

OFFICE OF THE NATIONAL PUBLIC AUDITOR
FEDERATED STATES OF MICRONESIA

REVIEW OF CHUUK STATE OFFICE OF PERSONNEL

(FY 2006-2007)

REPORT NO. 2007-05



Haser H. Hainrick
National Public Auditor



FEDERATED STATES OF MICRONESIA

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September 13, 2007

Honorable Members of the FSM Congress
His Excellency Manny Mori, President
Federated State of Micronesia
Palikir, Pohnpei FM 96941

RE: Review of Chuuk State Office of Personnel

We have completed our review of Chuuk State Office of Personnel (Personnel Office) for fiscal years 2006 and 2007 up to April 30, 2007. Our objective was to determine whether the Personnel Office complied with the Chuuk State Public Service System (CSPSS) Act and related regulations concerning personnel administration. The CSPSS is a personnel system based on widely accepted personnel principles including equal opportunity, impartial selection, and systematic classifications of positions. During our review, we examined the processes used to hire new employees, classify position and determine compensation. In testing the transactions, we selected a sample of employees of the Chuuk Department of Health Services. However, since our review focused on the systems and the processes used by the Personnel Office, we concluded that the deficiencies noted in the review of specific transactions for the Department of Health Services would also exist for all other departments, offices, and agencies of the Chuuk State Government. In addition, we reviewed internal controls in the Personnel Office and payroll processing.

We conducted our review in accordance with the *Quality Standards for Inspections* issued by the U.S. President's Council on Integrity and Efficiency and the Executive Council of Integrity and Efficiency.

As a result of our review, we concluded that the Personnel Office did not comply with requirements of the CSPSS Act. The Personnel Office had outdated policies and procedures and published an unauthorized list of exempt employees. Examples of non-compliance included employees hired before the approval of personnel actions, positions not properly classified, pay increases larger than authorized, promotions and reallocations not merit based, and stand-by differentials paid to ineligible employees. This situation, Personnel's lack of policies and procedures as well as non-compliance, increased the risk of abuse of the system and resulted in increased personnel costs. The detailed findings and recommendations are discussed in the attached report. In addition, we discussed some internal control weaknesses and suggested methods to strengthen controls over personnel actions. These are presented in the Appendix, which is included in the audit report.

On August 28, 2007, we discussed our draft findings with the Chuuk State Governor and officials from the Office of Personnel, Department of Health Services, Department of Administrative Services, and Compact Fund Control Commission. The officials agreed with our findings. We provided each official an opportunity to provide written comments to be included in the report. However, we did not receive any management comments in the 7-day deadline period. Because the comments are important aspects of our report, we formally extended the timeframe for the submission of the comments to September 11, 2007. As of the date of this report, we have not received the desired management comments so we are issuing this report without them.

Respectfully yours,

A handwritten signature in black ink, appearing to read 'H. Hainrick', enclosed within a large, horizontal oval shape.

Haser H. Hainrick
National Public Auditor

XC: Governor & Lt. Governor, Chuuk State
President, Speaker and Members of Chuuk Legislature
Personnel Officer, Chuuk State
Director, Department of Health Services, Chuuk State
Director, Department of Administrative Services, Chuuk State
Finance Officer, Chuuk State
Budget Officer, Chuuk State
Director, Compact Funds Control Commission

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BACKGROUND

In 1981, the Chuuk State Public Service System (CSPSS) Act established a personnel system based on widely accepted personnel principles.¹ The CSPSS embraced the principles of equal opportunity, non-discrimination, impartial selection, reasonable job security, systematic classifications of positions, fair and reasonable grievance procedures, and proper employer-employee relations.

The Chuuk State Office of Personnel (Personnel Office), a division within the Department of Administrative Services (DAS), was given the responsibility and authority of implementing the CSPSS. The Chief of Personnel has a staff of seven including one Assistant Chief, four Personnel Specialists, one Personnel Assistant, and a Secretary. The Personnel Office is responsible for all activities relating to employment for Chuuk State employees including recruiting, selecting, classifying positions, and maintaining personnel files.

CSPSS requires that all personnel actions (e.g. hiring, promotion) be approved by the Governor or Lt. Governor. In addition, the Chuuk State Compact Funds Control Commission (CFCC) must approve personnel actions that are paid through the Compact of Free Association, as amended (Amended Compact). CFCC was established by the Chuuk State Legislature to provide greater reliability in Amended Compact expenses paid by the DAS. CFCC reviews and approves individual transactions to provide additional assurance that funds are available and expenditures are properly paid.

Table 1 below shows the total fund budgeted and actual expenditures for the Personnel Office during Fiscal Year 2006 and 2007 and up to April 30, 2007.

Table 1 Chuuk State Office of Personnel
Budget Vs. Actual
For Periods Ending September 30, 2006 and April 30, 2007

	2006			2007		
	Budget	Actual	Variance	Budget	Actual	Variance
Personnel	\$79,000	\$82,645	\$-3,645	\$88,158	\$42,958	\$45,200
Travel	1,470	1,239	231	2,930	2,930	0
Fixed Assets	2,500	2,441	59	5,335	5,332	3
Office Supplies	1,500	1,469	31	2,000	51	1,949
Communications	500	258	242	1,000	591	409
Utilities	1,000	1,000	0	2,000	500	1,500
Printing	750	746	4	2,000	0	2,000
Vehicles	0	0	0	7,140	7,140	0
Repair	0	0	0	525	33	492
POL	0	0	0	500	329	171
Total	\$86,720	\$89,798	\$-3,078	\$111,588	\$59,864	\$51,724

Source: DAS Note that the data in the table is based on information from the DAS and we did not perform any audit procedures to determine its accuracy.

¹ Truk State Law 3-43, April 29, 1981.

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After approval of hiring documents and rate by the Personnel Office, the payroll section also within DAS processes the payroll and maintains employee compensation information. Currently, Chuuk State employs about 2,525 people.

The CSPSS Act protects employees covered by the personnel system. For example, it sets maximum biweekly work hours and allows additional compensation for employees who are required to work additional hours or must return to work when called. However, some employees are exempt from CSPSS and are not entitled to the same protection and benefits accorded to classified employees. For example, exempt employees are entitled to eight hours per working day of pay regardless of the number of hours they actually worked but they are not entitled to the basic benefits received by classified employees such as accrual of annual leave and overtime.

OBJECTIVE

This review is part of our efforts to oversee the use of Amended Compact Funds in the FSM. We selected for review two priority Amended Compact sectors: Education and Health. Then the Office of the National Public Auditor (ONPA) Chuuk staff performed a preliminary survey of these sectors to determine the focus of the review. The survey results indicated that there could be a problem with the personnel system. We decided the first review would cover the Health sector, which employed fewer people, and the second review would cover the Education sector. However, since the review focused on the systems and the processes used by the Personnel Office, we concluded that the deficiencies noted in the review of specific transactions for the Chuuk Department of Health Services (CDHS) would also exist for the Department of Education as well as all other departments, offices, and agencies of the Chuuk State Government. Therefore, at this time, this will be the only personnel review we plan to do.

Our objective was to determine whether the Personnel Office complied with the CSPSS Act and related regulations concerning personnel administration.

SCOPE

Our review covers fiscal year 2006 and 2007 up to April 30, 2007. However, the gathering, reviewing and testing of relevant information and documentations included previous and subsequent periods for analytical purposes. The review was conducted pursuant to Title 55 FSM Code, Chapter 5, which states in part:

“The Public Auditor shall inspect and audit transactions, accounts, books, and other financial records of every branch, department, office, agency, board, commission, bureau, and statutory authority of the National Government and of other public legal entities, including, but not limited to, States, subdivisions thereof, and nonprofit organizations receiving public funds from the National Government.”

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We performed the review in accordance with the *Quality Standards for Inspections* issued by the PCIE and ECIE² and included tests of records, transactions, and other auditing procedures that we considered necessary under the circumstances.

METHODOLOGY

We reviewed whether the Personnel Office complied with the CSPSS Act and related regulations. We also performed tests to ensure that adequate internal control measures were in place to assure such compliance.

In testing the transactions, we selected a sample of employees of the CDHS. CDHS is one of the major departments in the Chuuk State Government and its employees are covered under the CSPSS. The CDHS is a recipient of a number of funding sources that included the Amended Compact and several U.S. federally funded health programs. Although based on a sample of CDHS employees and the processing of their related personnel actions, our findings are applicable to all other employees' personnel actions processed by Personnel Office for other departments, offices, and agencies of the Chuuk State Government.

We obtained personnel listings from the Chuuk State Finance Office, the Personnel Office and the CDHS and performed review procedures to satisfy our review objective. We also examined records of a sample of appointments, promotions, and terminations. Of the sample provided, we also reviewed the recruitment process to ascertain if it complied with the requirements of the CSPSS Act and related regulations. Although our procedures also included tests of the personnel actions for removed, transferred and demoted employees there were no such actions during the period under review. Finally, we interviewed staff at Personnel Office, CDHS, Finance Office (including the payroll section), and Budget Office and examined supporting personnel and payroll documentations.

For our review of related payroll activities, we tested a judgmental sample of transactions to determine compliance with internal controls and accuracy of computations. However, if there were only few transactions for the entire period under review, we examined all the transactions.

PRIOR AUDIT COVERAGE

This is the first review of Chuuk State Personnel Office focusing on its administration of the CSPSS. However, we reviewed prior Single Audit Reports issued by Deloitte and Touché for findings relevant to personnel and payroll processing. The last audit covered the period from October 01, 2005 through September 30, 2006. There are no unresolved findings from previous reports covered by this review.

² U.S. President's Council on Integrity & Efficiency (PCIE) and the Executive Council on Integrity & Efficiency (ECIE)

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SUBSEQUENT EVENT

On May 23, 2007, the Chuuk State Governor signed into law CSL-8-07-06, which created the Chuuk State Public Service Commission.³ Under the new law, the Public Service Commission will be independent of the Chuuk State Government and replace the current Personnel Office. The Public Service Commission is to be overseen by a 5-member Commission, "...who are not employees of the Chuuk State Government, appointed or elected public officials, or members of any (state) board, commission, or authority receiving funding from Chuuk State Government".

The newly created Commission is now taking over the functions and responsibilities of the Personnel Office. Under the law, the Governor is required to submit to the Chuuk State Senate the names of all appointees to the Commission within 30 days after the Act was signed. As of this writing, names of the five Commission members have been submitted to the Chuuk State Senate for confirmation and two have been confirmed.

Although the focus of our review was on the Personnel Office, our recommendations are addressed to the new Public Service Commission as a starting point for them to review and update policies, regulations and eventual implementation.

CONCLUSIONS

In summary, we found that the Personnel Office did not comply with requirements of the CSPSS Act. The Personnel Office had outdated policies and procedures and published an unauthorized list of exempt employees. In addition, examples of non-compliance included employees hired before approval of personnel actions, positions not properly classified, step increases and reallocations not merit based, and stand-by differentials paid to ineligible employees. This situation increased the risk of abuse and resulted in increased personnel costs.

FINDINGS

**Outdated Policies and Procedures
and Unauthorized List of Exempt
Employees Increased Risk of Abuse**

We found that the Personnel Office did not have policies and procedures in place to carry out the requirements of the CSPSS and that Personnel Office's list of exempt employees was not authorized. The absence of policies and procedures has negatively affected all aspects of the CSPSS and left the system vulnerable to misuse and abuse. In addition, the Personnel Office revised and issued a list of exempt employees without seeking the Legislature's approval

³ In accordance with Article IX, Section 3 of the Chuuk State Constitution of 1990.

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thereby giving inappropriate and improper ranking, title and compensation to some employees.

Policies and Procedures — The CSPSS Act (Section 7, 3.b) and related regulations require the Personnel Office to prepare policies and procedures to carry out provisions of the CSPSS.

We found that since the system was established in 1981, the Personnel Office has not established policies and procedures required to ensure that uniform, complete and updated standards are in place to carryout the intended purpose of the CSPSS Act. We noted that the only written procedure on file covered the routing of the 1981 Personnel Action (PA) form but the department names listed on the form no longer exist. As a result, the procedures used to process personnel actions are based on unwritten past practices. The absence of written and transparent policies and procedures increases the risk of inconsistent and improper implementation and has left the system vulnerable to misuse and abuse.

Exempt Employees — the CSPSS Act and related regulations explicitly list the positions in the Chuuk State Government that are exempt from the system. Therefore, any changes to the list of exemptions would require action by the State Legislature.

We found that the Personnel Office, without an action of the Legislature, changed the positions on the exempt list. The CSPSS Act listed 28 positions, including the Governor, Lt. Governor, and members of the Chuuk State Legislature. In August of 2005, the Personnel Office issued a revised Classification Plan that included a new listing of positions exempt from the CSPSS regulations. The Personnel Office had the authority to update the Classification Plan but not to change the list of exempt employees. The newly published list enumerated 54 positions excluding the Governor, Lt. Governor, and members of the Chuuk State Legislature, and including Division Chiefs and Assistant Chiefs. As a result, the newly published exempt list is not compliant with the CSPSS Act and the newly exempt employees have been given inappropriate and improper ranking, title and compensation.

**Non-compliance Resulted
In Overpayments**

We found that the Personnel Office has repeatedly violated the CSPSS Act and related regulations. The deviations are frequent but inconsistently practiced resulting in a personnel system with little resemblance to the one envisioned by the CSPSS Act. Non-compliance issues covered practices of hiring, position classification, pay increases, promotions, and stand-by differential pay and resulted in overpayments to numerous employees.

Hiring — The CSPSS Regulations (Part III.B) prohibit the employment of an individual without an approved personnel action. It states, in part, "...employment of any person without an approved personnel action is prohibited. Supervisors or management officials shall not permit an employee to report to work without an appropriate and formally approved

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personnel action...” In addition, the Chuuk State Manual of Administration (part III) designated the review and approval by the Governor and Lt. Governor as the final approval step for personnel actions.

In CDHS, individuals were hired and reported to work before personnel actions were approved. In a sample of 16 newly hired employees, 94 percent (15 of 16) were given effective dates ranging from 10 to 210 days prior to the approval dates. In addition, 40 percent of these employees (6 of 15) received retroactive pay costing an unnecessary \$6,887. In the remaining 60 percent of the cases (9 of 15), CFCC denied the retroactive payments. We also noted that 3 of the 16 newly hired employees became permanent employees immediately despite a 1-year probationary period requirement. As a result, retroactive salaries of \$6,887 were paid to six sampled employees and not all newly hired employees were treated equally.

Position Classifications — The CSPSS regulations (Part V, Sub-part A.2) require that, “all positions subject to the provisions of the CSPSS Act shall be classified in accordance with an approved Chuuk State Position Classification Plan...” In addition, the CSPSS regulations authorize the Personnel Office to update the Position Classification Plan as needed.

Personnel’s classification of CDHS employees was not done in accordance with the Classification Plan. We found 41 percent (195 of 472) of the employee classifications reviewed did not comply with the provisions of the Position Classification Plan. Of this, 63 percent (123 of 195) were assigned pay levels and grades higher than that specified in the Classification Plan and the remaining 37 percent (72 of 195) were given lower pay levels and grades.

For example, 30 positions in CDHS (all the physician positions along with some top management positions) were readily classifiable under the revised plan. However, the Personnel Office continued to accord these positions exempt status, which increased salaries of sampled employees by over \$90,600 in fiscal year 2006. The increased salary of sampled employees ranged from \$2,799 to \$9,955 more than that allowed by the classification plan during the period under review. These violations resulted in inappropriate and improper ranking, title and compensation of employees and a classification system that appears unjust and unfair.

Pay Increases —the CSPSS Act (Section 17, Sub-section 7) states, in part, that if “... an employee’s performance, as determined through objective evaluation, has met accepted standards of productivity during a specific period, his base salary may be increased by one step in the appropriate level of the base salary schedule...”

The Personnel Office processed pay increases that did not comply with the law and regulations. Of the 112 personnel actions involving pay increases we reviewed, none were limited to an increase of one step but all were based on the amount available in approved budget. The pay increases range from two steps to the equivalent of 12 step increases. As a result, pay increases were not based on a merit system but rather on approved budget.

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Promotions — CSPSS Regulations require that promotions and reallocations⁴ be based on an employee's performance, as determined through objective evaluation. It further states "An employee who is promoted from a position in one class to an existing position in a higher class shall be compensated at the lowest step in the new pay level which equals to the amount of a two (2) step increase in the old pay level..."

The Personnel Office processed promotions and reallocations without proper documentation of performance evaluation and compensation was increased more than allowed by regulations. All promotions and reallocations tested (4 of 4) showed salary increases more than allowed by the regulations. In addition, we found that these promotions and job reallocations were put into effect without proper evaluation to determine whether such personnel actions were justified.

Stand-by Differential Pay —The CSPSS Regulations (Part V.B.20) outlined the conditions to be eligible for additional compensation when an employee can be called to work during normal off-duty hours. This is called a standby differential. It further states that, "...no employee who is receiving as part of his compensation a twenty (20) percent Standby Differential shall be paid a base salary rate in excess of \$521.28 biweekly..."

The Personnel Office paid 21 CDHS employees the stand-by differential even though they were ineligible because they were exempt and their pay exceeded the limit. The CSPSS Act was intended solely to protect those employees covered by the system. By definition, those "exempt" from the CSPSS Act were not covered by the system and were not entitled to receive the benefits of the system. Moreover, every employee, in question, was paid a base biweekly salary over the \$521.28 maximum limit ranging from \$561.54 to \$1,176.35. These 21 exempt employees received a total of \$97,402 in fiscal year 2006 and will receive an estimated \$112,518 for fiscal year 2007, for stand-by differential. As a result of the non-compliance with CSPSS regulations, ineligible sampled employees received stand-by differential compensation of more than \$200,000 in 2 years.

CAUSES AND RECOMMENDATIONS:

The Personnel Office's lack of leadership has resulted in a personnel system with no written policies and procedures and an office that is vulnerable to pressure from politicians and department officials.

The Personnel Office has inadvertently abandoned its fiduciary responsibilities as the administrator and protector of the CSPSS. This situation has cast serious doubt and eroded confidence in the credibility of the personnel system.

⁴ Reallocations are an increase in knowledge, skills, abilities and pay within the same position classification (e.g., an employee moves from Clerk I to Clerk II).

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While our review centered on Personnel Office, Chuuk State enacted a new law that created the Public Service Commission to take over the duties and responsibilities of the current Personnel Office. Therefore, we are addressing our recommendations to the Public Service Commission as the new agency responsible for the CSPSS. The Public Service Commission should be an instrument for positive changes in creating a sound and credible personnel environment in which employees will work with pride, dignity, inspiration and determination for the good of the public.

We recommend that the Public Service Commission enforce the requirements of the CSPSS Act and the related regulations including but not limited to the following actions:

- A. Review and propose modifications to the Chuuk State Legislature regarding the CSPSS Act and related regulations. The modifications should include deleting outdated practices (such as deleting paid vacation trips), updating list of exempt employees, and updating classification plan to reflect current organizational units and positions in the State Government.
- B. Develop policies and procedures to ensure that the Public Service Commission complies with all requirements of the CSPSS Act and related regulations.
- C. Realign the existing employees' positions and compensation to conform to the classification plan in the CSPSS Act and regulations. This information should then be distributed to all affected employees and departments.
- D. Conduct thorough training for its entire staff and all Chuuk State Government employees regarding compliance with the requirements of the CSPSS Act and regulations.

In addition, we provided suggestions regarding internal controls for consideration upon the development and/or update of policies and procedures for personnel administration and payroll processing.

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Appendix I
Observation on Internal Controls

We suggest that the following internal controls procedures be considered when developing and/or updating policies and procedures for personnel administration and payroll processing.

The Public Service Commission should consider:

- Updating the Organization Chart for the entire Chuuk State Government showing key areas of responsibilities and reporting relationships (This will provide management with a basis for evaluating the duties and responsibilities of staff.);
- Establishing pre-employment requirements such as a background check of references, previous employers and police to ensure qualified and competent staff;
- Providing a copy of job duties and responsibilities to new employees so they will be aware of job expectations;
- Requiring the completion of a departmental release form (Clearance Sheet) for employees transferring within or leaving the Government to ensure proper turnover of accountabilities;
- Developing and implementing procedures to ensure that an employee's personnel file is complete, accurate and up-to-date;
- Incorporating maintenance of employees' records into the duties and responsibilities of a position in the Public Service Commission;
- Establishing a technique to determine the completeness of documents in a employees' record such as using a table of contents; and
- Establishing an employee records logbook to track movement of records and pinpoint responsibility for missing records.

The Payroll section should consider:

- Developing and implementing control procedures for manual operation used in processing the payroll, (such as manual verification, supervisory review, disposition of exceptions noted, and storage of output reports);
- Developing and implementing procedures for offsite backup of payroll data and programs to protect the organization from interruption of operation in case of a disaster;
- Developing and periodically testing a Contingency Plan to minimize potential damage and assure continuity of data processing in case of a disaster;
- Developing policies and procedures to protect the data processing system when there is turn-over of payroll personnel.
- Requiring documentation (e.g. operator's run log) of the detailed activities performed every payroll period, (including the data backup, program parameters change, problems encountered and their resolution);
- Requiring that the operator's run log be approved to ensure proper supervision of these activities;

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- Developing and implementing alternative control procedures to lessen the risk of undetected modification in the employee master files; (An example of this procedure is independent test checking of master file changes that were made during the payroll period.);
- Purchasing time clocks for all departments to ensure the accuracy of employee attendance records;
- Performing periodic inventories of unused checks to detect any missing checks;
- Developing and implementing procedures to handle custodianship and reversal of unclaimed payroll checks; and
- Establishing control procedures to ensure accuracy of leave balances like test-checking every end of payroll of leave usage, accrual and balances.

The Department of Administrative Services should consider:

- Reviewing the various reports that can be generated by the payroll system and providing written guidelines as to which reports should be regularly generated, reviewed and approved, and
- Specifying in the written guidelines which reports should be maintained as electronic copies and which reports need to be printed out as hard copies.

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NATIONAL PUBLIC AUDITOR'S COMMENTS

We would like to thank management and staff at the Personnel Office, CSDH, DAS (Budget Office and Finance Office) for their assistance and cooperation during the course of the review.

The ONPA will perform a follow-up review within the next 6-9 months to ensure that the Public Service Commission has taken corrective measures to address all the findings and recommendations provided in this report.

In conformity with general practice, we discussed our draft findings with the Chuuk State Governor and officials from the Public Service Commission, DAS, CDHS and CFCC on August 28, 2007. The officials agreed with our findings. We provided each official an opportunity to provide written comments to be included in the report. However, we did not receive any management comments in the 7-day deadline period. Because the comments are important aspects of our report, we extended the timeframe for the submission of the comments to September 11, 2007. As of the date of this report, we have not received the desired management comments so we are issuing this report without them.

In addition to providing copies of this report to the President and Members of the Congress, we also sent copies to the Governor of Chuuk State, leadership of the Chuuk State Legislature, the Public Service Commission, the Director of CDHS, and the Vice-chairman of the CFCC. Furthermore, we will make copies available to other interested parties upon request.

If there are any questions or concerns regarding this report, please do not hesitate in contacting the office. Contact information for the Office can be found on the last page of this report, along with the ONPA staff who made major contributions to this report.



Haser H. Hainrick
National Public Auditor

September 13, 2007

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ONPA CONTACT AND STAFF ACKNOWLEDGEMENTS

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ACKNOWLEDGEMENTS

In addition to the contact named above, the following staff made key contributions to this report:

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