

OFFICE OF THE NATIONAL PUBLIC AUDITOR

FEDERATED STATES OF MICRONESIA



FINANCIAL AUDIT

**THE ADAPTATION FUND (AF), ENHANCING THE CLIMATE
RESILIENCE OF VULNERABLE ISLAND COMMUNITIES IN THE
FEDERATED STATES OF MICRONESIA PROJECT**

Year Ended December 31, 2024

Report No: 2026-09



**THE ADAPTATION FUND (AF), ENHANCING THE CLIMATE
RESILIENCE OF VULNERABLE ISLAND COMMUNITIES IN THE
FEDERATED STATES OF MICRONESIA PROJECT**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITOR'S REPORT**

YEAR ENDED DECEMBER 31, 2024

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Independent Auditors' Report

Micheal Yarofaitoar

The Acting Secretary

Department of Environment, Climate Change and Emergency Management

National Government of the Federated States of Micronesia

Palikir, Pohnpei FM 96941

Qualified Opinion

We have audited the accompanying financial statement of the Adaptation Fund Project for the year ended December 31, 2024, which comprises the Schedule of Receipts and Disbursements of the Adaptation Fund Project for the year ended December 31, 2024, and the related notes.

In our opinion, except for the possible effects on the matter described in the Basis for the Qualified Opinion section of this report, the accompanying Schedule of Receipts and Disbursements referred to above present fairly, in all material respects, the receipts and disbursements of the Adaptation Fund Project for the year ended December 31, 2024, in accordance with the cash basis of accounting described in **Note 2**.

Basis for Qualified Opinion

The opening balance of the Schedule of Receipts and Disbursements could not be reconciled with the Project's General Ledger and prior year audited financial statements. As described in **Note 3** to the Schedule, this was due to the lack of reconciliations and the transition to the new Financial Management Information System (FMIS).

We were unable to obtain sufficient appropriate audit evidence regarding the opening balance. Consequently, we were unable to determine whether any necessary adjustments were required to the opening balance and the resulting effect on the Schedule of Receipts and Disbursements for the year ended December 31, 2024.

We conducted our audit in accordance with auditing standards generally acceptable in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statement section of our report. We are required to be independent of the project and to meet our ethical responsibilities in accordance with the relevant ethical requirements relating to our audit.

Emphasis of Matter- Basis of Accounting

We draw attention to Note 2 to the Schedule, which describes the basis of accounting. The Schedule of Receipts and Disbursements is prepared on a cash basis to comply with the Project's financial reporting requirements. As a result, the Schedule may not be suitable for other purposes. Our opinion is not qualified with respect to this matter.

Responsibility of Management for the Financial Statement

Management is responsible for the preparation and fair presentation of the Schedule of Receipts and Disbursements in accordance with the cash basis of accounting described in Note 2, and for the design, implementation, and maintenance of internal controls relevant to that preparation and fair presentation, ensuring the Schedule is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility for the Audit of the Financial Statement

Our objectives are to obtain reasonable assurance about whether the Schedule of Receipts and Disbursements is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but not absolute assurance; therefore, it is not a guarantee that an audit conducted in accordance with GAAS and Government Auditing Standards will always detect a material misstatement when one exists.

The risk of not detecting a material misstatement resulting from fraud is higher than that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. Misstatements are considered material if there is a substantial likelihood that, individually or in aggregate, they would influence the judgment made by a reasonable user based on the financial statement.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the financial statement, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statement.
- Obtain an understanding of internal controls relevant to the audit to design audit procedures appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management and evaluate the overall presentation of the financial statement.

We are required to communicate to those charged with governance, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters we identified during the audit.

Other Reporting Required by *Government Auditing Standards*

In accordance with Government Auditing Standards, we have also issued our report dated April 24, 2026, which considers the Project's internal control over financial reporting and tests its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Project's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards.



Haser H. Hainrick
National Public Auditor

Palikir, Pohnpei
April 24, 2026

**FSM DEPARTMENT OF ENVIRONMENT, CLIMATE CHANGE
AND EMERGENCY MANAGEMENT ADAPTATION FUND
Enhancing the Climate Change Resilience of Vulnerable Island Communities
in the Federated States of Micronesia**

**Schedule of Receipts and Disbursements
For the year ended December 31, 2024**

	2024(\$)	2023(\$)
Cash on hand/fund balance, beginning of year	446,680.71	996,411
Receipts		
Adaptation Fund Grant	500,000.00	1,057,886
Total Receipts	500,000.00	1,057,886
Total Funds Available	946,680.71	2,054,297
Disbursements		
Gen Contractual Services	217,026.04	472,863
Office Supplies & Materials	139,430.48	42,215
Salaries & Benefits	154,458.28	172,450
Travel & Transportation	33,618.54	46,180
Expendable Equipment & Furniture	77,299.45	17,648
Freight	8,643.23	886
Equipment	12,500.00	14,085
Catering	12,275.69	8,172
Storage	6,600.00	6,100
Rental Services	133,087.50	375
Miscellaneous Goods/Services	150.00	484
POL	8,369.92	3,424
Advertising	197.00	3,172
Bank Fees	150.00	300
Compensation non-payroll	-	68
Books & Library	9,555.00	9,008
Total Disbursements	813,361.13	797,430
Excess of Receipts over Disbursements	<u>133,319.58</u>	<u>1,256,867</u>

See accompanying notes to the Schedule of Receipts and Disbursements

**FSM DEPARTMENT OF ENVIRONMENT, CLIMATE CHANGE
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Enhancing the Climate Change Resilience of Vulnerable Islands
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**Notes to Schedule of Receipts and Disbursements
For the Year Ended December 31, 2024**

(1) Organization and Project Description

The Adaptation Fund Project, *Enhancing the Climate Change Resilience of Vulnerable Islands Communities in the Federated States of Micronesia* (the “Project”), is funded by the Adaptation Fund Board through the Secretariat of the Pacific Regional Environment Program (SPREP).

The Project is implemented by the Department of Environment, Climate Change, and Emergency Management (DECEM) of the National Government of the Federated States of Micronesia (FSM), with financial administration support provided by the Department of Finance and Administration (DoFA).

The Project's overall objective is to strengthen the social, ecological, and economic resilience of vulnerable island communities in FSM. This objective is achieved through activities focused on water and coastal resource management, development planning, and the promotion of climate-resilient livelihoods, with integrated gender considerations.

The accompanying Schedule of Receipts and Disbursements relates solely to the financial activities of the Project as maintained by DECEM and DoFA and does not include the full financial position of the FSM National Government.

(2) Summary of Significant Accounting Policies

Basis of Accounting

The accompanying Schedule of Receipts and Disbursements has been prepared on a cash basis of accounting. Under this basis, receipts are recognized when cash is received, and disbursements when cash is paid.

The Schedule is prepared to comply with the Adaptation Fund's financial reporting requirements and is not intended to present the financial position or results of operations in accordance with generally accepted accounting principles in the United States of America. Accordingly, the Schedule may not be suitable for other purposes.

**FSM DEPARTMENT OF ENVIRONMENT, CLIMATE CHANGE
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The Schedule does not include certain assets and liabilities that would be recognized under accounting principles generally accepted in the United States of America.

(3) Opening Balance and Financial Management Information System Transition

The opening balance reported in the Schedule of Receipts and Disbursements as of January 1, 2024, could not be reconciled to the Project's General Ledger or to the prior year's audited balances. A variance was identified between these records, and no reconciliation was performed to verify the opening balance's accuracy and completeness.

This condition was attributed to the lack of formal reconciliation processes and the transition from the previous Financial Management Information System (FundWare) to the current system (FreeBalance). Supporting documentation and reconciliation records needed to verify the balances transferred between systems were unavailable for review.

As a result, the accuracy and completeness of the opening balance could not be determined. Consequently, the effect of this matter on the reported Schedule of Receipts and Disbursements for the year ended December 31, 2024, could not be determined. Accordingly, the opening balance has been presented as provided by management.

(4) Reporting Period and Currency

The accompanying Schedule of Receipts and Disbursements covers the period from January 1 through December 31, 2024.

The Project is a donor-funded activity implemented by DECEM and is accounted for separately from other FSM National Government funds and activities. The financial activities of the FSM National Government are reported in separate financial statements and are subject to an independent audit.

All amounts presented in the Schedule are expressed in United States dollars (USD), the official currency of the Federated States of Micronesia.

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Enhancing the Climate Change Resilience of Vulnerable Islands
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**INDEPENDENT AUDITOR'S 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**

Year Ended December 31, 2024



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Independent Auditor’s Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on An Audit of Financial Statement Performed in Accordance with Government Auditing Standards

Mr. Michael Yarofaitoar
Acting Secretary
Department of Environment, Climate Change and Emergency Management
National Government of the Federated States of Micronesia
Palikir, Pohnpei FM 96941

We have audited, in accordance with the 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 Schedule of Receipts and Disbursements of the Adaptation Fund Project for the year ended December 31, 2024, and have issued our report thereon on April 24, 2026, which contains a qualified opinion.

Report on Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Adaptation Fund Project’s internal control over financial reporting (internal control) to determine the audit procedures appropriate in the circumstances for the purpose of expressing our opinion on the Schedule, but not for the purpose of expressing an opinion on the effectiveness of the project’s internal control. Accordingly, we do not express an opinion on the effectiveness of the 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, 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 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 but important enough to merit the attention of those charged with governance.

Our consideration of internal control was limited to the purpose described in the first paragraph of this section and was not intended to identify all deficiencies in internal control that might constitute material weaknesses or significant deficiencies. Given these limitations, we identified deficiencies in internal control during our audit that we considered to be material weaknesses. We identified deficiencies in internal control, described in the accompanying Schedule of Findings and Responses as items 2024/01 and 2024/02, that we considered to be material weaknesses.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the project's Schedule of Receipts and Disbursements is free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements. Noncompliance with those provisions was not an objective of our audit, and accordingly, we do not express an opinion on that matter. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

The Project's Responses to Findings

The Project's responses to findings identified in our audit are set forth in the accompanying Schedule of Findings and Responses. These responses were not subject to the auditing procedures applied in the audit of the Schedule of Receipts and Disbursements, and accordingly, we express no opinion on them.

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 Project's internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Auditing Standards to consider the Project's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Haser H. Hainrick
National Public Auditor

Palikir, Pohnpei
April 24, 2026



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Report on Compliance with the Financial Covenants and Other Requirements of the Grant Agreement

Mr. Micheal Yarofaitoar

Acting Secretary

Department of Environment, Climate Change and Emergency Management

National Government of the Federated States of Micronesia

Palikir, Pohnpei FM 96941

We have audited the Adaptation Fund Project, Enhancing the Climate Change Resilience of Vulnerable Island Communities in the Federated States of Micronesia (the Project), for compliance with the types of compliance requirements described in the Grant Agreement dated November 4, 2022, with the Secretariat of the Pacific Regional Environment Program (SPREP), that could have a direct and material effect on the Project for the year ended December 31, 2024.

Management's Responsibility

Management is responsible for complying with the financial covenants and other requirements of the Grant Agreement.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance with the financial covenants and other requirements of the Grant Agreement referenced above. We conducted our compliance audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in the Government Auditing Standards, issued by the Comptroller General of the United States; and the audit requirements of the Grant Agreement.

Those standards and the Grant Agreement require that we plan and perform the audit to obtain reasonable assurance that noncompliance with the types of compliance requirements referred to above could have a direct and material effect on the Project. An audit includes, on a test basis, examining evidence of the Project's compliance with those requirements and performing such other procedures as we consider necessary in the circumstances.

Opinion

In our opinion, the Project complied, in all material respects, with the financial covenants and other requirements of the Grant Agreement referred to above that could have a direct and material effect on the Project for the year ended December 31, 2024.

Further, based on the procedures performed, nothing has come to our attention indicating that payments were not used for project purposes or related expenses.

Other Matter

We draw attention to the fact that certain project assets, including water tanks procured under the Project, were delivered to remote outer islands that were not accessible to the audit team during the audit period. As a result, we were unable to physically verify these assets. Our audit procedures in this regard were limited to examining supporting documentation provided by Project Management, including delivery records, invoices, and related documentation. Our opinion is not qualified with respect to this matter.

Report on Internal Control over Compliance

Management of the Project 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 the Project's internal control over compliance with the types of compliance requirements that could have a direct and material effect on the Project to determine the auditing procedures appropriate in the circumstances for the purpose of expressing an opinion on compliance and to test and report on internal control over compliance in accordance with the Grant Agreement, but not for the purpose of expressing an opinion on the effectiveness of the Project'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, detect, and correct noncompliance with the Grant Agreement's compliance requirements in a timely manner.

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 the Grant Agreement will not be prevented, detected, or 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 that is less severe than a material weakness but important enough to merit the attention of those charged with governance.

Our consideration of internal control over compliance was limited to the purpose described in the first paragraph of this section and was not intended to identify all deficiencies in

internal control over compliance that might constitute material weaknesses or significant deficiencies. Accordingly, material weaknesses or significant deficiencies may exist that have not been identified.

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. Accordingly, this communication is not suitable for any other purpose.



Haser H. Hainrick
National Public Auditor

Palikir, Pohnpei
April 24, 2026

**FSM DEPARTMENT OF ENVIRONMENT, CLIMATE CHANGE
AND EMERGENCY MANAGEMENT ADAPTATION FUND
Enhancing the Climate Change Resilience of Vulnerable Islands
Communities in the Federated States of Micronesia**

Schedule of Findings and Responses for the Year Ended December 31, 2024

**2024/01: Unreconciled Opening Balance between the General Ledger (GL) and
Schedule of Receipts and Disbursements.**

Criteria: Sound financial management practices require that opening balances in the General Ledger are reconciled with supporting records, such as the Schedule of Receipts and Disbursements. In addition, regular reconciliations should be performed and documented to ensure the accuracy and completeness of financial information.

Condition: Our review identified a variance of \$313,359.82 between the opening balance per the General Ledger (\$760,040.53) and the corresponding opening balance per the Schedule of Receipts and Disbursements (\$446,680.71), indicating that the two records were not reconciled.
The Schedule of Receipts and Disbursements is based on the project's internally maintained expenditure records. However, this balance could not be reconciled with the General Ledger. No reconciliation documentation was provided for audit verification, indicating that reconciliations were not performed.

Effects: This discrepancy increases the risk that the opening balances used in the preparation of the Schedule of Receipts and Disbursements are incomplete or misstated. The absence of documented reconciliations further increases the likelihood that errors or omissions may not be identified and corrected in a timely manner, thereby reducing the reliability of financial reporting and potentially resulting in a qualified or qualified audit opinion.

Root Causes: The issue is attributed to the lack of effective reconciliation to validate opening balances and to inadequate maintenance of supporting records to substantiate them. In addition, the transition from the old FMIS (FundWare) to the new FMIS (free balance) contributed to the discrepancies, as post-migration reconciliation was required to verify the accuracy and completeness of the opening balances transferred between systems.

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Recommendation:

We recommend that management reconcile opening balances in the General Ledger, prior-year audited balances, and supporting schedules, and investigate and resolve all identified variances to ensure the accuracy and completeness of reported amounts.

Management should establish and implement monthly reconciliation procedures, including timely preparation, independent review, and proper documentation, with sufficient supporting evidence retained. Roles and responsibilities for preparing and reviewing reconciliations should be clearly defined and assigned.

In addition, management should develop and implement standard operating procedures for reconciliation processes and system migrations to ensure the consistency and reliability of financial information.

We further recommend that DOFA, in coordination with project management, conduct a comprehensive post-migration review of the new FMIS (FreeBalance), reconciling all migrated balances and resolving any identified discrepancies in a timely manner.

View of Project Management:

Management recognizes the finding and concurs with the recommendations.

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2024/02: Insufficient supporting documentation for expenditures

Criteria: Sound financial management practices require all expenditures to be supported by adequate and appropriate documentation to ensure completeness, accuracy, and accountability in financial reporting.

Condition: Our review identified several instances in which supporting documentation was incomplete or unavailable for audit verification. For contractual services, supporting documentation for invoices totaling \$7,673 was incomplete or partially unavailable. Similarly, supporting documentation totaling \$9,250 for travel and transportation and \$1,800 for administrative costs was either incomplete or not fully provided for review.

Regarding salaries and wages, the documentation reviewed included timesheets, an unsigned employment contract, and incomplete approved timesheets. The total hours recorded across seven pay periods could not be fully reconciled, with 80 hours recorded compared with 56 hours reflected in the timesheet report. Supporting timesheets for the remaining hours were not provided. In addition, one employment contract had not been signed by the Department of Personnel, and limited documentation was available to verify the employee's employment status.

Effects: The lack of complete supporting documentation increases the risk that expenditures reported in the Schedule of Receipts and Disbursements are misstated or unsupported. It also reduces accountability and limits the ability to verify that transactions occurred, were recorded accurately, and complied with applicable requirements.

Root causes: These issues appear to stem from inadequate recordkeeping practices and a lack of effective controls to ensure that all supporting documentation is properly maintained, reviewed, and retained.

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Recommendation:

To strengthen controls over expenditure documentation and enhance accountability and the reliability of financial reporting, we recommend that management:

- Ensure that all expenditures are supported by complete, accurate, and properly approved documentation prior to payment.

View of Project Management:

Management accepts the root causes of the findings and recommendations