FEDERATED STATES OF MICRONESIA

OFFICE OF THE NATIONAL PUBLIC AUDITOR

FINANCIAL AUDIT

IFAD-SMALL ISLANDS FOOD AND WATER PROJECT GRANT NUMBER 2000004158

Year Ended September 30, 2025

Report No: 2026-10

SMALL ISLANDS FOOD AND WATER PROJECT
FEDERATED STATES OF MICRONESIA
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT

GRANT NUMBER 2000004158

FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT

YEAR ENDED SEPTEMBER 30, 2025

REPORT NO. 2026-10

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FEDERATED STATES OF MICRONESIA
Office of The National Public Auditor
P.O. Box PS-05, Palikir, Pohnpei FSM 96941
Tel: (691) 320-2862/2863 Fax: (691) 320-5482
CID Hotline: (691) 320-6768; Website: www.fsmopa.fm
Facebook: FSM Office of the National Public Auditor; E-mail: info@fsmopa.fm

INDEPENDENT AUDITORS' REPORT

Honorable Elina P. Akinaga
Secretary
Department of Resources and Development
National Government of the Federated States of Micronesia
Palikir, Pohnpei FM 96941

Report on the Audit of the Financial Statements

Qualified Opinion

We have audited the accompanying financial statements of the Small Islands Food and Water Project, Grant number 2000004158, for the year ended September 30, 2025, which comprise the Schedule of Statement of Financial Performance, Statement of Financial Position, Statement of Cash Flow, Fund Balances, and the related notes to the financial statements.

In our opinion, except for the effects of the matter described in the Basis for the Qualified Opinion section of this report, the accompanying financial statements referred to above present fairly, in all material respects, the financial position of the Small Islands Food and Water Project (SIFWaP) Grant 2000004158, as of September 30, 2025, and the results of its operations, changes in fund balances, and cash flows for the year then ended, in accordance with the accrual basis of accounting described in Note 2 of the financial statements.

Basis for Qualified Opinion

Material misstatements totaling approximately $14,087.70 were identified in payroll and related expenditure accounts resulting from unreconciled accounting entries within the FundWare system.

As of September 30, 2025, reconciliations had not been completed as well as the correcting adjustments necessary to support the accuracy of certain payroll and related expenditure balances in the financial statements.

Accordingly, we were unable to determine whether adjustments to payroll and related expenditure accounts were necessary.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits set forth in the 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 Statements 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 financial statements are prepared on an accrual basis in accordance with the Project's financial reporting requirements. As a result, the financial statements may not be suitable for another purpose. 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 these financial statements in accordance with the accrual basis of accounting described in Note 2, and for the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of the financial statements, ensuring they are free from material misstatement, whether due to fraud or error.

Management is also responsible for maintaining adequate accounting records, supporting documentation, and effective internal controls over financial reporting and compliance with the financing agreement requirements and applicable laws and regulations.

Auditor's Responsibility for the Audit of the Financial Statement

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are 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 it 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 statements, 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 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 internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of 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, regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that 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 May 27, 2026, on our consideration of the project's internal control over financial reporting and our tests of 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
May 27, 2026

Federated States of Micronesia
Small Islands Food and Water Project (IFAD GRANT #2000004158)

Statement of Financial Position (Balance Sheet)

As of September 30, 2025

ASSETS	2025	2024
Current Assets		
Cash in Bank (FY2025 funding in Separate Acct) Note 3 & 9	$ 118,795.00	
Cash Balance with Gen Fund (FY2023 unspent cash) Note 4	$ 9,773.73	$ 9,773.73
Total Current Assets	$ 128,568.73	$ 9,773.73
Fixed (Long-Term Assets)		
Property, Plant and Equipment (Note 13 & 14)	$ -	$ -
less: accumulated depreciation	$ -	$ -
Total Fixed Assets	$ -	$ -
TOTAL ASSETS	**$ 128,568.73**	**$ 9,773.73**
LIABILITIES AND FUND BALANCE		
Current Liabilities		
Due to Gen Fund Fund for unreimbursed exp Note 5	$ 87,300.66	$ -
Due to Gen Fund Fund (Reverse Batch) Note 5	$ 14,087.70	
Short-Term Loans	$ -	$ -
Income Taxes Payable	$ -	$ -
Accrued Salaries and Wages	$ -	$ -
Accrued Salaries and Wages	$ -	$ -
Current Portion of Long-Term Debt	$ -	$ -
Total Current Liabilities	$ 101,388.36	$ -
Long-Term Liabilities		
Long-Term debt	$ -	$ -
Deferred Income Tax	$ -	$ -
Other	$ -	$ -
Total Long-Term Liabilities	$ -	$ -
TOTAL LIABILITIES	**$ 101,388.36**	**$ -**
FUND BALANCE	**$ 27,180.37**	**$ 9,773.73**
TOTAL LIABILITIES AND FUND BALANCE	**$ 128,568.73**	**$ 9,773.73**

See notes to the financial statements

Federated States of Micronesia
Small Islands Food and Water Project (IFAD GRANT #2000004158)

Statement of Financial Activity (Income Statement)

For the fiscal year ending September 30, 2025

	2025	2024
REVENUES		
Grant Funds Received	$ 118,795.00	$ -
Others	$ -	$ -
Total Revenues	**$ 118,795.00**	**$ -**
EXPENDITURES		
General Operating and Administration Exp	$ 426.00	$ 4,297.55
Insurance	$ -	$ -
Maintenance and Repairs	$ -	$ -
Equipment and Materials	$ -	$ 6,591.96
Salaries and Wages (Note 5)	$ 80,798.55	$ 49,759.08
Salaries and Wages (System Glitch Reverse Batch) Note 5	$ 14,087.70	
Travel	$ 6,076.11	$ 12,318.12
Other	$ -	$ -
Total Expenditures (Note 5)	**$ 101,388.36**	**$ 72,966.71**
Excess of Revenues Over Expenditures	**$ 17,406.64**	**$(72,966.71)**

Changes in Fund Balance:

	2025	2024
Fund Balance beginning	$ 9,773.73	$ 82,740.44
Add: FY2025 Excess of Revenues Over Expenditures	$ 17,406.64	$ (72,966.71)
FUND BALANCE SEPT. 30, 2025	**$ 27,180.37**	**$ 9,773.73**

See notes to the financial statements

Federated States of Micronesia
Small Islands Food and Water Project (IFAD GRANT #2000004158)
Statement of Cash Flow
For the fiscal year ending September 30, 2025

	2025	2024
Cash Receipts for Grant Operations	**$ 118,795.00**	**$ -**
Cash Paid for Operations (Note 5)		
Gen Operating and Adm Expenses	$ -	$ 16,615.67
Salaries and Wages	$ -	$ 49,759.08
	$ -	$ 66,374.75
Net Cash from Operating activities	**$ 118,795.00**	**$ (66,374.75)**
Investing Activities	$ -	$ -
Cash paid for purchase of property and equipment	**$ -**	**$ (6,591.96)**
Cash from financing activities	$ -	$ -
Net Cash Increase (Decrease)	**$ 118,795.00**	**$ (72,966.71)**
Cash balance beginning	$ 9,773.73	$ 82,740.44
Cash balance ending	**$ 128,568.73**	**$ 9,773.73**

See notes to the financial statements

Federated States of Micronesia
Small Islands Food and Water Project (IFAD GRANT #2000004158)

Statement of Budgeted and Actual Expenditures

For the fiscal year ending September 30, 2025

EXPENDITURE CATEGORY	GAFSP BUDGET	ACTUAL FY25	VARIANCE (GAFSP)	Actual/Budget %
EQUIPMENT & MATERIALS	$ -	$ -	$ -	0%
GRANTS & SUBSIDIES	$ 61,900.00	$ -	$ 61,900.00	0%
CONSULTANTS WORKSHOP	$ 19,000.00	$ -	$ 19,000.00	0%
OPERATING COSTS	$ -	$ (6,502.11)	$ (6,502.11)	0%
SALARIES & ALLOWANCES	$ 70,035.00	$ (80,798.55)	$(10,763.55)	115%
TOTALS	**$ 150,935.00**	**$ (87,300.66)**	**$ 63,634.34**	**58%**

Federated States of Micronesia
Small Islands Food and Water Project (IFAD Grant # 2000004158)
Notes to the financial statements
For the Year Ended September 30, 2025

(1) Organization and Project Description

The Small Islands Food and Water Project (SIFWAP) is a multi-country project implemented in four countries: Federated States of Micronesia (FSM); Kiribati; Republic of the Marshall Islands (RMI); and Tuvalu. The four countries have adopted a multi-country approach because they are the smallest of the small island developing states (SIDS) and to benefit from economies of scale in the design, implementation, and supervision of the project. The project includes a common implementation framework, while activities and decision-making are decentralized, with flexibility for countries and communities to determine their own priorities.

The Lead Project Agency for SIFWAP in FSM is the Department of Resources & Development. Lead Agencies are responsible for overall project management and implementation, including preparing AWPBs and half-yearly and annual progress reports, and hosting the National Delivery Unit (NDU) at their headquarters.

The goal of SIFWaP is to ensure that people living in the beneficiary communities in FSM, Kiribati, RMI, and Tuvalu have access to sustainable, healthy diets. SIFWaP's development objective is to improve food, nutrition, and water security and livelihood opportunities in the small island communities of these countries.

(2) Summary of Significant Accounting Policies

1. Basis of Preparation

The accompanying financial statements and related notes have been prepared in accordance with Generally Accepted Accounting Principles (GAAP) and the FSM Financial Management Regulations 2021, as applicable to national government-administered projects.

2. Basis of Accounting

The Project's financial statements are prepared on an accrual basis, consistent with FSM Government financial management practices. Under this basis, revenues are recognized when earned and expenses when incurred, regardless of the timing of related cash flows.

Grant revenue is recognized when all conditions and eligibility requirements specified in the funding agreement are met.

3. Cash and Cash Equivalents

Cash and cash equivalents represent funds received in advance from IFAD and are recognized when the project receives funds into the Government General Account. Cash equivalents are not subject to significant risk of changes in value. The Project maintains its accounting records in United States Dollars (USD), which is the same as the denomination currency of the Designated Account (Government General Account) and the IFAD Grants (GAFSP & NZ Grant). Cash represents grant advance funds for the Small Islands Food and Water Project (SIFWaP), recognized as revenue and held in the Project's designated account.

The FSM National Government's Cash and cash equivalents general fund account consists of cash held in demand accounts and short-term investments with original maturities of three (3) months or less from the date of acquisition. Time deposits and other investments with original maturities exceeding ninety (90) days are excluded from cash equivalents and are reported separately, in accordance with FSM Treasury classifications.

4. Cash In Bank

Cash In Bank (FY25 grant funds in a separate account) - Funds of $118,795 (net of a $10 wire transfer charge) received for fiscal year 2025 were deposited and maintained in a separate bank account opened on August 15, 2024, for the grant.

Cash In Bank (FY24 grant cash balance in FSM General Fund account) - Funds of 82,740.44 for the fiscal year 2023 were deposited in the FSM National Government general funds bank account. It has a balance of $9,773.73 as of September 30, 2024, and is carried forward to September, 30, 2025.

5. Due to General Fund (Payables)

During Fiscal Year 2025, the Project incurred total expenditures of $101,388.36, which were paid through the FSM General Fund account and are due for reimbursement from the Grant Account, subject to the grantor's review and approval of the related supporting documentation. However, the FundWare system reflects only $87,300.66 as recorded expenditures payable to the General Fund. The remaining $14,087.70 pertains to salary-related expenditures that were affected by a reverse batch transaction in the FundWare system during FY2025, resulting in a reporting discrepancy. Consequently, while both amounts represent valid FY2025 project expenditures and amounts due to the General Fund, the full balance of $101,388.36 is not currently reflected in the FundWare expenditure reports. This matter is further explained in the memorandum attached to the Q1 to Q3 Interim Financial Report (IFR) submitted to IFAD, which serves as supporting documentation for the noted variance.

6. Expenditures

Project expenditures represent the cost of goods and services acquired to implement approved project activities. In accordance with the accrual basis of accounting and FSM financial regulations, expenditures are recorded when incurred and properly authorized, regardless of when payment is made.

7. Reporting Period

The financial statements cover the fiscal year from October 1, 2024, to September 30, 2025. Comparative figures, where presented, relate to the period from October 1, 2023, to September 30, 2024.

8. Statement of Cash Flows

The statement of cash flows is prepared in accordance with GAAP and FSM reporting practices. Cash flows are classified as follows:

a. Operating Activities: Cash flows related to the normal project operations;
b. Investing Activities: Cash flows from buying/selling assets like property or investments.
c. Financing Activities: Cash flows from borrowing or repaying debt, issuing or repurchasing stock.

9. Designated Account and Bank Reconciliation

During the fiscal year 2025 reporting period, a separate bank account was opened for the grant, and the advance of $118,795 (net of a $10 wire transfer charge) was deposited and maintained in that account. The initial funding of $82,740.44 received during FY2023 was deposited in the FSM General Funds account and has a remaining unspent/undisbursed balance of $9,773.73 carried forward from FY2024 to FY ending September 30, 2025. Funds deposited in both accounts had no recorded earned interest income or foreign exchange gains or losses.

The Project's designated account, specifically established to receive advance funds from IFAD, is maintained by the FSM National Government. Project expenses are processed through the FSM National Government's General Fund account and reimbursed by funds transfer from the project's specific account. The FY2025 total expenses of $87,300.66 were reimbursed through transfer of funds to the General Fund after the fiscal year ended September 30, 2026.

10. Sources and Uses of Funds

Project funding comes from grant advances provided by project donors and is used solely for eligible project expenditures in accordance with approved budgets, financing agreements, and FSM financial regulations.

11. Government Cash and In-Kind Contributions

The FSM National Government shall provide counterpart financing of $42,800 for the Small Islands Food and Water Project. Beneficiaries also contribute in-kind resources to support income-generating and public investment activities under Project Component 2.

12. Taxes and In-Kind Contributions

No taxes were paid or recognized as in-kind contributions during the reporting period.

13. Property, Plant and Equipment

PPE consists of fixed assets purchased during the current period. These assets increased the fixed asset balance on the balance sheet but do not generate income. If funded by a grant, the grant remains a funding source and does not turn into revenue. The purchase of PPE is recorded as an increase in assets, but it does not directly affect income.

14. Capitalization Threshold

The capitalization threshold is the dollar amount that determines whether an asset is properly accounted for. Asset acquisition costs below the threshold will be expensed as incurred. The capitalization threshold is currently set at $3,000.

15. Revolving Funds and General Revenue Funds

Funds received are fixed amounts authorized for specific operational purposes and are managed in accordance with FSM Financial Management Regulations. These funds do not fluctuate with income and are replenished or adjusted only through approved government financial processes.

Federated States of Micronesia
Small Islands Food and Water Project (IFAD Grant # 2000004158)
Supplementary Statements

Designated account statement			
For the Year Ended September 30, 2025	**US$** (or as otherwise denominated)	**Local currency equivalent** (optional)	
Opening balance Notes	$128,568.73	A	
Add:			
1 IFAD replenishments:			
WA No. Date XXX	0		
WA No. Date XXX	0		
Total	0	B	
2 Bank interest	0	C	
Deduct:			
Payments from Gov't Account			
Date Oct 1, 2024- September 30, 2025	$87,300.66		
Date XXX	0		
Total	87,300.66	E	
2 Bank charges	0	F	
3 Exchange rate differences		G	
Closing balance	$41,268.07	A+B+C-E-F-G	

Federated States of Micronesia
Small Islands Food and Water Project (IFAD Grant # 2000004158)
Supplementary Statements

Sources and Uses of Funds Statement for the year ended September 30, 2025

	IFAD Instrument n.2000004158 (in USD)		
Sources of Funds	**Previous period (FY2024)**	**Current period (FY2025)**	**Cumulative (Since Inception)**
IFAD: Grant No. 200004158, advance	0.00	118,795.00	208,795.00
Government of FSM, in cash	0.00	0.00	0.00
Government of FSM, in kind	0.00	0.00	0.00
Beneficiaries, in kind	0.00	0.00	0.00
Total Funds Received	**0.00**	**118,795.00**	**208,795.00**
Uses of Funds by Category: **(Grant no. 200004158)**	**Actual expenditures Previous period (USD)**	**Actual expenditures Current period (USD)**	**Cumulative (USD)**
Equipment and Materials	6,627.97	0.00	8,925.94
Grants and Subsidies		0.00	0.00
Consultancies		0.00	0.00
Workshops	6,667.94	0.00	6,667.94
Operating Costs	9,911.72	0.00	9,911.72
Salaries and Allowances	49,759.08	4,961.56	54,720.64
Total Funds Used	**72,966.71**	**7,259.56**	**80,226.27**
Uses of Funds by Component: **(Grant no. 200004158)**	**Actual expenditures Previous period (USD)**	**Actual expenditures Current period (USD)**	**Cumulative (USD)**

Component 1 CEE	0.00	0.00	0.00
Component 2 IE	0.00	0.00	0.00
Component 3 Policy FE	0.00	0.00	0.00
Component 4 PC&M	72,966.71	0.00	$80,226.27
Total Funds Used	**72,966.71**	**7,259.56**	**$80,226.27**

Counterpart contributions for the year ended September 30, 2025

1. **Contribution in-kind from GOV FSM (Note 12)**

Category	**For the year ended**	**For the year ended**	**Grand Total (USD)**
	30-09-24 (USD)	**30-09-25 (USD)**	
Equipment and Materials	-	-	-
Grants and Subsidies	-	-	-
Consultancies	-	-	-
Workshops	-	-	-
Operating Costs	-	-	-
Salaries and Allowances	-	-	-
Total	0.00	0.00	0.00

2. **Contribution in cash from Gov FSM (Note 12 & 13)**

Category	**For the year ended**	**For the year ended**	**Grand Total (USD)**
	30-09-24 (USD)	**30-09-25 (USD)**	
Equipment and Materials	0.00	0.00	0.00
Grants and Subsidies	0.00	0.00	0.00
Consultancies	0.00	0.00	0.00
Workshops	0.00	0.00	0.00
Operating Costs	0.00	0.00	0.00
Salaries and Allowances	0.00	0.00	0.00

Total	0.00	0.00	0.00

3. **Contribution in-kind from Beneficiaries (Note 12)**

Category	For the year ended 30-09-24 (USD)	For the year ended 30-09-25 (USD)	Grand Total (USD)
Equipment and Materials	0.00	0.00	0.00
Grants and Subsidies	0.00	0.00	0.00
Consultancies	0.00	0.00	0.00
Workshops	0.00	0.00	0.00
Operating Costs	0.00	0.00	0.00
Salaries and Allowances	0.00	0.00	0.00
Total	0.00	0.00	0.00

4. **Contribution in-kind from the Private Sector**

Category	For the year ended 30-09-24 (USD)	For the year ended 30-09-25 (USD)	Grand Total (USD)
Equipment and Materials	0.00	0.00	0.00
Grants and Subsidies	0.00	0.00	0.00
Consultancies	0.00	0.00	0.00
Workshops	0.00	0.00	0.00
Operating Costs	0.00	0.00	0.00
Salaries and Allowances	0.00	0.00	0.00
Total	0.00	0.00	0.00

Fixed Assets Schedule

Fixed Assets Schedule						
For the year ended September 30, 2025						
Description	**Ref No.**	**Location**	**Quantity**	**Total Cost (USD)**	**Source of financing (GAFSP, NZ, Gov-Ink, Gov-Cash**	**Date of purchase**

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 SEPTEMBER 30, 2025

FEDERATED STATES OF MICRONESIA
Office of The National Public Auditor
P.O. Box PS-05, Palikir, Pohnpei FSM 96941
Tel: (691) 320-2862/2863 Fax: (691) 320-5482
CID Hotline: (691) 320-6768; Website: www.fsmopa.fm
Facebook: FSM Office of the National Public Auditor; E-mail: info@fsmopa.fm

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

Honorable Elina P. Akinaga
Secretary
Department of Resources and Development
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 financial statements of the Small Islands Food and Water Project (SIFWAP), Grant Number 2000004158 for the year ended September 30, 2025, and have issued our report thereon dated May 27, 2026, which contains a qualified opinion.

Report on Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Small Islands Food and Water Project'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 opinion on the financial statement, 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 enable management or employees, in the normal course of performing their assigned functions, to prevent, detect, and correct misstatements in a timely manner. 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, 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. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider material weaknesses. However, we identified certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses as items 2025/01 and 2025/02, which we consider significant deficiencies.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the project's financial statement 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 Response to Findings

The Project's responses to findings identified in our audit are described in the accompanying Schedule of Findings and Responses. The Project's responses were not subject to the auditing procedures applied in the audit of the financial statements, 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* in considering 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
May 27, 2026

FEDERATED STATES OF MICRONESIA
Office of The National Public Auditor
P.O. Box PS-05, Palikir, Pohnpei FSM 96941
Tel: (691) 320-2862/2863 Fax: (691) 320-5482
CID Hotline: (691) 320-6768; Website: www.fsmopa.fm
Facebook: FSM Office of the National Public Auditor; E-mail: info@fsmopa.fm

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

Honorable Elina P. Akinaga
Secretary
Department of Resources and Development
National Government of the Federated States of Micronesia
Palikir, Pohnpei FM 96941

We have audited the Small Islands Food and Water Project (Grant 2000004158) 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 International Fund for Agriculture Development (IFAD), which could have a direct and material effect on the Project for the year ended September 30, 2025.

Management's Responsibility
Management is responsible for compliance with financial covenants and other requirements of the Financing Agreement.

Auditor's Responsibility
Our responsibility is to express an opinion on the Project's compliance with the financial covenants and other requirements of the Financing Agreement referred to 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 Financing Agreement. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether noncompliance with the 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.

As part of our audit procedures, we examined and verified supporting documentation for selected expenditures to determine whether expenditures were incurred for project purposes and in accordance with the Financing Agreement.

Payments were made for project purposes or project-related expenses, as evidenced by supporting documentation, including invoices, payment vouchers, and receipts.
We believe that our audit provides a reasonable basis for our audit opinion.

Opinion
In our opinion, the Project complied, in all material respects, with the financial covenants and other requirements of the Financing Agreement referred to above that could have a direct and material effect on the Project for the year ended September 30, 2025.

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

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 requirements that could have a direct and material effect on the Project to determine the auditing procedures appropriate in the circumstances for expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of the Project's internal control over compliance. Accordingly, we do not express 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 enable management or employees, in the normal course of performing their assigned functions, to prevent, detect, and correct noncompliance with the requirements of the Financing Agreement 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 the requirements 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, 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 preceding 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. 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 based on the requirements of the Financing Agreement. Accordingly, this communication is not suitable for any other purpose.

Haser H. Hainrick
National Public Auditor

Palikir, Pohnpei
May 27, 2026

Federated States of Micronesia
Small Islands Food and Water Project (IFAD Grant # 2000004158)
Schedule of Findings and Responses for the Year Ended September 30, 2025

2025/01: Misstatement in Payroll and Related Expenditure Accounts

The Project's payroll and related expenditure accounts were misstated and do not accurately reflect the supporting payroll and accounting records maintained in the FundWare system.

Criteria: The International Fund for Agricultural Development (IFAD) Financial Management Guidelines require that project financial statements present fairly, in all material respects, the project's financial position and expenditures and be supported by accurate accounting records and reconciliations.

The Government Accountability Office Standards for Internal Control in the Federal Government (Green Book) require that transactions and other significant events be accurately recorded and classified in a timely manner to maintain reliable financial reporting and accountability.

Condition: During audit testing of salaries and wages expenditure for FY2025, auditors initially identified a variance of $2,123.08 between payroll expenses reported in the financial statements and supporting payroll records.

This variance was initially assessed as an isolated payroll discrepancy potentially caused by system-generated reversal entries within the FundWare accounting system.

However, further audit procedures performed to investigate the matter revealed that the issue was not limited to payroll only. Expanded testing identified additional misstatements across payroll-related and expenditure accounts, resulting in cumulative discrepancies totaling **$14,087.70.**

The breakdown of the affected amounts is as follows:
Salaries:$3,846.16
Contractual Services: $9,230.78
Health Contributions: $47.28
Social Security Contributions: $963.48

The misstatements were associated with system-generated reversal entries and related posting issues in the FundWare system following interruptions in payroll batch processing.

According to correspondence from the Department of Finance and Administration (DOFA) dated March 30, 2026, addressed to IFAD, the discrepancies resulted from automated reversal entries triggered when payroll batch processing terminated prematurely.
DOFA explained that both the original and reversal entries remained in the system to preserve the integrity of the audit trail.

DOFA further advised that, because the affected transactions relate to a closed accounting period, adjustments cannot be made directly within the system and will instead be corrected through journal entries in the current open accounting period following reconciliation.

At the time of audit fieldwork, management had not provided a fully reconciled audit trail linking original entries, reversal entries, and any subsequent reposting to explain the cumulative differences identified.

Root Causes: The misstatement resulted from:

- System-generated reversal entries caused by interruptions in payroll batch processing within the FundWare system;
- Lack of formal control procedures over system-generated reversal entries;
- Inadequate reconciliations among payroll records, general ledger balances, and project financial statements before the financial statements were finalized; and
- Insufficient review and monitoring of payroll-related journal entries and adjustments.

Effects: The identified weaknesses:

- Reduced the reliability of accounting records generated by FundWare;
- Increased the risk that material misstatements in payroll and related expenditure accounts would not be detected on a timely basis;
- Contributed directly to cumulative misstatements totaling $14,087.70 in the financial statements; and
- Resulted in the financial statements being materially inaccurate at the time of audit fieldwork.

Although DOFA subsequently confirmed that the discrepancies were system-generated and did not represent unauthorized expenditures, corrective adjustments had not been fully processed and verified during the audit.

Recommendations:

We recommend that Project Management and DOFA work together to:

1. Reconstruct a complete audit trail for all affected payroll and expenditure entries, including original postings, reversal entries, and any subsequent reposting;
2. Perform comprehensive reconciliations among payroll records, the general ledger, and financial statements prior to finalization;
3. Process all necessary correcting journal entries in a timely manner and retain adequate supporting documentation;
4. Establish formal procedures for the review and approval of system-generated reversal entries within FundWare; and
5. Strengthen supervisory review controls over payroll processing and related financial reporting.

Management Comments:

Management generally agreed to the finding and concurs with the recommendations.

2025/02: Delays in Providing Audit Documentation

There were significant delays in obtaining supporting documentation from the Department of Finance and Administration (DOFA), which affected the timely completion of audit procedures.

Criteria: In accordance with Section 3 (Responsibilities of the Borrower/Recipient) and Section 4 (Audit Requirements) of the IFAD Handbook for Financial Reporting and Auditing of IFAD-Financed Projects, the Project is required to maintain complete and reliable accounting records and supporting documentation and to provide auditors with timely access to all information necessary to support audit procedures.

Further, under the Financing Agreement between the Government of the Federated States of Micronesia and IFAD, the Borrower/Recipient is required to maintain proper books and records and to ensure that such records are made available to auditors in a timely manner for audit and verification.

Condition: During the audit, significant delays were experienced in obtaining requested supporting documentation from DOFA.

The delays resulted in extensions to the audit timeline and prevented completion of certain audit procedures within the originally planned schedule.

In addition, the Project relied primarily on DOFA to maintain supporting financial documentation and did not maintain complete duplicate project records.

Root causes: The delays resulted primarily from:

- Insufficient coordination and delayed responses from DOFA in providing the requested audit documentation; and
- Weak document retention and filing practices at the project level.

Effects*:* The delays:

- Reduced audit efficiency and prolonged completion of audit procedures;
- Increased the risk that records may not be readily available for verification and oversight purposes;
- Increased the risk of incomplete audit evidence; and
- May affect the timely issuance of audited financial statements required under the financing agreement.

Recommendations:

We recommend that DOFA improve responsiveness and coordination with Project management and auditors to ensure that requested documentation is provided within agreed-upon timelines.

We further recommend that Project management strengthen document retention and coordination procedures by maintaining complete, organized project files, including approved payment vouchers, invoices, payroll records, contracts, travel authorizations, and other supporting documentation, in accordance with IFAD requirements and the Project Implementation Manual.

Management Comments:

Management generally agreed to the finding and concurs with the recommendations.

Federated States of Micronesia
Small Islands Food and Water Project (IFAD Grant # 2000004158)
Summary Schedule of Prior Year Audit Findings
Year ended September 30, 2025

Finding No	Audit finding	Status
2024/01	Non-Compliance with Records Management requirement under section 9 of the Project Implementation Manual	Implemented
2024/02	Non -Compliance with the Procurement requirement of the FMR Implemented	Implemented
2024/03	Variance between the Trial balance and the general Ledger	In Progress