

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

**REPORT ON THE AUDIT OF
FINANCIAL STATEMENTS IN ACCORDANCE
WITH OMB CIRCULAR A-133**

YEAR ENDED SEPTEMBER 30, 2011

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2011

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**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

**FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2011**

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**FINANCIAL STATEMENTS
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**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2011

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Chuuk (the State) as of and for the year ended September 30, 2011, which collectively comprise the State's basic financial statements as set forth in Section II of the foregoing table of contents. These financial statements are the responsibility of the management of the State. Our responsibility is to express opinions on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 10 to the financial statements, the State has not recorded a liability for land leases and related claims payable in the governmental activities and the General Fund and, accordingly, has not recorded an expenditure/expense for the current period change in that liability. Accounting principles generally accepted in the United States of America require that liabilities incurred attributable to services already rendered and that are not contingent upon a specific event that is outside of the control of the State be accrued as liabilities and expenditures/expenses, which would increase the liabilities, decrease net assets, and change the expenses of the governmental activities and increase the liabilities, increase fund deficit, and change the expenditures of the General Fund. The amount by which this departure would affect the liabilities, net assets and expenses of the governmental activities and the liabilities, fund deficit, and expenditures of the General Fund is not reasonably determinable.

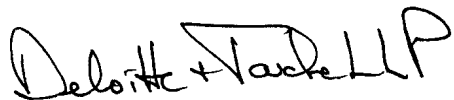
In our opinion, except for the effects of not recording a liability for land leases and related claims payable in the governmental activities and the General Fund, as discussed in the preceding paragraph, such financial statements, as set forth in Section II of the foregoing table of contents, present fairly, in all material respects, the respective financial position of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Chuuk as of September 30, 2011, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, during the year ended September 30, 2011, the State adopted Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 25, 2012, on our consideration of the State's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis, on pages 3 through 9, as well as the Schedule of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund and notes thereto, as set forth in Section III of the foregoing table of contents, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the management of the State. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the State's respective financial statements that collectively comprise the State's basic financial statements. The combining and individual fund financial statements, as set forth in Section IV of the foregoing table of contents, which are also the responsibility of the management of the State, are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such additional information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

June 25, 2012

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2011

This analysis, prepared by the Department of Administrative Services, Division of Treasury, offers readers of the Chuuk State Government's (Chuuk State) financial statements a narrative overview of the activities of the government for the fiscal year ended September 30, 2011. We encourage readers to consider this information in conjunction with Chuuk State's financial statements, which follow. Fiscal year 2010 comparative information has been included, where appropriate. This analysis is required by the Governmental Accounting Standards Board, (GASB) which provides guidelines on what must be included and excluded from this analysis.

FINANCIAL HIGHLIGHTS

- For the fiscal year ended September 30, 2011, Chuuk State's total net assets decreased by \$2.0 million (or 5.0 %) from \$40.3 million in the prior year to \$38.3 million. This decrease was primarily the result of Chuuk State paying Chuuk State municipal governments their portion of previously invested old Compact CIP funds and larger debt service payments on its ADB loans.
- During fiscal year 2011, Chuuk State's revenues of \$36.94 million increased from \$34.02 million (up 8.6%) in fiscal year 2010. The increase was attributable to increased revenue sharing proceeds, sales taxes and operating grants. Expenditures in fiscal year 2011 of \$36.26 million increased \$1.79 million (or 5.2%) from \$34.47 million in fiscal year 2010. The increase reflects an increase in expenditures to municipal governments.
- The General Fund deficit increased \$0.72 million in fiscal year 2011, increasing from \$7.55 million in the prior year to \$8.27 million. The State's extraordinary disbursement of municipal investments and larger debt service on its long-term debt contributed to this deficit increase.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

Government-Wide Financial Statements

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

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

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

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis, Continued
September 30, 2011

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

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

Fund Financial Statements

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

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

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

FINANCIAL ANALYSIS OF CHUUK STATE AS A WHOLE

Net assets may serve over time as a useful indicator of a government's financial position. At the end of fiscal year 2011, Chuuk State's assets exceeded liabilities by \$38.3 million. However, all these net assets are restricted as to the purposes they can be used for or are invested in capital assets. Chuuk State uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although Chuuk State's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. The following summary of Chuuk State's net assets as of September 30, 2011, with comparable balances for fiscal year 2010, discloses this relationship.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis, Continued
September 30, 2011

	<u>2011</u>	<u>2010</u>
Current and other non-capital assets	\$ 19,991,487	\$ 21,080,028
Capital assets	<u>45,544,752</u>	<u>48,427,808</u>
Total Assets	<u>65,536,239</u>	<u>69,507,836</u>
Long-term liabilities	13,992,943	14,193,647
Other liabilities	<u>13,235,778</u>	<u>15,004,799</u>
Total Liabilities	<u>27,228,721</u>	<u>29,198,446</u>
Net Assets		
Invested in capital assets	45,544,752	48,427,808
Restricted	20,367,882	19,598,963
Unrestricted	<u>(27,605,116)</u>	<u>(27,717,381)</u>
Total Net Assets	\$ <u>38,307,518</u>	\$ <u>40,309,390</u>

At the end of fiscal year 2011, Chuuk State's unrestricted assets showed a deficit of \$27.6 million, virtually unchanged from the prior year. This deficit is the result of having current and long-term commitments that are greater than currently available resources. Specifically, Chuuk State did not include in past annual budgets the full amounts needed to finance its current liabilities to municipalities, and others or its long-term liabilities arising from Asian Development Bank (ADB) loans and unused employee leave balances. Chuuk State will include these amounts in future years' budgets as funding permits.

Net assets decreased \$2.0 million (or 5%) from the prior year. Key elements of the decrease and the differences from the prior year are shown in the following schedule:

	<u>2011</u>	<u>2010</u>
Revenues:		
Program Revenues:		
Charges for services	\$ 1,547,731	\$ 1,322,279
Operating grants and contributions	28,506,354	26,263,981
Capital grants and contributions	-	275,097
General Revenues:		
Taxes	5,809,622	5,582,302
Unrestricted investment earnings (losses)	(7,948)	239,016
Other	<u>1,088,183</u>	<u>338,794</u>
Total revenues	<u>36,943,942</u>	<u>34,021,469</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis, Continued
September 30, 2011

Expenses:		
General government	6,096,882	3,476,244
Health services	10,090,269	9,600,404
Education	14,324,701	14,103,683
Economic development	1,527,920	855,231
Public safety	849,268	1,016,070
Public works and transportation	2,360,942	2,289,596
Community affairs	33,430	13,168
Boards and commissions	538,849	1,710,722
Judiciary	402,335	376,633
Payments to component units	40,775	259,454
Municipal affairs	1,943,829	914,648
Other	507,936	1,366,208
Unallocated Interest	<u>228,678</u>	<u>80,013</u>
Total expenses	<u>38,945,814</u>	<u>36,062,074</u>
Special Items:		
Forgiveness of Component Unit Debt	<u>-</u>	<u>3,554,435</u>
Total special items	<u>-</u>	<u>3,554,435</u>
Change in net assets	(2,001,872)	(5,595,040)
Net assets at the beginning of the year	<u>40,309,390</u>	<u>45,904,430</u>
Net assets at the end of the year	\$ <u>38,307,518</u>	\$ <u>40,309,390</u>

The detail indicates increases in both revenue and expenses in fiscal year 2011, and the reduction of net assets resulting in expenses exceeding revenues.

Revenues of \$36.94 million increased \$2.92 million (or 8.5%) from the prior year's \$34.02 million. Increases in local tax collections and in user charges offset declines in revenue sharing and investment losses. Compact revenues of \$28.5 million increased \$3.4 million (or 13.4%) from \$25.1 million in fiscal year 2010, reflecting the increased usage of sector grants. Revenue sharing proceeds of \$3.10 million in fiscal year 2011 were down \$0.34 million (or 9.9%) from fiscal year 2010's total of \$3.44 million. This decline is attributed to small declines in local construction activity and increased garnishments by the FSM national government of Chuuk's State's revenue shares. Combined local tax collections, department charges and user fees of \$4.25 million in fiscal 2011 increased \$0.79 million (or 23%) from fiscal 2010's total of \$3.46 million. The full increase in the local sales tax rate from 5% to 6% in July 2010 as well as adjustments to luxury tax rates were the primary cause of this increase in fiscal year 2011.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis, Continued
September 30, 2011

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

SOURCE OF REVENUE	<u>2011</u>	<u>2010</u>
Compact funding	77.2%	73.9%
Investments	(NM)	4.0%
Revenue sharing	8.4%	10.1%
Federal and other grants	0%	0.8%
Taxes and fees	11.5%	10.2%
Other	<u>2.9%</u>	<u>1.0%</u>
TOTAL	<u>100.0%</u>	<u>100.0%</u>

The predominance of sector funding as 77% of total revenue highlights the importance of optimizing sector grant utilization.

Expenses increased \$2.88 million (up 8%), from \$36.06 million in the prior fiscal year to \$38.94 million in fiscal year 2011.

The following table highlights major programs that increased in fiscal 2011 compared to fiscal 2010:

<u>2011 Expenditure Category</u>	<u>Total Increase FY2011 over 2010 ('000's)</u>
Payments and municipalities	\$ 1,029
Infrastructure Maintenance expenditures	673
Health services	490
ADB Debt service payments	275
Election Commission	258
Education	<u>221</u>
Total increases from prior year	\$ <u>2,946</u>

FINANCIAL ANALYSIS OF CHUUK STATE'S FUNDS

As noted earlier, Chuuk State uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. During fiscal year 2011, Chuuk State implemented GASB 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which reclassified components of fund balance. For Chuuk State, this resulted in a reclassification in beginning fund balance whereby the General Fund fund balance increased by \$1.13 million with the Other Governmental Funds decreasing by the same amount. This amount pertains to the fund balance of the former airport revolving fund which no longer is used as a special revenue fund. As of the end of fiscal year 2011, Chuuk State's governmental funds reported a combined fund balance of \$7.57 million, net of this reclassification, which represents a \$0.68 million increase (or 9.9%) from the \$6.89 million fund balance recorded at the end of fiscal 2010. Of this total combined fund balance, \$10.6 million is nonspendable because it is legally restricted to other purposes and \$10.3 million is restricted or committed to fund specific fund-related activities. These non-spendable and restricted fund balances are off-set by a combined unassigned fund deficit of \$13.3 million.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis, Continued
September 30, 2011

Footnote 9 of the financial statements gives further details of the fund balance components of Chuuk State's balance sheet.

GENERAL FUND BUDGETARY HIGHLIGHTS

In fiscal year 2011, actual revenues of \$8.36 million exceeded budgeted revenues of \$6.86 million by \$1.5 million. Actual expenditures of \$9.26 million were greater than budgetary appropriations of \$7.01 by \$2.25 million, resulting in an overall deficiency of revenues under expenditures of \$0.9 million. When combined with the transfer out to the infrastructure maintenance fund (\$0.39 million), the effects of GASB 54 implementation in which the airport revolving fund was consolidated into the general fund (\$1.08 million), and encumbrances for which goods or services had not been received (\$0.63 million), the net change in unreserved fund deficit on a budgetary basis was a positive \$0.42 million.

Chuuk State retains a balanced operating budget but two expenditure categories in fiscal year 2011 contributed to the deficiency of general fund revenues under expenditures. Firstly, debt financing activities of the State that are not budgeted have negative impacts on overall State operations. In fiscal year 2011, principal and debt service charges on ADB loans of \$0.64 million contributed to the deficiency. This represents a 73% increase from the \$0.365 million debt service charges paid in fiscal year 2010. Secondly, per the Presidential Order dated January 14, 2010, Chuuk State paid out \$1.52 million to its Municipalities of formerly invested Compact CIP funds.

CAPITAL ASSET AND DEBT ADMINISTRATION

Chuuk State's investment in capital assets for the primary government as of September 30, 2011, amounted to \$116.1 million, net of accumulated depreciation of \$70.56 million, leaving a net book value of \$45.54 million. This represents a net decrease of \$2.88 million (or 6%) from fiscal year 2010. Chuuk State recorded nominal additions of \$0.32 million in 2011 related to vehicles and other equipment, but current year depreciation charges of \$3.2 million resulted in the net decrease. The table below summarizes Chuuk State's net capital assets:

	<u>2011</u>	<u>2010</u>
Land	\$ 17,721,622	\$ 17,721,622
Airport Facilities	11,627,263	12,579,949
Buildings	4,140,384	4,362,601
Seaport Facilities	7,292,233	7,955,163
Vehicles/ Equipment	2,785,208	2,841,410
Infrastructure	<u>1,978,042</u>	<u>2,967,063</u>
	\$ <u>45,544,752</u>	\$ <u>48,427,808</u>

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

Long-Term Debt

The following schedule shows Chuuk State's summarized long-term debt for fiscal year 2011 and comparable amounts for fiscal year 2010.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis, Continued
September 30, 2011

	<u>2011</u>	<u>2010</u>
ADB Water Supply Loan (1459)	\$ 4,144,208	\$ 4,015,325
ADB Early Retirement Loan (1520)	5,624,605	5,735,235
ADB Private Sector Reform Program Loan (1873)	673,091	717,591
ADB Private Sector Reform Program Loan (1874)	1,249,258	1,307,601
ADB Basic Social Services Program Loan (1816)	<u>1,033,366</u>	<u>1,146,436</u>
	\$ <u>12,724,528</u>	\$ <u>12,922,188</u>

Long-term debt decreased by \$0.198 million (or 1.5%) in fiscal year 2011 as the net result of (i) foreign exchange adjustments on the ADB Early Retirement Loan that increased the liability by \$0.21 million, and (ii) principal payments totaling \$0.40 million.

Additional information on Chuuk State's long-term debt obligations can be found in Notes 7 and 8 to the accompanying financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Chuuk economy in fiscal year 2012 continues to perform at levels seen in fiscal 2011, with revenue collections trending only marginally higher than the prior year. As a result, State policymakers have cautiously kept general fund budgets capped within actual revenue collections, both in fiscal years 2012 and for the 2013 annual appropriation act. Revenue collections in excess of these fiscal ceilings will be used for debt relief payments of Chuuk's old liabilities.

CONTACTING CHUUK STATE'S FINANCIAL MANAGEMENT

The financial report is designed to provide our citizens, taxpayers, customers, and investments and creditors, a general overview of Chuuk State's finances to demonstrate its accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Director, Office of Administrative Services, P.O. Box 849, Weno, Chuuk FM 96942.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Statement of Net Assets
September 30, 2011

	Primary Government	Component Units
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 2,527,269	\$ 699,143
Time certificates of deposit	-	300,000
Equity interest in internal investment pool	321,799	48,011
Receivables, net of allowance for uncollectibles	2,987,238	1,021,788
Inventories	-	328,242
Prepayments	526,302	346,262
Total current assets	6,362,608	2,743,446
Noncurrent assets:		
Restricted assets:		
Investments	11,578,879	-
Investments	2,050,000	-
Capital assets, net of accumulated depreciation	45,544,752	2,208,545
Total noncurrent assets	59,173,631	2,208,545
Total assets	\$ 65,536,239	\$ 4,951,991
<u>LIABILITIES</u>		
Current liabilities:		
Current portion of long-term debt	\$ 365,445	\$ 6,188
Note payable	561,987	778,805
Accrued interest payable	175,576	-
Accounts payable	3,037,618	501,254
Land acquisition payable	8,628,545	-
Compensated absences payable	450,000	-
Other liabilities and accruals	16,471	2,243,280
Due to component units	136	-
Deferred revenues	-	17,693
Total current liabilities	13,235,778	3,547,220
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	12,359,083	452,689
Compensated absences payable, net of current portion	1,633,860	-
Total noncurrent liabilities	13,992,943	452,689
Total liabilities	27,228,721	3,999,909
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	45,544,752	970,863
Restricted for:		
Nonexpendable:		
Future operations	8,088,435	-
Expendable:		
Compact related	7,668,004	-
Debt service	3,490,444	-
Other purposes	1,120,999	1,251,671
Unrestricted	(27,605,116)	(1,270,452)
Total net assets	38,307,518	952,082
Total liabilities and net assets	\$ 65,536,239	\$ 4,951,991

See accompanying notes to basic financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Statement of Activities
Year Ended September 30, 2011

Functions/Programs	Program Revenues				Net (Expenses) Revenues and Changes in Net Assets	
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government	Component Units
Primary government:						
Governmental activities:						
General government	\$ 6,096,882	\$ 783,366	\$ 2,982,396	\$ -	\$ (2,331,120)	\$ -
Health services	10,090,269	81,539	9,310,722	-	(698,008)	-
Education	14,324,701	-	14,702,975	-	378,274	-
Economic development	1,527,920	-	1,510,261	-	(17,659)	-
Public safety	849,268	47,483	-	-	(801,785)	-
Public works and transportation	2,360,942	624,273	-	-	(1,736,669)	-
Community affairs	33,430	-	-	-	(33,430)	-
Boards and commissions	538,849	-	-	-	(538,849)	-
Judiciary	402,335	11,070	-	-	(391,265)	-
Payments to component units	40,775	-	-	-	(40,775)	-
Municipal affairs	1,943,829	-	-	-	(1,943,829)	-
Unallocated interest on long-term debt	228,678	-	-	-	(228,678)	-
Other	507,936	-	-	-	(507,936)	-
Total primary government	<u>\$ 38,945,814</u>	<u>\$ 1,547,731</u>	<u>\$ 28,506,354</u>	<u>\$ -</u>	<u>(8,891,729)</u>	<u>-</u>
Component units:						
Chuuk State Health Care Plan	\$ 976,195	\$ 1,181,574	\$ -	\$ 14,553	-	219,932
Chuuk Public Utility Corporation	4,024,299	2,983,031	-	1,175,861	-	134,593
Chuuk State Housing Authority	41,607	76,852	-	-	-	35,245
Total component units	<u>\$ 5,042,101</u>	<u>\$ 4,241,457</u>	<u>\$ -</u>	<u>\$ 1,190,414</u>	<u>-</u>	<u>389,770</u>
General revenues:						
Taxes:						
FSM revenue sharing:						
Gross revenue taxes					1,061,967	-
Import taxes					921,830	-
Income taxes					959,833	-
Other taxes					159,579	-
State taxes:						
Sales tax					2,115,045	-
Other excise taxes					591,368	-
Unrestricted investment income					(7,948)	-
Other					1,088,183	167,045
Total general revenues and special items					<u>6,889,857</u>	<u>167,045</u>
Change in net assets					(2,001,872)	556,815
Net assets at the beginning of the year					<u>40,309,390</u>	<u>395,267</u>
Net assets at the end of the year					<u>\$ 38,307,518</u>	<u>\$ 952,082</u>

See accompanying notes to basic financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Balance Sheet
Governmental Funds
September 30, 2011

	General	Special Revenue Grants Assistance	Permanent Compact Trust	Other Governmental Funds	Total
<u>ASSETS</u>					
Cash and cash equivalents	\$ 2,527,269	\$ -	\$ -	\$ -	\$ 2,527,269
Equity interest in internal investment pool	321,799	-	-	-	321,799
Investments	-	2,050,000	-	-	2,050,000
Receivables, net	1,061,483	1,925,755	-	-	2,987,238
Prepayments	365,692	160,610	-	-	526,302
Due from other funds	1,791,483	6,925,713	-	41,400	8,758,596
Restricted assets:					
Investments	3,490,444	-	8,088,435	-	11,578,879
Total assets	\$ 9,558,170	\$ 11,062,078	\$ 8,088,435	\$ 41,400	\$ 28,750,083
<u>LIABILITIES AND FUND BALANCES</u>					
Liabilities:					
Accounts payable	\$ 1,484,322	\$ 1,553,296	\$ -	\$ -	\$ 3,037,618
Accrued liabilities	8,043	8,428	-	-	16,471
Land acquisition payable	8,628,545	-	-	-	8,628,545
Note payable	561,987	-	-	-	561,987
Accrued interest payable	175,576	-	-	-	175,576
Due to component units	136	-	-	-	136
Due to other funds	6,967,113	1,791,483	-	-	8,758,596
Total liabilities	17,825,722	3,353,207	-	-	21,178,929
Fund balances (deficits):					
Nonspendable	297,552	2,210,610	8,088,435	-	10,596,597
Restricted	3,490,444	6,728,193	-	-	10,218,637
Committed	-	-	-	41,400	41,400
Unassigned:					
General fund	(12,055,548)	-	-	-	(12,055,548)
Special revenue funds	-	(1,229,932)	-	-	(1,229,932)
Total fund balances (deficits)	(8,267,552)	7,708,871	8,088,435	41,400	7,571,154
Total liabilities and fund balances (deficits)	\$ 9,558,170	\$ 11,062,078	\$ 8,088,435	\$ 41,400	

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are reported in the funds	45,544,752
Long-term liabilities, including loans payable, are not due and payable in the current period and, therefore, are not reported in the funds. The liabilities include:	
Long-term obligations	(12,724,528)
Compensated absences	(2,083,860)
	(14,808,388)
Net assets of governmental activities	\$ 38,307,518

See accompanying notes to basic financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficits)
Governmental Funds
Year Ended September 30, 2011

	General	Special Revenue Grants Assistance	Permanent Compact Trust	Other Governmental Funds	Total
Revenues:					
Compact funding	\$ -	\$ 28,311,583	\$ -	\$ -	\$ 28,311,583
Net change in the fair value of investments	(7,948)	-	-	-	(7,948)
Federal contributions and other grants	-	142,049	-	52,722	194,771
FSM revenue sharing	3,103,209	-	-	-	3,103,209
State taxes	2,706,413	-	-	-	2,706,413
Fees and charges	1,466,192	-	-	81,539	1,547,731
Other	1,088,183	-	-	-	1,088,183
Total revenues	<u>8,356,049</u>	<u>28,453,632</u>	<u>-</u>	<u>134,261</u>	<u>36,943,942</u>
Expenditures:					
Current:					
General government	3,199,596	1,723,671	-	-	4,923,267
Health services	-	9,974,090	-	177,608	10,151,698
Education	2,850	14,216,987	-	-	14,219,837
Economic development	105,604	1,433,013	-	-	1,538,617
Public safety	782,946	55,795	-	-	838,741
Public works and transportation	694,766	-	-	-	694,766
Community affairs	33,430	-	-	-	33,430
Boards and commissions	538,849	-	-	-	538,849
Judiciary	402,335	-	-	-	402,335
Payments to component units	40,775	-	-	-	40,775
Municipal affairs	1,943,829	-	-	-	1,943,829
Other	294,676	-	-	-	294,676
Debt service	639,598	-	-	-	639,598
Total expenditures	<u>8,679,254</u>	<u>27,403,556</u>	<u>-</u>	<u>177,608</u>	<u>36,260,418</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(323,205)</u>	<u>1,050,076</u>	<u>-</u>	<u>(43,347)</u>	<u>683,524</u>
Other financing sources (uses):					
Operating transfers in	-	393,065	-	-	393,065
Operating transfers out	(393,065)	-	-	-	(393,065)
Total other financing sources (uses), net	<u>(393,065)</u>	<u>393,065</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net change in fund balances (deficit)	<u>(716,270)</u>	<u>1,443,141</u>	<u>-</u>	<u>(43,347)</u>	<u>683,524</u>
Fund balances (deficits) at the beginning of the year	<u>(7,551,282)</u>	<u>6,265,730</u>	<u>8,088,435</u>	<u>84,747</u>	<u>6,887,630</u>
Fund balances (deficits) at the end of the year	<u>\$ (8,267,552)</u>	<u>\$ 7,708,871</u>	<u>\$ 8,088,435</u>	<u>\$ 41,400</u>	<u>\$ 7,571,154</u>

See accompanying notes to basic financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Reconciliation of the Statement of Revenues, Expenditures,
and Changes in Fund Balances of Governmental Funds
to the Statement of Activities
Year Ended September 30, 2011

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

Net change in fund balances - total governmental funds	\$ 683,524
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.	
This is the amount by which depreciation exceeded capital outlays in the current period	(2,883,056)
The incurrence of long-term debt (e.g. bonds, leases) provides current financial resources to governmental funds, while the repayment of principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction has any effect on net assets. For the current year, these amounts consist of:	
Repayment of ADB Loans	410,920
Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds. For the current year, these activities consist of:	
Foreign exchange adjustment in SDR amount for ADB Loans	<u>(213,260)</u>
Change in net assets of governmental activities	\$ <u>(2,001,872)</u>

See accompanying notes to basic financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

**DISCRETELY PRESENTED COMPONENT UNITS
Combining Statement of Net Assets
September 30, 2011**

<u>ASSETS</u>	<u>Chuuk State Health Care Plan</u>	<u>Chuuk Public Utility Corporation</u>	<u>Chuuk State Housing Authority</u>	<u>Total</u>
Current assets:				
Cash and cash equivalents	\$ 507,015	\$ 153,829	\$ 38,299	\$ 699,143
Time certificates of deposit	300,000	-	-	300,000
Investments	48,011	-	-	48,011
Receivables, net	288,725	277,682	405,245	971,652
Inventories	-	328,242	-	328,242
Due from primary government	50,000	-	136	50,136
Prepayments	-	346,262	-	346,262
	<u>1,193,751</u>	<u>1,106,015</u>	<u>443,680</u>	<u>2,743,446</u>
Total current assets				
Noncurrent assets:				
Capital assets, net of accumulated depreciation	<u>30,718</u>	<u>2,093,080</u>	<u>84,747</u>	<u>2,208,545</u>
Total assets	<u>\$ 1,224,469</u>	<u>\$ 3,199,095</u>	<u>\$ 528,427</u>	<u>\$ 4,951,991</u>
<u>LIABILITIES AND NET ASSETS</u>				
Current liabilities:				
Notes payable	\$ -	\$ 778,805	\$ -	\$ 778,805
Current portion of long-term debt	-	6,188	-	6,188
Accounts payable	117,635	382,661	958	501,254
Accrued liabilities	-	2,243,280	-	2,243,280
Deferred income	-	17,693	-	17,693
	<u>117,635</u>	<u>3,428,627</u>	<u>958</u>	<u>3,547,220</u>
Total current liabilities				
Noncurrent liabilities:				
Noncurrent portion of long-term debt	<u>-</u>	<u>452,689</u>	<u>-</u>	<u>452,689</u>
Total liabilities	<u>117,635</u>	<u>3,881,316</u>	<u>958</u>	<u>3,999,909</u>
Net assets (deficiency):				
Invested in capital assets, net of related debt	30,718	855,398	84,747	970,863
Restricted	1,076,116	175,555	-	1,251,671
Unrestricted	<u>-</u>	<u>(1,713,174)</u>	<u>442,722</u>	<u>(1,270,452)</u>
Total net assets (deficiency)	<u>1,106,834</u>	<u>(682,221)</u>	<u>527,469</u>	<u>952,082</u>
Total liabilities and net assets	<u>\$ 1,224,469</u>	<u>\$ 3,199,095</u>	<u>\$ 528,427</u>	<u>\$ 4,951,991</u>

See accompanying notes to basic financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

**DISCRETELY PRESENTED COMPONENT UNITS
Combining Statement of Revenues, Expenses, and Changes in Net Assets
Year Ended September 30, 2011**

	Chuuk State Health Care Plan	Chuuk Public Utility Corporation	Chuuk State Housing Authority	Total
Operating revenues:				
Charges for services	\$ 1,176,426	\$ 2,966,612	\$ 76,852	\$ 4,219,890
Other	5,148	16,419	-	21,567
Total operating revenues	<u>1,181,574</u>	<u>2,983,031</u>	<u>76,852</u>	<u>4,241,457</u>
Operating expenses:				
Cost of services	735,425	2,536,117	-	3,271,542
Depreciation	8,592	591,602	-	600,194
Administration and general	232,178	896,580	41,607	1,170,365
Total operating expenses	<u>976,195</u>	<u>4,024,299</u>	<u>41,607</u>	<u>5,042,101</u>
Operating income (loss)	<u>205,379</u>	<u>(1,041,268)</u>	<u>35,245</u>	<u>(800,644)</u>
Nonoperating revenues (expenses):				
Other income (loss)	12,940	230,893	-	243,833
Interest expense	(1,008)	(75,780)	-	(76,788)
Total nonoperating revenues (expenses), net	<u>11,932</u>	<u>155,113</u>	<u>-</u>	<u>167,045</u>
Net income (loss) before capital contributions	217,311	(886,155)	35,245	(633,599)
Capital contributions	<u>14,553</u>	<u>1,175,861</u>	<u>-</u>	<u>1,190,414</u>
Change in net assets (deficiency)	231,864	289,706	35,245	556,815
Net assets (deficiency) at the beginning of the year	<u>874,970</u>	<u>(971,927)</u>	<u>492,224</u>	<u>395,267</u>
Net assets (deficiency) at the end of the year	<u>\$ 1,106,834</u>	<u>\$ (682,221)</u>	<u>\$ 527,469</u>	<u>\$ 952,082</u>

See accompanying notes to basic financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(1) Summary of Significant Accounting Policies

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

A. Reporting Entity

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

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

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

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

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

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

i. Discretely Presented Component Units

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

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

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

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

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

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

ii. Omitted Governmental Funds

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

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

ii. Omitted Governmental Funds, Continued

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

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

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

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

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

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

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

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

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

ii. Omitted Governmental Funds, Continued

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

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

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

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

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

iii. Omitted Component Units

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

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

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

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements

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

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

The Statement of Net Assets presents all of the reporting entity's non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

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

The government-wide Statement of Net Assets reports \$20,367,882 of restricted net assets, of which \$1,120,999 is restricted by enabling legislation.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

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

C. Fund Financial Statements

The fund financial statements present a balance sheet and a statement of revenues, expenditures, and changes in fund balances for its major and aggregated non-major funds.

Major individual governmental funds are reported as separate columns in the fund financial statements pursuant to GASB reporting standards, with nonmajor governmental funds being combined into a single column.

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

D. Measurement Focus and Basis of Accounting

Government-Wide Financial Statements:

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

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

Governmental Fund Financial Statements:

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

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Governmental Fund Financial Statements, Continued:

For this purpose, the State considers revenues to be available if they are collected within sixty days of the end of the current fiscal period. Federal grants and assistance awards made on the basis of entitlement periods are recorded as revenue when available and entitlement occurs which is generally within 12 months of the end of the current fiscal period. Significant revenues susceptible to accrual include income and gross revenue taxes, federal grants, federal reimbursements and other reimbursements for use of materials and services. Miscellaneous revenues from other financing sources are recognized when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned, since they are both measurable and available. Expenditures generally are recorded in the period in which the related fund liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Component Unit Financial Statements:

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

The State reports the following governmental fund types:

i. General Fund

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

ii. Special Revenue Funds

These funds account for specific revenue sources that have been aggregated according to enabling legislation to support specific governmental activities.

iii. Capital Projects Funds

These funds account for the acquisition or construction of major State capital facilities financed primarily from loans and federal reimbursements.

iv. Permanent Fund

This fund accounts for resources that are legally restricted to the extent that only earnings, and not principal, may be used to support programs for the benefit of the government.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

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

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

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

E. Reporting Standards

As allowed by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the State's discretely presented component units follow all GASB pronouncements and those Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

F. Cash and Cash Equivalents and Time Certificates of Deposit

Cash and cash equivalents include cash held in demand accounts as well as short-term investments in U.S. Treasury obligations with a maturity date within three months of the date acquired by the State. Deposits maintained in time certificates of deposit with original maturity dates greater than ninety days are separately classified on the statement of net assets/balance sheet.

G. Investments

Investments and related investment earnings are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

H. Receivables

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

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

I. Prepaid Items

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

J. Interfund Receivables/Payables

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

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

K. Restricted Assets

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through loan agreements or enabling legislation. Specifically, the State has collateralized Asian Development Bank loan proceeds and earnings for the Chuuk State Early Retirement Scheme with investments recorded in the General Fund of \$3,490,444. Furthermore, investments recorded in the Compact Trust Fund of \$8,088,435 are restricted in that they are not available to be used in current operations.

L. Capital Assets

Capital assets, which include property, plant, equipment and infrastructure (e.g. roads, bridges, ramps and other similar items), are reported in the governmental activity column of the government-wide financial statements.

Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair market value at the date of donation.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

L. Capital Assets, Continued

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

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

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

M. Interfund/Intrafund Transactions

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

N. Compensated Absences

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

O. Fund Balance

GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, was implemented, effective for the fiscal year ending September 30, 2011. It establishes fund balance classifications based on the extent to which the State is bound to honor constraints on the specific purposes for which amounts in those funds can be spent. As a result of implementing this statement, there were significant changes in the State's fund structure. Funds that did not meet the new special revenue fund definition were moved to the General Fund. Amounts previously reported as reserved and unreserved fund balance are now reported under the following fund balance classifications:

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

O. Fund Balance, Continued

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

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

A formal minimum fund balance policy has not been adopted.

P. Risk Financing

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

Q. Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenditures and expenses during the reporting period. Actual results could differ from those estimates.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

R. New Accounting Standards

During fiscal year 2011, the State implemented the following pronouncements:

- GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in the governmental funds. The Statement requires governments to disclose information in the notes about the processes through which constraints are imposed, as well as accounting policies that determine whether restricted, committed, assigned, and unassigned amounts are considered to be spent. This Statement also provides guidance for classifying stabilization amounts on the face of the balance sheet and requires disclosure of certain information about stabilization arrangements in the notes to the financial statements. As a result of implementation, the Statement of Revenues, Expenditures and Changes in Fund Balance for Governmental Funds have been restated due to reclassification of funds. Beginning fund balance for the Other Governmental Funds decreased by \$1,131,480 while the General Fund increased by the same amount. Details on the State's fund balance classifications are reflected in note 9.
- GASB Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to measurement of OPEB obligations by certain employers participating in agent multiple-employer OPEB plans. The provisions of Statement 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

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Notes to Financial Statements
September 30, 2011

(1) Summary of Significant Accounting Policies, Continued

R. New Accounting Standards, Continued

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*, which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In July 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions* (an amendment of GASB Statement No. 53), which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty’s credit support provider, is replaced. The provisions of this statement are effective for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

S. Total Columns

Total columns are presented primarily to facilitate financial analysis. The Management’s Discussion and Analysis includes certain prior year summarized comparative information in total. Such information does not include sufficient detail to constitute a full comparative presentation. Accordingly, such information should be read in conjunction with the State’s financial statements for the year ended September 30, 2010 from which summarized information was derived.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(2) Deposits and Investments

GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

The State pools cash resources of its various funds in order to facilitate the management of cash. Unless otherwise required by law, interest income received on pooled cash accrues to the General Fund. Cash and cash equivalents applicable to a particular fund are readily identifiable. The State has invested the majority of its excess Compact Funds in a pooled investment fund which is managed under the control of the Federated Development Authority, an entity comprised of the FSM National Government and its four component states. Investment income originating from the pool accrues to the General Fund.

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

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

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

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

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

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(2) Deposits and Investments, Continued

A. Deposits

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

Category 1 - Deposits that are federally insured or collateralized with securities held by the State or its agent in the State's name;

Category 2 - Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in the State's name; or

Category 3 - Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in the State's name and non-collateralized deposits.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the State's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. The State does not have a deposit policy for custodial credit risk or foreign currency risk.

As of September 30, 2011, the carrying amount of the primary government's total cash and cash equivalents were \$2,527,269 and the corresponding bank balances were \$4,712,180, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2011, bank deposits in the amount of \$500,000 were FDIC insured. The State does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

As of September 30, 2011, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit was \$999,143 and the corresponding bank balances were \$1,043,875, which were maintained in financial institutions subject to FDIC insurance. As of September 30, 2011, bank deposits in the amount of \$551,753 were FDIC insured. The component units do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Therefore, these deposits are exposed to custodial credit risk.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(2) Deposits and Investments, Continued

B. Investments

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

Category 1 - Investments that are insured or registered, or securities held by the State or its agent in the State's name;

Category 2 - Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the State's name; or

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

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

As of September 30, 2011, the State's investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ 686,337
Other investments:	
Domestic equities	10,892,542
Cash management account	<u>321,799</u>
	\$ <u>11,900,678</u>

As of September 30, 2011, the General Fund has an Automated Cash Management account with the Bank of Hawaii in the amount of \$321,799.

As of September 30, 2011, the Grants Assistance Fund holds 16% of the shares of the Bank of the Federated States of Micronesia in the amount of \$1,500,000, 4.8% of the shares of the Pacific Islands Development Bank in the amount of \$250,000, and 1% of the shares of the FSM Development Bank in the amount of \$300,000. As the fair market value of these investments is not readily available, such have been recorded at cost.

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

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(2) Deposits and Investments, Continued

B. Investments, Continued

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the State will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The State's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the State's name by the State's custodial financial institutions at September 30, 2011.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the State. As of September 30, 2011, the State did not hold an investment in any one issuer that represented more than 5% of the State's total investments.

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

As of September 30, 2011, the State's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

Investment Type	Investment Maturities (In Years)					Credit Ratings
	Fair Value	Current	1-5	6-10	Over 10	
U.S. Treasury Notes and Bonds	\$ 4,776	\$ -	\$ 4,776	\$ -	\$ -	Aaa/AAA
U.S. Government Agency Obligations:						
Federal Home Loan Mortgage Corporation	176,265	-	2,096	25,662	148,507	AAA
Government National Mortgage Association	28,094	-	-	-	28,094	AAA
Federal National Mortgage Association	140,776	-	-	15,956	124,820	AAA
Tennessee Valley Authority	13,500	-	-	-	13,500	AAA
Housing Urban Development	21,687	-	21,687	-	-	No rating
Municipal Obligations	37,220	-	-	21,982	15,238	Aa1
Municipal Obligations	10,292	-	-	-	10,292	Aa2
Corporate Bonds	53,655	-	14,579	16,228	22,848	Aaa/AAA
Corporate Bonds	15,770	-	-	15,770	-	Aa1/AA+
Corporate Bonds	73,646	-	27,976	30,812	14,858	Aa2/AA
Corporate Bonds	18,503	-	-	-	18,503	A1/A+
Corporate Bonds	36,401	-	25,314	11,087	-	A2/A
Corporate Bonds	82,360	-	45,975	17,135	19,250	A3/A-
Corporate Bonds	50,046	-	38,746	11,300	-	Baa1/BBB+
Corporate Bonds	16,045	-	8,098	-	7,947	Baa2/BBB
Corporate Bonds	89,301	30,350	15,055	10,559	33,337	No rating
	\$ <u>686,337</u>	\$ <u>30,350</u>	\$ <u>204,302</u>	\$ <u>176,491</u>	\$ <u>457,194</u>	

**STATE OF CHUUK
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Notes to Financial Statements
September 30, 2011

(3) Receivables

Primary Government

Receivables as of September 30, 2011, for the primary government's individual major funds and nonmajor funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	<u>General</u>	<u>Grants Assistance</u>	<u>Total</u>
Receivables:			
General receivables	\$ 382,148	\$ 113,461	\$ 495,609
FSM National Government	<u>1,179,074</u>	<u>1,812,294</u>	<u>2,991,368</u>
	1,561,222	1,925,755	3,486,977
Less: allowance for uncollectible Accounts	<u>(499,739)</u>	-	<u>(499,739)</u>
Net receivables	<u>\$1,061,483</u>	<u>\$ 1,925,755</u>	<u>\$2,987,238</u>

Discretely Presented Component Units

Receivables as of September 30, 2011, for the discretely presented component units in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

Chuuk State Health Care Plan:

General	\$ 323,124
Less: allowance for uncollectible accounts	<u>(42,872)</u>
Net receivables	\$ <u>280,252</u>

Chuuk Public Utility Corporation:

General	\$ 1,144,633
Other	<u>22,989</u>
	1,167,622
Less: allowance for uncollectible accounts	<u>(889,940)</u>
Net receivables	\$ <u>277,682</u>

Chuuk State Housing Authority:

Receivables:	
Loans	\$ 2,182,301
Other	<u>120,000</u>
	2,302,301
Less: allowance for uncollectible accounts	<u>(1,897,056)</u>
Net receivables	\$ <u>405,245</u>

**STATE OF CHUUK
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Notes to Financial Statements
September 30, 2011

(4) Interfund Receivables and Payables

Receivables and payables between funds reflected as due to/from other funds in the combined balance sheet at September 30, 2011, are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Grants Assistance	General	\$ 6,925,713
General	Grants Assistance	1,791,483
Nonmajor governmental funds	General	<u>41,400</u>
		<u>\$ 8,758,596</u>

(5) Fixed Assets

Capital asset activities of the primary government for the year ended September 30, 2011, are as follows:

	<u>Balance October 1, 2010</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance September 30, 2011</u>
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 17,721,622	\$ -	\$ -	\$ 17,721,622
Capital assets, being depreciated:				
Airport facilities	38,107,415	-	-	38,107,415
Buildings	10,215,030	-	-	10,215,030
Seaport facilities	26,517,208	-	-	26,517,208
Vehicles and other equipment	8,375,371	324,020	-	8,699,391
Infrastructure	<u>14,835,315</u>	<u>-</u>	<u>-</u>	<u>14,835,315</u>
	<u>98,050,339</u>	<u>324,020</u>	<u>-</u>	<u>98,374,359</u>
Less accumulated depreciation for:				
Airport facilities	(25,527,466)	(952,686)	-	(26,480,152)
Buildings	(5,852,429)	(222,217)	-	(6,074,646)
Seaport facilities	(18,562,045)	(662,930)	-	(19,224,975)
Vehicles and other equipment	(5,553,961)	(380,222)	-	(5,914,183)
Infrastructure	<u>(11,868,252)</u>	<u>(989,021)</u>	<u>-</u>	<u>(12,857,273)</u>
	<u>(67,344,153)</u>	<u>(3,207,076)</u>	<u>-</u>	<u>(70,551,229)</u>
	<u>30,706,186</u>	<u>(2,883,056)</u>	<u>-</u>	<u>27,823,130</u>
	<u>\$ 48,427,808</u>	<u>\$ (2,883,056)</u>	<u>\$ -</u>	<u>\$ 45,544,752</u>

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

General government	\$ 1,209,796
Health services	209,036
Education	111,542
Public safety	10,527
Public works and transportation	<u>1,666,175</u>
	<u>\$ 3,207,076</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(6) Short-Term Debt

Primary Government

Note payable to the FSM National Government, payable in quarterly installments of \$416,667, non-interest bearing with a service charge of 1% per annum, due on September 30, 2001. \$ 561,987

No activity in short-term debt of the primary government occurred during the year ended September 30, 2011.

Discretely Presented Component Units

Chuuk Public Utility Corporation (CPUC):

Note payable to a commercial bank on an original line of credit of \$150,000 bearing interest of 7.25% per annum. The loan is collateralized by a security interest in fixed assets, accounts receivable and inventories and is past due, and is therefore presented as a current liability. \$ 81,921

Note payable to the Federated States of Micronesia Development Bank on an amount drawn with an available total of \$737,743 bearing interest of 9% per annum with principal installments of \$4,000 per month. Proceeds from the note were used for cash power meters and other equipment purchases and is collateralized by major machinery, equipment and assignment of income. The loan requires that CPUC maintain hazard insurance which has not been obtained. As a result, this note is presented as a current liability. 696,884

\$ 778,805

Changes in short-term debt of the discretely presented component units is as follows:

	Balance October 1, <u>2010</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, 2011
Notes payable:				
CPUC	\$ <u>808,918</u>	\$ <u> </u> -	\$(<u>30,113</u>)	\$ <u>778,805</u>

(7) Long-Term Obligations

Primary Government

Asian Development Bank (ADB) Loans:

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

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2011

(7) Long-Term Obligations, Continued

Primary Government, Continued

Asian Development Bank (ADB) Loans, Continued:

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

Funds for the repayment of the ADB loan are expected to be derived from the annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The Financing Agreement requires the State to continue to appropriate salaries for the abolished positions and deposit the appropriated funds into the ERS Trust Account. These funds had not been deposited to the Trust Account as of September 30, 2011. As of September 30, 2011, the amount outstanding against this loan was \$5,624,605. Of the required \$5,300,000 identified for future debt service payments, \$3,490,444 is deposited in an investment account held jointly with the FSM National Government. That investment account is restricted for the repayment of this debt and other ADB related debt set forth below.

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Program Loan with ADB (Loan Number 1816 FSM (SF)) for the purpose of funding the Basic Social Services Project, with interest at 1% to 1.5% per annum. Principal payments shall be made semiannually commencing February 1, 2009, with a maturity date of August 1, 2032. As of September 30, 2011, the balance payable on this loan amounted to \$1,033,366.

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Program Loans with ADB (Loan Number 1873 (SF) and Loan Number 1874 FSM (SF)) for the purpose of promoting private sector development in Chuuk, with interest at 1% to 1.5% per annum. Principal payments shall be made in 32 equal semi-annual payments with the first payment due on May 15, 2011 and the last payment on November 15, 2025. As of September 30, 2011, the balances payable on these loans amounted to \$673,091 and \$1,249,258, respectively.

On December 21, 2010, the Chuuk Public Utilities Corporation (CPUC) and the State agreed through memorandum of understanding to offset certain claims and transferred certain debt between CPUC and the State. The transferred debt was the FSM National Government Program Loan with ADB (Loan Number 1459 (SF)), totaling \$3,554,435, for water wells and electric construction purposes, with interest at 1% to 1.5% per annum. Principal payments shall be made semiannually commencing August 1, 2007, with a maturity date of August 1, 2036. The State has elected to record this transaction during the year ended September 30, 2011, which, in essence, represents forgiveness of debt owed by CPUC to the State and, accordingly, has been presented as a special item in the accompanying financial statements. As of September 30, 2011, the balance payable on this loan amounted to \$4,144,208.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(7) Long-Term Obligations, Continued

Primary Government, Continued

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

<u>Year Ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 365,445	\$ 142,015	\$ 507,460
2013	365,445	137,605	503,050
2014	365,445	133,195	498,640
2015	365,445	128,785	498,230
2016	365,445	124,374	489,819
2017-2021	2,777,162	536,718	3,313,880
2022-2026	2,876,220	376,521	3,252,741
2027-2031	2,667,353	221,359	2,888,712
2032-2036	2,331,463	80,994	2,412,457
2037-2039	<u>245,105</u>	<u>2,440</u>	<u>247,545</u>
	<u>\$ 12,724,528</u>	<u>\$ 1,884,007</u>	<u>\$ 14,608,535</u>

Discretely Presented Component Units

Chuuk Public Utility Corporation:

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

\$ 170,608

Loan payable to the State, facilitated by an ADB loan (Loan Number 2100-FSM) to the FSM National Government, original amount of \$2,800,000, due in semi-annual installments of varying amounts through January 15, 2019. Interest is payable at LIBOR plus 0.6% per annum (2.1% at September 30, 2011). Proceeds were used for the purchase of two generator sets and related costs.

228,269

\$ 458,877

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(7) Long-Term Obligations, Continued

Discretely Presented Component Units, Continued

Chuuk Public Utilities Corporation, Continued:

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

<u>Year Ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 6,188	\$ 7,801	\$ 13,989
2013	11,505	10,294	21,799
2014	13,563	8,236	21,799
2015	14,462	7,977	22,439
2016	15,392	7,714	23,106
2017-2021	94,458	33,563	128,021
2022-2026	135,746	22,581	158,327
2027-2031	126,502	8,620	135,122
2032-2036	<u>41,061</u>	<u>1,584</u>	<u>42,645</u>
	<u>\$ 458,877</u>	<u>\$ 108,370</u>	<u>\$ 567,247</u>

(8) Changes in Long-Term Obligations

Primary Government

Long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2011, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net assets:

	<u>Balance October 1, 30, 2010</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance September 30, 2011</u>	<u>Due Within One Year</u>
Loans payable:					
ADB loans:					
Loan 1459	\$ 4,015,325	\$ 213,260	\$ (84,377)	\$ 4,144,208	\$ 92,031
Loan 1520	5,735,235	-	(110,630)	5,624,605	122,266
Loan 1816	1,146,436	-	(113,070)	1,033,366	49,204
Loan 1873	717,591	-	(44,500)	673,091	46,415
Loan 1874	<u>1,307,601</u>	<u>-</u>	<u>(58,343)</u>	<u>1,249,258</u>	<u>55,529</u>
	12,922,188	213,260	(410,920)	12,724,528	365,445
Other:					
Compensated absences	<u>2,083,860</u>	<u>610,969</u>	<u>(610,969)</u>	<u>2,083,860</u>	<u>450,000</u>
	<u>\$15,006,048</u>	<u>\$ 824,229</u>	<u>\$ (1,021,889)</u>	<u>\$14,808,388</u>	<u>\$ 815,445</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(8) Changes in Long-Term Obligations

Primary Government, Continued

Included in the net additions is a foreign exchange adjustment due to a change in the SDR calculation of \$213,260, which was passed through by the FSM National Government, and resulted in an increase in the outstanding loans payable to the FSM National Government.

Discretely Presented Component Units

During the year ended September 30, 2011, the following changes occurred in long-term obligations of the discretely presented component units:

	Balance October 1, <u>2010</u>	<u>Additions</u>	<u>Reductions</u>	Balance September <u>30, 2011</u>	Due Within <u>One Year</u>
Loans payable:					
CPUC	\$ <u> -</u>	\$ <u>458,877</u>	\$ <u> -</u>	\$ <u>458,877</u>	\$ <u>6,188</u>

(9) Fund Balance

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

	General <u>Fund</u>	Grants Assistance <u>Fund</u>	Compact Trust <u>Fund</u>	Nonmajor <u>Funds</u>	Total Governmental <u>Funds</u>
Non-spendable:					
General government	\$ 297,552	\$ 2,948	\$ -	\$ -	\$ 300,500
Economic development	-	29,782	-	-	29,782
Health services	-	127,880	-	-	127,880
FSM Development Bank	-	300,000	-	-	300,000
Pacific Islands Development Bank	-	250,000	-	-	250,000
Bank of the FSM	-	1,500,000	-	-	1,500,000
Permanent fund principal	-	-	8,088,435	-	8,088,435
Restricted for:					
Debt service	3,490,444	-	-	-	3,490,444
Capital projects	-	2,250,737	-	-	2,250,737
General government	-	907,227	-	-	907,227
Economic development	-	307,147	-	-	307,147
Education	-	1,537,739	-	-	1,537,739
Health services	-	1,596,410	-	-	1,596,410
Other foreign assistance	-	128,933	-	-	128,933
Committed:					
Health services	-	-	-	41,400	41,400
Unassigned	<u>(12,343,895)</u>	<u>(1,229,932)</u>	<u>-</u>	<u>-</u>	<u>(13,573,827)</u>
	\$ <u>(8,555,899)</u>	\$ <u>7,708,871</u>	\$ <u>8,088,435</u>	\$ <u>41,400</u>	\$ <u>7,282,807</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(10) Contingencies

Sick Leave

It is the policy of the State to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave as of September 30, 2011 is \$4,795,067.

Insurance Coverage

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

Encumbrances

The State utilizes encumbrance accounting to identify fund obligations. Encumbrances represent commitments related to unperformed contracts for goods. At September 30, 2011, the State has significant encumbrances summarized as follows:

<u>General</u>	<u>Grants Assistance</u>	<u>Compact Trust</u>	<u>Other Governmental Funds</u>	<u>Total</u>
\$ <u>630,330</u>	\$ <u>5,460,239</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>6,090,569</u>

Federal Grants

The State participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. The ultimate disposition of questioned costs can be determined only by final action of the respective grantor agencies. No provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

Litigation

The State is a party to various legal proceedings in which the State's Attorney General indicates that pending land lease cases and other related claims against the State exist at September 30, 2011 in an amount that is material to the financial statements. Due to an inability to predict the ultimate outcome of these matters, no provision for these liabilities has been made in the accompanying financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2011

(10) Contingencies, Continued

Delinquent Taxes

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

General Fund Financial Position

The State's General Fund has sustained recurring operating deficits and has an unassigned fund deficit of \$12,055,548 at September 30, 2011. In addition, at September 30, 2011, the primary government's current liabilities exceed current assets by \$6,873,170.

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

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

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

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2011

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Revenues, Expenditures and Changes in Deficit
Budget and Actual - General Fund
Year Ended September 30, 2011

	<u>Budgeted Amounts</u>		Actual - Budgetary Basis (see Note 1)	Variance with Final Budget - Positive (Negative)
	<u>Original</u>	<u>Final</u>		
Revenues:				
Local revenues	\$ 5,958,582	\$ 6,864,316	\$ 8,363,997	\$ 1,499,681
Net change in fair value of investments	-	-	(7,948)	(7,948)
Total revenues	<u>5,958,582</u>	<u>6,864,316</u>	<u>8,356,049</u>	<u>1,491,733</u>
Expenditures:				
Current:				
General government	3,125,620	3,546,487	3,480,139	66,348
Education	3,747	3,747	3,847	(100)
Economic development	76,426	75,779	107,329	(31,550)
Public safety	877,962	836,241	786,941	49,300
Public works and transportation	695,818	753,395	716,189	37,206
Community affairs	-	-	33,430	(33,430)
Boards and commissions	430,134	606,572	589,821	16,751
Judiciary	427,652	401,261	407,914	(6,653)
Payments to component units	42,984	42,984	40,783	2,201
Municipal affairs	348,435	528,435	2,122,579	(1,594,144)
Other	4,140	213,822	329,133	(115,311)
Debt service	-	-	639,598	(639,598)
Total expenditures	<u>6,032,918</u>	<u>7,008,723</u>	<u>9,257,703</u>	<u>(2,248,980)</u>
Deficiency of revenues under expenditures	<u>(74,336)</u>	<u>(144,407)</u>	<u>(901,654)</u>	<u>(757,247)</u>
Other financing uses:				
Operating transfers out	<u>(463,136)</u>	<u>(393,065)</u>	<u>(393,065)</u>	<u>-</u>
Total other financing uses	<u>(463,136)</u>	<u>(393,065)</u>	<u>(393,065)</u>	<u>-</u>
Net change in deficit	<u>(537,472)</u>	<u>(537,472)</u>	<u>(1,294,719)</u>	<u>(757,247)</u>
Other changes in fund deficit:				
GASB 54 implementation:				
Chuuk Airport Authority (note 2)	-	-	1,079,599	1,079,599
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary purposes but in the year the supplies are received for financial reporting purposes	537,472	537,472	630,330	92,858
Fund deficit at the beginning of the year	<u>(8,682,762)</u>	<u>(8,682,762)</u>	<u>(8,682,762)</u>	<u>-</u>
Fund deficit at the end of the year	<u>\$ (8,682,762)</u>	<u>\$ (8,682,762)</u>	<u>\$ (8,267,552)</u>	<u>\$ 415,210</u>

See accompanying notes to required supplementary information - budgetary reporting.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Required Supplementary Information – Budgetary Reporting
September 30, 2011

(1) Budgetary Information

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

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

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

(2) GASB 54 Implementation

During the year ended September 30, 2011, the State implemented GASB Statement No. 54, which resulted in funds not meeting the special revenue fund definition being moved to the General Fund. Accordingly, the Chuuk Airport Authority Fund that was previously presented as a special revenue fund has been moved to the General Fund. The effect on the fund balance of the General Fund is as follows:

Chuuk Airport Authority Fund:	
Fund balance at the beginning of the year	\$ 1,131,480
Expenditures and other financing uses:	
Department of Administration and Finance	<u>(51,881)</u>
Fund balance at the end of the year	\$ <u>1,079,599</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2011

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Combining Schedule of Expenditures by Account
Governmental Funds
Year Ended September 30, 2011

	General	Special	Permanent	Other	Total
		Revenue		Governmental	
		Grants	Compact	Funds	
		Assistance	Trust		
Expenditures:					
Salaries and wages					
Regular	\$ 3,998,934	\$ 10,645,889	\$ -	\$ 8,883	\$ 14,653,706
Overtime	90,781	634,764	-	-	725,545
Fringe benefits	443,686	1,311,630	-	-	1,755,316
Travel and transportation	485,306	576,053	-	14,637	1,075,996
Books and library materials	-	466,596	-	-	466,596
Communications	(6,157)	131,945	-	389	126,177
Dues, membership, and subscriptions	-	3,572	-	-	3,572
Food stuffs	51,009	495,362	-	-	546,371
Port charges	1,763	18,763	-	474	21,000
Office supplies and materials	84,662	1,189,231	-	22,819	1,296,712
POL	169,663	884,458	-	99	1,054,220
Printing and reproduction	27,295	107,982	-	-	135,277
Rental services	19,490	48,761	-	7,427	75,678
Repairs and maintenance	5,961	231,962	-	2,209	240,132
Constructional materials	-	142,093	-	-	142,093
Utilities	114,026	445,060	-	2,253	561,339
Goods and services	(36,649)	12,670	-	64,215	40,236
Subsidies and contributions	76,090	307,580	-	-	383,670
Medical referrals	-	81,047	-	-	81,047
Medical supplies	-	2,451,879	-	7,956	2,459,835
Contractual services	126,494	3,703,791	-	1,635	3,831,920
Professional services	-	348,710	-	-	348,710
Housing allowance	16,618	71,530	-	-	88,148
Compensation non-payroll	-	500	-	27,016	27,516
Scholarships and allowances	-	807,099	-	17,098	824,197
Training	(2,128)	237,201	-	-	235,073
Official allowance	625,296	-	-	-	625,296
Meeting fees and allowance	17,400	6,705	-	-	24,105
Representation allowance	57,250	-	-	-	57,250
Insurance	-	3,287	-	-	3,287
Leased housing, buildings and land	59,401	350,253	-	-	409,654
Bank charges	1,071	3,249	-	-	4,320
Equipment	62,136	1,219,076	-	-	1,281,212
Furniture and fixtures	10,119	126,340	-	498	136,957
Vehicles	16,538	338,518	-	-	355,056
Principal repayment	401,774	-	-	-	401,774
Interest payments	237,824	-	-	-	237,824
Payout to municipalities	1,522,715	-	-	-	1,522,715
Miscellaneous	886	-	-	-	886
	<u>\$ 8,679,254</u>	<u>\$ 27,403,556</u>	<u>\$ -</u>	<u>\$ 177,608</u>	<u>\$ 36,260,418</u>

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

GENERAL FUND

September 30, 2011

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

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures by Function, and Changes in Deficit
General Fund
Year Ended September 30, 2011
(with comparative totals for the year ended September 30, 2010)

	2011	2010
Revenues:		
FSM revenue sharing:		
Gross revenue taxes	\$ 1,061,967	\$ 1,169,675
Import taxes	921,830	1,089,340
Income taxes	959,833	1,068,329
Other taxes	159,579	116,838
FSM revenue sharing	3,103,209	3,444,182
State taxes:		
Sales tax	2,115,045	1,531,990
Other excise taxes	591,368	606,130
	2,706,413	2,138,120
Fees and charges:		
Licenses and permits	710,925	548,159
Leases and other rentals	130,994	129,012
	841,919	677,171
Departmental charges:		
Transportation collections	624,273	538,742
Net change in the fair value of investments	(7,948)	239,016
Other revenues	1,088,183	338,794
Total revenues	8,356,049	7,376,025
Expenditures:		
Current:		
General government:		
Office of the Governor	384,825	361,311
State Legislature	2,242,369	2,044,548
Department of Planning and Statistics	59,620	6,711
Department of Administrative Services	512,782	934,333
	3,199,596	3,346,903
Education:		
Department of Education	2,850	106,580
Economic development:		
Department of Agriculture	39,363	39,064
Department of Marine Resources	35,019	34,679
Historic Preservation Office	12,154	-
Department of Commerce & Industries	19,068	-
	105,604	73,743
Public safety:		
Office of the Attorney General	216,207	191,339
Department of Public Safety	566,739	586,972
	782,946	778,311
Public works and transportation:		
Department of Transportation	694,766	557,115
Community affairs:		
Broadcast	33,430	-

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures by Function, and Changes in Deficit, Continued
General Fund

Year Ended September 30, 2011

(with comparative totals for the year ended September 30, 2010)

	2011	2010
Expenditures, continued:		
Current, continued:		
Boards and commissions:		
Chuuk Recreation Board	-	14,253
Land Commission	92,313	75,669
Public Service Commission	87,969	13,168
Election Commission	358,567	110,195
	538,849	213,285
Judiciary:		
State Court	402,335	376,633
Payments to component units:		
Chuuk State Housing Authority	40,775	43,090
Municipal affairs:		
Payments to municipalities	1,943,829	914,648
Other:		
Farmers Home Administration	22,675	24,134
Peace Corps	9,994	3,000
Micro Games	14,418	53,929
Goodwill games	-	19,986
Guandong Province	4,000	32,808
2011 Economic Summit	59,096	-
Insurance broker	15,750	-
ESG	88,812	-
Disaster Coordinating Office	19,460	-
Labor and Manpower	8,709	-
Other	51,762	-
	294,676	133,857
Debt service:		
Principal repayment	401,774	285,082
Interest payment	237,824	80,013
	639,598	365,095
Total expenditures	8,679,254	6,909,260
Excess (deficiency) of revenues over (under) expenditures	(323,205)	466,765
Other financing uses:		
Operating transfers out	(393,065)	(366,466)
Net change in deficit	(716,270)	100,299
Deficit at the beginning of the year	(7,551,282)	(8,783,061)
Deficit at the end of the year	\$ (8,267,552)	\$ (8,682,762)

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures and Changes in Deficit
Budget and Actual - General Fund
Year Ended September 30, 2011

	Budgeted Amounts		Actual	Variance with
	Original	Final	Budgetary Basis (see Note 1)	Final Budget Positive/(Negative)
Revenues:				
Local revenues	\$ 5,958,582	\$ 6,864,316	\$ 8,363,997	\$ 1,499,681
Net change in fair value of investments	-	-	(7,948)	(7,948)
Total revenues	5,958,582	6,864,316	8,356,049	1,491,733
Expenditures:				
Current:				
General government:				
Office of the Governor	411,028	472,940	519,383	(46,443)
State Legislature	2,045,981	2,386,064	2,397,298	(11,234)
Department of Planning and Statistics	-	-	59,620	(59,620)
Department of Administrative Services	668,611	687,483	503,838	183,645
	<u>3,125,620</u>	<u>3,546,487</u>	<u>3,480,139</u>	<u>66,348</u>
Education:				
Department of Education	3,747	3,747	3,847	(100)
Economic development:				
Department of Agriculture	39,913	39,266	39,363	(97)
Department of Marine Resources	36,513	36,513	36,744	(231)
Historic Preservation Office	-	-	12,154	(12,154)
Department of Commerce & Industry	-	-	19,068	(19,068)
	<u>76,426</u>	<u>75,779</u>	<u>107,329</u>	<u>(31,550)</u>
Public safety:				
Office of the Attorney General	238,873	236,906	219,892	17,014
Department of Public Safety	639,089	599,335	567,049	32,286
	<u>877,962</u>	<u>836,241</u>	<u>786,941</u>	<u>49,300</u>
Public works and transportation:				
Department of Transportation	695,818	753,395	716,189	37,206
Community affairs:				
Department of Public Affairs	-	-	33,430	(33,430)
Boards and commissions:				
Chuuk Recreation Board	16,056	16,056	-	16,056
Land Commission	91,581	91,581	93,549	(1,968)
Election Commission	225,434	401,872	408,303	(6,431)
Public Service Commission	95,706	95,706	87,969	7,737
Mortlocks Commission	1,357	1,357	-	1,357
	<u>430,134</u>	<u>606,572</u>	<u>589,821</u>	<u>16,751</u>
Judiciary:				
State Court	427,652	401,261	407,914	(6,653)
Payments to component units:				
Chuuk State Housing Authority	42,984	42,984	40,783	2,201
Municipal affairs:				
Payments to municipalities	348,435	528,435	2,122,579	(1,594,144)
Other:				
Farmers Home Administration	-	22,682	22,675	7
Peace Corps	3,000	10,000	9,994	6
Micro Games	-	-	14,418	(14,418)
Guandong Province	1,140	6,140	6,000	140
2011 Economic Summit	-	60,000	59,096	904
Insurance broker	-	15,000	15,750	(750)
ESG	-	100,000	96,151	3,849
Disaster Coordinating Office	-	-	19,460	(19,460)
Labor and Manpower	-	-	8,709	(8,709)
Other	-	-	75,740	(75,740)
China Travel	-	-	1,140	(1,140)
	<u>4,140</u>	<u>213,822</u>	<u>329,133</u>	<u>(115,311)</u>

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures and Changes in Deficit
Budget and Actual - General Fund, Continued
Year Ended September 30, 2011

	Budgeted Amounts		Actual Budgetary Basis (see Note 1)	Variance with Final Budget Positive/(Negative)
	Original	Final		
Debt service:				
Principal repayment	-	-	401,774	(401,774)
Interest payments	-	-	237,824	(237,824)
	-	-	639,598	(639,598)
Total expenditures	6,032,918	7,008,723	9,257,703	(2,248,980)
Deficiency of revenues under expenditures	(74,336)	(144,407)	(901,654)	(757,247)
Other financing uses:				
Operating transfers out	(463,136)	(393,065)	(393,065)	-
Total other financing uses	(463,136)	(393,065)	(393,065)	-
Net change in deficit	(537,472)	(537,472)	(1,294,719)	(757,247)
Other changes in fund deficit:				
GASB 54 implementation:				
Chuuk Airport Authority	-	-	1,079,599	1,079,599
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary purposes but in the year the supplies are received for financial reporting purposes	537,472	537,472	630,330	92,858
Fund deficit at the beginning of the year	(8,682,762)	(8,682,762)	(8,682,762)	-
Fund deficit at the end of the year	\$ (8,682,762)	\$ (8,682,762)	\$ (8,267,552)	\$ 415,210

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

NONMAJOR GOVERNMENTAL FUNDS - SPECIAL REVENUE FUNDS

September 30, 2011

Special revenue funds are used to account for specific revenues that are legally restricted for particular purposes. A brief discussion of the State's Nonmajor Governmental Funds - Special Revenue Funds as of September 30, 2011, follows:

Hospital Revolving Fund

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

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet
September 30, 2011

	Education Sector	Health Sector	Environment Sector	Private Sector Development	Capacity Building Sector	Supplemental Education	IMF	Infrastructure	U.S. Federal Grants	Foreign Assistance	CFSM Grants	Compact I Capital Projects	Total
ASSETS													
Investments	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 2,050,000	\$ 2,050,000
Receivables:													
FSM National Government	750,001	750,000	50,001	100,000	75,000	50,000	-	-	-	-	36,015	-	1,811,017
Advances	19,567	12,943	3,170	15,958	17,450	44,372	-	-	-	-	1,278	-	114,738
Prepayments	-	127,880	12,208	17,574	2,948	-	-	-	-	-	-	-	160,610
Due from other funds	-	1,417,770	44,220	157,758	977,598	1,764,562	2,108,875	-	66,374	179,784	-	208,772	6,925,713
	<u>\$ 769,568</u>	<u>\$ 2,308,593</u>	<u>\$ 109,599</u>	<u>\$ 291,290</u>	<u>\$ 1,072,996</u>	<u>\$ 1,858,934</u>	<u>\$ 2,108,875</u>	<u>\$ -</u>	<u>\$ 66,374</u>	<u>\$ 179,784</u>	<u>\$ 37,293</u>	<u>\$ 2,258,772</u>	<u>\$ 11,062,078</u>
LIABILITIES AND FUND BALANCES (DEFICITS)													
Liabilities:													
Accounts payable	\$ 233,452	\$ 584,303	\$ 21,410	\$ 42,550	\$ 175,340	\$ 312,767	\$ 66,910	\$ 130	\$ 53,855	\$ 50,851	\$ 11,728	\$ -	\$ 1,553,296
Accrued liabilities	-	-	-	-	-	8,428	-	-	-	-	-	-	8,428
Due to other funds	1,587,867	-	-	-	-	-	-	77,466	-	-	126,150	-	1,791,483
Total liabilities	<u>1,821,319</u>	<u>584,303</u>	<u>21,410</u>	<u>42,550</u>	<u>175,340</u>	<u>321,195</u>	<u>66,910</u>	<u>77,596</u>	<u>53,855</u>	<u>50,851</u>	<u>137,878</u>	<u>-</u>	<u>3,353,207</u>
Fund balances:													
Non-spendable	-	127,880	12,208	17,574	2,948	-	-	-	-	-	-	2,050,000	2,210,610
Restricted	-	1,596,410	75,981	231,166	894,708	1,537,739	2,041,965	-	12,519	128,933	-	208,772	6,728,193
Committed	-	-	-	-	-	-	-	-	-	-	-	-	-
Assigned	-	-	-	-	-	-	-	-	-	-	-	-	-
Unassigned	(1,051,751)	-	-	-	-	-	-	(77,596)	-	-	(100,585)	-	(1,229,932)
Total fund balances (deficits)	<u>(1,051,751)</u>	<u>1,724,290</u>	<u>88,189</u>	<u>248,740</u>	<u>897,656</u>	<u>1,537,739</u>	<u>2,041,965</u>	<u>(77,596)</u>	<u>12,519</u>	<u>128,933</u>	<u>(100,585)</u>	<u>2,258,772</u>	<u>7,708,871</u>
Total liabilities and fund balances (deficits)	<u>\$ 769,568</u>	<u>\$ 2,308,593</u>	<u>\$ 109,599</u>	<u>\$ 291,290</u>	<u>\$ 1,072,996</u>	<u>\$ 1,858,934</u>	<u>\$ 2,108,875</u>	<u>\$ -</u>	<u>\$ 66,374</u>	<u>\$ 179,784</u>	<u>\$ 37,293</u>	<u>\$ 2,258,772</u>	<u>\$ 11,062,078</u>

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances (Deficits)
Year Ended September 30, 2011

	Education Sector	Health Sector	Environment Sector	Private Sector Development	Capacity Building Sector	Supplemental Education	IMF	Infrastructure	U.S. Federal Grants	Foreign Assistance	CFSM Grants	Compact I Capital Projects	Total
Revenues:													
Compact funding	\$ 9,410,425	\$ 9,258,000	\$ 680,261	\$ 830,000	\$ 1,729,653	\$ 5,292,550	\$ 1,110,694	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 28,311,583
Federal and other grants	-	-	-	-	-	-	-	-	-	106,034	36,015	-	142,049
Total revenues	<u>9,410,425</u>	<u>9,258,000</u>	<u>680,261</u>	<u>830,000</u>	<u>1,729,653</u>	<u>5,292,550</u>	<u>1,110,694</u>	<u>-</u>	<u>-</u>	<u>106,034</u>	<u>36,015</u>	<u>-</u>	<u>28,453,632</u>
Expenditures by function:													
Current:													
General government	-	-	-	-	1,541,242	-	-	77,596	-	104,833	-	-	1,723,671
Health services	-	9,974,090	-	-	-	-	-	-	-	-	-	-	9,974,090
Education	10,462,176	-	-	-	-	3,754,811	-	-	-	-	-	-	14,216,987
Economic development	-	-	592,072	737,584	-	-	103,357	-	-	-	-	-	1,433,013
Public safety	-	-	-	-	-	-	-	-	-	-	55,795	-	55,795
Total expenditures	<u>10,462,176</u>	<u>9,974,090</u>	<u>592,072</u>	<u>737,584</u>	<u>1,541,242</u>	<u>3,754,811</u>	<u>103,357</u>	<u>77,596</u>	<u>-</u>	<u>104,833</u>	<u>55,795</u>	<u>-</u>	<u>27,403,556</u>
Excess (deficiency) of revenues over (under) expenditures	(1,051,751)	(716,090)	88,189	92,416	188,411	1,537,739	1,007,337	(77,596)	-	1,201	(19,780)	-	1,050,076
Other financing sources:													
Operating transfers in	-	-	-	-	-	-	393,065	-	-	-	-	-	393,065
Net change in fund balances (deficits)	(1,051,751)	(716,090)	88,189	92,416	188,411	1,537,739	1,400,402	(77,596)	-	1,201	(19,780)	-	1,443,141
Fund balances (deficits) at the beginning of the year	<u>-</u>	<u>2,440,380</u>	<u>-</u>	<u>156,324</u>	<u>709,245</u>	<u>-</u>	<u>641,563</u>	<u>-</u>	<u>12,519</u>	<u>127,732</u>	<u>(80,805)</u>	<u>2,258,772</u>	<u>6,265,730</u>
Fund balances (deficits) at the end of the year	<u>\$ (1,051,751)</u>	<u>\$ 1,724,290</u>	<u>\$ 88,189</u>	<u>\$ 248,740</u>	<u>\$ 897,656</u>	<u>\$ 1,537,739</u>	<u>\$ 2,041,965</u>	<u>\$ (77,596)</u>	<u>\$ 12,519</u>	<u>\$ 128,933</u>	<u>\$ (100,585)</u>	<u>\$ 2,258,772</u>	<u>\$ 7,708,871</u>

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances (Deficits)
Year Ended September 30, 2011

	Education Sector	Health Sector	Environment Sector	Private Sector Development	Capacity Building Sector	Supplemental Education	IMF	Infrastructure	U.S. Federal Grants	Foreign Assistance	CFSM Grants	Compact I Capital Projects	Total
Revenues:													
Compact funding	\$ 9,410,425	\$ 9,258,000	\$ 680,261	\$ 830,000	\$ 1,729,653	\$ 5,292,550	\$ 1,110,694	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 28,311,583
Federal and other grants	-	-	-	-	-	-	-	-	-	106,034	36,015	-	142,049
Total revenues	<u>9,410,425</u>	<u>9,258,000</u>	<u>680,261</u>	<u>830,000</u>	<u>1,729,653</u>	<u>5,292,550</u>	<u>1,110,694</u>	<u>-</u>	<u>-</u>	<u>106,034</u>	<u>36,015</u>	<u>-</u>	<u>28,453,632</u>
Expenditures by account:													
Salaries and wages:													
Regular	6,331,289	2,524,723	230,492	251,398	-	1,307,987	-	-	-	-	-	-	10,645,889
Overtime	-	625,278	1,316	2,107	-	6,063	-	-	-	-	-	-	634,764
Fringe benefits	704,272	368,087	26,295	36,770	14,176	162,030	-	-	-	-	-	-	1,311,630
Travel and transportation	159,999	127,317	16,877	88,185	45,070	130,635	-	4,022	-	-	3,948	-	576,053
Books and library materials	223,383	-	-	-	4,407	238,806	-	-	-	-	-	-	466,596
Communications	14,395	20,441	13,488	17,822	21,167	43,462	-	-	-	-	1,170	-	131,945
Dues, memberships, and subscriptions	-	2,257	290	150	-	875	-	-	-	-	-	-	3,572
Food stuffs	171,464	226,851	-	326	41	93,274	-	-	-	-	3,406	-	495,362
Freight and port charges	-	1,157	1,106	1,547	126	14,827	-	-	-	-	-	-	18,763
Office supplies and materials	374,518	235,150	86,389	67,696	23,567	345,972	-	-	-	53,491	2,448	-	1,189,231
POL	-	574,237	67,726	33,790	9,656	184,437	-	1,772	-	-	12,840	-	884,458
Printing and reproduction	79,086	15,943	-	-	3,945	9,008	-	-	-	-	-	-	107,982
Rental services	957	13,898	10,683	1,173	254	21,796	-	-	-	-	-	-	48,761
Repairs and maintenance	4,501	161,102	9,672	10,387	2,723	43,404	-	-	-	-	173	-	231,962
Construction materials	-	6,161	6,465	48,661	-	80,806	-	-	-	-	-	-	142,093
Utilities	3,000	373,049	10,200	11,500	3,000	44,311	-	-	-	-	-	-	445,060
Goods and services	2,895	4,222	-	326	1,887	3,340	-	-	-	-	-	-	12,670
Subsidies and contributions	303,279	-	-	-	-	4,301	-	-	-	-	-	-	307,580
Medical referrals	-	81,047	-	-	-	-	-	-	-	-	-	-	81,047
Medical supplies	-	2,451,879	-	-	-	-	-	-	-	-	-	-	2,451,879
Contractual services	866,207	900,937	64,221	70,953	1,000,961	625,353	103,357	71,802	-	-	-	-	3,703,791
Professional services	9,983	-	-	29,777	257,409	51,541	-	-	-	-	-	-	348,710
Housing allowance	-	65,230	6,300	-	-	-	-	-	-	-	-	-	71,530
Scholarships and allowances	807,099	-	-	-	-	-	-	-	-	-	-	-	807,099
Fees and meeting allowances	6,705	-	-	-	-	-	-	-	-	-	-	-	6,705
Training	135,236	21,536	2,700	26,880	-	50,849	-	-	-	-	-	-	237,201
Insurance	-	2,087	-	1,200	-	-	-	-	-	-	-	-	3,287
Leased housing, buildings and land	60,270	157,251	709	18,900	37,823	75,300	-	-	-	-	-	-	350,253
Compensation non-payroll	-	500	-	-	-	-	-	-	-	-	-	-	500
Equipment	133,261	876,917	18,615	13,889	58,530	88,815	-	-	22,724	-	6,325	-	1,219,076
Furniture and fixtures	6,141	54,829	3,158	4,048	2,244	55,920	-	-	-	-	-	-	126,340
Vehicles	64,236	81,992	15,370	-	51,118	71,699	-	-	28,618	-	25,485	-	338,518
Bank charges	-	12	-	99	3,138	-	-	-	-	-	-	-	3,249
Total expenditures	<u>10,462,176</u>	<u>9,974,090</u>	<u>592,072</u>	<u>737,584</u>	<u>1,541,242</u>	<u>3,754,811</u>	<u>103,357</u>	<u>77,596</u>	<u>-</u>	<u>104,833</u>	<u>55,795</u>	<u>-</u>	<u>27,403,556</u>
Excess (deficiency) of revenues over (under) expenditures	(1,051,751)	(716,090)	88,189	92,416	188,411	1,537,739	1,007,337	(77,596)	-	1,201	(19,780)	-	1,050,076
Other financing sources:													
Operating transfers in	-	-	-	-	-	-	393,065	-	-	-	-	-	393,065
Net change in fund balances (deficits)	(1,051,751)	(716,090)	88,189	92,416	188,411	1,537,739	1,400,402	(77,596)	-	1,201	(19,780)	-	1,443,141
Fund balances (deficits) at the beginning of the year	-	2,440,380	-	156,324	709,245	-	641,563	-	12,519	127,732	(80,805)	2,258,772	6,265,730
Fund balances (deficits) at the end of the year	<u>\$ (1,051,751)</u>	<u>\$ 1,724,290</u>	<u>\$ 88,189</u>	<u>\$ 248,740</u>	<u>\$ 897,656</u>	<u>\$ 1,537,739</u>	<u>\$ 2,041,965</u>	<u>\$ (77,596)</u>	<u>\$ 12,519</u>	<u>\$ 128,933</u>	<u>\$ (100,585)</u>	<u>\$ 2,258,772</u>	<u>\$ 7,708,871</u>

See Accompanying Independent Auditors' Report.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

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

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Chuuk as of and for the year ended September 30, 2011, which collectively comprise the State of Chuuk's basic financial statements and have issued our report thereon dated June 25, 2012, which report was qualified with respect to a liability for land leases and related claims payable in the governmental activities and the General Fund and includes a reference for the adoption of a new accounting standard. Except as discussed in the preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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

Internal Control Over Financial Reporting

Management of the State of Chuuk is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the State of Chuuk's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of Chuuk's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Chuuk's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Questioned Costs (pages 67 through 72), we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

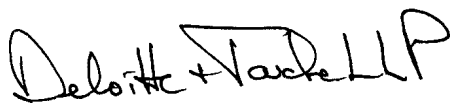
A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 2011-2, 2011-4 and 2011-5 to be a material weaknesses. 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. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 2011-1 and 2011-3 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Chuuk's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The State of Chuuk's response to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the State of Chuuk's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the management of the State of Chuuk, the Honorable Members of the Chuuk State Legislature, others within the entity, federal awarding agencies, pass-through entities, the cognizant audit and other federal agencies, and is not intended to be and should not be used by anyone other than these specified parties.



June 25, 2012

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT
COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND
ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB
CIRCULAR A-133 AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

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

Compliance

We have audited the State of Chuuk's compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on the State of Chuuk's major federal program for the year ended September 30, 2011. The State of Chuuk's major federal program is identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (pages 67 through 72). Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the State of Chuuk's management. Our responsibility is to express an opinion on the State of Chuuk's compliance based on our audit.

As discussed in Note 2b to the Schedule of Expenditures of Federal Awards, the State of Chuuk's basic financial statements include the operations of certain entities whose federal awards are not included in the Schedule of Expenditures of Federal Awards for the year ended September 30, 2011. Our audit, described below, did not include the operations of the entities identified in Note 2b as these entities conducted separate audits in accordance with OMB Circular A-133, if required.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the State of Chuuk's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the State of Chuuk's compliance with those requirements.

In our opinion, the State of Chuuk complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended September 30, 2011. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as item 2011-1.

Internal Control Over Compliance

Management of the State of Chuuk is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the State of Chuuk's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the State of Chuuk's internal control over compliance.

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

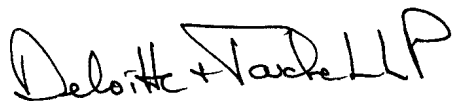
Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies as described in the accompanying Schedule of Findings and Questioned Costs as item 2011-1. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Chuuk as of and for the year ended September 30, 2011, and have issued our report thereon dated June 25, 2012, which report was qualified with respect to a liability for land leases and related claims payable in the governmental activities and the General Fund and includes a reference for the adoption of a new accounting standard. Our audit was performed for the purpose of forming our opinions on the financial statements that collectively comprise the State of Chuuk's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards (pages 62 and 63) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the State of Chuuk. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

The State of Chuuk's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the State of Chuuk's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of the management of the State of Chuuk, the Honorable Members of the Chuuk State Legislature, others within the entity, federal awarding agencies, pass-through entities, the cognizant audit and other federal agencies, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

June 25, 2012

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Summary Schedule of Expenditures of Federal Awards, by Grantor
Year Ended September 30, 2011

<u>Agency/Program</u>	<u>Expenditures</u>
U.S. Department of the Interior	\$ <u>27,242,928</u>
GRAND TOTAL	\$ <u><u>27,242,928</u></u>
Reconciliation to the basic financial statements:	
Grants Assistance Fund	\$ 27,403,556
Less: CFSM Grants	(55,795)
Non-US Grants	<u>(104,833)</u>
	\$ <u><u>27,242,928</u></u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2011

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF THE INTERIOR		
Economic, Social and Political Development of the Territories:		
Compact Sector Grants - Capacity Building Sector		\$ 1,541,242
Compact Sector Grants - Education Sector		10,462,176
Supplemental Education Grant		3,754,811
Compact Sector Grants - Environment Sector		592,072
Compact Sector Grants - Health Sector		9,974,090
Compact Sector Grants - Private Sector Development		737,584
Compact Sector Grants - Infrastructure Maintenance		103,357
Compact Sector Grants - Infrastructure		<u>77,596</u>
Total Compact Sector Grants Fund	15.875	<u>27,242,928</u>
U.S. DEPARTMENT OF THE INTERIOR TOTAL		<u><u>\$ 27,242,928</u></u>

Note: The above grants are received in a subrecipient capacity through the FSM National Government.

See accompanying notes to schedule of expenditures of federal awards.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2011

1. Scope of Audit

The State of Chuuk (the State) is one of the four States of the Federated States of Micronesia. All significant operations of the State are included in the scope of the OMB Circular A-133 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as the State's cognizant agency for Single Audit.

A. Programs Subject to Single Audit

The Schedule of Expenditures of Federal Awards presents each federal program related to the following agency:

- U.S. Department of the Interior

2. Summary of Significant Accounting Policies

A. Basis of Accounting

For purposes of this report, certain accounting procedures were followed which help illustrate the expenditures of the individual programs. All expenses and capital outlays are reported as expenditures on the accrual method of accounting.

B. Reporting Entity

For purposes of complying with The Single Audit Act of 1984, as amended in 1996, the State's reporting entity is defined in Note 1A to its September 30, 2011 basic financial statements; and all of the discretely presented component units are excluded. Accordingly, the accompanying Schedule of Expenditures of Federal Awards presents the federal award programs administered by the State, as defined above, for the year ended September 30, 2011.

C. Subgrantees

Certain program funds are passed through the State to subgrantee organizations. The Schedule of Expenditures of Federal Awards does not contain separate schedules disclosing how all the subgrantees outside of the State's control utilize these funds.

D. Indirect Cost Allocation

The State does not receive any indirect cost allocation and does not charge indirect costs against federal programs.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2011

2. Summary of Significant Accounting Policies, Continued

E. CFDA #15.875

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

3. Component Units

The State's component units are to separately satisfy the requirements of OMB Circular A-133. The following presents information concerning component units, which are to separately satisfy their A-133 requirements.

Chuuk Public Utility Corporation

The Chuuk Public Utility Corporation, (CPUC), a discretely presented component unit, is the recipient of various pass-through funds from Chuuk State and direct grants from the U.S. Department of the Interior. The CPUC is to separately satisfy its 2011 reporting responsibilities under the Single Audit Act.

Chuuk State Housing Authority

The Chuuk State Housing Authority (CSHA), a discretely presented component unit, is the recipient of various pass-through funds from Chuuk State and certain direct grants.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Programs Selected For
Audit in Accordance with OMB Circular A-133
Year Ended September 30, 2011

<u>Program Title</u>	<u>CFDA No.</u>	<u>2011 Fiscal Year Expenditures</u>
<u>U.S. Department of the Interior</u>		
Compact of Free Association:		
Compact Sector Grants	15.875	\$ <u>27,242,928</u>
Total U.S. Federal program expenditures		\$ <u>27,242,928</u>
% of total U.S. Federal expenditures covered by major programs		<u>100%</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2011

Part I - Summary of Auditors' Results

Financial Statements

- | | |
|--|-----------|
| 1. Type of auditors' report issued: | Qualified |
| Internal control over financial reporting: | |
| 2. Material weakness(es) identified? | Yes |
| 3. Significant deficiency(ies) identified? | Yes |
| 4. Noncompliance material to financial statements noted? | No |

Federal Awards

- | | |
|---|---|
| Internal control over major programs: | |
| 5. Material weakness(es) identified? | No |
| 6. Significant deficiency(ies) identified? | Yes |
| 7. Type of auditors' report issued on compliance for major programs: | Unqualified |
| 8. Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? | Yes |
| 9. Identification of major programs: | |
| <u>CFDA Number</u>
15.875 | <u>Federal Program</u>
Economic, Social and Political Development of the Territories – Compact of Free Association Sector Grants |
| 10. Dollar threshold used to distinguish between Type A and Type B Programs: | \$817,287 |
| 11. Auditee qualified as a low-risk auditee? | No |

Part II - Financial Statement Findings Section

<u>Reference #</u>	<u>Findings</u>
2011-1	Equipment and Real Property Management
2011-2	Revenues
2011-3	Revenues
2011-4	Payments to Municipalities
2011-5	Leases payable

Part III - Federal Award Findings and Questioned Cost Section

<u>Reference #</u>	<u>CFDA #</u>	<u>Findings</u>	<u>Questioned Costs</u>
2011-1	15.875	Equipment and Real Property Management	\$ -

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2011

Finding No.: 2011-1
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
Grant Number: Compact of Free Association Compact Sector Grants
Requirement: Equipment and Real Property Management
Questioned Cost: \$0

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

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

Cause: This appears to be a potential weakness in internal control requiring that fixed assets be periodically maintained.

Effect: The expected life of fixed assets may be lessened. However, no questioned costs result from this finding as no specific instances came to our attention in fiscal year 2011 of unnecessary expenditures that occurred due to this condition.

Prior Year Status: Noncompliance with maintenance of fixed assets was reported as a finding in the fiscal years 2006 to 2010 single audits.

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

Auditee Response and Corrective Action: In the current year, effort has been made to put an end to this prior year audit finding. A memo has been disseminated to all departments, agencies and offices in implementing fixed asset inventory and maintenance requesting corresponding department to monitor and document their fixed asset maintenance activities. DAS is taking necessary steps to ensure compliance with federal equipment requirements to clear the stated audit finding.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2011

Finding No.: 2011-2
Area: Revenues

Criteria: A functioning system of internal control requires that daily collections be deposited timely to the bank.

Condition: The following collections were not timely deposited.

<u>Date</u>	<u>ACT_NAME</u>	<u>JNL</u>	<u>TRNS</u>	<u>REF_1</u>	<u>REF_2</u>	<u>Amount</u>	<u>Days Between Receipt and Deposit</u>
1/14/2011	Services Tax	CRJ	57594T-0000000	3024	Tax Servic	\$ (2,021.32)	3
1/14/2011	Alcohol Sales Tax	CRJ	57637T-0000002	3832	Sales Tax	3,108.75	3
2/15/2011	Alcohol Sales Tax	CRJ	59495T-0000003	3819	Tax Paymen	(3,911.25)	1
1/14/2011	Gen Sales Tax	CRJ	57641T-0000000	4133	Tax Sales	(11,613.39)	3
1/17/2011	Gen Sales Tax	CRJ	57752T-0000000	4159	Payment on	(3,553.29)	1
1/17/2011	Gen Sales Tax	CRJ	57812T-0000000	3668	sales tax	(20,280.65)	1
2/15/2011	Gen Sales Tax	CRJ	59447T-0000007	4143	Sales tax	(8,306.36)	1
2/15/2011	Gen Sales Tax	CRJ	59724T-0000000	4215	Sales Tax	(10,903.30)	1
5/13/2011	Gen Sales Tax	CRJ	64657T-0000004	3381	Sales tax	(7,235.47)	1
6/16/2011	Gen Sales Tax	CRJ	66842T-0000001	4189	6% sales t	(1,659.37)	1
7/15/2011	Gen Sales Tax	CRJ	68580T-0000000	3819	Payment fo	(10,881.78)	1
7/15/2011	Gen Sales Tax	CRJ	68663T-0000000	4177	Partial pa	(5,798.46)	1
9/22/2011	Airline Landing Fee	CRJ	73403T-0000000	4175	Collection	(5,116.58)	2
1/3/2011	Airport Departure Fee	CRJ	56649T-0000001	4134	Departure	940.00	1
2/15/2011	Airport Departure Fee	CRJ	59480T-0000000	4134	Departure	(800.00)	1

Cause: The cause of this condition is non-timely cash deposits.

Effect: A potential misstatement of financial statements could result from this condition.

Recommendation: We recommend that the State timely deposit its cash collections.

Auditee Response and Corrective Action: The management agrees with the audit finding and recommendation. It is DAS standard procedure to deposit daily cash collections on the following banking day. Cash collections are put in a safe of restricted access. Unavoidable circumstances such as transportation problems and treasury staff absences caused the delayed of a day or two in the deposits. DAS Treasury is making effort to ensure that daily cash collections are deposited in a timely manner.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2011

Finding No.: 2011-3
Area: Revenues

Criteria: Revenue recorded in the accounting system should be supported by underlying documentation, such as passenger manifests.

Condition: Passenger manifests were not available to support the following:

<u>DATE1</u>	<u>DSP</u>	<u>JNL</u>	<u>TRNS</u>	<u>REF_1</u>	<u>REF_2</u>	<u>REF_3</u>	<u>AMT</u>
1/3/2011	Chuuk International Airport	CRJ	56649T-0000001	4134	Departure	Fee Airport	\$ 940
2/15/2011	Chuuk International Airport	CRJ	59480T-0000000	4134	Departure	Fee Airport	800
5/25/2011	Chuuk International Airport	CRJ	65474T-0000000	4134	departure	Fee Airport	1,040
9/7/2011	Chuuk International Airport	CRJ	72265T-0000000	4134	Departure	Fee Airport	660

Cause: The cause of this condition is the lack of periodic verification of airport collections.

Effect: A potential unrecorded receivable could exist as a result of this matter.

Recommendation: We recommend that the State require that airport collections are appropriately supported.

Auditee Response and Corrective Action: We agree with the finding and recommendation. The tax and revenue supervisor will make sure that airport departure fee collections are verified and reconciled with the certified passenger manifest issued by United Airline. Accordingly, cash receipt for departure fee collections will be supported with passenger manifests and ensure that stated finding will no longer occur.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2011

Finding No.: 2011-4
Area: Payments to Municipalities

Criteria: Disbursements of funds to the municipalities should be subject to standard State accounting controls.

Condition: We were not provided documentary evidence indicating the adequacy of municipal accounting system supporting payments of \$1.5 million to municipalities during the fiscal year. The source of funds used for this payment came from Chuuk State investments administered by the FSM National Government. We were unable to determine if the respective municipalities possess effective accounting systems that can adequately account for and document the use of these funds. We also were not provided with memorandums of agreement executed with the municipalities that set forth terms and conditions underlying the use of these funds.

Cause: The cause of this finding is our inability to access agreements underlying the payments and to establish whether municipal accounting systems are sufficient to protect the State's interests.

Effect: The effect of the condition is potential noncompliance with local laws.

Recommendation: We recommend that disbursements of funds follow local laws and regulations and that these funds be subject to audit.

Auditee Response and Corrective Action: We agree with the finding and recommendation. All the payouts of old Compact CIP were made by the FSM National Government in accordance with the Presidential Order dated January 14, 2010. Although the original MOU for Municipal project payout (dated January 31, 2007) required the Governor's approval of a municipal spending plan, the revised procedure omitted this requirement. For this and other reasons, Chuuk State's Attorney General protested such but the payments went ahead based upon the FSMG's AG's office go ahead.

Consequently, although the Municipalities were required to provide official bank account information to FSM finance prior to the payments, there was no requirement to convey intended uses of each Municipalities prorated funds prior to payout and the Governor's approval was not required for these disbursements. As a result the State had no means to verify that the funds were spent in accordance with its laws and regulations. An attempt to obtain such from the relevant municipalities is in progress.

As of September 30, 2011 most of the Chuuk municipalities had received their proportionate share of investment funds. This was an exceptional transaction in which Chuuk State Government's financial management regulations were overridden by legal opinions and procedures at the national government.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2011

Finding No. 2011-5
Area: Leases Payable

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

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

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

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

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

Auditee Response and Correction Action: We agree with the finding and recommendation. DAS will continue its search and reconstruction activities for the remaining lost lease agreements until finally completed. The finance staff and the DAS legal advisor continue making effort in collaboration with the land management and land commission for the resolution of this audit finding.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Unresolved Prior Year Findings and Questioned Costs
Year Ended September 30, 2011

Questioned Costs

For the year ended September 30, 2011, the following questioned costs were noted and prior questioned costs resolved:

	Questioned Costs Set Forth in Prior Audit Report <u>2010</u>	Questioned Costs Resolved During Fiscal Year <u>2011</u>	Unresolved Questioned Costs at <u>September 30, 2011</u>
Unresolved Questioned Costs FY 10	\$ _____	\$ _____	\$ _____
Questioned Costs FY 11			_____
			\$ <u>_____</u>