

**STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA**

**FINANCIAL STATEMENTS  
AND  
INDEPENDENT AUDITORS' REPORT**

**YEAR ENDED SEPTEMBER 30, 2008**

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

FINANCIAL STATEMENTS  
YEAR ENDED SEPTEMBER 30, 2008

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## INDEPENDENT AUDITORS' REPORT

Honorable Wesley Simina  
Governor, State of Chuuk  
Federated States of Micronesia:

We have audited the accompanying statement of net assets of the governmental activities, and the governmental funds balance sheet for each major fund and the aggregate remaining fund information of the State of Chuuk (the State) as of September 30, 2008. These financial statements, as set forth in Section II of the foregoing table of contents, are the responsibility of the management of the State.

Except as discussed in the following paragraphs, 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.

While detailed property records exist, prior-year records and supporting data were not made available for our audit concerning the underlying costs for capital assets or the bases supporting the stated carrying values. Therefore, we are not able to satisfy ourselves about the amounts at which capital assets and related accumulated depreciation are recorded for the governmental activities in the accompanying statement of net assets at September 30, 2008.

Because of inadequacies in the accounting records, detailed records regarding land acquisitions payable and the underlying supporting documentation evidencing the validity of land acquisition expenditures/expenses for the primary government had not been maintained and were not made available for our audit. Therefore, we are not able to satisfy ourselves about the amounts at which the liabilities for the governmental activities and the General Fund are recorded in the accompanying statement of net assets and governmental funds balance sheet at September 30, 2008.

As discussed in Note 9 to the financial statements, the State has not recorded a liability for land leases and other 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.

Because of inadequacies in the accounting records, detailed records regarding inventory, utility plant, accounts payable and accrued expense account balances for the Chuuk Public Utilities Corporation have not been maintained and certain supporting data were not made available for our audit. The financial activities of the Chuuk Public Utilities Corporation are included in the State's basic financial statements as a discretely presented component unit and represent 68% and 70% of the assets and revenues, respectively, of the State's aggregate discretely presented component units.

The financial statements of the Chuuk State Housing Authority have not been audited, and we were not engaged to audit these financial statements as part of our audit of the State's basic financial statements. The financial activities of the Chuuk State Housing Authority are included in the State's basic financial statements as a discretely presented component unit and represent 17% and 2% of the assets and revenues, respectively, of the State's aggregate discretely presented component units.

Because of the significance of the matters discussed in the sixth through eighth paragraphs above, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements of the aggregate discretely presented component units, the statement of activities for the governmental activities, the governmental funds statement of revenues, expenditures, and changes in fund balances (deficits), and the reconciliation of the statement of revenues, expenditures, and changes in fund balances of governmental funds to the statement of activities for the year ended September 30, 2008.

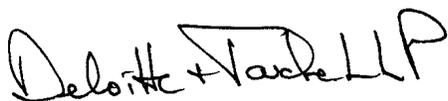
In our opinion, except for the effects of not recording a liability for land leases and our inability to examine evidence supporting other claims payable in the governmental activities and the General Fund, as discussed in the fifth paragraph above, and except for the effects of such adjustments, if any, as might have been determined to be necessary had prior-year records concerning capital assets for governmental activities been adequate, and had the accounting records been adequate for us to satisfy ourselves about land acquisitions payable recorded for the governmental activities and the General Fund, as discussed in the third and fourth paragraphs above, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the State as of September 30, 2008 and the changes in its net assets, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis, on pages 4 through 9, as well as the Schedule of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund and notes thereto, on pages 44 through 46, 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 supplementary information. However, we did not audit such information and we do not express an opinion on it.

As discussed in Note 1 to the financial statements, the beginning net assets of the governmental activities within the accompanying financial statements has been restated.

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 of the State. Such additional information has been subjected to the auditing procedures applied by us 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. Because of the significance of the matter discussed in the sixth paragraph above, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the additional information in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 29, 2009, 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 the 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.

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

June 29, 2009

**STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis  
September 30, 2008

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, 2008. We encourage readers to consider this information in conjunction with Chuuk State's financial statements, which follow. Fiscal year 2007 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, 2008, Chuuk State's total net assets decreased by \$1.68 million (or 2.7%) from \$62.34 million in the prior year to \$60.66 million. This decrease was the result of foreign exchange losses on Chuuk State's ADB loans and unrestricted investment losses on its Early Retirement fund investment portfolio.
- During fiscal year 2008, Chuuk State's revenues of \$24.95 million declined from \$31.58 million (down 21%) in fiscal year 2007. The decline was attributable to investment losses in fiscal year 2008 on its Early Retirement and Compact Trust Fund portfolios. Expenditures in fiscal year 2008 of \$26.54 million also declined \$2.81 million (or 9.6 %) from \$29.35 million in fiscal year 2007. The decline in expenses reflects the Chuuk State's fiscal restraints to control expenditures within the ceiling of actual revenue collections and the added savings from a reduction in force implemented in fiscal year 2008. Special items of (\$0.42) million in fiscal year 2008 were also down \$2.66 million (or 86%) from \$3.08 million in the prior year due to the difference in liability write-offs Chuuk State undertook in fiscal year 2007 vs. in 2008.
- The General Fund incurred a deficit in its budget in fiscal year 2008: actual revenues of \$4.19 million were \$1.71 million lower (or 29%) than expenditures of \$5.9 million. This deficit was due in part to the result of a decrease in the value of investments which declined \$0.79 million. The expenditure budget reflected a positive budget variance. General fund expenditures of \$5.9 million were \$0.07 million (or 1.2%) less than general fund appropriations of \$5.97 million.
- During fiscal year 2008, Chuuk State's general fund balance deficit decreased by \$3.53 million (or 29%); decreasing from \$12.11 million in the prior year to \$8.58 million. The decrease is the result of the \$3.5 million grant from the People's Republic of China that was that was transferred in to the general fund and used to liquidate prior year liabilities.

**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 indicator to measure Chuuk State's financial position.

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Management's Discussion and Analysis  
September 30, 2008

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

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

- **Governmental Activities** - Most of Chuuk State's basic services are included here, such as education, health, special appropriations, finance, judiciary, and general administration. Compact sector and other federal grants finance most of these activities.
- **Component Units** - Chuuk State includes the operating results of the Chuuk State Health Care Plan, the Chuuk Public Utility Corporation, and the Chuuk 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 statement, 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 Compact Sector Grants Fund, the U.S. Federal Grants 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 2008, Chuuk State's assets exceeded liabilities by \$60.75 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 provide 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, 2007, with comparable balances for fiscal year 2007, discloses this relationship.

|                                      | <u>2008</u>       | <u>2007</u>       |
|--------------------------------------|-------------------|-------------------|
| Current and other non-capital assets | \$ 19,250,209     | \$ 23,650,670     |
| Capital assets                       | <u>66,120,790</u> | <u>67,391,235</u> |
| Total Assets                         | <u>85,370,999</u> | <u>91,041,905</u> |
| Long-term liabilities                | 9,524,505         | 7,761,051         |
| Other liabilities                    | <u>15,190,075</u> | <u>19,732,711</u> |
| Total Liabilities                    | <u>24,714,580</u> | <u>27,493,762</u> |

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Management's Discussion and Analysis  
September 30, 2008

|   |                      |                      |
|---|----------------------|----------------------|
| Net Assets:                                     |                      |                      |
| Invested in capital assets, net of related debt | 66,120,790           | 67,391,235           |
| Restricted                                      | 17,516,915           | 21,932,518           |
| Unrestricted                                    | <u>(22,981,286)</u>  | <u>(25,779,315)</u>  |
| Total Net Assets                                | \$ <u>60,656,419</u> | \$ <u>63,544,438</u> |

At the end of fiscal year 2008 Chuuk State's unrestricted assets showed a deficit of \$22.98 million, a decrease of \$2.8 million (or 11.2%) 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 vendors 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 \$1.68 million (or 2.7%) from the prior year. Key elements of the decrease and the differences from the prior year are shown in the following schedule:

|  | <u>2008</u>          | <u>2007</u>          |
|--|----------------------|----------------------|
| Revenues:                                      |                      |                      |
| Program revenues:                              |                      |                      |
| Charges for services                           | \$ 1,001,670         | \$ 896,227           |
| Operating grants and contributions             | 22,165,679           | 23,219,888           |
| Capital Grants and contributions               | (1,466,665)          | 1,267,090            |
| General Revenues:                              |                      |                      |
| Taxes  | 3,837,966            | 3,864,578            |
| Unrestricted investment earnings (losses)      | (787,438)            | 1,851,965            |
| Other  | <u>202,583</u>       | <u>483,938</u>       |
| Total revenues                                 | <u>24,953,795</u>    | <u>31,583,686</u>    |
| Expenses:                                      |                      |                      |
| General government                             | 5,874,817            | 4,625,740            |
| Health Services                                | 7,388,592            | 5,825,991            |
| Education                                      | 9,408,457            | 11,150,145           |
| Economic development                           | 360,407              | 713,593              |
| Public Safety                                  | 904,667              | 1,428,484            |
| Public works and transportation                | 2,059,799            | 2,323,457            |
| Community Affairs                              | -                    | 302,304              |
| Boards and commissions                         | 1,486,207            | 611,387              |
| Judiciary                                      | 406,764              | 553,728              |
| Payments to components                         | 207,125              | 205,545              |
| Municipal Affairs                              | 139,551              | 633,208              |
| Other  | <u>33,761</u>        | <u>1,021,515</u>     |
| Total expenses                                 | <u>28,270,147</u>    | <u>29,395,097</u>    |
| Special Items:                                 |                      |                      |
| Recovery on previously written off receivables | -                    | 1,049,602            |
| Write-down of investments                      | -                    | (1,202,005)          |
| Write-off of liabilities                       | <u>428,333</u>       | <u>3,233,483</u>     |
| Total special items                            | <u>(428,333)</u>     | <u>3,081,080</u>     |
| Change in net assets                           | (1,683,732)          | 5,269,669            |
| Net assets at the beginning of the year        | <u>63,544,538</u>    | <u>58,274,769</u>    |
| Net assets at the end of the year              | \$ <u>60,656,419</u> | \$ <u>63,544,538</u> |

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Management's Discussion and Analysis  
September 30, 2008

The detail indicates the significant decline in both revenues and expenditures in fiscal year 2008.

Revenues of \$24.95 million decreased \$6.63 million (or 21%) from the prior year's \$31.58 million primarily from the significant losses on Compact Trust Fund and Early Retirement Fund investment portfolios. These investment funds are pooled with other FSM States and managed by outside money managers. In fiscal year 2008, Chuuk's portion of the Compact Trust fund investments declined \$1.47 million to \$7.03 million, vs. \$8.50 million in fiscal year 2007. The losses reflect the overall decline of world stock markets in fiscal year 2008 and hence, were outside of Chuuk State's control.

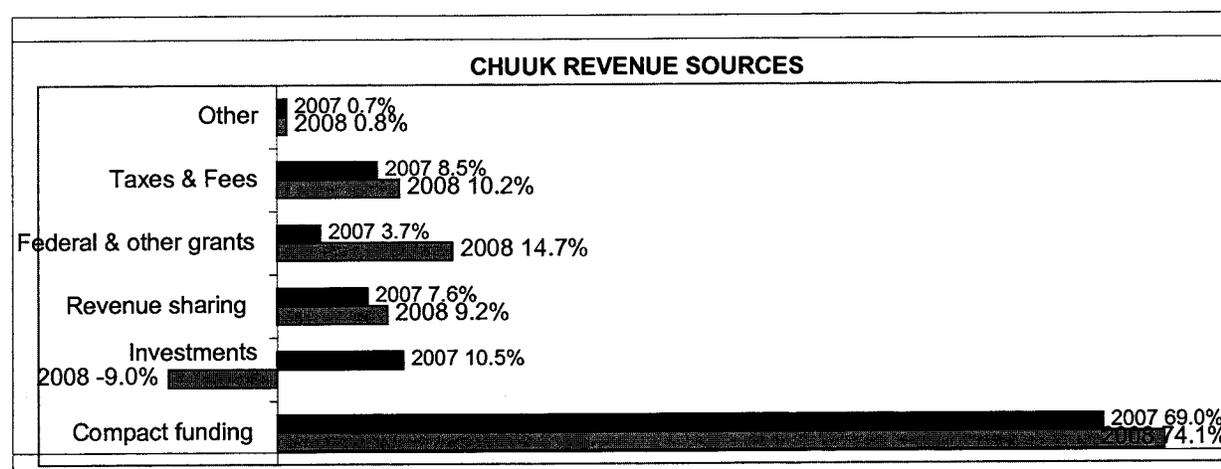
In fiscal year 2008, operating grants and contributions of \$22.11 million declined 4.3% from \$23.22 in fiscal year 2007. The composition of this revenue category also changed as the following table illustrates:

|   | 2008            | 2007            | PY CHANGE        | %             |
|---|-----------------|-----------------|------------------|---------------|
|   | (IN MILLIONS)   | (IN MILLIONS)   | (IN MILLIONS)    | CHANGE        |
| Compact Grants                                  | \$ 18.50        | \$ 22.13        | \$ (3.63)        | 16.4%         |
| People's Republic of China Grant                | 3.50            | -               | 3.50             | NA            |
| Other U.S. Federal Grants                       | 0.17            | 1.09            | (0.92)           | (84.4%)       |
| <b>Total Operating Grants and Contributions</b> | <b>\$ 22.17</b> | <b>\$ 23.22</b> | <b>\$ (1.05)</b> | <b>(4.5%)</b> |

The decline in Compact sector grants was the result of underutilization of education and special education sector grants as well as the suspension by U.S. Office of Insular Affairs of non-conforming programs under the private, environmental and public capacity building sectors.

If investment losses and gains and outside grants are eliminated from revenue totals, total revenue sharing, taxes and fees, and departmental charges of \$4.84 million in fiscal year 2008 showed a modest increase of \$0.08 million (or 1.7%) from the \$4.76 million comparable totals in fiscal year 2007.

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



Total expenses of \$27.07 million in fiscal year 2008 decreased \$2.81 million (or 9.57%) from \$29.35 million of expenditures in fiscal year 2007. Significant reductions were the \$1.08 million decline (9.7%) in expenditures for education as the result of underutilization of education sector grants; a reduction of \$0.38 (32%) million in public works infrastructure expenditures, and a decline in general fund personnel expenditures of approximately \$1.1 million as the result of the reduction in force implemented by the government.

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Management's Discussion and Analysis  
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In fiscal year 2008 Chuuk State's net assets were also negatively affected by foreign exchange losses of \$0.23 million on its ADB loans. This loss was partially off-set by a \$0.43 million write-down in liabilities for land purchases as the result of debt forgiveness agreements with various landowners. The \$0.43 million increase in net assets resulting from this matter compares unfavorably with the \$1.88 million increase in fiscal year 2007, wherein Chuuk State undertook a program to analyze and write-off prior year medical referral and other liabilities. The aforementioned foreign exchange losses have been included in general government expenses.

**FINANCIAL ANALYSIS OF CHUUK STATE'S FUNDS**

As noted earlier, Chuuk State uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. As of the end of fiscal year 2008, Chuuk State's governmental funds reported a combined fund balance of \$4.63 million which represents a \$0.16 million increase (or 3.6%) from the \$4.47 million deficit fund balance recorded at the end of fiscal 2007. This increase is attributable to the reduction of the unreserved general fund deficit by \$7.2 million during the year ended September 30, 2008. Of this total combined fund balance, \$20.72 million is reversed to indicate that it is not available for new spending because it has already been committed: 1) to generate income for future operations (\$7.03 million); 2) to liquidate contracts and purchase orders of the prior period (\$3.43 million) or; 3) to fund specific general fund-related activities (\$10.26 million). These reserved fund balances are off-set by a combined deficit of \$16.09 million, a decrease of \$6.68 million (or 29.3%) from fiscal year 2007.

**GENERAL FUND BUDGETARY HIGHLIGHTS**

During the fiscal year, actual expenditures were less than the budgetary appropriations by \$1.7 million, resulting in a budgetary deficit of \$0.4 million. Offsetting the general fund deficiency of revenues under expenditures was the \$3.5 million grant from the People's Republic of China, a \$0.43 million reduction in land purchase liabilities, and a .98 million decrease in reserves for continuing appropriations and debt service. When combined with the operating deficit these positive offsets reduced the general fund deficit by \$3.53 million.

**CAPITAL ASSET AND DEBT ADMINISTRATION**

Capital Assets

Chuuk State's investment in capital assets for the primary government as of September 30, 2008, amounted to \$89.94 million, net of accumulated depreciation of \$23.82 million, leaving a net book value of \$66.12 million. This represents a net decrease of \$1.27 million (or 1.9%) from fiscal year 2007. The table below summarizes Chuuk State's capital assets:

|                            | <u>2008</u>          | <u>2007</u>          |
|----------------------------|----------------------|----------------------|
| Land                       | \$ 24,392,433        | \$ 24,392,433        |
| Airport Facilities         | 23,299,610           | 24,014,767           |
| Buildings                  | 6,671,010            | 6,159,482            |
| Seaport Facilities         | 4,925,312            | 5,205,514            |
| Vehicles / other equipment | 850,543              | 1,226,878            |
| Infrastructure             | <u>5,981,882</u>     | <u>6,392,162</u>     |
|                            | \$ <u>66,120,790</u> | \$ <u>67,391,235</u> |

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

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Management's Discussion and Analysis  
September 30, 2008

Long-Term Debt

The following schedule shows Chuuk State's non-current liabilities for fiscal year 2008 and comparable amounts for fiscal year 2007.

|   | <u>2008</u>         | <u>2007</u>         |
|---|---------------------|---------------------|
| ADB Early Retirement Loan                     | \$ 5,300,000        | \$ 5,300,000        |
| ADB Private Sector Reform Program Loan (1873) | 739,840             | 650,000             |
| ADB Private Sector Reform Program Loan (1874) | 866,110             | 523,083             |
| ADB Basic Social Services Program Loan (1816) | <u>1,359,662</u>    | <u>241,957</u>      |
| Total noncurrent liabilities                  | \$ <u>8,926,927</u> | \$ <u>6,715,040</u> |

Long-term debt obligations increased by \$2.21 million (or 31.8%) in fiscal year 2008 as the result of expanded participation in the Private sector and basic social services program loans (\$1.21 million) and exchange losses incurred on the SDR currency funding the loans (\$.23 million).

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

**ECONOMIC FACTORS AND NEXT YEAR'S BUDGET**

The fiscal discipline characterizing Chuuk State operations in fiscal year 2008 has continued into fiscal year 2009:

- The State is maintaining general fund expenditures within revenue collections in fiscal year 2009 by only allotting appropriations if there is revenue to cover them.
- The permanent effects of reducing the reduction in force (RIF) in fiscal year 2008 (elimination of 307 positions and \$1.17 million in personnel expense savings) continue into fiscal year 2009 where no new positions have been added.
- Debt reduction efforts of prior year liabilities continue in fiscal year 2009 with some \$0.39 million of old US federal grant invoices having been paid.

In spite of being able to rationalize budgetary operations within the confines of a balanced budget for the past two fiscal years, the State is still not meeting general fund revenue projections and is consequently not funding certain important programs. The non-funding of infrastructure (sector) maintenance matching and debt relief fund transfer payments are two such general fund programs that have been cut because of deficiency of revenues under appropriations. Hence, increasing local revenue collections will be a top priority in fiscal year 2009 and beyond. Additionally, staunching the decline of the education sector grants, the largest of the Compact transfer payments, will also need to be addressed. Also, in order to overcome the holdup of infrastructure project implementation it will be necessary for the State to more aggressively tackle land disputes and sort out its liabilities for land purchases and leases. Finally, if the acute world economic problems that are ongoing in fiscal year 2009 continue to have negative fiscal impacts, Chuuk State will need to further reduce the cost of its government in order to live within reduced means.

**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 189, Weno, Chuuk FM 96942.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Statement of Net Assets  
September 30, 2008

|  | Primary<br>Government | Component<br>Units |
|--|-----------------------|--------------------|
| <u>ASSETS</u>  |                       |                    |
| Current assets:                                      |                       |                    |
| Cash and cash equivalents                            | \$ 811,919            | \$ 231,465         |
| Time certificates of deposit                         | -                     | 450,000            |
| Equity interest in internal investment pool          | 2,434,305             | -                  |
| Receivables, net of allowance for uncollectibles     | 1,464,744             | 1,370,062          |
| Inventories  | -                     | 195,861            |
| Prepayments  | 642,286               | 350                |
| Restricted assets:                                   |                       |                    |
| Cash and cash equivalents                            | -                     | -                  |
| Total current assets                                 | 5,353,254             | 2,247,738          |
| Noncurrent assets:                                   |                       |                    |
| Restricted assets:                                   |                       |                    |
| Investments  | 11,423,455            | -                  |
| Investments  | 2,473,500             | -                  |
| Capital assets, net of accumulated depreciation      | 66,120,790            | 3,109,216          |
| Total noncurrent assets                              | 80,017,745            | 3,109,216          |
| Total assets   | \$ 85,370,999         | \$ 5,356,954       |
| <u>LIABILITIES</u>                                   |                       |                    |
| Current liabilities:                                 |                       |                    |
| Bank overdraft                                       | \$ -                  | \$ 111,346         |
| Current portion of long-term debt                    | 122,062               | 939,138            |
| Notes payable  | 561,987               | -                  |
| Accounts payable                                     | 5,058,630             | 111,945            |
| Land acquisition payable                             | 8,611,373             | -                  |
| Compensated absences payable                         | 450,000               | -                  |
| Other liabilities and accruals                       | 386,023               | 2,404,499          |
| Deferred revenues                                    | -                     | 287,693            |
| Total current liabilities                            | 15,190,075            | 3,854,621          |
| Noncurrent liabilities:                              |                       |                    |
| Noncurrent portion of long-term obligations          | 8,025,186             | 3,522,834          |
| Compensated absences payable, net of current portion | 1,499,319             | -                  |
| Total noncurrent liabilities                         | 9,524,505             | 3,522,834          |
| Total liabilities                                    | 24,714,580            | 7,377,455          |
| <u>NET ASSETS</u>                                    |                       |                    |
| Invested in capital assets, net of related debt      | 66,120,790            | (1,352,756)        |
| Restricted for:                                      |                       |                    |
| Nonexpendable:                                       |                       |                    |
| Future operations                                    | 7,032,909             | 651,233            |
| Expendable:  |                       |                    |
| Compact related                                      | 4,884,110             | -                  |
| Debt service   | 4,390,546             | -                  |
| Other purposes                                       | 1,209,350             | -                  |
| Unrestricted   | (22,981,286)          | (1,318,978)        |
| Total net assets                                     | 60,656,419            | (2,020,501)        |
| Total liabilities and net assets                     | \$ 85,370,999         | \$ 5,356,954       |

See accompanying notes to basic financial statements.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Statement of Activities  
Year Ended September 30, 2008

| Functions/Programs                      | Expenses             | Program Revenues        |  | Net (Expenses) Revenues and<br>Changes in Net Assets |                       |                       |
|---|----------------------|-------------------------|--|--|-----------------------|-----------------------|
|   |                      | Charges for<br>Services | Operating<br>Grants and<br>Contributions | Capital<br>Grants and<br>Contributions               | Primary<br>Government | Component<br>Units    |
| <b>Primary government:</b>              |                      |                         |  |  |                       |                       |
| Governmental activities:                |                      |                         |  |  |                       |                       |
| General government                      | \$ 5,874,817         | \$ 333,237              | \$ 3,990,477                             | \$ -   | \$ (1,551,103)        | \$ -                  |
| Health services                         | 7,388,592            | -                       | 6,732,451                                | -  | (656,141)             | -                     |
| Education                               | 9,408,457            | -                       | 9,574,173                                | -  | 165,716               | -                     |
| Economic development                    | 360,407              | -                       | 229,088                                  | -  | (131,319)             | -                     |
| Public safety                           | 904,667              | 43,416                  | 136,328                                  | -  | (724,923)             | -                     |
| Public works and transportation         | 2,059,799            | 625,017                 | -  | -  | (1,434,782)           | -                     |
| Boards and commissions                  | 1,486,207            | -                       | 1,296,037                                | -  | (190,170)             | -                     |
| Judiciary                               | 406,764              | -                       | -  | -  | (406,764)             | -                     |
| Payments to component units             | 207,125              | -                       | 207,125                                  | -  | -                     | -                     |
| Municipal affairs                       | 139,551              | -                       | -  | -  | (139,551)             | -                     |
| Future operations                       | -                    | -                       | -  | (1,466,665)  | (1,466,665)           | -                     |
| Other                                   | 33,761               | -                       | -  | -  | (33,761)              | -                     |
| Total primary government                | <u>\$ 28,270,147</u> | <u>\$ 1,001,670</u>     | <u>\$ 22,165,679</u>                     | <u>\$ (1,466,665)</u>                                | <u>(6,569,463)</u>    | <u>-</u>              |
| <b>Component units:</b>                 |                      |                         |  |  |                       |                       |
| Chuuk State Health Care Plan            | \$ 992,387           | \$ 767,323              | \$ -                                     | \$ -   | -                     | (225,064)             |
| Chuuk Public Utility Corporation        | 4,731,706            | 2,421,386               | 384,473                                  | -  | -                     | (1,925,847)           |
| Chuuk State Housing Authority           | 169,947              | 79,656                  | -  | -  | -                     | (90,291)              |
| Total component units                   | <u>\$ 5,894,040</u>  | <u>\$ 3,268,365</u>     | <u>\$ 384,473</u>                        | <u>\$ -</u>  | <u>-</u>              | <u>(2,241,202)</u>    |
| <b>General revenues:</b>                |                      |                         |  |  |                       |                       |
| Taxes:                                  |                      |                         |  |  |                       |                       |
| Revenue sharing                         |                      |                         |  |  |                       |                       |
|   |                      |                         |  |  | 2,306,567             | -                     |
| Excise taxes                            |                      |                         |  |  |                       |                       |
|   |                      |                         |  |  | 1,531,399             | -                     |
| Unrestricted investment losses          |                      |                         |  |  |                       |                       |
|   |                      |                         |  |  | (787,438)             | -                     |
| Other                                   |                      |                         |  |  |                       |                       |
|   |                      |                         |  |  | 202,583               | 29,653                |
| Total general revenues                  |                      |                         |  |  |                       |                       |
|   |                      |                         |  |  | <u>3,253,111</u>      | <u>29,653</u>         |
| <b>Special items:</b>                   |                      |                         |  |  |                       |                       |
| Write-off of liabilities                |                      |                         |  |  |                       |                       |
|   |                      |                         |  |  | 428,333               | -                     |
| Change in net assets                    |                      |                         |  |  |                       |                       |
|   |                      |                         |  |  | (2,888,019)           | (2,211,549)           |
| Net assets at the beginning of the year |                      |                         |  |  |                       |                       |
|   |                      |                         |  |  | <u>63,544,438</u>     | <u>191,048</u>        |
| Net assets at the end of the year       |                      |                         |  |  |                       |                       |
|   |                      |                         |  |  | <u>\$ 60,656,419</u>  | <u>\$ (2,020,501)</u> |

See accompanying notes to basic financial statements.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Balance Sheet  
Governmental Funds  
September 30, 2008

|   | General              | Special<br>Revenue<br>Grants<br>Assistance | Permanent<br>Compact<br>Trust | Other<br>Governmental<br>Funds | Total                |
|---|----------------------|--|-------------------------------|--------------------------------|----------------------|
| <b>ASSETS</b>   |                      |  |                               |                                |                      |
| Cash and cash equivalents   | \$ 811,919           | \$ -                                       | \$ -                          | \$ -                           | \$ 811,919           |
| Equity interest in internal investment pool   | 2,434,305            | -  | -                             | -                              | 2,434,305            |
| Investments   | -                    | 2,473,500                                  | -                             | -                              | 2,473,500            |
| Receivables, net:   |                      |  |                               |                                |                      |
| FSM National Government   | 545,171              | 919,573                                    | -                             | -                              | 1,464,744            |
| Prepayments   | 97,118               | 545,168                                    | -                             | -                              | 642,286              |
| Due from other funds  | 2,109,430            | 4,112,530                                  | -                             | 1,196,831                      | 7,418,791            |
| Restricted assets:  |                      |  |                               |                                |                      |
| Investments   | 4,390,546            | -  | 7,032,909                     | -                              | 11,423,455           |
| Total assets  | <u>\$ 10,388,489</u> | <u>\$ 8,050,771</u>                        | <u>\$ 7,032,909</u>           | <u>\$ 1,196,831</u>            | <u>\$ 26,669,000</u> |
| <b>LIABILITIES AND FUND BALANCES</b>  |                      |  |                               |                                |                      |
| Liabilities:  |                      |  |                               |                                |                      |
| Accounts payable  | \$ 4,214,617         | \$ 844,013                                 | \$ -                          | \$ -                           | \$ 5,058,630         |
| Accrued liabilities   | 272,874              | 113,149                                    | -                             | -                              | 386,023              |
| Land acquisition payable  | 8,611,373            | -  | -                             | -                              | 8,611,373            |
| Note payable  | 561,987              | -  | -                             | -                              | 561,987              |
| Due to other funds  | 5,309,361            | 2,109,430                                  | -                             | -                              | 7,418,791            |
| Total liabilities   | <u>18,970,212</u>    | <u>3,066,592</u>                           | <u>-</u>                      | <u>-</u>                       | <u>22,036,804</u>    |
| Fund balances (deficits):   |                      |  |                               |                                |                      |
| Reserved for:   |                      |  |                               |                                |                      |
| Related assets  | -                    | 2,473,500                                  | 7,032,909                     | 1,196,831                      | 10,703,240           |
| Encumbrances  | 447,946              | 2,986,017                                  | -                             | -                              | 3,433,963            |
| Continuing appropriations   | 2,196,255            | -  | -                             | -                              | 2,196,255            |
| Debt service  | 4,390,546            | -  | -                             | -                              | 4,390,546            |
| Unreserved:   |                      |  |                               |                                |                      |
| General fund  | (15,616,470)         | -  | -                             | -                              | (15,616,470)         |
| Special revenue funds   | -                    | (475,338)                                  | -                             | -                              | (475,338)            |
| Total fund balances (deficits)  | <u>(8,581,723)</u>   | <u>4,984,179</u>                           | <u>7,032,909</u>              | <u>1,196,831</u>               | <u>4,632,196</u>     |
| Total liabilities and fund balances   | <u>\$ 10,388,489</u> | <u>\$ 8,050,771</u>                        | <u>\$ 7,032,909</u>           | <u>\$ 1,196,831</u>            |                      |
| 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  |                      |  |                               |                                |                      |
|   |                      |  |                               |                                | 66,120,790           |
| 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: |                      |  |                               |                                |                      |
|   |                      |  |                               | (8,147,248)                    |                      |
|   |                      |  |                               | (1,949,319)                    |                      |
|   |                      |  |                               |                                | <u>(10,096,567)</u>  |
| Net assets of governmental activities   |                      |  |                               |                                | <u>\$ 60,656,419</u> |

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, 2008

|  | General               | Special<br>Revenue<br>Grants<br>Assistance | Permanent<br>Compact<br>Trust | Other<br>Governmental<br>Funds | Total               |
|--|-----------------------|--|-------------------------------|--------------------------------|---------------------|
| <b>Revenues:</b>   |                       |  |                               |                                |                     |
| Compact funding  | \$ -                  | \$ 18,496,298                              | \$ -                          | \$ -                           | \$ 18,496,298       |
| Net decrease in the fair value of investments                | (787,438)             | -  | (1,466,665)                   | -                              | (2,254,103)         |
| Federal contributions and other grants                       | -                     | 3,669,381                                  | -                             | -                              | 3,669,381           |
| Revenue sharing  | 2,306,567             | -  | -                             | -                              | 2,306,567           |
| Excise taxes   | 1,531,399             | -  | -                             | -                              | 1,531,399           |
| Fees and charges   | 310,567               | 45,998                                     | -                             | 20,088                         | 376,653             |
| Departmental charges   | 625,017               | -  | -                             | -                              | 625,017             |
| Other  | 202,583               | -  | -                             | -                              | 202,583             |
| Total revenues   | <u>4,188,695</u>      | <u>22,211,677</u>                          | <u>(1,466,665)</u>            | <u>20,088</u>                  | <u>24,953,795</u>   |
| <b>Expenditures:</b>   |                       |  |                               |                                |                     |
| <b>Current:</b>  |                       |  |                               |                                |                     |
| General government   | 2,382,348             | 2,506,446                                  | -                             | -                              | 4,888,794           |
| Health services  | 554,958               | 6,732,451                                  | -                             | -                              | 7,287,409           |
| Education  | 554,958               | 9,531,119                                  | -                             | -                              | 10,086,077          |
| Economic development   | 131,319               | 229,088                                    | -                             | -                              | 360,407             |
| Public safety  | 749,047               | 136,328                                    | -                             | -                              | 885,375             |
| Public works and transportation                              | 761,162               | -  | -                             | -                              | 761,162             |
| Boards and commissions                                       | 190,170               | 1,296,037                                  | -                             | -                              | 1,486,207           |
| Payments to component units                                  | -                     | 207,125                                    | -                             | -                              | 207,125             |
| Judiciary  | 406,764               | -  | -                             | -                              | 406,764             |
| Municipal affairs  | 139,551               | -  | -                             | -                              | 139,551             |
| Other  | 33,761                | -  | -                             | -                              | 33,761              |
| Total expenditures   | <u>5,904,037</u>      | <u>20,638,594</u>                          | <u>-</u>                      | <u>-</u>                       | <u>26,542,631</u>   |
| Excess (deficiency) of revenues<br>over (under) expenditures | <u>(1,715,342)</u>    | <u>1,573,083</u>                           | <u>(1,466,665)</u>            | <u>20,088</u>                  | <u>(1,588,836)</u>  |
| <b>Other financing sources (uses):</b>                       |                       |  |                               |                                |                     |
| Proceeds from debt   | 1,322,649             | -  | -                             | -                              | 1,322,649           |
| Transfers in from other funds                                | 3,499,999             | -  | -                             | -                              | 3,499,999           |
| Transfers out to other funds                                 | -                     | (3,499,999)                                | -                             | -                              | (3,499,999)         |
| Total other financing sources<br>(uses), net                 | <u>4,822,648</u>      | <u>(3,499,999)</u>                         | <u>-</u>                      | <u>-</u>                       | <u>1,322,649</u>    |
| <b>Special items:</b>  |                       |  |                               |                                |                     |
| Write-off of liabilities                                     | 428,333               | -  | -                             | -                              | 428,333             |
| Total special items  | <u>428,333</u>        | <u>-</u>                                   | <u>-</u>                      | <u>-</u>                       | <u>428,333</u>      |
| Net change in fund balances (deficit)                        | 3,535,639             | (1,926,916)                                | (1,466,665)                   | 20,088                         | 162,146             |
| Fund balances (deficits) at the<br>beginning of the year     | <u>(12,117,361)</u>   | <u>6,911,095</u>                           | <u>8,499,574</u>              | <u>1,176,743</u>               | <u>4,470,051</u>    |
| Fund balances (deficits) at the<br>end of the year           | <u>\$ (8,581,722)</u> | <u>\$ 4,984,179</u>                        | <u>\$ 7,032,909</u>           | <u>\$ 1,196,831</u>            | <u>\$ 4,632,197</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, 2008

Amounts reported for governmental activities in the statement of activities on page 11 are different because:

|  |                       |
|--|-----------------------|
| Net change in fund balances - total governmental funds from page 13  | \$ 162,145            |
| 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  | (1,270,445)           |
| 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:   |                       |
| Compensated absences   | (347,511)             |
| The issuance 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. This amount is the net effect of these differences in the treatment of long-term debt and related items | <u>(1,432,208)</u>    |
| Change in net assets of governmental activities as presented on page 11  | \$ <u>(2,888,019)</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, 2008

| <u>ASSETS</u>                                   | <u>Chuuk State<br/>Health Care<br/>Plan</u> | <u>Chuuk<br/>Public Utility<br/>Corporation</u> | <u>Chuuk<br/>State Housing<br/>Authority</u> | <u>Total</u>        |
|---|---|---|--|---------------------|
| Current assets:                                 |   |   |  |                     |
| Cash and cash equivalents                       | \$ 162,816                                  | \$ 4,854  | \$ 63,795                                    | \$ 231,465          |
| Time certificates of deposit                    | 450,000                                     | -   | -  | 450,000             |
| Receivables, net:                               |   |   |  |                     |
| General   | 149,594                                     | 344,502   | 252,232                                      | 746,328             |
| Loans   | -   | -   | 623,734                                      | 623,734             |
| Inventories                                     | -   | 195,861   | -  | 195,861             |
| Prepayments                                     | 350   | -   | -  | 350                 |
|   | <u>762,760</u>                              | <u>545,217</u>                                  | <u>939,761</u>                               | <u>2,247,738</u>    |
| Total current assets                            |   |   |  |                     |
| Noncurrent assets:                              |   |   |  |                     |
| Capital assets, net of accumulated depreciation | 34,915                                      | 2,961,336                                       | 112,965                                      | 3,109,216           |
|   | <u>34,915</u>                               | <u>2,961,336</u>                                | <u>112,965</u>                               | <u>3,109,216</u>    |
| Total assets                                    | <u>\$ 797,675</u>                           | <u>\$ 3,506,553</u>                             | <u>\$ 1,052,726</u>                          | <u>\$ 5,356,954</u> |
| <u>LIABILITIES AND NET ASSETS</u>               |   |   |  |                     |
| Current liabilities:                            |   |   |  |                     |
| Bank overdraft                                  | \$ -  | \$ 111,346                                      | \$ -   | \$ 111,346          |
| Current portion of long-term debt               | -   | 939,138   | -  | 939,138             |
| Accounts payable                                | 111,527                                     | -   | 418  | 111,945             |
| Accrued liabilities                             | -   | 2,404,499                                       | -  | 2,404,499           |
| Deferred income                                 | -   | 287,693   | -  | 287,693             |
|   | <u>111,527</u>                              | <u>3,742,676</u>                                | <u>418</u>                                   | <u>3,854,621</u>    |
| Total current liabilities                       |   |   |  |                     |
| Noncurrent liabilities:                         |   |   |  |                     |
| Noncurrent portion of long-term debt            | -   | 3,522,834                                       | -  | 3,522,834           |
|   | <u>-</u>                                    | <u>3,522,834</u>                                | <u>-</u>                                     | <u>3,522,834</u>    |
| Total noncurrent liabilities                    |   |   |  |                     |
| Total liabilities                               | <u>111,527</u>                              | <u>7,265,510</u>                                | <u>418</u>                                   | <u>7,377,455</u>    |
| Net assets:                                     |   |   |  |                     |
| Invested in capital assets, net of related debt | 34,915                                      | (1,500,636)                                     | 112,965                                      | (1,352,756)         |
| Restricted                                      | 651,233                                     | -   | -  | 651,233             |
| Unrestricted                                    | -   | (2,258,321)                                     | 939,343                                      | (1,318,978)         |
|   | <u>686,148</u>                              | <u>(3,758,957)</u>                              | <u>1,052,308</u>                             | <u>(2,020,501)</u>  |
| Total net assets                                |   |   |  |                     |
| Total liabilities and net assets                | <u>\$ 797,675</u>                           | <u>\$ 3,506,553</u>                             | <u>\$ 1,052,726</u>                          | <u>\$ 5,356,954</u> |

See Accompanying Independent Auditors' Report.

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, 2008

|   | <u>Chuuk State<br/>Health Care<br/>Plan</u> | <u>Chuuk<br/>Public Utility<br/>Corporation</u> | <u>Chuuk<br/>State Housing<br/>Authority</u> | <u>Total</u>          |
|---|---|---|--|-----------------------|
| Operating revenues:                         |   |   |  |                       |
| Charges for services                        | \$ 743,707                                  | \$ 2,399,490                                    | \$ 79,656                                    | \$ 3,222,853          |
| Other                                       | 23,616                                      | 21,896  | -  | 45,512                |
| Total operating revenues                    | <u>767,323</u>                              | <u>2,421,386</u>                                | <u>79,656</u>                                | <u>3,268,365</u>      |
| Operating expenses:                         |   |   |  |                       |
| Cost of services                            | 758,062                                     | 2,305,709                                       | -  | 3,063,771             |
| Depreciation                                | 13,278                                      | 1,012,243                                       | 18,384                                       | 1,043,905             |
| Administration and general                  | 221,047                                     | 1,088,916                                       | 151,563                                      | 1,461,526             |
| Total operating expenses                    | <u>992,387</u>                              | <u>4,406,868</u>                                | <u>169,947</u>                               | <u>5,569,202</u>      |
| Operating loss                              | <u>(225,064)</u>                            | <u>(1,985,482)</u>                              | <u>(90,291)</u>                              | <u>(2,300,837)</u>    |
| Nonoperating revenues (expenses):           |   |   |  |                       |
| Contributions from primary government       | -   | 384,473   | -  | 384,473               |
| Other income                                | -   | 29,653  | -  | 29,653                |
| Interest expense                            | -   | (324,838)                                       | -  | (324,838)             |
| Total nonoperating revenues (expenses), net | <u>-</u>                                    | <u>89,288</u>                                   | <u>-</u>                                     | <u>89,288</u>         |
| Net loss                                    | <u>(225,064)</u>                            | <u>(1,896,194)</u>                              | <u>(90,291)</u>                              | <u>(2,211,549)</u>    |
| Net assets at the beginning of the year     | 911,212                                     | (1,862,763)                                     | 1,142,599                                    | 191,048               |
| Net assets at the end of the year           | <u>\$ 686,148</u>                           | <u>\$ (3,758,957)</u>                           | <u>\$ 1,052,308</u>                          | <u>\$ (2,020,501)</u> |

See Accompanying Independent Auditors' Report.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(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 net assets and results of operations of the following legally separate entities are presented as part of the State's operations:

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

i. Discretely Presented 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.

ii. Omitted Governmental Funds

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

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

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

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

ii. Omitted Governmental Funds, Continued

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.

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.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

ii. Omitted Governmental Funds, Continued

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.

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.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

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 \$17,516,915 of restricted net assets, of which \$1,209,350 is restricted by enabling legislation.

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.

STATE OF CHUUK  
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Notes to Financial Statements  
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting

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.

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

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.

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 proprietary fund'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 expenses not meeting this definition are reported as nonoperating expenses.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

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.

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 the receipt of U.S. federal financial assistance, including United States Congress appropriations under United States Public Law 99-239, as amended, Title II, Article I, Section 211(a) and approved by the FSM Congress to promote economic advancement and budgetary self-reliance, and other foreign government financial assistance grants. These appropriations are to be used for assistance in education, health care, the environment, public sector capacity building, and private sector development, or for other areas as mutually agreed, with priorities in the education and health care sectors.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Compact Trust Fund, a Governmental Fund Type - Permanent Fund. This fund accounts for United States Congress appropriations under United States Public Law 99-239, as amended, Title II, Article I, Section 215 and approved by the FSM Congress 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. Earnings from funds invested would not be available for distribution until October 2023.

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.

H. Receivables

In general, tax revenue is recognized on the government-wide 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. Reimbursements due to the State for expenditures on federally funded reimbursement and grant programs are reported as "receivables from federal agencies".

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

H. Receivables, Continued

Receivables of the primary government and discretely presented component units are primarily due from businesses and individuals residing in the State. The allowance for uncollectible accounts primarily represents estimated uncollectible amounts based on past collection experience and the aging of the accounts.

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 government-wide and 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 \$4,390,546. Furthermore, investments recorded in the Compact Trust Fund of \$7,032,909 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 assets (e.g. roads, bridges, docks, water and sewer lines, water catchments, and other similar items), are reported in the governmental activity column of the government-wide financial statements. Such assets, whether purchased or constructed, are recorded at historical cost or estimated historical cost. Donated capital assets are recorded at estimated fair market value at the date of donation.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

L. Capital Assets, Continued

The State currently holds no title to land. Machinery and equipment, other than vehicles and boats, are capitalized when the cost of individual items exceed \$50,000. Vehicles and boats, along with significant repair and maintenance qualifying as a betterment of such, are capitalized regardless of cost and depreciated. Buildings and infrastructure projects, along with significant improvements or reconstruction qualifying as a betterment of such, are capitalized when the cost of individual items or projects exceed \$100,000. The costs of normal maintenance and repairs that do not add to the value of the capital asset or materially extend capital asset lives are not capitalized.

Capital assets of the primary government and the 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.

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

During the year ended September 30, 2008, the State recorded transfers to the General Fund of \$3,499,999 from the Grants Assistance Fund as a reimbursement for expenditures paid on behalf of Foreign Assistance grants.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

N. Deferred Revenues

In the government-wide financial statements, deferred revenue is recognized when cash, receivables or other assets are recorded prior to being earned. In the governmental fund financial statements deferred revenue represents monies received or revenues accrued which have not been earned or do not meet the “available” criterion for revenue recognition under the modified accrual basis of accounting.

O. Compensated Absences

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

P. Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. The unreserved fund balances for the governmental funds represent the amount available for budgeting future operations. The reserve for related assets as of September 30, 2008, is represented by the following assets:

|                      | <u>General</u> | <u>Grants<br/>Assistance</u> | <u>Compact<br/>Trust</u> | <u>Other<br/>Governmental<br/>Funds</u> | <u>Totals</u>       |
|----------------------|----------------|------------------------------|--------------------------|---|---------------------|
| Investments          | \$ -           | \$2,473,500                  | \$ -                     | \$ -                                    | \$ 2,473,500        |
| Due from other funds | -              | -                            | -                        | 1,196,831                               | 1,196,831           |
| Restricted assets:   |                |                              |                          |   |                     |
| Investments          | -              | -                            | <u>7,032,909</u>         | -                                       | <u>7,032,909</u>    |
|                      | <u>\$ -</u>    | <u>\$2,473,500</u>           | <u>\$7,032,909</u>       | <u>\$1,196,831</u>                      | <u>\$10,703,240</u> |

The continuing appropriations within the General Fund includes \$2,196,255 set aside for future payments of the Chuuk State Legislature Building Complex and for future payments for Chuuk Municipal capital projects.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

Q. 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.

R. 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.

T. New Accounting Standards

During fiscal year 2008, the State implemented GASB Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, GASB Statement No. 48, Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues, and GASB Statement No. 50, Pension Disclosures an amendment of GASB Statements No. 25 and 27. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments and GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other post-employment benefits. GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing, and includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. The implementation of these pronouncements did not have a material effect on the accompanying financial statements.

In June 2004, GASB issued Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other post-employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

T. New Accounting Standards, Continued

In December 2006, GASB issued Statement No. 49, Accounting and Financial Reporting for Pollution Remediation Obligations. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In June 2007, GASB issued Statement No. 51, Accounting and Financial Reporting for Intangible Assets. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In November 2007, GASB issued Statement No. 52, Land and Other Real Estate Held as Investments by Endowments. GASB Statement No. 52 improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income. The provisions of this statement are effective for periods beginning after June 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In June 2008, GASB issued Statement No. 53, Accounting and Financial Reporting for Derivative Instruments. GASB Statement No. 53 is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

U. 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, 2007 from which summarized information was derived.

STATE OF CHUUK  
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Notes to Financial Statements  
September 30, 2008

(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.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(2) Deposits and Investments, Continued

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.

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. Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The State does not have a deposit policy for custodial credit risk or foreign currency risk.

As of September 30, 2008, the carrying amount of the primary government's total cash and cash equivalents were \$811,919 and the corresponding bank balances were \$1,842,895, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2008, bank deposits in the amount of \$200,000 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, 2008, the carrying amount of the discretely presented component units' approximated bank balances. Of the bank balance amounts, substantially all cash is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2008, bank deposits in the amount of \$531,478 were FDIC insured. The discretely presented component units do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(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, 2008, the State's investments at fair value are as follows:

Fixed income securities:

|                       |              |
|-----------------------|--------------|
| Domestic fixed income | \$ 1,453,592 |
|-----------------------|--------------|

Other investments:

|                   |           |
|-------------------|-----------|
| Domestic equities | 7,423,438 |
|-------------------|-----------|

|                         |                  |
|-------------------------|------------------|
| Cash management account | <u>2,546,425</u> |
|-------------------------|------------------|

|  |                  |
|--|------------------|
|  | <u>9,969,863</u> |
|--|------------------|

|  |                      |
|--|----------------------|
|  | \$ <u>11,423,455</u> |
|--|----------------------|

As of September 30, 2008, 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, 1% of the shares of the FSM Development Bank in the amount of \$300,000, and 0.01% of the shares of the Bank of Guam in the amount of \$423,500. As the fair market value of these investments is not readily available, such have been recorded at cost.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(2) Deposits and Investments, Continued

B. Investments, Continued

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

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the State will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The State's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the State's name by the State's custodial financial institutions at September 30, 2008.

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, 2008, 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, 2008, the State's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

| Investment Type                                      | Rating Type | Maturity (in years) |                  |                  |                  | Total              |
|--|-------------|---------------------|------------------|------------------|------------------|--------------------|
|  |             | Current             | 1-5              | 6-10             | Over             |                    |
| U.S Treasury obligations total                       |             | \$ 15,826           | \$ 20,815        | \$ 90,039        | \$ 93,376        | \$ 220,056         |
| U.S. government agency obligations:                  |             |                     |                  |                  |                  |                    |
| Federal Farm Credit Bank                             |             | -                   | 73,516           | -                | -                | 73,516             |
| Federal Home Loan Bank                               |             | 14,669              | 56,262           | -                | -                | 70,931             |
| Federal Home Loan Mortgage Corporation               |             | -                   | 83,573           | 25,965           | 285,374          | 394,912            |
| Federal National Mortgage Association                |             | -                   | 33,336           | 14,559           | 217,059          | 264,954            |
| Government National Mortgage Corporation             |             | -                   | -                | -                | 8,498            | 8,498              |
| Housing Urban Development Tennessee Valley Authority |             | -                   | 14,605           | -                | -                | 14,605             |
| Tennessee Valley Authority                           |             | 41,138              | -                | -                | 11,361           | 52,499             |
| Corporate notes and obligations                      | A1          | -                   | 45,526           | 25,059           | -                | 70,585             |
| Corporate notes and obligations                      | A2          | 30,378              | -                | 7,342            | 27,623           | 65,343             |
| Corporate notes and obligations                      | A3          | -                   | -                | -                | 11,805           | 11,805             |
| Corporate notes and obligations                      | AA2         | -                   | 18,427           | -                | 35,442           | 53,869             |
| Corporate notes and obligations                      | AA3         | 4,231               | -                | -                | 22,440           | 26,671             |
| Corporate notes and obligations                      | AAA         | 5,347               | -                | -                | -                | 5,347              |
| Corporate notes and obligations                      | B2          | -                   | 4,429            | -                | -                | 4,429              |
| Corporate notes and obligations                      | BAA1        | -                   | 28,697           | 31,874           | 9,128            | 69,699             |
| Corporate notes and obligations                      | BAA2        | -                   | -                | 13,506           | 6,783            | 20,289             |
| Corporate notes and obligations                      | BAA3        | 10,146              | -                | 15,438           | -                | 25,584             |
| Grand Total  |             | <u>\$121,735</u>    | <u>\$379,186</u> | <u>\$223,782</u> | <u>\$728,889</u> | <u>\$1,453,592</u> |

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(3) Receivables

Receivables as of September 30, 2008, for the primary government's individual major governmental funds and nonmajor governmental funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

|  | <u>General</u>   | <u>Grants<br/>Assistance</u> | <u>Total</u>       |
|--|------------------|------------------------------|--------------------|
| Receivables:                               |                  |                              |                    |
| FSM State Government                       | \$943,514        | \$919,573                    | \$1,863,087        |
| Less: allowance for uncollectible accounts | <u>(398,343)</u> | <u>-</u>                     | <u>(398,343)</u>   |
| Net receivables                            | <u>\$545,171</u> | <u>\$919,573</u>             | <u>\$1,464,744</u> |

Discretely Presented Component Units

Chuuk Public Utilities Corporation

Receivables as of September 30, 2008, for the Chuuk Public Utilities Corporation in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

|  |                    |
|--|--------------------|
| General                                    | \$1,728,397        |
| Less: allowance for uncollectible accounts | <u>(1,383,895)</u> |
| Net receivables                            | <u>\$ 344,502</u>  |

Chuuk State Health Care Plan

Receivables as of September 30, 2008, for the Chuuk State Health Care Plan in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

|  |                   |
|--|-------------------|
| General                                    | \$ 149,594        |
| Less: allowance for uncollectible accounts | <u>-</u>          |
| Net receivables                            | <u>\$ 149,594</u> |

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(3) Receivables, Continued

Chuuk State Housing Authority

Receivables as of September 30, 2008, for the Chuuk State Housing Authority in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

|  |                    |
|--|--------------------|
| Receivables:                               |                    |
| General                                    | \$ 252,232         |
| Loans                                      | <u>2,170,790</u>   |
|  | 2,423,022          |
| Less: allowance for uncollectible accounts | <u>(1,547,056)</u> |
| Net receivables                            | <u>\$ 875,966</u>  |

(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, 2008, are summarized as follows:

| <u>Receivable Fund</u>      | <u>Payable Fund</u> | <u>Amount</u>       |
|-----------------------------|---------------------|---------------------|
| General                     | Grants Assistance   | \$ 2,109,430        |
| Grants Assistance           | General             | 4,112,530           |
| Nonmajor governmental funds | General             | <u>1,196,831</u>    |
|                             |                     | <u>\$ 7,418,791</u> |

Interfund receivables not expected to be repaid within the next twelve months are summarized as follows:

| <u>Receivable Fund</u>                                  | <u>Payable Fund</u> | <u>Amount</u>       |
|---|---------------------|---------------------|
| Nonmajor governmental funds:<br>Chuuk Airport Authority | General             | <u>\$ 1,196,831</u> |

(5) Fixed Assets

Capital asset activities of the primary government for the year ended September 30, 2008, are as follows:

|  | <u>Balance<br/>October<br/>1, 2007</u> | <u>Additions</u> | <u>Retirements</u> | <u>Balance<br/>September<br/>30, 2008</u> |
|--|--|------------------|--------------------|---|
| Governmental activities:               |  |                  |                    |   |
| Capital assets, not being depreciated: |  |                  |                    |   |
| Land                                   | <u>\$ 24,392,433</u>                   | <u>\$ -</u>      | <u>\$ -</u>        | <u>\$ 24,392,433</u>                      |

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(5) Fixed Assets, Continued

|  | Balance<br>October<br><u>30, 2007</u> | <u>Additions</u>          | <u>Retirements</u> | Balance<br>September<br><u>30, 2008</u> |
|--|---------------------------------------|---------------------------|--------------------|---|
| Capital assets, being depreciated:               |                                       |                           |                    |   |
| Airport facilities                               | \$ 30,406,300                         | \$ -                      | \$ -               | \$ 30,406,300                           |
| Buildings  | 11,235,322                            | 691,831                   | -                  | 11,927,153                              |
| Seaport facilities                               | 7,718,305                             | -                         | -                  | 7,718,305                               |
| Vehicles and other equipment                     | 5,232,121                             | 10,290                    | -                  | 5,242,411                               |
| Infrastructure                                   | <u>10,257,000</u>                     | <u>-</u>                  | <u>-</u>           | <u>10,257,000</u>                       |
| <br>Total capital assets, being depreciated      | <br><u>64,849,048</u>                 | <br><u>702,121</u>        | <br><u>-</u>       | <br><u>65,551,169</u>                   |
| Less accumulated depreciation for:               |                                       |                           |                    |   |
| Airport facilities                               | (6,391,534)                           | (715,158)                 | -                  | (7,106,690)                             |
| Buildings  | (5,075,840)                           | (180,302)                 | -                  | (5,256,142)                             |
| Seaport facilities                               | (2,512,791)                           | (280,202)                 | -                  | (2,792,793)                             |
| Vehicles   | (4,005,243)                           | (386,625)                 | -                  | (4,391,868)                             |
| Infrastructure                                   | <u>(3,864,838)</u>                    | <u>(410,280)</u>          | <u>-</u>           | <u>(4,275,118)</u>                      |
|  | <u>(21,850,246)</u>                   | <u>(1,972,566)</u>        | <u>-</u>           | <u>(23,822,812)</u>                     |
| <br>Total capital assets, being depreciated, net | <br><u>42,998,802</u>                 | <br><u>(1,270,445)</u>    | <br><u>-</u>       | <br><u>41,728,357</u>                   |
| <br>Governmental activities capital assets, net  | <br><u>\$ 67,391,235</u>              | <br><u>\$ (1,270,445)</u> | <br><u>\$ -</u>    | <br><u>\$ 66,120,790</u>                |

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

|                                 |                     |
|---------------------------------|---------------------|
| General government              | \$ 460,245          |
| Health services                 | 140,787             |
| Education                       | 53,605              |
| Public safety                   | 19,292              |
| Public works and transportation | <u>1,298,637</u>    |
|                                 | <u>\$ 1,972,566</u> |

(6) Special Item

During the year ended September 30, 2008, the State reevaluated recorded payables and wrote-off liabilities within the General Fund of \$428,333. Accordingly, such has been presented as a special item within the accompanying financial statements.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(7) Short-Term Debt

The note payable of the primary government is as follows:

General Fund:

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, 2008.

(8) Long-Term Obligations

Asian Development Bank (ADB Loan#1520 FSM (SF)) Early Retirement Program Loan

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 through the FSM National Government, non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The activities of the ERS Program are recorded in the General Fund.

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

Funds for the repayment of the ERS 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 appropriate funds into the ERS Trust Account. These funds had not been deposited to the Trust Account as of September 30, 2008. As of September 30, 2008, the amount outstanding against this loan was \$5,961,316. This amount has been identified as future debt service payments and is included in the General Fund reserve for debt service of which \$4,390,546 is actually 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.

ADB Loan Number 1873 FSM (SF) - Private Sector Development Program Loan

ADB Loan Number 1873 FSM (SF) - Private Sector Development Program Loan (SDR 1,017,120), bearing interest at 1% per annum during the grace period and 1.5% thereafter. The loan is payable semiannually commencing May 15, 2010 in an amount of \$40,625 plus interest, with a maturity date of November 15, 2025. As of September 30, 2008, the amount outstanding against this loan was \$739,840.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(8) Long-Term Obligations, Continued

ADB Loan Number 1874 FSM (SF) - Private Sector Development Project Loan

ADB Loan Number 1874 FSM (SF) - Private Sector Development Project Loan (SDR 1,392,783), bearing interest at of 1% per annum during the grace period and at 1.5% thereafter. The loan is payable semiannually commencing May 15, 2010 in an amount of \$37,083 plus interest, with a maturity date of November 15, 2033. As of September 30, 2008, the amount outstanding against this loan was \$866,110.

ADB Loan Number 1816 FSM (SF) – Basic Social Services Project Loan

ADB Loan Number 1816 FSM (SF) – Basic Social Services Project Loan (SDR 1,829,927), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing February 1, 2009 in an amount of \$76,247, at which time the service charge increases to 1.5% per annum, with a maturity date of August 1, 2032. As of September 30, 2008, the amount outstanding against this loan was \$1,359,663.

During the year ended September 30, 2008, the FSM National Government informed the State of exchange losses incurred on the above loans. The State recorded \$227,921 as expenses in the statement of activities due to this matter. Dialogue with the FSM National Government will continue, and any reductions of these losses will be recorded in fiscal year 2009 upon resolution.

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

| <u>Year ending<br/>September 30,</u> | <u>Principal</u>   | <u>Interest</u>    | <u>Total</u>       |
|--------------------------------------|--------------------|--------------------|--------------------|
| 2009                                 | \$ 105,754         | \$ 80,413          | \$ 186,167         |
| 2010                                 | 235,867            | 94,186             | 330,053            |
| 2011                                 | 235,867            | 91,177             | 327,044            |
| 2012                                 | 235,867            | 88,167             | 324,034            |
| 2013                                 | 235,867            | 260,699            | 496,566            |
| 2014-1018                            | 1,358,543          | 341,983            | 1,700,526          |
| 2019-2023                            | 1,799,923          | 233,704            | 2,033,627          |
| 2024-2028                            | 1,707,443          | 125,842            | 1,833,285          |
| 2029-2033                            | 1,386,384          | 34,570             | 1,420,954          |
| 2034-2037                            | <u>845,733</u>     | <u>-</u>           | <u>845,733</u>     |
|                                      | <u>\$8,147,248</u> | <u>\$1,350,741</u> | <u>\$9,497,989</u> |

Other long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2008, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net assets:

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(8) Long-Term Obligations, Continued

|                         | <u>Balance<br/>October 1,<br/>30, 2007</u> | <u>Additions</u>   | <u>Reductions</u> | <u>Balance<br/>September<br/>30, 2008</u> | <u>Due Within<br/>One Year</u> |
|-------------------------|--|--------------------|-------------------|---|--------------------------------|
| Loan payable:           |  |                    |                   |   |                                |
| ADB loans               | \$6,715,040                                | \$1,550,574        | \$ 118,366        | \$ 8,147,248                              | \$ 122,062                     |
| Other:                  |  |                    |                   |   |                                |
| Compensated<br>absences | <u>1,601,808</u>                           | <u>347,511</u>     | <u>-</u>          | <u>1,949,319</u>                          | <u>450,000</u>                 |
|                         | <u>\$8,316,848</u>                         | <u>\$1,898,085</u> | <u>\$ 118,366</u> | <u>\$10,096,567</u>                       | <u>\$620,606</u>               |

Discretely Presented Component Units

Chuuk Public Utilities Corporation

Note payable to a commercial bank, 90 day terms, interest at prime plus 2% on a \$150,000 line of credit. The loan is collateralized by a bank deposit and security interest in fixed assets, accounts receivable and inventories. \$ 81,921

Note payable to the FSM Development Bank, interest at 9%, due in monthly installments of \$4,000. The loan is collateralized by major machinery, equipment and assignment of income. 737,743

Note payable to the FSM National Government, interest at 6.82%, due in semi-annual installments commencing August 1, 2007. 3,642,308

\$ 4,461,972

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

| <u>Year ending<br/>September 30,</u> | <u>Principal</u>    | <u>Interest</u>     | <u>Total</u>        |
|--------------------------------------|---------------------|---------------------|---------------------|
| 2009                                 | \$ 939,138          | \$ 185,039          | \$ 1,124,177        |
| 2010                                 | 59,737              | 180,965             | 240,702             |
| 2011                                 | 59,737              | 176,891             | 236,628             |
| 2012                                 | 59,737              | 172,816             | 232,553             |
| 2013                                 | 59,737              | 168,742             | 228,479             |
| 2014-2018                            | 448,058             | 777,506             | 1,225,564           |
| 2019-2023                            | 796,595             | 553,409             | 1,350,004           |
| 2024-2028                            | 796,595             | 281,769             | 1,078,364           |
| 2029-2031                            | <u>1,242,638</u>    | <u>41,472</u>       | <u>1,284,110</u>    |
|                                      | \$ <u>4,461,972</u> | \$ <u>2,538,609</u> | \$ <u>7,000,581</u> |

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(8) Long-Term Obligations, Continued

Discretely Presented Component Units, Continued

During the year ended September 30, 2008, the following changes occurred in liabilities reported as part of the discretely presented component units long-term liabilities in the statement of net assets:

|                | Balance<br>October 1,<br><u>2007</u> | <u>Additions</u> | <u>Reductions</u> | Balance<br>September<br>30, 2008 | Due Within<br><u>One Year</u> |
|----------------|--------------------------------------|------------------|-------------------|----------------------------------|-------------------------------|
| Loans payable: | <u>\$4,198,212</u>                   | <u>\$348,768</u> | <u>\$85,008</u>   | <u>\$4,461,972</u>               | <u>\$939,138</u>              |

(9) 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, 2008 is \$4,526,860.

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.

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. Cumulative questioned costs of \$2,056,336 relating to fiscal years 2003 through 2008 have been set forth in the State's Single Audit Report for the year ended September 30, 2008.

The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(9) Contingencies, Continued

Litigation

The State is a party to various legal proceedings. However, the State is currently negotiating with judgment creditors to arrive at settlement amounts favorable to both parties. Claims must be adjudicated and are not recognized as current liabilities of the State as they cannot be paid without an underlying appropriation from the State Legislature and a corresponding allotment from the Executive Branch. No appropriation currently exists to finance these judgments. The State's Attorney General indicates that pending land lease cases and other claims against the State exist at September 30, 2008 in an amount that is material to the financial statements. Due to an inability to predict the ultimate outcome of these matters, no provision for these liabilities has been made in the accompanying financial statements.

Delinquent Taxes

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

Loan Guarantee

The State has guaranteed repayment of a note payable of Chuuk Public Utility Corporation (CPUC) to the Asian Development Bank. The loan additionally passed through the FSM National Government. At September 30, 2008, the loan balance recorded by CPUC is \$3,642,308.

General Fund Financial Position

The State's General Fund has sustained recurring operating deficits and has an unreserved fund deficit of \$15,616,470 at September 30, 2008. In addition, at September 30, 2008, the primary government's current liabilities exceed current assets by \$9,885,365.

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 will sell 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.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements  
September 30, 2008

(9) Contingencies, Continued

General Fund Financial Position, Continued

- The State agreed to work to balance its proposed FY09 budget.
- The State agreed to eliminate 400 positions from its operations budget. The elimination will involve two phases: 200 positions by March 31, 2008, and another 200 by March 31, 2009.
- The State will work to restructure its government to include restructuring the Chuuk Legislature into a unicameral legislature. The State agreed to ensure that voting on the Legislature restructuring constitutional amendment is on the March 2009 General Ballot.
- The State will develop a public awareness program to educate the Chuukese people about the imminent need for reform.

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

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2008

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Schedule of Revenues, Expenditures and Changes in Deficit  
Budget and Actual - General Fund  
Year Ended September 30, 2008

|   | Budgeted Amounts |                 | Actual -<br>Budgetary<br>Basis<br>(see Note 1) | Variance with<br>Final Budget -<br>Positive<br>(Negative) |
|---|------------------|-----------------|--|---|
|   | Original         | Final           |  |   |
| Revenues:   |                  |                 |  |   |
| Local revenues                                    | \$ -             | \$ -            | \$ 4,976,133                                   | \$ 4,976,133  |
| Net decrease in the fair value of investments     | -                | -               | (787,438)                                      | (787,438)   |
| Total revenues                                    | -                | -               | 4,188,695                                      | 4,188,695   |
| Expenditures:                                     |                  |                 |  |   |
| Current:  |                  |                 |  |   |
| General government                                | 2,374,095        | 2,374,095       | 2,414,975                                      | (40,880)  |
| Health services                                   | -                | -               | 551,583  | (551,583)   |
| Education   | -                | -               | 550,523  | (550,523)   |
| Economic development                              | 123,958          | 143,732         | 132,844  | 10,888  |
| Public safety                                     | 878,302          | 878,302         | 752,030  | 126,272   |
| Public works and transportation                   | 656,565          | 656,565         | 730,771  | (74,206)  |
| Boards and commissions                            | 289,662          | 289,662         | 198,569  | 91,093  |
| Judiciary   | 452,080          | 452,080         | 409,317  | 42,763  |
| Municipal affairs                                 | 211,110          | 211,110         | 141,811  | 69,299  |
| Other   | 927,701          | 967,781         | 22,609   | 945,172   |
| Total expenditures                                | 5,913,473        | 5,973,327       | 5,905,031                                      | 68,296  |
| Deficiency of revenues under expenditures         | (5,913,473)      | (5,973,327)     | (1,716,336)                                    | 4,256,991   |
| Other financing sources:                          |                  |                 |  |   |
| Proceeds from debt                                | -                | -               | 1,322,649                                      | 1,322,649   |
| Transfers in from other funds                     | -                | -               | 3,499,999                                      | 3,499,999   |
| Total other financing sources                     | -                | -               | 4,822,648                                      | 4,822,648   |
| Special items:                                    |                  |                 |  |   |
| Write-off of liabilities                          | -                | -               | 428,333  | 428,333   |
| Total special items                               | -                | -               | 428,333  | 428,333   |
| Net change in deficit                             | (5,913,473)      | (5,973,327)     | 3,534,645                                      | 9,507,972   |
| Other changes in unreserved deficit               |                  |                 |  |   |
| Decrease in reserve for related assets            | -                | -               | 2,726,678                                      | 2,726,678   |
| Decrease in reserve for continuing appropriations | -                | -               | 69,943   | 69,943  |
| Decrease in reserve for debt service              | -                | -               | 911,796  | 911,796   |
| Unreserved deficit at the beginning of the year   | (22,859,532)     | (22,859,532)    | (22,859,532)                                   | -   |
| Unreserved deficit at the end of the year         | \$ (28,773,005)  | \$ (28,832,859) | \$ (15,616,470)                                | \$ 13,216,389   |

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, 2008

(1) Budgetary Information

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 utilized for budgetary control purposes. Encumbrances outstanding at year-end are reported as reservations of fund balance and will be funded as expenditures in the ensuing year. Encumbrances remain as reservations of fund balance until becoming expended or canceled. If an encumbrance is subsequently canceled, the funds revert to the applicable unreserved fund balance unless otherwise required by law.

Budgetary expenditures, which are on a basis other than GAAP, represent current charges against appropriations; current charges consist of all current year liquidated and unliquidated encumbrances. Budgetary expenditures are therefore determined by subtracting both current year liquidations of prior year encumbrances and unliquidated prior year encumbrances from the combined total of current year. When reviewed in relation to respective budgets, budgetary expenditures provide the principal means of evaluating current year operating performance and management stewardship. Amounts included on the Statement of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund (which are presented on a non-GAAP budgetary basis) are reconciled to unreserved deficit of the Combined Balance Sheet within the other charges in unreserved deficit section of that statement.

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.

For the year ended September 30, 2008, expenditures of the General Fund exceeded budget at the program area level (i.e., legal level of budgetary control as follows):

| <u>Program Area</u>             | <u>Excess</u> |
|---------------------------------|---------------|
| Office of the Governor          | \$ 183,208    |
| Public Works and Transportation | 74,206        |

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

Notes to Required Supplementary Information – Budgetary Reporting  
September 30, 2008

(2) Reconciliation - GAAP and Budgetary Bases of Accounting

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.

Accounting principles used in developing data on a budgetary basis differ from those used in preparing the financial statements in conformity with GAAP. Amounts included on the Statement of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund (which are presented on a non-GAAP budgetary basis) are reconciled to unreserved deficit of the Governmental Fund Balance Sheet within the other changes in unreserved deficit section of that statement. Furthermore, the net change in fund balance (deficit) to the net change in unreserved fund deficit for the General Fund is as follows:

|                                       |                     |
|---------------------------------------|---------------------|
| Net change in fund balance (deficit)  | \$ 1,621,145        |
| Decrease in encumbrances              | <u>(994)</u>        |
| Net change in unreserved fund deficit | \$ <u>3,534,644</u> |

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2008

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

GENERAL FUND

September 30, 2008

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, 2008  
(with comparative totals for the year ended September 30, 2007)

|   | 2008         | 2007         |
|---|--------------|--------------|
| Revenues:                                   |              |              |
| FSM revenue sharing                         | \$ 2,306,567 | \$ 2,254,793 |
| Excise taxes:                               |              |              |
| Sales tax                                   | 983,773      | 1,121,973    |
| Hotel                                       | 142,948      | 133,013      |
| Tobacco                                     | 98,309       | 75,727       |
| Alcoholic beverages                         | 118,653      | 129,792      |
| Delinquent tax collections                  | 75,257       | 36,074       |
| Other excise taxes                          | 112,459      | 113,206      |
|   | 1,531,399    | 1,609,785    |
| Fees and charges:                           |              |              |
| Licenses and permits                        | 254,695      | 147,772      |
| Leases and other rentals                    | 55,872       | 57,679       |
|   | 310,567      | 205,451      |
| Departmental charges:                       |              |              |
| Transportation collections                  | 625,017      | 596,416      |
| Net change in the fair value of investments | (787,438)    | 1,851,965    |
| Other revenues                              | 202,583      | 483,938      |
| Total revenues                              | 4,188,695    | 7,002,348    |
| Expenditures:                               |              |              |
| Current:                                    |              |              |
| General government:                         |              |              |
| Office of the Governor                      | 529,975      | 530,147      |
| State Legislature                           | 1,571,213    | 2,524,932    |
| Department of Planning and Statistics       | -            | 130,607      |
| Department of Treasury                      | 281,160      | 1,108,303    |
|   | 2,382,348    | 4,293,989    |
| Education:                                  |              |              |
| Department of Education                     | 554,958      | 603          |
| Economic Development:                       |              |              |
| Department of Agriculture                   | 46,535       | 133,957      |
| Department of Marine Resources              | 84,784       | 111,855      |
|   | 131,319      | 245,812      |
| Health services                             | 554,958      | -            |

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, 2008  
(with comparative totals for the year ended September 30, 2006)

|   | 2008           | 2007            |
|---|----------------|-----------------|
| Expenditures, continued:                          |                |                 |
| Current, continued:                               |                |                 |
| Public Safety:                                    |                |                 |
| Office of the Attorney General                    | \$ 200,487     | \$ 261,262      |
| Department of Public Safety                       | 548,560        | 376,705         |
|   | 749,047        | 637,967         |
| Public Works and Transportation:                  |                |                 |
| Department of Transportation                      | 761,162        | 1,118,264       |
| Community Affairs:                                |                |                 |
| Department of Public Affairs                      | -              | 277,789         |
| Boards and Commissions:                           |                |                 |
| Chuuk Recreation Board                            | 16,401         | 42,124          |
| Land Commission                                   | 88,720         | 91,630          |
| Environmental Protection Agency                   | 4,423          | -               |
| Election Commission                               | 80,626         | 88,961          |
| Mortlocks Commission                              | -              | 13,943          |
| Faichuk Commission                                | -              | 36,266          |
|   | 190,170        | 272,924         |
| Judiciary:  |                |                 |
| State Court                                       | 406,764        | 553,728         |
| Payments to component units:                      |                |                 |
| Chuuk Coconut Authority                           | -              | 24,577          |
| Chuuk State Housing Authority                     | -              | 48,610          |
|   | -              | 73,187          |
| Municipal Affairs:                                |                |                 |
| Payments to municipalities                        | 139,551        | 633,208         |
| Other:  |                |                 |
| Small Business Development Center                 | 354            | -               |
| Farmers Home Administration                       | 17,269         | 38,209          |
| Disaster assistance                               | -              | 2,580           |
| Legal services                                    | -              | 10,000          |
| Red Cross   | 3,680          | 12,778          |
| Peace Corps                                       | 6,300          | 7,250           |
| Other   | 6,158          | 819,479         |
|   | 33,761         | 890,296         |
| Total expenditures                                | 5,904,037      | 8,997,767       |
| Deficiency of revenues under expenditures         | (1,715,342)    | (1,995,419)     |
| Other financing sources:                          |                |                 |
| Loan proceeds                                     | 1,322,649      | 773,501         |
| Transfers in from other funds                     | 3,499,999      | 3,639,440       |
| Transfers out to other funds                      | -              | (284,872)       |
| Total other financing sources                     | 4,822,648      | 4,128,069       |
| Special items:                                    |                |                 |
| Recovery on previously written off<br>receivables | -              | 1,049,602       |
| Write off of liabilities                          | 428,333        | 3,233,483       |
| Total other financing sources                     | 428,333        | 4,283,085       |
| Net change in deficit                             | 3,535,639      | 6,415,735       |
| Deficit at the beginning of the year              | (12,117,361)   | (18,533,096)    |
| Deficit at the end of the year                    | \$ (8,581,722) | \$ (12,117,361) |

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, 2008

|   | Budgeted Amounts |                 | Actual<br>Budgetary Basis<br>(see Note 1) | Variance with<br>Final Budget<br>Positive/(Negative) |
|---|------------------|-----------------|---|--|
|   | Original         | Final           |   |  |
| Revenues:   |                  |                 |   |  |
| Local revenues                                    | \$ -             | \$ -            | \$ 4,976,133                              | \$ 4,976,133   |
| Net increase in the fair value of investments     | -                | -               | (787,438)                                 | (787,438)  |
| Total revenues                                    | -                | -               | 4,188,695                                 | 4,188,695  |
| Expenditures:                                     |                  |                 |   |  |
| Current:  |                  |                 |   |  |
| General government:                               |                  |                 |   |  |
| Office of the Governor                            | 340,268          | 340,268         | 523,476                                   | (183,208)  |
| State Legislature                                 | 1,687,990        | 1,687,990       | 1,610,330                                 | 77,660   |
| Department of Planning and Statistics             | -                | -               | (1,780)                                   | 1,780  |
| Department of Treasury                            | 345,837          | 345,837         | 282,949                                   | 62,888   |
|   | 2,374,095        | 2,374,095       | 2,414,975                                 | (40,880)   |
| Health Services:                                  |                  |                 |   |  |
| Department of Health Services                     | -                | -               | 551,583                                   | (551,583)  |
| Education:  |                  |                 |   |  |
| Department of Education                           | -                | -               | 550,523                                   | (550,523)  |
| Economic Development:                             |                  |                 |   |  |
| Department of Marine Resources                    | 69,400           | 80,198          | 86,509                                    | (6,311)  |
| Department of Agriculture                         | 54,558           | 63,534          | 46,535                                    | 16,999   |
| Department of Commerce and Industry               | -                | -               | (200)                                     | 200  |
|   | 123,958          | 143,732         | 132,844                                   | 10,888   |
| Public Safety:                                    |                  |                 |   |  |
| Office of Attorney General                        | 207,726          | 207,726         | 207,149                                   | 577  |
| Department of Public Safety                       | 670,576          | 670,576         | 544,881                                   | 125,695  |
|   | 878,302          | 878,302         | 752,030                                   | 126,272  |
| Public Works and Transportation:                  |                  |                 |   |  |
| Department of Transportation                      | 656,565          | 656,565         | 730,771                                   | (74,206)   |
| Boards and Commissions:                           |                  |                 |   |  |
| Chuuk Recreation Board                            | 23,882           | 23,882          | 16,401                                    | 7,481  |
| Election Commission                               | 84,074           | 84,074          | 89,025                                    | (4,951)  |
| Land Commission                                   | 97,411           | 97,411          | 88,720                                    | 8,691  |
| Public Service Commission                         | 84,295           | 84,295          | -   | 84,295   |
| Education Board                                   | -                | -               | 4,423                                     | (4,423)  |
|   | 289,662          | 289,662         | 198,569                                   | 91,093   |
| Judiciary:  |                  |                 |   |  |
| State Court                                       | 452,080          | 452,080         | 409,317                                   | 42,763   |
| Municipal Affairs:                                |                  |                 |   |  |
| Payments to municipalities                        | 211,110          | 211,110         | 141,811                                   | 69,299   |
| Other:  |                  |                 |   |  |
| Farmers Home Administration                       | 25,850           | 25,850          | 17,269                                    | 8,581  |
| Small Business Center                             | -                | -               | 354                                       | (354)  |
| Red Cross   | -                | -               | 3,680                                     | (3,680)  |
| Peace Corps                                       | 7,500            | 7,500           | 6,300                                     | 1,200  |
| Debt relief                                       | 894,351          | 894,351         | -   | 894,351  |
| Other   | -                | 40,080          | (4,994)                                   | 45,074   |
|   | 927,701          | 967,781         | 22,609                                    | 945,172  |
| Total expenditures                                | 5,913,473        | 5,973,327       | 5,905,031                                 | 68,296   |
| Deficiency of revenues under expenditures         | (5,913,473)      | (5,973,327)     | (1,716,336)                               | 4,256,991  |
| Other financing sources:                          |                  |                 |   |  |
| Proceeds from debt                                | -                | -               | 1,322,649                                 | 1,322,649  |
| Transfers in from other funds                     | -                | -               | 3,499,999                                 | 3,499,999  |
| Total other financing sources                     | -                | -               | 4,822,648                                 | 4,822,648  |
| Special items:                                    |                  |                 |   |  |
| Write off of liabilities                          | -                | -               | 428,333                                   | 428,333  |
| Total special items                               | -                | -               | 428,333                                   | 428,333  |
| Net change in deficit                             | (5,913,473)      | (5,973,327)     | 3,534,645                                 | 9,507,972  |
| Other changes in unreserved deficit:              |                  |                 |   |  |
| Decrease in reserve for related assets            | -                | -               | 2,726,678                                 | 2,726,678  |
| Decrease in reserve for continuing appropriations | -                | -               | 69,943                                    | 69,943   |
| Decrease in reserve for debt service              | -                | -               | 911,796                                   | 911,796  |
| Unreserved deficit at the beginning of the year   | (22,859,532)     | (22,859,532)    | (22,859,532)                              | -  |
| Unreserved deficit at the end of the year         | \$ (28,773,005)  | \$ (28,832,859) | \$ (15,616,470)                           | \$ 13,216,389  |

See Accompanying Independent Auditors' Report.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS - SPECIAL REVENUE FUNDS

September 30, 2008

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, 2008, follows:

Chuuk Airport Authority Fund

This fund accounts for funds received by the Airport Authority for the maintenance of Chuuk Airport.

CFSM Grants Fund

This fund accounts for activities received from FSM congressional appropriations utilized by the State to finance general governmental operations.

Compact Other Grants Fund

This fund accounts for the following funds received under the Compact of Free Association:

Compact Section 212 - Special Development Assistance Fund: This grant is restricted for special development assistance and is granted under the Compact of Free Association with the United States.

Compact 214(c) - Energy Grant Fund: This fund accounts for funds, granted under the Compact of Free Association with the United States, specifically restricted for energy programs.

Compact 216 (a)(2) Health and Medical Fund: This fund accounts for funds granted under the Compact of Free Association with the United States, specifically restricted for health and medical programs including referrals to hospital and treatment centers.

Compact Section 216(a)(3) Scholarship Fund: This fund accounts for funds granted under the Compact of Free Association with the United States to the FSM National Government which are subgranted to the State and are specifically restricted for educational scholarships at U.S. and Micronesian higher education institutions.

Compact Special Block Grant Section 221 (b) Fund

This fund accounts for funds granted under the Compact of Free Association with the United States, specifically restricted for health and education.

See Accompanying Independent Auditors' Report.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA  
NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS

Combining Balance Sheet  
September 30, 2008

Chuuk  
Airport  
Authority

ASSETS

Due from other funds

\$ 1,196,831

FUND BALANCES

Fund balances:

Reserved for:  
Related assets

\$ 1,196,831

See Accompanying Independent Auditors' Report.

STATE OF CHUUK  
 FEDERATED STATES OF MICRONESIA  
 NONMAJOR GOVERNMENTAL FUNDS  
 SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures By Function, and Changes in Fund Balances  
 Year Ended September 30, 2008

|   | <u>Chuuk<br/>Airport<br/>Authority</u> |
|---|--|
| Revenues:                                 |  |
| Fees and charges                          | \$ 20,088                              |
| Total revenues                            | <u>20,088</u>                          |
| Expenditures by function:                 |  |
| Current:                                  |  |
| General Government                        | -                                      |
| Health Services                           | -                                      |
| Education                                 | -                                      |
| Public Safety                             | -                                      |
| Total expenditures                        | <u>-</u>                               |
| Other financing sources (uses):           |  |
| Transfers in from other funds             | -                                      |
| Transfers out to other funds              | -                                      |
| Total other financing sources (uses), net | <u>-</u>                               |
| Net change in fund balances               | 20,088                                 |
| Fund balance at the beginning of the year | <u>1,176,743</u>                       |
| Fund balance at the end of the year       | <u>\$ 1,196,831</u>                    |

See Accompanying Independent Auditors' Report.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

COMPACT OF FREE ASSOCIATION  
SECTION 211(a) SECTOR GRANT FUNDS

Combining Balance Sheet  
September 30, 2008

|   | Education Sector    | Health Sector     | Capacity Building Sector | Environment Sector | Private Sector Development | Supplemental Education | US Federal Grants | Foreign Assistance | CFSM Grants      | Compact I Capital Projects | Total               |
|---|---------------------|-------------------|--------------------------|--------------------|----------------------------|------------------------|-------------------|--------------------|------------------|----------------------------|---------------------|
| <b>ASSETS</b>                                   |                     |                   |                          |                    |                            |                        |                   |                    |                  |                            |                     |
| Due from other funds                            | \$ 3,450,940        | \$ 278,719        | \$ -                     | \$ 99,643          | \$ 67,373                  | \$ -                   | \$ -              | \$ 178,583         | \$ -             | \$ 37,272                  | \$ 4,112,530        |
| Receivables                                     | 3,976               | 8,125             | (654)                    | 1,185              | 79,437                     | 42,512                 | 749,996           | -                  | 34,996           | -                          | 919,573             |
| Investment                                      | -                   | -                 | -                        | -                  | -                          | -                      | -                 | -                  | -                | 2,473,500                  | 2,473,500           |
| Prepayments                                     | -                   | 542,429           | -                        | -                  | -                          | 2,739                  | -                 | -                  | -                | -                          | 545,168             |
|   | <u>\$ 3,454,916</u> | <u>\$ 829,273</u> | <u>\$ (654)</u>          | <u>\$ 100,828</u>  | <u>\$ 146,810</u>          | <u>\$ 45,251</u>       | <u>\$ 749,996</u> | <u>\$ 178,583</u>  | <u>\$ 34,996</u> | <u>\$ 2,510,772</u>        | <u>\$ 8,050,771</u> |
| <b>LIABILITIES AND FUND BALANCES (DEFICITS)</b> |                     |                   |                          |                    |                            |                        |                   |                    |                  |                            |                     |
| Liabilities:                                    |                     |                   |                          |                    |                            |                        |                   |                    |                  |                            |                     |
| Accounts payable                                | \$ 42,470           | \$ 304,140        | \$ 5,221                 | \$ 16,741          | \$ 6,476                   | \$ 16,297              | \$ 392,185        | \$ 50,851          | \$ 9,632         | \$ -                       | \$ 844,013          |
| Accrued liabilities                             | 113,149             | -                 | -                        | -                  | -                          | -                      | -                 | -                  | -                | -                          | 113,149             |
| Due to other funds                              | -                   | -                 | 1,191,374                | -                  | -                          | 507,218                | 345,292           | -                  | 65,546           | -                          | 2,109,430           |
| Total liabilities                               | <u>155,619</u>      | <u>304,140</u>    | <u>1,196,595</u>         | <u>16,741</u>      | <u>6,476</u>               | <u>523,515</u>         | <u>737,477</u>    | <u>50,851</u>      | <u>75,178</u>    | <u>-</u>                   | <u>3,066,592</u>    |
| Fund balances:                                  |                     |                   |                          |                    |                            |                        |                   |                    |                  |                            |                     |
| Reserved for:                                   |                     |                   |                          |                    |                            |                        |                   |                    |                  |                            |                     |
| Encumbrances                                    | 749,569             | 1,654,089         | 35,459                   | 32,353             | 17,748                     | 443,375                | 39,009            | -                  | 14,415           | -                          | 2,986,017           |
| Unreserved                                      | 2,549,728           | (1,128,956)       | (1,232,708)              | 51,734             | 122,586                    | (921,639)              | (26,490)          | 127,732            | (54,597)         | 2,510,772                  | 1,998,162           |
| Total fund balances                             | <u>3,299,297</u>    | <u>525,133</u>    | <u>(1,197,249)</u>       | <u>84,087</u>      | <u>140,334</u>             | <u>(478,264)</u>       | <u>12,519</u>     | <u>127,732</u>     | <u>(40,182)</u>  | <u>2,510,772</u>           | <u>4,984,179</u>    |
| Total liabilities and fund balances             | <u>\$ 3,454,916</u> | <u>\$ 829,273</u> | <u>\$ (654)</u>          | <u>\$ 100,828</u>  | <u>\$ 146,810</u>          | <u>\$ 45,251</u>       | <u>\$ 749,996</u> | <u>\$ 178,583</u>  | <u>\$ 34,996</u> | <u>\$ 2,510,772</u>        | <u>\$ 8,050,771</u> |

See Accompanying Independent Auditors' Report.

STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA

COMPACT OF FREE ASSOCIATION  
SECTION 211(a) SECTOR GRANT FUNDS

Combining Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balances (Deficits)  
Year Ended September 30, 2008

|  | Education Sector    | Health Sector     | Capacity Building Sector | Environment Sector | Private Sector Development | Supplemental Education | US Federal Grants | Foreign Assistance | CFSM Grants        | Compact I Capital Projects | Total               |
|--|---------------------|-------------------|--------------------------|--------------------|----------------------------|------------------------|-------------------|--------------------|--------------------|----------------------------|---------------------|
| <b>Revenues:</b>                                 |                     |                   |                          |                    |                            |                        |                   |                    |                    |                            |                     |
| Compact funding                                  | \$ 8,963,089        | \$ 6,746,776      | \$ 904,479               | \$ 447,896         | \$ 630,109                 | \$ 803,949             | \$ -              | \$ -               | \$ -               | \$ -                       | \$ 18,496,298       |
| Federal contribution and others                  | -                   | -                 | -                        | -                  | -                          | -                      | 41,650            | 3,627,731          | -                  | -                          | 3,669,381           |
| Fees and charges                                 | -                   | -                 | -                        | -                  | -                          | -                      | -                 | -                  | 45,998             | -                          | 45,998              |
|  | <u>8,963,089</u>    | <u>6,746,776</u>  | <u>904,479</u>           | <u>447,896</u>     | <u>630,109</u>             | <u>803,949</u>         | <u>41,650</u>     | <u>3,627,731</u>   | <u>45,998</u>      | <u>-</u>                   | <u>22,211,677</u>   |
| <b>Expenditures by function:</b>                 |                     |                   |                          |                    |                            |                        |                   |                    |                    |                            |                     |
| Current:   |                     |                   |                          |                    |                            |                        |                   |                    |                    |                            |                     |
| General government                               | -                   | -                 | 2,367,713                | -                  | 137,782                    | -                      | 951               | -                  | -                  | -                          | 2,506,446           |
| Health services                                  | -                   | 6,732,451         | -                        | -                  | -                          | -                      | -                 | -                  | -                  | -                          | 6,732,451           |
| Education  | 6,889,053           | -                 | -                        | -                  | -                          | 2,599,012              | 43,054            | -                  | -                  | -                          | 9,531,119           |
| Economic development                             | -                   | -                 | -                        | 92,075             | 137,013                    | -                      | -                 | -                  | -                  | -                          | 229,088             |
| Public safety                                    | -                   | -                 | 92,912                   | -                  | -                          | -                      | -                 | -                  | 43,416             | -                          | 136,328             |
| Boards and commissions                           | 831,976             | -                 | 64,625                   | 293,229            | 106,207                    | -                      | -                 | -                  | -                  | -                          | 1,296,037           |
| Payment to component units                       | 73,028              | 25,324            | -                        | -                  | 108,773                    | -                      | -                 | -                  | -                  | -                          | 207,125             |
| Other  | -                   | -                 | -                        | -                  | -                          | -                      | -                 | -                  | -                  | -                          | -                   |
| Total expenditures                               | <u>7,794,057</u>    | <u>6,757,775</u>  | <u>2,525,250</u>         | <u>385,304</u>     | <u>489,775</u>             | <u>2,599,012</u>       | <u>44,005</u>     | <u>-</u>           | <u>43,416</u>      | <u>-</u>                   | <u>20,638,594</u>   |
| Excess (deficiency) of revenue over expenditures | 1,169,032           | (10,999)          | (1,620,771)              | 62,592             | 140,334                    | (1,795,063)            | (2,355)           | 3,627,731          | 2,582              | -                          | 1,573,083           |
| <b>Other financing sources (uses):</b>           |                     |                   |                          |                    |                            |                        |                   |                    |                    |                            |                     |
| Transfers in from other funds                    | -                   | -                 | -                        | -                  | -                          | -                      | -                 | -                  | -                  | -                          | -                   |
| Transfers out to other funds                     | -                   | -                 | -                        | -                  | -                          | -                      | -                 | (3,499,999)        | -                  | -                          | (3,499,999)         |
| Total other financing sources (uses), net        | <u>-</u>            | <u>-</u>          | <u>-</u>                 | <u>-</u>           | <u>-</u>                   | <u>-</u>               | <u>-</u>          | <u>(3,499,999)</u> | <u>-</u>           | <u>-</u>                   | <u>(3,499,999)</u>  |
| Net change in fund balances                      | 1,169,032           | (10,999)          | (1,620,771)              | 62,592             | 140,334                    | (1,795,063)            | (2,355)           | 127,732            | 2,582              | -                          | (1,926,916)         |
| Fund balances at the beginning of the year       | <u>2,130,265</u>    | <u>536,132</u>    | <u>423,522</u>           | <u>21,495</u>      | <u>-</u>                   | <u>1,316,799</u>       | <u>14,874</u>     | <u>-</u>           | <u>(42,764)</u>    | <u>2,510,772</u>           | <u>6,911,095</u>    |
| Fund balances at the end of the year             | <u>\$ 3,299,297</u> | <u>\$ 525,133</u> | <u>\$ (1,197,249)</u>    | <u>\$ 84,087</u>   | <u>\$ 140,334</u>          | <u>\$ (478,264)</u>    | <u>\$ 12,519</u>  | <u>\$ 127,732</u>  | <u>\$ (40,182)</u> | <u>\$ 2,510,772</u>        | <u>\$ 4,984,179</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 Wesley Simina  
Governor, State of Chuuk  
Federated States of Micronesia:

We have audited the statement of net assets of the governmental activities, and the governmental funds balance sheet for each major fund and the aggregate remaining fund information of the State of Chuuk (the State) as of September 30, 2008 and have issued our report thereon dated June 29, 2009, which was qualified with respect to: 1) a liability for land leases and other claims payable in the governmental activities and the General Fund; 2) the inadequacy of records concerning capital assets for governmental activities; 3) the inadequacy of accounting records for land acquisitions payable recorded for the governmental activities and the General Fund, and stated that the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the financial statements of the aggregate discretely presented component units, the statement of activities for the governmental activities, the governmental funds statement of revenues, expenditures, and changes in fund balances (deficits), and the reconciliation of the statement of revenues, expenditures, and changes in fund balances of governmental funds to the statement of activities for the year ended September 30, 2008. 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 Chuuk State Health Care Plan, which was audited by us, the Chuuk Public Utility Corporation, which we were engaged to audit, and the Chuuk State Housing Authority, which has not been audited. 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 the Chuuk State Health Care Plan and the Chuuk Public Utility Corporation. The findings, if any, included in those reports are not included herein.

### Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State'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's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State'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 would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control deficiency* 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 misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs (pages 68 through 73) as items 2008-2, 2008-3, and 2008-4 to be significant deficiencies in internal control over financial reporting.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

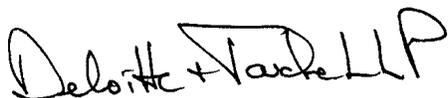
Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiencies described above are material weaknesses.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State'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 one instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying Schedule of Findings and Questioned Costs as item 2008-4.

The State'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's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the management of the State, others within the entity, federal awarding agencies, pass-through entities, and 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 29, 2009

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS  
APPLICABLE TO 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 Wesley Simina  
Governor, State of Chuuk  
Federated States of Micronesia:

Compliance

We have audited the compliance of the State of Chuuk (the State) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended September 30, 2008. The State's major federal program is identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (pages 68 through 73). Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the State's management. Our responsibility is to express an opinion on the State's compliance based on our audit.

As discussed in Note 2b to the Schedule of Expenditures of Federal Awards, the State'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, 2008. 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; 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'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's compliance with those requirements.

As described in item 2008-4 in the accompanying Schedule of Findings and Questioned Costs, the State did not comply with requirements regarding equipment and real property management that are applicable to its CFDA # 15.875 Compact of Free Association, Sector Grants major program. Compliance with such requirements is necessary, in our opinion, for the State to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the State complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended September 30, 2008. However, the results of our auditing procedures disclosed an instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying Schedule of Findings and Questioned Costs as item 2008-1.

### Internal Control Over Compliance

The management of the State 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 internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, 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 internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and others that we consider to be material weaknesses.

A *control deficiency* in an entity's internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as finding 2008-4 to be significant deficiencies.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. However, we believe that the significant deficiencies described above are material weaknesses.

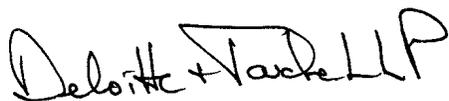
The State's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the State's responses and, accordingly, we express no opinion on them.

### Schedule of Expenditures of Federal Awards

We have audited the statement of net assets of the governmental activities, and the governmental funds balance sheet for each major fund and the aggregate remaining fund information of the State of Chuuk (the State) as of September 30, 2008 and have issued our report thereon dated June 29, 2009, which was qualified with respect to: 1) a liability for land leases and other claims payable in the governmental activities and the General Fund; 2) the inadequacy of records concerning capital assets for governmental activities; 3) the inadequacy of accounting records for land acquisitions payable recorded for the governmental activities and the General Fund, and stated that the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the financial statements of the aggregate discretely presented component units, the statement of activities for the governmental activities, the

governmental funds statement of revenues, expenditures, and changes in fund balances (deficits), and the reconciliation of the statement of revenues, expenditures, and changes in fund balances of governmental funds to the statement of activities for the year ended September 30, 2008. The accompanying Schedule of Expenditures of Federal Awards (pages 62 through 64) is presented for the purpose 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. Because the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the statement of activities for the governmental activities, and the governmental funds statement of revenues, expenditures, and changes in fund balances (deficits), we do not express an opinion on the Schedule of Expenditures of Federal Awards.

This report is intended solely for the information and use of the State, federal awarding agencies, pass-through entities, and the cognizant audit and other federal agencies, and is not intended to be and should not be used by anyone other than those specified parties.

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

June 29, 2009

**STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA**

Summary Schedule of Expenditures of Federal Awards, by Grantor  
Year Ended September 30, 2008

| Agency/Program  | Expenditures         |
|---|----------------------|
| U.S. Department of the Interior                                     | \$ 20,552,124        |
| U.S. Department of Education  | <u>43,054</u>        |
| GRAND TOTAL   | <u>\$ 20,595,178</u> |
| <br>Reconciliation to the basic financial statements is as follows: |                      |
| Grants Assistance Fund Expenditures:                                |                      |
| Federal related:  |                      |
| Compact Sector Grants - Capacity Build                              | \$ 2,525,250         |
| Compact Sector Grants - Education                                   | 7,794,057            |
| Supplemental Education Grant  | 2,599,012            |
| Compact Sector Grants - Environment                                 | 385,304              |
| Compact Sector Grants - Health                                      | 6,757,775            |
| Compact Sector Grants - Private                                     | 489,775              |
| Other U.S. Federal Grants   | <u>44,005</u>        |
|   | \$ 20,595,178        |
| Non-federal related:  |                      |
| CFSM Grants   | <u>43,416</u>        |
| Total expenditures (page 13)  | <u>\$ 20,638,594</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, 2008

| Agency/Program   | CFDA#  | Expenditures         |
|--|--------|----------------------|
| U.S. DEPARTMENT OF THE INTERIOR                                |        |                      |
| Economic, Social and Political Development of the Territories: |        |                      |
| Compact Sector Grants - Capacity Build                         |        | \$ 2,525,250         |
| Compact Sector Grants - Education                              |        | 7,794,057            |
| Supplemental Education Grant                                   |        | 2,599,012            |
| Compact Sector Grants - Environment                            |        | 385,304              |
| Compact Sector Grants - Health                                 |        | 6,757,775            |
| Compact Sector Grants - Private                                |        | <u>489,775</u>       |
| Total Compact Sector Grants Fund                               | 15.875 | <u>20,551,173</u>    |
| Historic Preservation Fund Grants-In-Aid                       | 15.904 | <u>951</u>           |
| U.S. DEPARTMENT OF THE INTERIOR TOTAL                          |        | <u>\$ 20,552,124</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**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2008

| <u>Agency/Program</u>              | <u>CFDA#</u> | <u>Expenditures</u>  |
|------------------------------------|--------------|----------------------|
| U.S. DEPARTMENT OF EDUCATION       |              |                      |
| Special Education-Grants to States | 84.027B      | <u>43,054</u>        |
| U.S. DEPARTMENT OF EDUCATION TOTAL |              | <u>\$ 43,054</u>     |
| GRAND TOTAL                        |              | <u>\$ 20,595,178</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, 2008

1. Scope of Audit

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

Schedules of Expenditures of Federal Awards are presented for each federal program related to the following agencies:

- U.S. Department of the Interior
- U.S. Department of Education

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, 2008 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, 2008.

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, 2008

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 Utilities Corporation

The Chuuk Public Utilities 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 2008 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. The CSHA has yet to satisfy its 2008 reporting responsibilities under the Single Audit Act.

**STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA**

Schedule of Programs Selected For  
Audit in Accordance with OMB Circular A-133  
Year Ended September 30, 2008

| <u>Grantor</u><br><u>Program Title</u>                               | <u>CFDA No.</u> | <u>2008</u><br><u>Fiscal Year</u><br><u>Expenditures</u> |
|--|-----------------|--|
| <u>U.S. Department of the Interior</u>                               |                 |  |
| Compact of Free Association:   |                 |  |
| Compact Sector Grants  | 15.875          | \$ <u>20,551,173</u>                                     |
| Total U.S. Federal program<br>expenditures selected                  |                 |  |
| Total U.S. Federal program expenditures                              |                 | \$ <u>20,595,178</u>                                     |
| % of total U.S. Federal<br>expenditures covered by major<br>programs |                 | <u>99%</u>   |

**STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2008

**Part I - Summary of Auditors' Results**

- |   |               |
|---|---------------|
| 1. Type of auditors' report issued:   | Qualified     |
| Internal control over financial reporting:  |               |
| 2. Material weakness(es) identified?  | Yes           |
| 3. Significant deficiency(ies) identified that is not considered to be a material weakness? | None reported |
| 4. Noncompliance material to the financial statements noted?                                | Yes           |

*Federal Awards*

Internal control over major programs:

- |   |           |
|---|-----------|
| 5. Material weakness(es) identified?  | Yes       |
| 6. Significant deficiency(ies) identified that is not considered to be a material weakness?                               | Yes       |
| 7. Type of auditors' report issued on compliance for major programs:  | Qualified |
| 8. Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? | Yes       |
| 9. The State's major programs were as follows:  |           |

|                    |  |  |
|--------------------|--|--|
| <u>CFDA Number</u> | <u>Federal Program</u>   |  |
| 15.875             | Economic, Social and Political Development of the Territories:<br>Compact of Free Association, Compact Sector Grants |  |

- |  |           |
|--|-----------|
| 10. Dollar threshold used to distinguish between Type A and Type B Programs, as those terms are defined in OMB Circular A-133: | \$617,855 |
| 11. The State qualified as a low-risk auditee, as that term is defined in OMB Circular A-133?                                  | No        |

**Part II - Financial Statement Findings Section**

| <u>Reference #</u> | <u>Findings</u>     |
|--------------------|---------------------|
| 2008-2             | Revenue             |
| 2008-3             | Cash                |
| 2008-4             | Prior Year Findings |

**Part III - Federal Award Findings and Questioned Cost Section**

| <u>Reference #</u> | <u>CFDA #</u> | <u>Findings</u>                          | <u>Questioned Costs</u> |
|--------------------|---------------|--|-------------------------|
| 2008-1             | 15.875        | Procurement and Suspension and Debarment | \$ 11,519               |
| 2008-4             | 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, 2008

Finding No.: 2008-1  
 Federal Agency: U.S. Department of the Interior  
 CFDA Program: 15.875 Economic, Social and Political Development of the Territories  
 Grant Number: Compact Sector Grants  
 Requirement: Procurement and Suspension and Debarment  
 Questioned Costs: \$11,519

**Criteria:** In accordance with applicable procurement requirements, expenditures should be supported by procurement documents to substantiate the procurement method. Furthermore, such records should be kept on file and be made available for examination.

**Condition:** For 4 (or 6%) of 63 non-payroll transactions tested, either no or insufficient procurement documentation was provided to support competitive procurement requirements:

| <u>Fun</u><br><u>d</u> | <u>Account</u>       | <u>Org</u> | <u>Desc 1</u> | <u>Amount</u>    |
|------------------------|----------------------|------------|---------------|------------------|
| 15                     | Cmpt II SEG Fund     | 60         | 6963T-0000047 | \$ 3,854         |
| 15                     | Cmpt II SEG Fund     | 60         | 6963T-0000051 | 3,854            |
| 15                     | Cmpt II SEG Fund     | 60         | 4925T-0000015 | 3,700            |
| 72                     | ELEMENTARY EDUCATION | 721411     | 810136203     | <u>111</u>       |
|                        |                      |            | Total         | <u>\$ 11,519</u> |

**Cause:** The State did not maintain underlying supporting documentation to substantiate procurement methods.

**Effect:** The State is in noncompliance with applicable procurement requirements, resulting in questioned costs.

**Recommendation:** The State should strengthen controls to ensure that underlying supporting documentation is maintained on file to substantiate procurement methods.

**Auditee Response and Corrective Action Plan:** No or insufficient procurement documentation was provided to support competitive procurement requirements.

**Questioned Cost      \$7,708**

Management concurs with the finding and recommendation. Additional airfare price solicitation other than from Truk Travel were not obtained because there was no other travel agency on the island and Continental Airlines does not provide other airline airfare quotations. Presently, Chuuk State has no other travel agency on the island, making the three price quotations difficult to obtain for travel outside Micronesia.

**Questioned Cost      \$3,811**

Management concurs with the finding and recommendation. The finding pertains to on lack of written documentation to explain the why a vendor was selected who did not submit the lowest quote. Chuuk State DAS has advised the Department of Education of the necessity to document all procurement decisions where the vendor providing the lowest price was not selected.

**STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2008

Finding No.: 2008-2  
Area: Revenue

**Criteria:** Revenues should be supported by, and agree with, underlying billings, cash receipts, bank validated deposit slips, contracts/leases and other valid documentation. Additionally, cash collections should be deposited in a timely manner and reconciled with the underlying deposit in the bank statement. Furthermore, such records should be kept on file and be available for examination.

**Condition:** For 17 (or 39%) of 44 General Fund revenue transactions tested, the following cash receipts were not available for examination:

| <u>Date</u> | <u>Transaction</u> | <u>Ref 1</u> | <u>Ref 2</u>             | <u>Posted Amount</u> |
|-------------|--------------------|--------------|--------------------------|----------------------|
| 9/30/08     | 17553T-0000005     | jv890092     |                          | \$ 29,750            |
| 2/01/08     | 358T-0000032       | 4143         | Payment fo               | 5,700                |
| 2/01/08     | 358T-0000107       | 3819         | Payment fo               | 15,522               |
| 2/22/08     | 1001T-0000001      | 4150         | Fuel tax J               | 2,389                |
| 2/01/08     | 358T-0000027       | 4185         | Payment fo               | 1,381                |
| 2/15/08     | 361T-0000036       | 4135         | Payment for              | 1,023                |
| 11/19/07    | 30                 | 3284406      | 3OVEMBER COLLECTION 2007 | 5,541                |
| 11/23/07    | 30                 | 3284702      | NOVEMBER COLLECTION 2007 | 900                  |
| 10/08/07    | 30                 | 3279505      | OCTOBER COLLECTION 2007  | 7,602                |
| 10/15/07    | 30                 | 3281107      | OCTOBER COLLECTION 2007  | 36,544               |
| 11/14/07    | 30                 | 3284106      | NOVEMBER COLLECTION 2007 | 22,527               |
| 11/15/07    | 30                 | 3284208      | NOVEMBER COLLECTION 2007 | 38,339               |
| 12/17/07    | 30                 | 3287303      | DECEMBER COLLECTION 2007 | 22,558               |
| 11/14/07    | 30                 | 3284107      | NOVEMBER COLLECTION 2007 | 6,229                |
| 11/16/07    | 30                 | 3284307      | NOVEMBER COLLECTION 2007 | 6,931                |
| 10/04/07    | 30                 | 3279104      | OCTOBER COLLECTION 2007  | 740                  |
| 12/18/07    | 30                 | 3287511      | DECEMBER COLLECTION 2007 | 287                  |
|             |                    |              | Total                    | \$ <u>203,962</u>    |

**Cause:** There appears to be weak internal controls over ensuring that revenues are supported by, and agree with, underlying billings, cash receipts, bank validated deposit slips, contracts/leases and other valid documentation and that cash collections are deposited in a timely manner and reconciled with the underlying deposit in the bank statement.

**Effect:** The condition may result in a potential misstatement of revenues.

**Recommendation:** The State should strengthen internal controls to ensure that revenues are supported by, and agree with, underlying billings, cash receipts, bank validated deposit slips, contracts/leases and other valid documentation and that cash collections are deposited in a timely manner and reconciled with the underlying deposit in the bank statement. Furthermore, such records should be kept on file and be available for examination.

**Auditee Response and Corrective Action Plan:** All such receipts are now available in DAS for audit inspection and it is standard practice for Chuuk DAS to store all detailed cash receipts and related deposit slips. Consequently, there is no substantive internal control problem to resolve.

**STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2008

Finding No.: 2008-3  
Area: Cash

Criteria: Cash accounts should be reconciled in a timely manner. Additionally, the reconciliation should be made available for examination.

Condition: For the following accounts, no bank reconciliation was provided for examination:

| <u>G/L</u><br><u>Bank</u> | <u>G/L Name</u>            | <u>G/L Balance</u> |
|---------------------------|----------------------------|--------------------|
| 99-1018                   | CIB- Chuuk St PRIDE (DOE)  | \$ 131,732.50      |
| 99-1035                   | CIB-C/A Sector Payroll BOG | \$ 588,450.01      |
| 99-1044                   | CIB-C/A Sector BFSM        | \$ 182,875.78      |
| 99-1046                   | CIB-C/A Hospital BFSM      | \$ (36,425.00)     |
| 99-1049                   | CIB-C/A BFSM-old 125       | \$(344,607.52)     |
| 99-1060                   | Deposit Clearing           | \$ 35,349.55       |

Cause: There appears to be weak internal controls over ensuring that proper monthly bank reconciliations are performed in a timely manner.

Effect: The condition may result in a potential misstatement of cash.

Prior Year Status: The above condition is reiterative of prior year findings.

Recommendation: The State should strengthen internal controls to ensure that monthly bank reconciliations are performed in a timely manner and that reconciling items are resolved and corrected in the next month.

Auditee Response and Corrective Action Plan:

**99-1018      CIB St PRIDE (DOE)                      131,732.50**

Management agrees with the finding. The bank statements for this account were sent to the Department of Education. However, the Chief of Finance will request the bank to directly send bank statements to Finance for the timely preparation of the bank reconciliation. However, all bank reconciliations for this account are already done and completed.

**99-1035      CIB-C/A Sector Payroll BOG                      588,450.01**

Management agrees with the finding. The reconciliation is now complete and ready for review.

**99-1044      CIB-C/A Sector BFSM                              182,875.78**

This account is the old sector general account and was officially closed in October 2007. A balance was maintained to clear outstanding checks and then that also was transferred to the new sector account. The September 20, 2008 bank statement was provided the auditors. The remaining book balance will be written off in 2009.



**STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2008

Finding No.           2008-4  
Area:                    Prior Year Findings

Criteria: Prior year findings should be resolved in a timely manner.

Condition: The following prior year findings remain unresolved:

2007-13 – Annual Leave Taken  
2007-20 – Encumbrances  
2007-07 – Implementation of Fixed Assets for GAS 34

Cause: The cause of this condition is that the State management has engaged in numerous other projects during the year and was not able to devote substantial time to the abovementioned.

Effect: The effect of this condition is that the same matters continue to impact the State as were specified in prior years.

Recommendation: The State should set a timetable and obtain technical assistance to assist in resolution of the abovementioned matters.

Auditee Response and Correction Action: We agree with the finding and recommendation. Chuuk DAS is obtaining technical assistance to implement fixed assets for GAS 34 with a December 31, 2009 schedule for completion. We believe the problems associated with annual leave taken and encumbrances have been resolved and will submit such for the removal of the finding in 2009.

**STATE OF CHUUK  
FEDERATED STATES OF MICRONESIA**

Resolution of Prior Years' Findings and Questioned Costs  
Year Ended September 30, 2008

For the year ended September 30, 2008, the following questioned costs were noted and prior questioned costs resolved:

|                                   | Questioned Costs<br>Set Forth in<br>Prior Audit Report<br><u>2007</u> | Questioned<br>Costs Resolved<br>During Fiscal Year<br><u>2008</u> | Unresolved<br>Questioned Costs at<br><u>September 30, 2008</u> |
|-----------------------------------|---|---|--|
| Unresolved Questioned Costs FY 01 | \$ 150,597  | \$ 150,597  | \$ -   |
| Unresolved Questioned Costs FY 02 | 154,072   | 154,072   | -  |
| Unresolved Questioned Costs FY 03 | 1,807,858   | 1,685,829   | 122,029  |
| Unresolved Questioned Costs FY 04 | 3,374,699   | 3,326,700   | 47,999   |
| Unresolved Questioned Costs FY 05 | 1,247,167   | 1,247,167   | -  |
| Unresolved Questioned Costs FY 06 | 958,987   | -   | 958,987  |
| Unresolved Questioned Costs FY 07 | <u>1,578,943</u>  | <u>663,141</u>  | <u>915,802</u>   |
|                                   | \$ <u>9,272,323</u>   | \$ <u>7,227,506</u>   | 2,044,817  |
| Questioned Costs FY 08            |   |   | <u>11,519</u>  |
|                                   |   |   | \$ <u>2,056,336</u>  |

During the fiscal year ended September 30, 2008, certain questioned costs, aggregating \$7,227,506, were resolved by the FSM National Government.