,077	904,757
Goods and services	15,510	3,052	(50)	(9,092)	32,875	4,989	7,774	-	-	13,041	-	10,562	70,887
Subsidies and contributions	215,322	-	-	-	-	-	-	-	-	-	-	2,500	225,596
Medical referrals	-	99,464	-	-	-	-	-	-	-	-	-	-	99,464
Medical supplies	-	2,003,588	-	-	-	-	-	-	-	2,754	-	-	2,006,342
Contractual services	1,328,024	849,226	75,115	77,517	282,933	373,840	15,058	2,691	-	49,225	-	2,000	3,055,629
Professional services	419,349	-	-	-	42,000	30,040	-	-	-	-	-	-	491,389
Scholarships and allowances	356,540	-	-	-	-	69,496	-	-	-	-	-	-	426,036
Fees and meeting allowances	24,960	-	525	-	-	1,750	-	-	-	108,283	-	5,000	140,518
Training	360,947	20,760	-	-	1,211	279,230	-	-	-	3,525	-	-	665,673
Insurance	-	-	-	1,960	-	-	-	-	-	-	-	-	1,960
Leased housing, buildings and land	180,193	151,540	14,385	16,065	59,030	206,273	-	-	-	11,813	-	-	639,299
Compensation non-payroll	-	55,203	-	-	-	7,400	-	-	-	2,000	-	37,546	102,149
Equipment	199,583	329,073	6,995	3,085	23,219	248,508	6,240	-	-	91,953	101	2,340	911,097
Furniture and fixtures	62,024	5,878	-	-	-	81,755	-	-	-	-	-	28,624	178,281
Vehicles	90,650	94,862	11,130	-	-	59,996	-	-	-	-	-	-	256,638
Total expenditures	10,808,360	9,526,281	634,517	365,961	765,709	3,814,810	680,493	2,974	-	2,036,321	5,631	278,422	28,919,479
Excess (deficiency) of revenues over (under) expenditures	-	(253,331)	-	-	(345,709)	-	-	(2,974)	-	-	12,374	-	(589,640)
Other financing sources:													
Operating transfers in	-	-	-	-	-	-	-	507,600	-	-	-	-	507,600
Net change in fund balances	-	(253,331)	-	-	(345,709)	-	-	504,626	-	-	12,374	-	(82,040)
Fund balances at the beginning of the year	-	430,192	-	-	1,616,304	1,715,167	-	834,721	-	12,519	149,774	-	4,758,677
Fund balances at the end of the year	\$ -	\$ 176,861	\$ -	\$ -	\$ 1,270,595	\$ 1,715,167	\$ -	\$ 1,339,347	\$ -	\$ 12,519	\$ 162,148	\$ -	\$ 4,676,637

See Accompanying Independent Auditors' Report.

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

Honorable Johnson Elimo
Governor, State of Chuuk
Federated States of Micronesia:

We have audited, 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, the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of State of Chuuk as of and for the year ended September 30, 2016, and the related notes to the financial statements, which collectively comprise State of Chuuk's basic financial statements, and have issued our report thereon dated June 30, 2017. Our report was qualified with respect to governmental activities expenses and General Fund expenditures and a liability for land leases and related claims payable in the governmental activities and the General Fund, and includes emphasis-of-matter paragraphs concerning implementation of new accounting standards and collectibility of receivables.

For purposes of this report, our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts and grants, and other matters did not include the discretely presented component units, which were all audited by us. We have issued separate reports on our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters for these entities. The findings, if any, included in those reports are not included herein.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered State of Chuuk's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of State of Chuuk's internal control. Accordingly, we do not express an opinion on the effectiveness of State of Chuuk's internal control.

A *deficiency in internal control* 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 and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Questioned Costs as items 2016-002 and 2016-003 that we consider to be material weaknesses.

Compliance and Other Matters

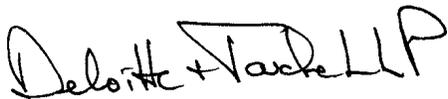
As part of obtaining reasonable assurance about whether State of Chuuk's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material 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 or other matters that are required to be reported under *Government Auditing Standards*.

State of Chuuk's Response to Findings

State of Chuuk's response to the findings identified in our audit are described in the accompanying corrective action plan. State of Chuuk's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



June 30, 2017

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS REQUIRED BY THE UNIFORM GUIDANCE

Honorable Johnson Elimo
Governor, State of Chuuk
Federated States of Micronesia:

Report on Compliance for Each Major Federal Program

We have audited State of Chuuk's compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of State of Chuuk's major federal programs for the year ended September 30, 2016. State of Chuuk's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs.

As discussed in Note 3B to the Schedule of Expenditures of Federal Awards, State of Chuuk's basic financial statements include the operations of certain entities whose federal awards are not included in the accompanying Schedule of Expenditures of Federal Awards for the year ended September 30, 2016. Our audit, described below, did not include the operations of the entities identified in Note 3B as these entities conducted separate audits in accordance with Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the Uniform Guidance), if required.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of State of Chuuk's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the Uniform Guidance. Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about State of Chuuk's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of State of Chuuk's compliance.

Opinion on Each Major Federal Program

In our opinion, State of Chuuk complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2016.

Other Matters

The results of our auditing procedures disclosed instances of noncompliance which are required to be reported in accordance with the Uniform Guidance and which are described in the accompanying Schedule of Findings and Questioned Costs as item 2016-001. Our opinion on each major federal program is not modified with respect to these matters.

State of Chuuk's response to the noncompliance findings identified in our audit are described in the accompanying corrective action plan. State of Chuuk's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of State of Chuuk is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered State of Chuuk's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of State of Chuuk's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

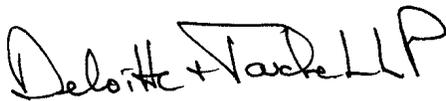
Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in the accompanying Schedule of Findings and Questioned Costs as item 2016-001 that we consider to be significant deficiencies.

State of Chuuk's response to the internal control over compliance findings identified in our audit are described in the accompanying corrective action plan. State of Chuuk's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of State of Chuuk as of and for the year ended September 30, 2016, and the related notes to the financial statements, which collectively comprise State of Chuuk's basic financial statements. We issued our report thereon dated June 30, 2017, which contained qualified opinions on those financial statements with respect to governmental activities expenses and General Fund expenditures and a liability for land leases and related claims payable in the governmental activities and the General Fund, and includes emphasis-of-matter paragraphs concerning implementation of new accounting standards and collectibility of receivables. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of Federal Awards is fairly stated in all material respects in relation to the basic financial statements as a whole.



June 30, 2017

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Summary Schedule of Expenditures of Federal Awards, by Grantor
Year Ended September 30, 2016

Agency/Program	Expenditures
U.S. Agency for International Development	\$ 26
U.S. Department of the Interior	26,599,105
U.S. Department of Education	832,557
U.S. Department of Health and Human Services	<u>1,203,738</u>
GRAND TOTAL	<u>\$ 28,635,426</u>
Reconciliation to the basic financial statements:	
Grants Assistance Fund expenditures	\$ 28,919,479
Less: CFMS Grants Fund expenditures	(278,422)
Foreign Assistance Fund expenditures	<u>(5,631)</u>
	<u>\$ 28,635,426</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2016

Federal Grantor/Pass-Through Grantor/Program	CFDA#	Pass-Through Entity Identifying #	Expenditures
U.S. DEPARTMENT OF THE INTERIOR		A2	
Pass-Through Federated States of Micronesia National Government:			
Economic, Social and Political Development of the Territories:	15.875		
Compact Sector Grants - Education Sector			\$ 10,808,360
Compact Sector Grants - Health Sector			9,526,281
Compact Sector Grants - Environment Sector			634,517
Compact Sector Grants - Private Sector Development			365,961
Compact Sector Grants - Capacity Building Sector			765,709
Supplemental Education Grant			3,814,810
Compact Sector Grants - ERA			680,493
Compact Sector Grants - Infrastructure Maintenance			<u>2,974</u>
Total Compact Sector Grants Fund			<u>26,599,105</u>
TOTAL U.S. DEPARTMENT OF THE INTERIOR TOTAL			<u>\$ 26,599,105</u>
U.S. DEPARTMENT OF EDUCATION		A2	
Pass-Through Federated States of Micronesia National Government:			
Special Education - Grants to States	84.027		<u>\$ 832,557</u>
TOTAL U.S. DEPARTMENT OF EDUCATION TOTAL			<u>\$ 832,557</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES		A2	
Pass-Through Federated States of Micronesia National Government:			
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116		\$ 172,486
Substance Abuse and Mental Health Services - Projects of Regional and National Significance	93.243		290,235
Maternal and Child Health Federal Consolidated Program	93.110		9,328
Personal Responsibility Education Program	93.092		37,721
Block Grant for Prevention and Treatment of Substance Abuse	93.959		176,864
Family Planning Services	93.217		51,795
Universal Newborn Hearing Screening	93.251		23,512
Immunization Cooperative Agreements	93.268		148,785
CDC and Prevention - Investigations and Technical Assistance	93.283		9,092
Chronic Disease Prevention and Health	93.544		-
HIV Prevention Activities - Health Department Based	93.940		-
HIV Care Formula Grants	93.917		7,657
Preventive Health Services - Sexually Transmitted Disease Control	93.977		19,867
Cooperative Agreements for State-Based Diabetes Control	93.988		14,225
Maternal and Child Health Services Block Grant to the States	93.994		131,985
CCPI Cancer Program	93.UNKNOWN		<u>110,186</u>
TOTAL U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES TOTAL			<u>\$ 1,203,738</u>
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT		A2	
Restoration of Agricultural Productive Capacities of Households Afforded by Typhoon Maysak	98.UNKNOWN		<u>\$ 26</u>
TOTAL U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT TOTAL			<u>\$ 26</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 28,635,426</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2016

1. Scope

The State of Chuuk is one of the four States of the Federated States of Micronesia. All significant operations of the State of Chuuk are included in the scope of the audit (the "Single Audit"). The U.S. Department of the Interior has been designated as the State of Chuuk's cognizant agency for the Single Audit.

2. Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards (the Schedule) includes the federal grant activity of the State of Chuuk under programs of the federal government for the year ended September 30, 2016. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the State of Chuuk, it is not intended to and does not present the financial position or changes in financial position of the State of Chuuk.

3. Summary of Significant Accounting Policies

A. Basis of Accounting

Expenditures reported on the Schedule are reported on the modified accrual basis of accounting, consistent with the manner in which State of Chuuk maintains its accounting records. All expenditures and capital outlays that represent the federal share are reported as expenditures. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Pass-through entity identifying numbers are presented, where available.

B. Reporting Entity

For purposes of complying with the Single Audit Act of 1984, as amended in 1996, the State of Chuuk's reporting entity is defined in Note 1A to its September 30, 2016 basic financial statements; and all of the discretely presented component units are excluded. Accordingly, the accompanying Schedule presents the federal award programs administered by the State of Chuuk, as defined above, for the year ended September 30, 2016.

C. Matching Costs

Matching costs, i.e., the non-federal share of certain program costs, are not included in the accompanying Schedule.

D. Subgrantees

Certain program funds are passed through the State of Chuuk to subgrantee organizations. The Schedule does not contain separate schedules disclosing how the subgrantee outside of the State of Chuuk's control utilizes these funds.

E. Indirect Cost Allocation

The State of Chuuk did not receive any indirect cost allocation and does not elect to use the de minimis indirect cost rate allowed under the Uniform Guidance. State of Chuuk did not charge indirect costs against federal programs.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2016

3. Summary of Significant Accounting Policies, Continued

F. CFDA #15.875

CFDA #15.875 represents the Office of Insular Affairs (OIA), U.S. Department of the Interior. Funding from this source is subject to varying rules and regulations since OIA administers the Compact of Free Association, which is a treaty, and is not a federal program. The Compact is comprised of various funded programs, each with separate compliance requirements. To maximize audit coverage of OIA funding, the OIG has recommended that programs administered under CFDA #15.875 be grouped by like compliance requirements and such groupings be separately evaluated for purposes of major program determinations.

G. Component Units

The State of Chuuk's component units are to separately satisfy the requirements of the Uniform Guidance, if applicable. The following presents information concerning the State of Chuuk's component units:

Chuuk Public Utility Corporation

The Chuuk Public Utility Corporation (CPUC), a discretely presented component unit, is the recipient of various pass-through funds from the State of Chuuk. The CPUC is to separately satisfy its 2016 reporting responsibilities under the Single Audit Act. CPUC's total federal award expenditures for the year ended September 30, 2016 is \$7,513,496.

Chuuk State Housing Authority

The Chuuk State Housing Authority (CSHA), a discretely presented component unit, is the recipient of various pass-through funds from the State of Chuuk and certain direct grants. CSHA's total federal award expenditures for the year ended September 30, 2016 is undetermined.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2016

Section I - Summary of Auditors' Results

Financial Statements

- | | |
|---|--------------------------|
| 1. Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP: | Unmodified and Qualified |
| Internal control over financial reporting: | |
| 2. Material weakness(es) identified? | Yes |
| 3. Significant deficiency(ies) identified? | None reported |
| 4. Noncompliance material to financial statements noted? | No |

Federal Awards

Internal control over major federal programs:

- | | |
|---|------------|
| 5. Material weakness(es) identified? | No |
| 6. Significant deficiency(ies) identified? | Yes |
| 7. Type of auditors' report issued on compliance for major federal programs: | Unmodified |
| 8. Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? | Yes |
| 9. Identification of major federal programs: | |

<u>CFDA Numbers</u>	<u>Name of Federal Program or Cluster</u>
---------------------	---

15.875	Economic, Social and Political Development of the Territories – Compact of Free Association, As Amended, Compact Sector Grants
--------	--

- | | |
|--|------------|
| 10. Dollar threshold used to distinguish between Type A and Type B Programs: | \$ 859,063 |
| 11. Auditee qualified as low-risk auditee? | No |

Section II – Financial Statements Findings

<u>Finding #</u>	<u>Finding</u>
2016-002	Timely and Accurate Reconciliations
2016-003	Land Leases

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2016

Section III - Federal Award Findings and Questioned Costs

<u>Finding #</u>	<u>CFDA #</u>	<u>Finding</u>	<u>Questioned Costs</u>
2016-001	15.875	Equipment and Real Property Management	\$ -

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2016

Finding No.: 2016-001
Federal Agency: U.S. Department of the Interior
Pass-Through Entity: Federated States of Micronesia National Government
CFDA Program: 15.875 Economic, Social and Political Development of the Territories -
Compact of Free Association, As Amended, Compact Sector Grants
Requirement: Equipment and Real Property Management
Questioned Costs: \$0

Criteria: Management should periodically review asset maintenance activities to facilitate compliance with program objectives and requirements.

Condition: No documented procedures are currently in place requiring that fixed assets undergo required maintenance.

Cause: The cause of the above condition appears to be a potential weakness in internal control requiring that fixed assets be periodically maintained.

Effect: The effect of the above condition is the expected life of fixed assets may be lessened. However, no questioned costs result from this finding as no specific instances came to our attention in fiscal year 2016 of unnecessary expenditures that occurred due to this condition.

Identification as a Repeat Finding: Finding No. 2015-001.

Recommendation: We recommend that the State strengthen internal control requiring that periodic reviews be performed and that asset maintenance activities be documented and monitored.

Auditee Response and Corrective Action Plan: We agree with the audit finding and recommendation, please note that Chuuk State Equipment and Real Property Maintenance Plan is already in place. However, documented procedures for maintenance activities review and monitoring are still not completed. We will work on this immediately. DAS Supply and Procurement staff in collaboration with corresponding staff responsible for fixed asset of other departments, agencies and offices receiving fixed assets from sector funding are currently working together to ensure compliance and documentation of periodic reviews and maintenance activities of fixed assets and monitoring undertaken.

See the auditee-prepared corrective action plan.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2016

Finding No.: 2016-002
Area: Timely and Accurate Reconciliations

Criteria: Reconciling subsidiary ledgers to the general ledger on a regular basis is fundamental and critical to maintaining accurate financial records and to minimizing the opportunity for misappropriation of funds or fraudulent activities.

Condition: We determined subsidiary records, particularly cash and equivalents, contained variances that are not timely reconciled.

Cause: The cause of this condition is an absence of timely or accurate bank reconciliations and subsidiary ledgers reconciliations.

Effect: The effect of this condition is a potential misstatement of the financial statements.

Recommendation: The State should perform monthly reconciliations of all cash accounts and subsidiary ledgers.

Identification as a Repeat Finding: Finding No. 2015-005.

Auditee Response and Correction Action Plan: As with prior reconciliation findings, we agree with the 2016 finding and recommendation. DAS has hired a CPA to assist with reconciliation problems and who is currently concentrating efforts on reconciliation and adjustment of all bank accounts to general ledger accounts. During FY 2017 numerous adjustments were made by the banks to correct bank errors and DAS to correct accounting errors occurring during FY 2017 and previous years. In addition, DAS has initiated recruiting efforts to locate an individual to assist with the reconciliation process. DAS plans to have all bank accounts reconciled and adjusted on a monthly basis, where appropriate for 2017.

See the auditee-prepared corrective action plan.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2016

Finding No.: 2016-003
Area: Land Leases

Criteria: A functioning system of internal control requires that subsidiary ledgers be maintained and be supported by underlying supporting documentation, such as vendor contracts, lease agreements, etc.

Condition: The State lost many of its lease agreements in a fire some years ago and has been working to compile all of its land and building leases and to determine if liabilities should be recorded for delinquent lease payments. Due to the state of this project, we were not able to obtain documentation and to determine if an associated liability should be recorded in the financial statements and if all requisite lease disclosures have been included in notes thereto.

Cause: The cause of this condition is that management is still researching and reconstructing the underlying lease data.

Effect: The effect of this condition is a potential misstatement of the financial statements and the notes thereto resulting in a qualification.

Recommendation: The State should set a timetable and obtain technical assistance to assist in resolution of this matter.

Identification as a Repeat Finding: Finding No. 2015-006.

Auditee Response and Correction Action Plan: Funding for this project was provided during this year's budget and procurement of the services was done on time and in compliance with requirements. However, when the final selection was made and the contract was drafted, OIA disapproved the selected individual for some unknown reasons. We will continue to work with OIA to assist in the resolution of this finding.

See the auditee-prepared corrective action plan.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Unresolved Prior Audit Findings and Questioned Costs
Year Ended September 30, 2016

Questioned Costs

The prior year Single Audit report on compliance with laws and regulations noted the following questioned costs and comments that were unresolved at September 30, 2016:

	<u>Questioned Costs</u>
Questioned costs as previously reported:	
Fiscal year 2013 Single Audit	\$ 194,238
Fiscal year 2014 Single Audit	114,918
Fiscal year 2015 Single Audit	<u>55,292</u>
	364,448
Questioned costs of fiscal year 2016 Single Audit	<u>-</u>
Unresolved questioned costs at September 30, 2016	\$ <u>364,448</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Summary Schedule of Prior Audit Findings and Questioned Costs
Year Ended September 30, 2016

<u>Finding Number</u>	<u>CFDA Number</u>	<u>Questioned Costs</u>	<u>Status</u>
2013-001	15.875	\$ -	Not corrected or resolved. See Finding 2014-001
2013-002	15.875	19,940	Not corrected or resolved.
2013-003	15.875	160,270	Not corrected or resolved. See Finding 2014-002
2013-004	15.875	14,028	Not corrected or resolved. See Finding 2014-003
2014-001	15.875	-	Not corrected or resolved. See Finding 2015-001
2014-002	15.875	82,298	Not corrected or resolved.
2014-003	15.875	32,620	Not corrected or resolved.
2015-002	15.875	6,800	Not corrected or resolved.
2015-003	15.875	13,006	Not corrected or resolved.
2015-004	84.027	<u>35,486</u>	Not corrected or resolved.
		\$ <u>364,448</u>	

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

CORRECTIVE ACTION PLAN
2 CFR § 200.511(c)
Year Ended September 30, 2016

Finding Number	Corrective Action Plan	Anticipated Completion Date	Responsible Person (Contact details)
2016-001	DAS Supply and Procurement staff designated by the Chief of finance in collaboration with corresponding staff responsible for fixed asset of other departments, agencies and offices receiving fixed assets from sector funding will work together to make sure that implementation of the documented procedures and documentation of periodic reviews and maintenance activities of fixed assets and monitoring undertaken	September 30, 2017	Kath Sound - Chief of Finance kathy_sound@yahoo.com
2016-002	As with prior reconciliation findings, we agree with the 2016 finding and recommendation. DAS has hired a CPA to assist with reconciliation problems and who is currently concentrating efforts on reconciliation and adjustment of all bank accounts to general ledger accounts. During FY 2017 numerous adjustments were made by the banks to correct bank errors and DAS to correct accounting errors occurring during FY 2017 and previous years. In addition, DAS has initiated recruiting efforts to locate an individual to assist with the reconciliation process. DAS plans to have all bank accounts reconciled and adjusted on a monthly basis, where appropriate for 2017.	September 30, 2017	Kath Sound - Chief of Finance kathy_sound@yahoo.com
2016-003	To hire an attorney and will continue to work with OIA to assist in the resolution of this finding.	September 30, 2017	Sabino Asor – State Attorney General Sab.asor@hotmail.com