

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

**REPORT ON THE AUDIT OF
FINANCIAL STATEMENTS IN ACCORDANCE
WITH THE UNIFORM GUIDANCE**

YEAR ENDED SEPTEMBER 30, 2017

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2017

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**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2017

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**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2017

INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the aggregate discretely presented component units and each major fund of the State of Chuuk (the State) as of and for the year ended September 30, 2017, and the related notes to the financial statements, which collectively comprise the State's basic financial statements as set forth in Section III of the foregoing table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinions.

Summary of Opinions

Opinion Unit	Type of Opinion
Governmental Activities	Qualified
Aggregate Discretely Presented Component Units	Unmodified
General Fund	Qualified
Grants Assistance Fund	Unmodified
Compact Trust Fund	Unmodified

Basis for Qualified Opinions on Governmental Activities and General Fund

As discussed in Note 12 to the financial statements, the State has not recorded a liability for land leases and related claims payable in the governmental activities and the General Fund and, accordingly, has not recorded an expenditure/expense for the current period change in that liability. Accounting principles generally accepted in the United States of America require that liabilities incurred attributable to services already rendered and that are not contingent upon a specific event that is outside of the control of the State be accrued as liabilities and expenditures/expenses, which would increase the liabilities, decrease net position, 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 position and expenses of the governmental activities and the liabilities, fund deficit, and expenditures of the General Fund is not reasonably determinable.

Qualified Opinions

In our opinion, except for the matters described in the "Basis for Qualified Opinions on Governmental Activities and General Fund" paragraph, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the General Fund of the State of Chuuk as of September 30, 2017, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Unmodified Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the aggregate discretely presented component units, the Grants Assistance Fund and the Compact Trust Fund of the State of Chuuk as of September 30, 2017, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matter*Receivables from the FSM National Government*

As discussed in Note 3 to the financial statements, the State is in discussions with the FSM National Government to determine the ultimate collectability of certain receivables due from the FSM National Government in consultation with federal grantor agencies arising from Compact sector grant transactions.

Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

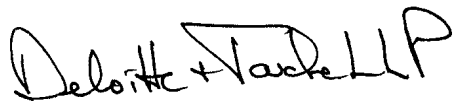
Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 10 as well as the Schedule of Revenues, Expenditures, and Changes in Fund Deficit – Budget and Actual – General Fund and notes thereto, on pages 49 and 50, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Government Accounting Standards Board (GASB) who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State's basic financial statements. The combining and individual fund financial statements as set forth in Section V of the foregoing table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual fund financial statements are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining and individual fund financial statements are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 21, 2018, 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 solely describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the State's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the State's internal control over financial reporting and compliance.



June 21, 2018

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2017

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, 2017. We encourage readers to consider this information in conjunction with Chuuk State's financial statements, which follow. Fiscal year 2016 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, 2017, Chuuk State's total net position increased by \$3.047 million (or 7.64%) from \$39.864 million in the prior year to \$42.911 million.
- During fiscal year 2017, both revenues and expenses increased over fiscal year 2016. Chuuk State's revenues of \$43.094 million increased by \$4.282 million (or 11.03 %) from \$38.812 million in fiscal year 2016. The increase in revenue was primarily attributable to increased operating grants, revenue sharing, local taxes and fees and unrestricted investment earnings. Expenses in fiscal year 2017 of \$40.046 million increased by \$1.493 million (or 3.88%) from \$38.553 million in fiscal year 2016. The increase is due to increases in expenses for health, education sector, economic development, capital projects and unallocated interest on long-term debt.
- The General Fund deficit decreased by \$1.588 million in fiscal year 2017, from \$5.177 million in the prior year to \$3.589 million. The increase in revenues contributed to the deficit decrease.

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

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

**STATE OF CHUUK
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Management's Discussion and Analysis, Continued
September 30, 2017

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

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

Fund Financial Statements

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

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

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

FINANCIAL ANALYSIS OF CHUUK STATE AS A WHOLE

Net position may serve over time as a useful indicator of a government's financial position. At the end of fiscal year 2017, Chuuk State's assets exceeded liabilities by \$42.911 million. However, all these net assets are restricted as to the purposes they can be used for or are invested in capital assets. Chuuk State uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although Chuuk State's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. The following summary of Chuuk State's net position as of September 30, 2017, with comparable balances for fiscal year 2016, discloses this relationship.

**STATE OF CHUUK
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Management's Discussion and Analysis, Continued
September 30, 2017

	Governmental Activities			
	<u>2017</u>	<u>2016</u>	<u>Change</u>	<u>%</u>
Current and other assets	\$ 31,854,162	\$ 24,366,090	\$ 7,488,072	30.73
Capital assets	<u>38,068,703</u>	<u>39,100,174</u>	<u>(1,031,471)</u>	(2.64)
Total Assets	<u>69,922,865</u>	<u>63,466,264</u>	<u>6,456,601</u>	10.17
Current and other liabilities	18,410,820	14,658,654	3,752,166	25.60
Long-term debt	<u>8,600,911</u>	<u>8,943,674</u>	<u>(342,763)</u>	(3.83)
Total Liabilities	<u>27,011,731</u>	<u>23,602,328</u>	<u>3,409,403</u>	14.45
Net Position:				
Net investment in capital assets	38,068,703	39,100,174	(1,031,471)	(2.64)
Restricted	23,601,626	21,636,297	1,965,329	9.08
Unrestricted	<u>(18,759,195)</u>	<u>(20,872,535)</u>	<u>2,113,340</u>	(10.12)
Total net position	<u>42,911,134</u>	<u>39,863,936</u>	<u>3,047,198</u>	7.64
Total Liabilities and Net Position	\$ <u>69,922,865</u>	\$ <u>63,466,264</u>	\$ <u>6,456,601</u>	10.17

At the end of fiscal year 2017, Chuuk State's unrestricted net position showed a deficit of \$18.759 million, a decrease of \$2.113 million (10.125%) from the prior year \$20.872 million. This deficit is the result of having current and long-term commitments that are greater than currently available resources. 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 position increased by \$3.047 million (or 7.64%) from the prior year. Key elements of the increase and the differences from the prior year are shown in the following schedule:

	Governmental Activities			
	<u>2017</u>	<u>2016</u>	<u>Change</u>	<u>%</u>
Revenues:				
Program Revenues:				
Charges for services	\$ 2,416,402	\$ 2,286,421	\$ 129,981	5.68
Operating/capital grants and contributions	<u>30,242,438</u>	<u>28,329,839</u>	<u>1,912,599</u>	6.75
	<u>32,658,840</u>	<u>30,616,260</u>	<u>2,042,580</u>	6.67
General Revenues:				
Taxes	7,018,183	6,453,810	564,373	8.74
Unrestricted investment earnings	394,879	(144,209)	539,088	(373.82)
Other	<u>1,144,258</u>	<u>721,433</u>	<u>422,825</u>	58.61
	<u>8,557,320</u>	<u>7,031,034</u>	<u>1,526,286</u>	21.71
Total revenues	41,216,160	37,647,294	3,568,866	9.48
Special item-SDR foreign exchange gain	-	51,520	(51,520)	(100.00)
Contributions to permanent fund	<u>1,877,570</u>	<u>1,112,947</u>	<u>764,623</u>	68.70
Total revenues and contributions	<u>43,093,730</u>	<u>38,811,761</u>	<u>4,281,969</u>	11.03

**STATE OF CHUUK
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Management's Discussion and Analysis, Continued
September 30, 2017

	Governmental Activities			
	<u>2017</u>	<u>2016</u>	<u>Change</u>	<u>%</u>
Expenses:				
General government	5,893,425	6,415,438	(522,013)	(8.14)
Health services	11,485,387	10,805,290	680,097	6.29
Education	15,931,685	15,442,223	489,462	3.17
Economic development	1,371,673	1,051,991	319,682	30.39
Public safety	1,206,473	1,322,886	(116,413)	(8.80)
Public works and transportation	1,551,441	1,551,817	(376)	(0.02)
Community affairs	147,190	143,061	4,129	2.89
Boards and commissions	986,098	718,894	267,204	37.17
Judiciary	512,282	481,475	30,807	6.40
Payments to component units	65,134	114,001	(48,867)	(42.87)
Municipal affairs	419,732	413,757	5,975	1.44
Unallocated Interest on long-term debt	206,328	51,179	155,149	303.15
Capital projects	268,086	-	268,086	100.00
Other	<u>1,598</u>	<u>40,572</u>	<u>(38,974)</u>	<u>(96.06)</u>
Total expenses	<u>40,046,532</u>	<u>38,552,584</u>	<u>1,493,948</u>	<u>3.88</u>
Change in net position	3,047,198	259,177	2,788,021	1,075.72
Net position at the beginning of the year	<u>39,863,936</u>	<u>39,604,759</u>	<u>259,177</u>	<u>0.65</u>
Net position at the end of the year	\$ <u>42,911,134</u>	\$ <u>39,863,936</u>	\$ <u>3,047,198</u>	<u>7.64</u>

The detail indicates the increases in both revenues and expenses in fiscal year 2017, and the marginal increase in overall net position of \$3.047 million.

Revenues and contributions of \$43.093 million increased by \$4.281 million (or 11.03%) from the prior year's \$38.811 million. The key elements of the increase were due to an increase in program revenues as more grant drawdowns from higher utilization of sector grant occurred and improved local tax collections compared with prior year.

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

<u>SOURCES OF REVENUE</u>	<u>2017</u>	<u>2016</u>
Compact funding	64.1%	67.1%
Federal and other grants	6.1%	6.0%
Investments	5.3%	2.5%
Revenue sharing	9.4%	9.4%
Taxes and fees	12.5%	13.2%
Other	<u>2.6%</u>	<u>1.8%</u>
	<u>100.0%</u>	<u>100.0%</u>

**STATE OF CHUUK
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Management's Discussion and Analysis, Continued
September 30, 2017

Notwithstanding the increases in both revenues shares passed through the State and local taxes and fees that reduce dependency on Compact funding, the preponderance of sector funding as 64.1% of the total revenue highlights the importance of maximizing Compact sector grant utilization.

Total Expenses increased by \$1.493 million (or 3.88%), from \$38.553 million in the prior fiscal year to \$40.047 million in fiscal year 2017. The most notable increases in fiscal year 2017 were in the health sector \$0.680 million, education sector \$0.489 million, economic development \$0.319 million, boards and commissions \$0.267 million, capital projects \$0.268 million and unallocated interest on long term debt \$0.155 million. The major decreases of expenses in general government \$0.522 million, public safety \$0.116 million and other government agencies \$0.088 million offset the increase.

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 2017, Chuuk State's governmental funds reported a combined fund balance of \$15.714 million, which represents a \$3.734 million increase (31.17%) from the \$11.979 million fund balance recorded at the end of fiscal 2016. Of this total combined fund balance, \$15.969 million is non-spendable because it is legally restricted to other purposes and \$8.386 million is restricted to fund specific fund-related activities. These non-spendable and restricted fund balances are off-set by combined unassigned fund deficit of \$8.642 million.

General Fund

Most of the basic current operational services are recorded, reported, and accounted for in the General Fund, except for Health, Education, Environment, Private Sector Development, Capacity Building, ERA and IMF which are reported and accounted for in the Grant Assistance Fund. As shown in the accompanying financial statements, at the end of fiscal year 2017, the General Fund recorded total revenues of \$10.799 million with total expenditures of \$8.705 million resulting in an excess of \$2.094 million even after repayment of ADB loans principal and interest of \$ \$0.549 million. At the end of the year, General Fund deficit decreased by \$1.588 million decreasing from \$5.177 million in the prior year to \$3.589 million, which included a local match transfer out to IMF Grants Assistance Fund of \$0.506 million. The State needs to continue to develop strategies to increase revenues and reduce expenditures in order to sustainably eliminate the fund balance deficit over the next few years.

Grants Assistance Fund

The Grants Assistance Fund consists of funding provided through the amended Compact of Free Association Sector Grants; US Federal Grants, and other Non-US grants. As shown in the accompanying financial statements, at the end of fiscal year 2017, the Grant Assistance Fund had total revenues of \$30.242 million and total expenditures of \$30.527 million. This resulted in a deficit of \$(0.284 million). Nevertheless, a total of \$0.506 million of operating transfers-in to finance infrastructure maintenance programs were recorded, which effectuated a net change in fund balance deficit of \$0.222 million. This brings a total overall fund balance of \$4.899 million. As shown in the above numbers, this is an indication of appropriate spending in the Grant Assistance Fund and management will ensure that required internal controls are in place.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis, Continued
September 30, 2017

Compact Trust Fund

The Trust Fund was established to account for Chuuk State's share of the Compact Trust Fund. The Fund is managed by the FSM National Government and is a long term restricted Fund. At the end of fiscal year 2017, the fund recorded a net change in the fair value of its investments of \$1.878 million, which increased the fund balance at the end of the year to \$14.247 million.

Other Governmental Fund

This fund is established to account and report on fees collected for services at the hospital. At the end of fiscal year 2017, total revenue collected was \$0.174 million at the same time total expenditures were \$0.128 million. This resulted in an excess of revenues over expenditures of (\$0.046) million.

Note 9 of the financial statements gives further details of the fund balance components of Chuuk State.

GENERAL FUND BUDGETARY HIGHLIGHTS

In fiscal year 2017, actual revenues of \$10.799 million exceeded the budgeted revenues of \$8.188 million by \$2.611 million. Actual budgetary expenditures of \$9.055 million were greater than budgetary appropriations of \$7.912 million by \$1.143 million, resulting in an overall excess of revenues over expenditures of \$1.445 million. When combined with the transfer out to other fund (\$0.506 million), the net change in unreserved fund deficit on a budgetary basis was a positive (\$1.239 million). In accordance with the principles of budgetary accounting, the deficit includes encumbrances for which goods or services had not been received of \$0.349 million, the net change in unreserved fund deficit on a budgetary basis was a positive amount of \$1.814 million.

Chuuk State retains a balanced operating budget but debt financing activities of the State that are not budgeted have a negative impact on overall State operations. In fiscal year 2017, principal and debt service charges for ADB loans of \$0.549 million contributed to the deficiency.

CAPITAL ASSET AND DEBT ADMINISTRATION

Chuuk State's investment in capital assets for the primary government as of September 30, 2017, amounted to \$124.416 million, net of accumulated depreciation of \$86.348 million, leaving a net book value of \$38.068 million. This represents a net decrease of \$1.031 million (or 2.64%) from fiscal year 2016. Chuuk State recorded major additions of \$1.291 million in 2017 related to land of \$0.309 million, buildings of \$0.539 million and vehicles and other equipment of \$0.443 million, but current year depreciation charges of \$2.322 million resulted in the net decrease. The table below summarizes Chuuk State's net capital assets:

	Governmental Activities			
	<u>2017</u>	<u>2016</u>	<u>Change</u>	<u>%</u>
Land	\$ 18,263,682	\$ 17,954,462	\$ 309,220	1.72
Airport Facilities	5,911,151	6,863,838	(952,687)	(13.88)
Buildings	7,918,527	7,650,381	268,146	3.51
Seaport Facilities	3,314,652	3,977,582	(662,930)	(16.67)
Vehicles / Equipment	<u>2,660,691</u>	<u>2,653,911</u>	<u>6,780</u>	0.26
	\$ <u>38,068,703</u>	\$ <u>39,100,174</u>	\$ <u>(1,031,471)</u>	<u>(2.64)</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis, Continued
September 30, 2017

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

Long -Term Debt

The following schedule shows Chuuk State's summarized long-term debt for fiscal year 2017 and comparable amounts for fiscal year 2016.

	Governmental Activities			
	<u>2017</u>	<u>2016</u>	<u>Change</u>	<u>%</u>
ADB Water Supply Loan (1459)	\$ 3,037,842	\$ 3,163,851	\$ (126,009)	(3.98)
ADB Early Retirement Loan (1520)	4,305,583	4,363,469	(57,886)	(1.33)
ADB Basic Social Services Program Loan (1816)	141,055	223,067	(82,012)	(36.77)
ADB Private Sector Reform Program Loan (1873)	330,097	365,015	(34,918)	(9.57)
ADB Private Sector Reform Program Loan (1874)	<u>786,334</u>	<u>828,271</u>	<u>(41,937)</u>	(5.06)
	\$ <u>8,600,911</u>	\$ <u>8,943,673</u>	\$ <u>(342,762)</u>	(3.83)

Long-term debt decreased by \$0.342 million (or 3.83%) in fiscal year 2017 as the result of loan repayments with an SDR adjustment resulting in gradual debt reductions.

Additional information on Chuuk State's long-term debt obligations can be found in Notes 6 and 7 to the accompanying financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

Chuuk State local revenue collections are showing growth in fiscal year 2018 with revenue collections trending is expected to have marginal growth from prior year. As a result, State policymakers have cautiously kept general fund budgets capped within actual revenue collections, both in fiscal years 2018 and for the 2019 annual appropriation act. Revenue collections in excess of these fiscal ceilings will be used for debt relief payments of Chuuk's old liabilities.

CONTACTING CHUUK STATE'S FINANCIAL MANAGEMENT

The financial report is designed to provide our citizens, taxpayers, customers, and investments and creditors, a general overview of Chuuk State's finances to demonstrate its accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Director, Office of Administrative Services, P.O. Box 849, Weno, Chuuk FM 96941

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Statement of Net Position
September 30, 2017

	Primary Government	Component Units
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 1,693,064	\$ 1,938,266
Time certificates of deposit	-	200,000
Equity interest in internal investment pool	33,416	491,647
Receivables, net of allowance for uncollectibles	4,906,087	1,418,411
Inventories	-	834,084
Prepayments	912,982	-
Restricted assets:		
Cash and cash equivalents	5,279,787	-
Total current assets	<u>12,825,336</u>	<u>4,882,408</u>
Noncurrent assets:		
Restricted assets:		
Investments	17,890,754	-
Investments	588,072	-
Other assets	550,000	802,061
Capital assets:		
Nondepreciable capital assets	18,263,682	-
Capital assets, net of accumulated depreciation	19,805,021	21,224,943
Total noncurrent assets	<u>57,097,529</u>	<u>22,027,004</u>
Total assets	<u>\$ 69,922,865</u>	<u>\$ 26,909,412</u>
<u>LIABILITIES</u>		
Current liabilities:		
Current portion of long-term debt	\$ 459,729	\$ 263,043
Accounts payable	1,795,764	129,294
Land acquisition payable	8,591,745	-
Compensated absences payable	427,958	7,359
Other liabilities and accruals	929,078	391,279
Unearned revenues	4,824,005	62,380
Total current liabilities	<u>17,028,279</u>	<u>853,355</u>
Noncurrent liabilities:		
Accrued annual leave, net of current portion	-	28,352
Noncurrent portion of long-term obligations	8,141,182	4,429,566
Compensated absences payable, net of current portion	939,665	-
Claims and judgments payable	902,605	-
Total noncurrent liabilities	<u>9,983,452</u>	<u>4,457,918</u>
Total liabilities	<u>27,011,731</u>	<u>5,311,273</u>
<u>NET POSITION</u>		
Net investment in capital assets	38,068,703	16,532,334
Restricted for:		
Nonexpendable:		
Future operations	14,246,906	-
Expendable:		
Compact related	5,554,170	-
Debt service	3,643,848	-
Other purposes	156,702	517,506
Unrestricted	(18,759,195)	4,548,299
Total net position	<u>42,911,134</u>	<u>21,598,139</u>
Total liabilities and net position	<u>\$ 69,922,865</u>	<u>\$ 26,909,412</u>

See accompanying notes to financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Statement of Activities
Year Ended September 30, 2017

Functions/Programs	Program Revenues				Net (Expenses) Revenues and Changes in Net Position	
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government	Component Units
Primary government:						
Governmental activities:						
General government	\$ 5,893,425	\$ 1,457,762	\$ 3,918,775	\$ -	\$ (516,888)	\$ -
Health services	11,485,387	174,298	9,718,429	-	(1,592,660)	-
Education	15,931,685	-	15,351,537	-	(580,148)	-
Economic development	1,371,672	-	985,610	-	(386,062)	-
Public safety	1,206,473	86,262	-	-	(1,120,211)	-
Public works and transportation	1,551,441	698,080	-	-	(853,361)	-
Community affairs	147,190	-	-	-	(147,190)	-
Boards, commissions and other	986,098	-	-	-	(986,098)	-
Judiciary	512,282	-	-	-	(512,282)	-
Payments to component units	65,134	-	-	-	(65,134)	-
Municipal affairs	419,732	-	-	-	(419,732)	-
Unallocated interest on long-term debt	108,114	-	-	-	(108,114)	-
Capital projects	268,086	-	-	268,086	-	-
Other	1,598	-	-	-	(1,598)	-
Total primary government	<u>39,948,317</u>	<u>2,416,402</u>	<u>29,974,351</u>	<u>268,086</u>	<u>(7,289,478)</u>	<u>-</u>
Component units:						
Chuuk State Health Care Plan	1,580,125	1,657,788	-	-	-	77,663
Chuuk Public Utility Corporation	6,601,995	6,321,837	-	1,827,180	-	1,547,022
Chuuk State Housing Authority	154,547	154,406	-	-	-	(141)
Total component units	<u>\$ 8,336,667</u>	<u>\$ 8,134,031</u>	<u>\$ -</u>	<u>\$ 1,827,180</u>	<u>-</u>	<u>1,624,544</u>
General revenues:						
Taxes:						
FSM revenue sharing:						
Gross revenue taxes					1,447,776	-
Import taxes					1,360,428	-
Income taxes					1,071,124	-
Other taxes					179,052	-
State taxes:						
Sales tax					2,349,134	-
Other excise taxes					610,669	-
Unrestricted investment income					394,879	110,249
Other					845,322	876,359
Total general revenues					<u>8,258,384</u>	<u>986,608</u>
Special item - loss on SDR foreign exchange					(98,214)	-
Special item - gain on Compact sector close out					298,936	-
Contributions to permanent fund					<u>1,877,570</u>	<u>-</u>
Total general revenues, special item and contributions					<u>10,336,676</u>	<u>986,608</u>
Change in net position					<u>3,047,198</u>	<u>2,611,152</u>
Net position at the beginning of the year					<u>39,863,936</u>	<u>18,986,987</u>
Net position at the end of the year					<u>\$ 42,911,134</u>	<u>\$ 21,598,139</u>

See accompanying notes to financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Balance Sheet
Governmental Funds
September 30, 2017

	General	Special Revenue Grants Assistance	Permanent Compact Trust	Other Governmental Funds	Total
ASSETS					
Cash and cash equivalents	\$ 1,693,064	\$ -	\$ -	\$ -	\$ 1,693,064
Equity interest in internal investment pool	33,416	-	-	-	33,416
Investments	588,072	-	-	-	588,072
Receivables, net	809,969	4,082,793	-	13,325	4,906,087
Prepayments	271,737	586,564	-	54,681	912,982
Due from other funds	3,562,111	10,063,204	-	93,370	13,718,685
Other assets	550,000	-	-	-	550,000
Restricted assets:					
Cash and cash equivalents	5,279,787	-	-	-	5,279,787
Investments	3,643,848	-	14,246,906	-	17,890,754
Total assets	<u>\$ 16,432,004</u>	<u>\$ 14,732,561</u>	<u>\$ 14,246,906</u>	<u>\$ 161,376</u>	<u>\$ 45,572,847</u>
LIABILITIES AND FUND BALANCES (DEFICIT)					
Liabilities:					
Accounts payable	\$ 1,028,945	\$ 762,643	\$ -	\$ 4,176	\$ 1,795,764
Accrued liabilities	243,283	685,239	-	556	929,078
Land acquisition payable	8,591,745	-	-	-	8,591,745
Unearned revenues	-	4,824,005	-	-	4,824,005
Due to other funds	10,156,574	3,562,111	-	-	13,718,685
Total liabilities	<u>20,020,547</u>	<u>9,833,998</u>	<u>-</u>	<u>4,732</u>	<u>29,859,277</u>
Fund balances (deficit):					
Nonspendable	1,409,809	257,795	14,246,906	54,681	15,969,191
Restricted	3,643,848	4,640,768	-	101,963	8,386,579
Unassigned:					
General fund	<u>(8,642,200)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(8,642,200)</u>
Total fund balances (deficit)	<u>(3,588,543)</u>	<u>4,898,563</u>	<u>14,246,906</u>	<u>156,644</u>	<u>15,713,570</u>
Total liabilities and fund balances	<u>\$ 16,432,004</u>	<u>\$ 14,732,561</u>	<u>\$ 14,246,906</u>	<u>\$ 161,376</u>	
Amounts reported for governmental activities in the statement of net position are different because:					
Capital assets used in governmental activities are not financial resources and, therefore, are reported in the funds					38,068,703
Long-term liabilities, including loans payable, are not due and payable in the current period and, therefore, are not reported in the funds. The liabilities include:					
Long-term obligations				(8,600,911)	
Compensated absences				(1,367,623)	
Claims and judgements payable				(902,605)	
					<u>(10,871,139)</u>
Net position of governmental activities					<u>\$ 42,911,134</u>

See accompanying notes to financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficit)
Governmental Funds
Year Ended September 30, 2017

		Special Revenue	Permanent	Other Governmental Funds	Total
	General	Grants Assistance	Compact Trust		
Revenues:					
Compact funding	\$ -	\$ 27,624,155	\$ -	\$ -	\$ 27,624,155
Net change in the fair value of investments	394,879	-	1,877,570	-	2,272,449
Federal contributions and other grants	-	2,618,282	-	-	2,618,282
FSM revenue sharing	4,058,380	-	-	-	4,058,380
State taxes	2,959,803	-	-	-	2,959,803
Fees and charges	2,242,104	-	-	174,298	2,416,402
Other	845,322	-	-	-	845,322
Total revenues	10,500,488	30,242,437	1,877,570	174,298	42,794,793
Expenditures:					
Current:					
General government	3,794,654	1,354,624	-	-	5,149,278
Health services	102,004	11,263,362	-	127,737	11,493,103
Education	-	16,255,162	-	-	16,255,162
Economic development	101,934	1,269,738	-	-	1,371,672
Public safety	1,097,327	115,593	-	-	1,212,920
Public works and transportation	894,111	-	-	-	894,111
Community affairs	147,190	-	-	-	147,190
Boards, commissions and other	986,098	-	-	-	986,098
Judiciary	546,453	-	-	-	546,453
Payments to component units	65,134	-	-	-	65,134
Municipal affairs	419,732	-	-	-	419,732
Other	1,598	-	-	-	1,598
Capital projects	-	268,086	-	-	268,086
Debt service	549,090	-	-	-	549,090
Total expenditures	8,705,325	30,526,565	-	127,737	39,359,627
Excess (deficiency) of revenues over (under) expenditures	1,795,163	(284,128)	1,877,570	46,561	3,435,166
Other financing sources (uses):					
Operating transfers in	-	506,054	-	-	506,054
Operating transfers out	(506,054)	-	-	-	(506,054)
Total other financing sources (uses), net	(506,054)	506,054	-	-	-
Special item:					
Compact Sector close out	298,936	-	-	-	298,936
Net change in fund balances (deficit)	1,588,045	221,926	1,877,570	46,561	3,734,102
Fund balances (deficit) at the beginning of the year	(5,176,588)	4,676,637	12,369,336	110,083	11,979,468
Fund balances (deficit) at the end of the year	\$ (3,588,543)	\$ 4,898,563	\$ 14,246,906	\$ 156,644	\$ 15,713,570

See accompanying notes to 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, 2017

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

Net change in fund balances - total governmental funds	\$ 3,734,102
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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 (\$2,322,846) exceeded capital outlays (\$1,291,375) in the current period.	(1,031,471)
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The incurrence of long-term debt (e.g. bonds, leases) provides current financial resources to governmental funds, while the repayment of principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction has any effect on net position. For the current year, these amounts consist of:

Repayment of ADB loans and loss on SPR foreign exchange adjustment	342,762
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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:

Change in compensated absences payable	<u>1,805</u>
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Change in net position of governmental activities	\$ <u>3,047,198</u>
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See accompanying notes to financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

DISCRETELY PRESENTED COMPONENT UNITS
Combining Statement of Net Position
September 30, 2017

<u>ASSETS</u>	Chuuk State Health Care Plan	Chuuk Public Utility Corporation	Chuuk State Housing Authority	Total
Current assets:				
Cash and cash equivalents	\$ 512,210	\$ 1,287,966	\$ 138,090	\$ 1,938,266
Time certificates of deposit	200,000	-	-	200,000
Investments	491,647	-	-	491,647
Receivables, net	474,803	533,419	410,189	1,418,411
Inventories	-	834,084	-	834,084
Total current assets	<u>1,678,660</u>	<u>2,655,469</u>	<u>548,279</u>	<u>4,882,408</u>
Noncurrent assets:				
Deposits	41,750	760,311	-	802,061
Capital assets:				
Nondepreciable capital assets	-	-	-	-
Capital assets, net of accumulated depreciation	<u>16,498</u>	<u>21,189,020</u>	<u>19,425</u>	<u>21,224,943</u>
Total assets	<u>\$ 1,736,908</u>	<u>\$ 24,604,800</u>	<u>\$ 567,704</u>	<u>\$ 26,909,412</u>
<u>LIABILITIES AND NET POSITION</u>				
Current liabilities:				
Current portion of long-term debt	\$ -	\$ 263,043	\$ -	\$ 263,043
Compensated absence payable	-	7,359	-	7,359
Accounts payable	103,153	8,564	17,577	129,294
Accrued liabilities	-	306,414	84,865	391,279
Unearned income	-	62,380	-	62,380
Total current liabilities	<u>103,153</u>	<u>647,760</u>	<u>102,442</u>	<u>853,355</u>
Noncurrent liabilities:				
Accrued annual leave, net of current portion	-	28,352	-	28,352
Noncurrent portion of long-term debt	-	4,429,566	-	4,429,566
Total liabilities	<u>103,153</u>	<u>5,105,678</u>	<u>102,442</u>	<u>5,311,273</u>
Net position:				
Net investment in capital assets	16,498	16,496,411	19,425	16,532,334
Restricted	-	517,506	-	517,506
Unrestricted	<u>1,617,257</u>	<u>2,485,205</u>	<u>445,837</u>	<u>4,548,299</u>
Total net position	<u>1,633,755</u>	<u>19,499,122</u>	<u>465,262</u>	<u>21,598,139</u>
Total liabilities and net position	<u>\$ 1,736,908</u>	<u>\$ 24,604,800</u>	<u>\$ 567,704</u>	<u>\$ 26,909,412</u>

See accompanying notes to financial statements.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

DISCRETELY PRESENTED COMPONENT UNITS
Combining Statement of Revenues, Expenses, and Changes in Net Position
Year Ended September 30, 2017

	Chuuk State Health Care Plan	Chuuk Public Utility Corporation	Chuuk State Housing Authority	Total
Operating revenues:				
Charges for services	\$ 1,644,444	\$ 6,321,837	\$ 149,053	\$ 8,115,334
Other	13,344	-	5,353	18,697
Total operating revenues	<u>1,657,788</u>	<u>6,321,837</u>	<u>154,406</u>	<u>8,134,031</u>
Operating expenses:				
Cost of services	1,273,393	3,058,352	-	4,331,745
Depreciation	6,407	881,223	3,415	891,045
Administration and general	300,325	2,662,420	151,132	3,113,877
Total operating expenses	<u>1,580,125</u>	<u>6,601,995</u>	<u>154,547</u>	<u>8,336,667</u>
Operating (loss) income	<u>77,663</u>	<u>(280,158)</u>	<u>(141)</u>	<u>(202,636)</u>
Nonoperating revenues (expenses):				
Other income (loss)	57,422	52,827	-	110,249
Operating grants	-	876,359	-	876,359
Total nonoperating revenues, net	<u>57,422</u>	<u>929,186</u>	<u>-</u>	<u>986,608</u>
Net income before capital contributions	135,085	649,028	(141)	783,972
Capital contributions	-	1,827,180	-	1,827,180
Change in net position	135,085	2,476,208	(141)	2,611,152
Net position at the beginning of the year	<u>1,498,670</u>	<u>17,022,914</u>	<u>465,403</u>	<u>18,986,987</u>
Net position at the end of the year	<u>\$ 1,633,755</u>	<u>\$ 19,499,122</u>	<u>\$ 465,262</u>	<u>\$ 21,598,139</u>

See accompanying notes to financial statements.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2017

(1) Summary of Significant Accounting Policies

The State of Chuuk (the State) was constituted on October 1, 1984, under the provisions of the Chuuk State Constitution (the Constitution) as approved by the people of Chuuk. The Constitution provides for the separation of powers of the executive, legislative, and judicial branches of the government.

The accompanying financial statements of 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.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

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

i. Discretely Presented Component Units

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

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

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. The State has the ability to impose its will on CPUC.

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

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

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

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2017

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

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.

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

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

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

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

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

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

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2017

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

ii. Omitted Governmental Funds, Continued

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

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

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

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

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

iii. Omitted Component Units

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

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

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. The State has the ability to impose its will on CPFC.

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Notes to Financial Statements
September 30, 2017

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements

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

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

The Statement of Net Position presents all of the reporting entity's non-fiduciary assets and deferred outflows of resources, and liabilities and deferred inflows of resources with the difference reported as net position. Net position is reported in the following categories:

- Net investment in capital assets 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 position - 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 position - 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 position consists of net position, which does not meet the definition of the two preceding categories. Unrestricted net position often is designated, (for example, internally restricted), to indicate that management does not consider such to be available for general operations.

The government-wide Statement of Net Position reports \$23,601,626 of restricted net position, of which none is restricted by enabling legislation.

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Notes to Financial Statements
September 30, 2017

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

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

C. Fund Financial Statements

The fund financial statements present a balance sheet and a statement of revenues, expenditures, and changes in fund balances for its major and aggregated non-major funds. Major individual governmental funds are reported as separate columns in the fund financial statements pursuant to GASB reporting standards, with nonmajor governmental funds being combined into a single column.

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

D. Measurement Focus and Basis of Accounting

Government-Wide Financial Statements:

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

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

Governmental Fund Financial Statements:

Governmental fund financial statements account for the general governmental activities of the State and are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become susceptible to accrual; generally when they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For the purpose, the State considers revenues to be available if they are collected within 60 days of the end of the current fiscal period.

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Notes to Financial Statements
September 30, 2017

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Governmental Fund Financial Statements, Continued:

Significant revenues susceptible to accrual include income and gross revenue taxes, federal grants, federal reimbursements and other reimbursements for use of materials and services. Miscellaneous revenues from other financing sources are recognized when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned, since they are both measurable and available. Expenditures generally are recorded in the period in which the related fund liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Component Unit Financial Statements:

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

Fund Accounting:

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:

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.

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

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

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Notes to Financial Statements
September 30, 2017

(1) Summary of Significant Accounting Policies, Continued

E. Cash and Cash Equivalents and Time Certificates of Deposit

Cash and cash equivalents of the primary government and the discretely presented component units include cash held in demand accounts as well as short-term investments with maturity dates 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 position/balance sheet.

F. Investments

Investments and related investment earnings of the primary government and the discretely presented component units are recorded at fair value using quoted market prices. Fair value is the price that would be received to sell an asset or paid to transfer a liability (ie., the exit price) in an orderly transaction between market participants at the date as of which the fair value of an asset or liability is determined.

The State categorizes its fair value measurements within the fair value hierarchy established by GAAP. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs. In certain instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy is based on the lowest level of input that is significant to the fair measurement. Investments not categorized under the fair value hierarchy are shown at either Net Asset Value (NAV) or amortized cost.

G. Receivables

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

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

H. Inventories

Inventories of the discretely presented component units are valued at the lower of cost (FIFO) or market.

I. Prepaid Items

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

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Notes to Financial Statements
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(1) Summary of Significant Accounting Policies, Continued

J. Interfund Receivables/Payables

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

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

K. Restricted Assets

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through loan agreements or enabling legislation. Specifically, the State has collateralized Asian Development Bank loan proceeds and earnings for the Chuuk State Early Retirement Scheme with investments recorded in the General Fund of \$3,643,848. Furthermore, investments recorded in the Compact Trust Fund of \$14,246,906 are restricted in that they are not available to be used in current operations.

As of September 30, 2017, cash and cash equivalents of the primary government were restricted for the following uses:

Savings account established in accordance with Section 211(d)(2) of the Compact of Free Association, as amended, for the purpose of funding the State's infrastructure maintenance plan	\$ 1,606,455
Deposit account established for the purpose of federal grants program activities	19,792
Deposit accounts established for the purpose of receiving payments pursuant to the Compact of Free Association, as amended	<u>3,653,540</u>
	\$ <u>5,279,787</u>

L. Other Assets

The State holds approximately 3.3% of the outstanding shares of Pacific Islands Development Bank with a carrying value of \$250,000 and 7% of the outstanding shares of the FSM Development Bank with a carrying value of \$300,000. These equity interests do not meet the definition of an investment as the assets are held primarily for economic development and are presented as other assets in the accompanying financial statements.

M. Capital Assets

Capital assets, which include property, plant, equipment and infrastructure (e.g. roads, bridges, ramps and other similar items), are reported in the governmental activity column of the government-wide financial statements. Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair market value at the date of donation.

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Notes to Financial Statements
September 30, 2017

(1) Summary of Significant Accounting Policies, Continued

M. Capital Assets, Continued

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

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

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

N. Deferred Outflows of Resources

In addition to assets, the statements of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. The State has no items that qualify for reporting in this category.

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. Unearned Revenues

In the government-wide financial statements, unearned revenue is recognized when cash, receivables or other assets are recorded prior to their being earned. In the governmental fund financial statements, unearned 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. The unearned revenue in the governmental fund financial statements has primarily resulted as federal funds are received in advance of eligible expenditures.

Q. Deferred Inflows of Resources

In addition to liabilities, the statements of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. The State has no items that qualify for reporting in this category.

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Notes to Financial Statements
September 30, 2017

(1) Summary of Significant Accounting Policies, Continued

R. Fund Balance

Fund balance classifications are based on the extent to which the State is bound to honor constraints on the specific purposes for which amounts in those funds can be spent and are reported under the following fund balance classifications:

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

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

A formal minimum fund balance policy has not been adopted.

S. 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.

T. New Accounting Standards

During fiscal year 2017, the State implemented the following pronouncements:

- GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements 67 and 68 with the reporting requirements in Statement 68.

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Notes to Financial Statements
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(1) Summary of Significant Accounting Policies, Continued

T. New Accounting Standards, Continued

- GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, as amended*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB).
- GASB Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements.
- GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, which addresses a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*.
- GASB Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units.
- GASB Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

The implementation of these statements did not have a material effect on the accompanying financial statements.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, as amended*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

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Notes to Financial Statements
September 30, 2017

(1) Summary of Significant Accounting Policies, Continued

T. New Accounting Standards, Continued

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The provisions in Statement No. 81 are effective for fiscal years beginning after December 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) associated with the retirement of a tangible capital asset. The provisions in Statement No. 83 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments. The provisions in Statement No. 84 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2017, GASB issued Statement No. 85, *Omnibus 2017*, which address practice issues that have been identified during implementation and application of certain GASB Statements including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits). The provisions in Statement No. 85 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In May 2017, GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt. The provisions in Statement No. 86 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

**STATE OF CHUUK
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Notes to Financial Statements
September 30, 2017

(1) Summary of Significant Accounting Policies, Continued

U. 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.

V. Estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and deferred outflows of resources, liabilities and deferred inflows of resources, 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.

W. 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, 2016 from which summarized information was derived.

(2) Deposits and Investments

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:

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Notes to Financial Statements
September 30, 2017

(2) Deposits and Investments, Continued

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

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

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

The Secretary of Administration and Finance shall be responsible for investment of all public funds collected or appropriated for use by the State. Funds under this arrangement shall include all appropriations from the State, whether funds are appropriated from the State Treasury or funds from other sources. Any funds in excess of the amount necessary for the operation of the State shall be deposited or invested to earn the safest optimum interest. The Secretary shall determine the amount to be invested with the consideration that such amount should not cause disruption of any government service due to low or lack of funds in the operational budget. The Secretary shall cause all investments to be made into financially secure institutions in Chuuk or abroad as determined by the financial institution paying the highest rate of interest on savings when the investment is made.

The investment policy for the Compact Trust Fund (the Trust Fund), which was adopted by the Trust Fund Committee on September 15, 2010 and amended through December 17, 2013 requires the Trust Fund to allocate its managed investment portfolios among domestic and foreign equity and fixed income securities. All or a portion of the Trust Fund may be invested in exchange traded funds ("ETFs"), mutual funds, real estate investment trusts ("REITs"), separate accounts and common trust funds (commingled vehicles), hedge funds, private equity funds, and other pooled investment vehicles ("pooled vehicles"). A common trust fund is similar to an open-ended investment company or mutual fund, but participation is limited to investors with trust accounts. Commingled and pooled vehicles that invest exclusively in marketable fixed income securities are considered to be fixed income securities for the purpose of compliance with the Trust Fund's investment policy.

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Notes to Financial Statements
September 30, 2017

(2) Deposits and Investments, Continued

The fair values of ETFs, mutual funds, and common trust funds are generally determined by the fair value of the underlying marketable equity and debt securities owned, which are principally common stocks and bonds, respectively. Publicly traded ETFs, mutual funds, and similar vehicles may trade at prices above or below the fair values of the underlying investments held; therefore the fair value of such investments may differ from the sum of the fair values of the underlying investments owned. The core fixed income portfolios may be invested in debt securities issued by the U.S. government and government agencies, foreign governments, domestic and international corporate securities, including asset-backed and mortgage-backed obligations. The fixed income portfolio may invest in convertible and high yield debt securities; however the average quality of the fixed income portfolio must be rated "investment grade" by at least one nationally recognized rating agency at the time of purchase. The Trust Fund's fixed income investment objective is for each portfolio to achieve total return similar to a relevant index, such as Barclays Capital Aggregate Index and the Bank of America Merrill Lynch Global High Yield Index.

The Trust Fund's equity investment objective is for its various portfolios to achieve total returns similar to their benchmark equity indices. Benchmark indices include the Russell 3000, the S&P 500 and the MSCI EAFE.

Private equity funds are a form of pooled investment vehicle, typically limited partnerships controlled by a private equity firm that acts as general partner. The general partner seeks to obtain specific dollar commitments from qualified institutional and accredited investors to invest capital in the fund as limited partners. The passive limited partners fund pro rata portions of their commitments when the general partner has identified an appropriate opportunity, which may be venture capital in the form of equity securities, convertible debt securities, or real estate for which no active markets exist. Venture capital is often used to finance new products and technologies, expand working capital, make acquisitions, or finance leveraged buyouts. A typical private equity fund could make between 15 and 25 separate investments over a ten-year life, with no single investment exceeding 10% of the total capital commitment. The fair values of the underlying investments held by each private equity fund are generally determined by management of the equity investee or as determined by the general partner or manager of the private equity fund and is based upon the Trust Fund's percentage ownership of the underlying investments. Investments in private equity funds generally tend to be illiquid for significant periods of time.

Hedge funds are a form of pooled investment vehicle, generally a limited partnership or a foreign (off-shore) investment corporation, that seeks to maximize absolute returns whose offering memorandum allows for the fund to take both long and short positions, use leverage and derivatives, and invest in many markets. Hedge funds often take large risks using a broad range of speculative strategies, including investing in unconventional and illiquid investments. The fair value of the Trust Fund's investment in a hedge fund is determined by the hedge fund manager and is based upon the Trust Fund's percentage ownership of the underlying investments.

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Notes to Financial Statements
September 30, 2017

(2) Deposits and Investments, Continued

Commingled separate accounts invested in real estate and related assets are carried at fair value of the underlying investments. The fair value of separate account investments in real property real estate partnerships are generally determined based on independent appraisals obtained no less frequently than annually. The fair value of separate account investments in real estate partnerships are generally determined based upon the equity method of accounting, and the fair value of underlying investments in real estate loans and mortgages are generally determined through the use of cash flow forecasting or other models by management of the insurance company that manages the separate account.

Derivatives, options and future contracts are permitted investments for the purpose of reducing risk and efficient portfolio management. Derivatives, options and futures may not be used for speculative purposes.

A. Deposits

Custodial credit risk is the risk that in the event of a bank failure, the State's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. The State does not have a deposit policy for custodial credit risk or foreign currency risk.

As of September 30, 2017, the carrying amount of the primary government's total cash and cash equivalents were \$6,972,851 and the corresponding bank balances were \$8,620,768, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2017, bank deposits in the amount of \$500,000 were FDIC insured. The State does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

As of September 30, 2017, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit was \$2,138,266 and the corresponding bank balances were \$2,251,808, which were maintained in financial institutions subject to FDIC insurance. As of September 30, 2017, bank deposits in the amount of \$1,000,000 were FDIC insured. The component units do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Therefore, these deposits are exposed to custodial credit risk.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2017

(2) Deposits and Investments, Continued

B. Investments

Primary Government

As of September 30, 2017, the State's investments are as follows:

General Fund:

Fixed income	\$ 1,037,272
Domestic equities	588,072
Common equities	2,606,576
Cash management account	<u>33,416</u>
	<u>4,265,336</u>

Compact Trust Fund:

Common trust funds:	
Domestic Equity	2,949,547
International Equity	4,881,923
Fixed Income	3,004,540
Private Equity	1,072,539
Hedge Fund	799,959
Real Estate	1,500,875
Money market funds	<u>37,523</u>

14,246,906

\$ 18,512,242

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, 2017.

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, 2017, the State did not have any investments in a single issuer that represented 5% or more of the investments of the State.

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.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

The Trust Fund's fixed income allocation consists of a Mercer Investment Management Opportunistic Fixed Income mutual fund ("MIM OFI") and a Mercer Investment Management Core Fixed Income Fund ("MIM CFI"); the performance of these funds is expected to closely replicate the performance of 50% of the JP Morgan Government Bond Index Emerging Market Global Diversified Index and 50% Bank of America/Merrill Lynch Global High Yield and the Barclays Capital U.S. Aggregate Bond Index, respectively. The bonds held by MIM CFI vary in credit quality with an average overall rating of "Aa3" as rated by Moody's as of September 30, 2017. High yield debt receiving a credit rating below "A" comprises approximately 32.7% of the MIM CFI fixed income portfolio as rated by Moody's at September 30, 2017. At September 30, 2017, the weighted average maturity of the bonds comprising MIM CFI is 9.96 years.

The bonds held by MIM OFI vary in credit quality with an average overall rating of "BB" as rated by Moody's as of September 30, 2017. High yield debt receiving a credit rating below "A" comprises approximately 79.9% of the MIM OFI fixed income portfolio as rated by Moody's at September 30, 2017. At September 30, 2017, the weighted average maturity of the bonds comprising MIM OFI is 8.56 years.

The Trust Fund's investment policy does not require direct investment in fixed maturity securities ("Bonds") as a means of managing its exposure to loss of principal due to increasing interest rates. The Trust Fund's investment policy requires the performance of each investment class to be periodically compared with an associated benchmark. Bonds and bond funds generally decrease in value in response to rising interest rates. Bonds, however, have a fixed date of maturity and do not have exposure to loss of principal from rising interest rates, whereas shares of a common trust fund, ETF, or similar investment vehicle have no maturity date.

The Trust Fund's exposure to foreign currency risk is derived from its investment in common trust funds, ETFs and REITs that hold investments in securities of foreign issuers and sovereigns. Foreign currency risk is the risk that changes in foreign exchange rates will adversely affect the fair values of an investment or deposit. At September 30, 2017, the Trust Fund held approximately \$198,312,000 in securities of foreign issuers held in common trust funds. Of this amount, approximately \$37,201,000 was held in securities whose functional currency is the Euro, \$16,282,000 whose functional currency is the British pound, \$24,087,000 whose functional currency is the Japanese yen, and \$120,742,000 in functional currencies of 36 other countries. Foreign currency exposure data is not available for the Trust Fund's investment in the Hedge Funds and its investments in Global Private Equity Funds, which comprise 12.8% of invested assets at September 30, 2017.

The Trust Fund's investment in hedge funds includes ownership of the Mercer Hedge Fund Series A ("Mercer Hedge Fund") and the Blackstone Partners Offshore Fund Ltd. Mercer Hedge Funds Investors SPC, who incorporated the Mercer Hedge Fund, and the Blackstone Partners Offshore Fund Ltd. are registered under the Mutual Funds Law of the Cayman Islands. The fair value of the Trust Fund's position in the hedge fund pools are equivalent to the value of the pool shares.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

The State owns 25,000 shares of the outstanding common stock of the Bank of the Federated States of Micronesia, which engages in commercial banking services in the FSM. An equity investment in the common stock of the Bank of the Federated States of Micronesia (investee) is stated at the net asset value (NAV). The NAV is used as a practical expedient to estimate fair value. The NAV is determined based on the total shareholders' equities reported by the investee.

As of September 30, 2017, the State's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

<u>Investment Type</u>	<u>Investment Maturities (In Years)</u>					<u>Credit Ratings</u>
	<u>Fair Value</u>	<u>Current</u>	<u>1-5</u>	<u>6-10</u>	<u>Over 10</u>	
U.S. Treasury Notes and Bonds	\$ 359,893	\$ 30,400	\$ 103,439	\$ 201,018	\$ 25,036	Aaa
U.S. Government Agencies						
Obligations:						
Federal Home Loan Bank Disc	21,501	-	-	21,501	-	Aaa
Federal Home Loan Mortgage						
Corp	13,623	530	553	-	12,540	Aaa
Federal National Mortgage						
Association	92,631	67,897	9,697	-	15,037	Aaa
Government National Mortgage						
Corp	795	-	-	-	795	Aaa
Overseas Private Inv Corp	73,909	-	-	73,909	-	Aaa
Private Export Funding Secured	28,702	-	-	28,702	-	Aaa
Tennessee Valley Authority	15,163	-	-	15,163	-	Aaa
Freddie Mac	26,264	-	13,854	12,410	-	Aaa
U.S. Agency	-	-	-	-	-	A2
Municipal obligations	56,911	-	28,645	17,017	11,249	Aa1
Mortgage-Backed	-	-	-	-	-	Aa1
Asset Backed	-	-	-	-	-	Aa3
Corporate Bonds	88,956	27,719	31,942	21,077	8,218	Aaa
Corporate Bonds	43,150	-	34,851	8,299	-	Aa1
Corporate Bonds	15,329	-	8,381	6,948	-	Aa2
Corporate Bonds	39,779	8,317	8,359	23,103	-	Aa3
Corporate Bonds	28,743	-	-	21,720	7,023	A1
Corporate Bonds	28,208	11,110	-	17,098	-	A2
Corporate Bonds	29,224	-	16,655	8,444	4,125	A3
Corporate Bonds	12,861	-	-	5,811	7,050	Baa1
Corporate Bonds	12,694	-	5,592	7,102	-	Baa2
Corporate Bonds	12,963	-	-	-	12,963	Baa3
Corporate Bonds	6,792	-	-	-	6,792	Ba1
Corporate Bonds	29,181	-	-	4,550	24,631	Unrated
	<u>\$1,037,272</u>	<u>\$145,973</u>	<u>\$261,968</u>	<u>\$493,872</u>	<u>\$135,459</u>	

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(2) Deposits and Investments, Continued

B. Investments, Continued

The State has the following recurring fair value measurements as of September 30, 2017:

General Fund:

	<u>Total</u>	<u>Fair Value Measurements Using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments by fair value level:				
Fixed income:				
U.S. Treasury obligations	\$ 359,893	\$ -	\$ 359,893	\$ -
U.S. Government Agencies	272,589	-	272,589	-
Municipal obligations	56,911	-	56,911	-
Corporate notes	<u>347,879</u>	-	<u>347,879</u>	-
Total fixed income	<u>1,037,272</u>	-	<u>1,037,272</u>	-
Equity securities:				
U.S. equities	<u>2,606,576</u>	<u>2,606,576</u>	-	-
Total investments at fair value	3,643,848	\$ <u>2,606,576</u>	\$ <u>1,037,272</u>	\$ -
Investments measured at NAV:				
Equity investment in the Bank of the FSM	588,072			
Investments measured at amortized cost:				
Cash management account	<u>33,416</u>			
	\$ <u>4,265,336</u>			

Compact Trust Fund:

	<u>Total</u>	<u>Fair Value Measurements Using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments by fair value level:				
Common trust funds:				
Domestic Equity	\$ 2,949,547	\$ 2,949,547	\$ -	\$ -
International Equity	4,881,923	4,881,923	-	-
Fixed Income	3,004,540	3,004,540	-	-
Private Equity	<u>1,072,539</u>	-	-	<u>1,072,539</u>
Total investments at fair value	11,908,549	\$ <u>10,836,010</u>	\$ -	\$ <u>1,072,539</u>
Investments measured at NAV:				
Hedge Fund	799,959			
Real Estate	1,500,875			
Investments measured at amortized cost:				
Money market funds	<u>37,523</u>			
	\$ <u>14,246,906</u>			

Discretely Presented Component Units

As of September 30, 2017, investments comprise the following:

Chuuk State Health Care Plan (CSHCP):

Fixed income securities:	
Fixed income	\$ 30,622
Other investments:	
Common equities	331,309
Mutual funds	19,815
Money market funds	<u>109,901</u>
	\$ <u>491,647</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units, Continued

Chuuk State Health Care Plan (CSHCP), Continued

As of September 30, 2017, the Plan's investments recorded at fair value were as follows:

	Hierarchy As of September 30, 2017			Moody's Credit Rating		Maturity At September 30, 2017			
	Level 1	Level 2	Level 3			Less than 1 year	1 - 5 years	6 - 10 years	More than 10 years
Investments by fair value level:					No Maturity				
Fixed income securities	\$ 30,622	\$ -	\$ -	Aaa	\$ -	\$ -	\$ -	\$30,622	\$ -
Mutual funds	19,815	-	-	Aaa	19,815	-	-	-	-
Common stock	-	331,309	-	Aaa	331,309	-	-	-	-
	50,437	331,309	-		351,124	-	-	30,622	-
Investments measured at amortized cost:									
Money market funds	109,901	-	-		-	109,901	-	-	-
Total investments	\$160,338	\$331,309	\$-		\$351,124	\$109,901	\$-	\$30,622	\$-

(3) Receivables

Primary Government

Receivables as of September 30, 2017, for the primary government's individual major funds and nonmajor funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	General	Grants Assistance	Compact Trust	Other Governmental Funds	Total
Receivables:					
General receivables	\$ 1,206,530	\$ 124,305	\$ -	\$ 13,325	\$ 1,344,160
FSM National Government	656,589	3,958,488	-	-	4,615,077
	1,863,119	4,082,793	-	13,325	5,959,237
Less: allowance for uncollectible accounts	(1,053,150)	-	-	-	(1,053,150)
Net receivables	\$ 809,969	\$ 4,082,793	\$ -	\$ 13,325	\$ 4,906,087

The final settlement of receivables due from the FSM National Government arising from Compact sector grant transactions can be determined only by final action of the FSM National Government in consultation with the grantor agency. Management is of the opinion that collection efforts will be favorable and thus no allowance for uncollectible accounts is considered necessary.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(3) Receivables, Continued

Presented Component Units

Receivables as of September 30, 2017, for the discretely presented component units in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	Chuuk State Health Care Plan	Chuuk Public Utility Corporation	Chuuk State Housing Authority	Total
Receivables:				
General	\$ 517,675	\$ 771,536	\$ 2,339,657	\$ 3,628,868
Other	<u>-</u>	<u>59,507</u>	<u>120,605</u>	<u>180,112</u>
	517,675	831,043	2,460,262	3,808,980
Allowance for uncollectable accounts	<u>(42,872)</u>	<u>(297,624)</u>	<u>(2,050,073)</u>	<u>(2,390,569)</u>
	\$ <u>474,803</u>	\$ <u>533,419</u>	\$ <u>410,189</u>	\$ <u>1,418,411</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, 2017, are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Grants Assistance	General	\$ 10,063,204
General	Grants Assistance	3,562,111
Nonmajor governmental funds	General	<u>93,370</u>
		\$ <u>13,718,685</u>

(5) Capital Assets

Capital asset activities for the year ended September 30, 2017, are as follows:

Primary Government

	Balance October 1, 2016	Additions	Retirements	Balance September 30, 2017
Governmental activities:				
Depreciable assets:				
Airport facilities	\$ 38,107,415	\$ -	\$ -	\$ 38,107,415
Buildings	14,990,391	538,844	-	15,529,235
Seaport facilities	26,517,208	-	-	26,517,208
Vehicles and other equipment	10,720,369	443,311	-	11,163,680
Infrastructure	<u>14,835,315</u>	<u>-</u>	<u>-</u>	<u>14,835,315</u>
	105,170,698	982,155	-	106,152,853
Less accumulated depreciation for:				
Airport facilities	(31,243,579)	(952,685)	-	(32,196,264)
Buildings	(7,340,010)	(270,698)	-	(7,610,708)
Seaport facilities	(22,539,626)	(662,930)	-	(23,202,556)
Vehicles and other equipment	(8,066,456)	(436,533)	-	(8,502,989)
Infrastructure	<u>(14,835,315)</u>	<u>-</u>	<u>-</u>	<u>(14,835,315)</u>
	(84,024,986)	(2,322,846)	-	(86,347,832)
	21,145,712	(1,340,691)	-	19,805,021
Nondepreciable assets:				
Land	<u>17,954,462</u>	<u>309,220</u>	<u>-</u>	<u>18,263,682</u>
	\$ <u>39,100,174</u>	\$ <u>(1,031,471)</u>	\$ <u>-</u>	\$ <u>38,068,703</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(5) Capital Assets, Continued

Primary Government, Continued

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

General government	\$ 1,227,162
Health services	207,489
Education	215,366
Public safety	8,499
Public works and transportation	<u>664,330</u>
	<u>\$ 2,322,846</u>

Discretely Presented Component Units

	Balance October 1, 2016	Addition	Retirements	Balance September 30, 2017
Depreciable assets:				
Buildings	\$ 415,089	\$ 3,042	\$ -	\$ 418,131
Utility plant	24,404,634	9,103,706	-	33,508,340
Machinery, equipment, others	<u>285,501</u>	<u>21,186</u>	<u>-</u>	<u>306,687</u>
	25,105,224	9,127,934	-	34,233,158
Less accumulated depreciation	<u>(12,117,975)</u>	<u>(890,240)</u>	<u>-</u>	<u>(13,008,215)</u>
	12,987,249	8,237,694	-	21,224,943
Nondepreciable assets:				
Construction work-in-progress	<u>6,372,278</u>	<u>2,666,376</u>	<u>(9,038,654)</u>	<u>-</u>
	<u>\$ 19,359,527</u>	<u>\$ 10,904,070</u>	<u>\$ (9,038,654)</u>	<u>\$ 21,224,943</u>

(6) Long-Term Obligations

Primary Government

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 Asian Development Bank (ADB) (Loan Number 1520 (SF)) through the FSM National Government, non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The activities of the ERS Program are recorded in the General Fund.

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.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(6) Long-Term Obligations, Continued

Primary Government, Continued

Funds for the repayment of the ADB loan are expected to be derived from the annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The Financing Agreement requires the State to continue to appropriate salaries for the abolished positions and deposit the appropriated funds into the ERS Trust Account. These funds had not been deposited to the Trust Account as of September 30, 2017. As of September 30, 2017, the amount outstanding against this loan was \$4,305,583. Of the required \$5,300,000 identified for future debt service payments, \$3,643,848 is deposited in an investment account held jointly with the FSM National Government. That investment account is restricted for the repayment of this debt and other ADB related debt set forth below.

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Program Loan with ADB (Loan Number 1816 FSM (SF)) for the purpose of funding the Basic Social Services Project, with interest at 1% to 1.5% per annum. Principal payments shall be made semiannually commencing February 1, 2009, with a maturity date of August 1, 2032. As of September 30, 2017, the balance payable on this loan amounted to \$141,055.

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Program Loans with ADB (Loan Number 1873 (SF) and Loan Number 1874 FSM (SF)) for the purpose of promoting private sector development in Chuuk, with interest at 1% to 1.5% per annum. Principal payments shall be made in 32 equal semi-annual payments with the first payment due on May 15, 2010 and the last payment on November 15, 2025. As of September 30, 2017, the related principal balances were \$330,097 and \$786,334, respectively.

On December 21, 2010, the Chuuk Public Utilities Corporation (CPUC) and the State agreed through memorandum of understanding to offset certain claims and transferred certain debt between CPUC and the State. The transferred debt was the FSM National Government Program Loan with ADB (Loan Number 1459 (SF)), totaling \$3,868,102, for water wells and electric construction purposes, with interest at 1% to 1.5% per annum. Principal payments shall be made semiannually commencing August 1, 2007, with a maturity date of August 1, 2036. As of September 30, 2017, the balance payable on this loan amounted to \$3,037,842.

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

<u>Year Ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$ 459,729	\$ 92,297	\$ 552,026
2019	471,086	87,277	558,363
2020	471,086	82,086	553,172
2021	471,086	76,896	547,982
2022	471,086	71,706	542,792
2023-2027	2,308,531	280,794	2,589,325
2028-2032	2,161,275	160,257	2,321,532
2033-2037	<u>1,787,032</u>	<u>49,690</u>	<u>1,836,722</u>
	\$ <u>8,600,911</u>	\$ <u>901,003</u>	\$ <u>9,501,914</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(6) Long-Term Obligations, Continued

Discretely Presented Component Units

Chuuk Public Utility Corporation:

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

\$ 2,073,600

Loan payable to the State, facilitated by an ADB loan (Loan Number 2100-FSM) to the FSM National Government, original amount of \$2,800,000, due in semi-annual installments of varying amounts through January 15, 2019. Interest is payable at LIBOR plus 0.6% per annum (2.1% at September 30, 2016). Proceeds were used for the purchase of two generator sets and related costs.

2,469,926

A \$207,000 loan with the FSM Development Bank, bearing interest fixed at 7% per annum, payable over 60 monthly installments of \$4,099, maturing in February 2021. The loan is collateralized by a security interest in the fixed assets. Proceed was used to pay off an existing outstanding payable.

149,083

\$ 4,692,609

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

<u>Year Ending</u> <u>September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$ 263,043	\$ 97,966	\$ 361,009
2019	278,943	84,331	363,274
2020	296,910	76,897	373,807
2021	286,612	69,158	355,770
2022	283,815	63,679	347,494
2023-2027	1,743,093	227,238	1,970,331
2028-2032	1,286,943	71,217	1,358,160
2033-2036	<u>253,250</u>	<u>4,430</u>	<u>257,680</u>
	\$ <u>4,692,609</u>	\$ <u>694,916</u>	\$ <u>5,387,525</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(7) Changes in Long-Term Obligations

Primary Government

Long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2017, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net position:

	Balance October 1, <u>2016</u>	<u>Additions</u>	<u>Reductions</u>	Balance September <u>30, 2017</u>	Due Within <u>One Year</u>
Loans payable:					
ADB loans:					
Loan 1459	\$ 3,163,851	\$ -	\$ (126,009)	\$ 3,037,842	\$ 159,898
Loan 1520	4,363,469	-	(57,886)	4,305,583	215,294
Loan 1816	223,067	-	(82,012)	141,055	9,402
Loan 1873	365,015	-	(34,918)	330,097	27,478
Loan 1874	<u>828,271</u>	<u>-</u>	<u>(41,937)</u>	<u>786,334</u>	<u>47,657</u>
	8,943,673	-	(342,762)	8,600,911	459,729
Other:					
Claims and judgments	902,605	-	-	902,605	-
Compensated absences	<u>1,369,428</u>	<u>381,041</u>	<u>(382,846)</u>	<u>1,367,623</u>	<u>427,958</u>
	<u>\$ 11,215,706</u>	<u>\$ 381,041</u>	<u>\$ (725,608)</u>	<u>\$ 10,871,139</u>	<u>\$ 887,687</u>

When the ADB extends credit to a particular country, the loan is booked in Special Drawing Rights (SDRs) but the actual loan is delivered in the currency of the borrower, at the current exchange rate between the currency and the SDR. The value of the SDR is subject to periodic review by the International Monetary Fund, which may result in the recognition of a foreign exchange gain or loss. During the year ended September 30, 2017, the State recognized a foreign exchange loss of \$98,214 associated with valuation of the SDR, which is presented as a special item in the accompanying financial statements, and which results in a reduction in ADB loans payable.

Discretely Presented Component Units

During the year ended September 30, 2017, the following changes occurred in long-term obligations of the discretely presented component units:

	Balance October 1, <u>2016</u>	<u>Additions</u>	<u>Reductions</u>	Balance September <u>30, 2017</u>	Due Within <u>One Year</u>
Long-term debt	\$ 4,942,837	\$ -	\$ (250,228)	\$ 4,692,609	\$ 263,043
Accrued annual leave	<u>40,140</u>	<u>-</u>	<u>(4,429)</u>	<u>35,711</u>	<u>7,359</u>
	<u>\$ 4,982,977</u>	<u>\$ -</u>	<u>\$ (254,657)</u>	<u>\$ 4,728,320</u>	<u>\$ 270,402</u>

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(8) Interfund/Intrafund Transactions

Operating transfers in/out for each major governmental fund and nonmajor governmental funds in the aggregate, for the year ended September 30, 2017, are as follows:

	<u>Transfers Out</u>	<u>Transfers In</u>
General Fund:		
Grants Assistance Fund	\$ 506,054	\$ -
Grants Assistance Fund:		
General Fund	<u>-</u>	<u>506,054</u>
	<u>\$ 506,054</u>	<u>\$ 506,054</u>

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. Specifically, the State transferred \$506,054 from the General Fund to the Grants Assistance Fund to primarily finance infrastructure maintenance programs.

(9) Fund Balance

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

	General Fund	Grants Assistance Fund	Compact Trust Fund	Nonmajor Funds	Total Governmental Funds
Non-spendable:					
General government	\$ 271,737	\$ 257,795	\$ -	\$ 54,681	\$ 584,213
FSM Development Bank	300,000	-	-	-	300,000
Pacific Islands Development Bank	250,000	-	-	-	250,000
Bank of the FSM	588,072	-	-	-	588,072
Permanent fund principal	-	-	14,246,906	-	14,246,906
Restricted:					
Debt service	3,643,848	-	-	-	3,643,848
Capital projects	-	1,561,273	-	-	1,561,273
General government	-	1,269,696	-	-	1,269,696
Education	-	1,535,120	-	-	1,535,120
Health services	-	112,531	-	101,963	214,494
Other foreign assistance	-	162,148	-	-	162,148
Unassigned	<u>(8,642,200)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(8,642,200)</u>
	<u>\$ (3,588,543)</u>	<u>\$ 4,898,563</u>	<u>\$ 14,246,906</u>	<u>\$ 156,644</u>	<u>\$ 15,713,570</u>

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2017

(10) Contingencies

Sick Leave

It is the policy of the State to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave as of September 30, 2017 is \$4,521,084.

Insurance Coverage

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

Encumbrances

The State utilizes encumbrance accounting to identify fund obligations. Encumbrances represent commitments related to unperformed contracts for goods. At September 30, 2017, the State has significant encumbrances summarized as follows:

<u>General</u>	<u>Grants Assistance</u>	<u>Compact Trust</u>	<u>Other Governmental Funds</u>	<u>Total</u>
\$ <u>349,289</u>	\$ <u>4,640,768</u>	\$ <u> </u> -	\$ <u>31,446</u>	\$ <u>5,021,503</u>

Federal Grants

The State participates in a number of federally assisted grant programs and other various U.S. Department of the Interior grants. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed.

Litigation

The State is a party to various legal proceedings in which the State's Attorney General indicates that pending land lease cases and other related claims against the State exist at September 30, 2017 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.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2017

(10) Contingencies, Continued

General Fund Financial Position

The State's General Fund has sustained recurring operating deficits and has an unassigned fund deficit of \$8,642,200 at September 30, 2017. In addition, at September 30, 2017, the primary government's current liabilities exceed current assets.

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

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

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

(11) Budgetary Compliance

For the year ended September 30, 2017, significant over-expenditures exceeding appropriations within the General Fund were as follows:

Department of Administrative Services	\$ 79,761
Department of Education	\$ 9,337
Economic development	\$ 88,093
Public affairs	\$ 138,782
Board, commissions, other	\$ 649,140
Chuuk Housing Authority	\$ 7,109
Other	\$ 1,598
Debt service	\$ 549,090

(12) Land Lease and Related Claims

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

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2017

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Revenues, Expenditures and Changes in Deficit
Budget and Actual - General Fund
Year Ended September 30, 2017

	Budgeted Amounts		Actual - Budgetary Basis	Variance with Final Budget - Positive (Negative)
	Original	Final		
Revenues:				
Local revenues	\$ 8,187,708	\$ 8,187,708	\$ 10,105,609	\$ 1,917,901
Net change in fair value of investments	-	-	394,879	394,879
Total revenues	<u>8,187,708</u>	<u>8,187,708</u>	<u>10,500,488</u>	<u>2,312,780</u>
Expenditures:				
Current:				
General government	3,690,696	4,111,125	4,007,383	103,742
Education	92,847	92,667	102,004	(9,337)
Economic development	14,830	14,830	102,923	(88,093)
Public safety	1,148,992	1,190,764	1,104,730	86,034
Public works and transportation	970,919	1,007,201	957,219	49,982
Community affairs	5,048	10,048	148,830	(138,782)
Boards and commissions	1,015,408	352,438	1,001,578	(649,140)
Judiciary	621,189	641,199	581,079	60,120
Payments to component units	58,429	58,590	65,699	(7,109)
Municipal affairs	432,749	432,749	432,481	268
Other	-	-	1,598	(1,598)
Debt service	-	-	549,090	(549,090)
Total expenditures	<u>8,051,107</u>	<u>7,911,611</u>	<u>9,054,614</u>	<u>(1,143,003)</u>
Excess (deficiency) of revenues over (under) expenditures	136,601	276,097	1,445,874	1,169,777
Other financing uses:				
Operating transfers out	<u>(506,054)</u>	<u>(506,054)</u>	<u>(506,054)</u>	<u>-</u>
Special item:				
Compact Sector close out	-	-	298,936	298,936
Net change in deficit	<u>(369,453)</u>	<u>(229,957)</u>	<u>1,238,756</u>	<u>1,468,713</u>
Other changes in fund deficit:				
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary purposes but in the year the supplies are received for financial reporting purposes	-	-	349,289	349,289
Fund deficit at the beginning of the year	<u>(5,176,588)</u>	<u>(5,176,588)</u>	<u>(5,176,588)</u>	<u>-</u>
Fund deficit at the end of the year	<u>\$ (5,546,041)</u>	<u>\$ (5,406,545)</u>	<u>\$ (3,588,543)</u>	<u>\$ 1,818,002</u>

See accompanying notes to required supplementary information - budgetary reporting.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Required Supplementary Information – Budgetary Reporting
September 30, 2017

(1) Budgetary Information

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

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

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

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2017

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Combining Schedule of Expenditures by Account
Governmental Funds
Year Ended September 30, 2017

		Special Revenue			
	General	Grants Assistance	Compact Trust	Other Governmental Funds	Total
Expenditures:					
Salaries and wages					
Regular	\$ 4,250,552	\$ 11,481,109	\$ -	\$ -	\$ 15,731,661
Overtime	88,551	657,814	-	-	746,365
Fringe benefits	561,821	1,555,526	-	-	2,117,347
Travel and transportation	618,403	592,027	-	-	1,210,430
Books and library materials	-	259,337	-	-	259,337
Communications	47,217	176,873	-	-	224,090
Dues, membership, and subscription:	25,081	151,951	-	-	177,032
Food stuffs	67,305	490,353	-	-	557,658
Port charges	11,322	28,526	-	-	39,848
Office supplies and materials	132,057	2,756,291	-	-	2,888,348
POL	137,873	577,502	-	-	715,375
Printing and reproduction	11,797	118,824	-	-	130,621
Rental services	10,874	164,662	-	-	175,536
Repairs and maintenance	17,499	612,797	-	-	630,296
Constructional materials	-	14,048	-	-	14,048
Utilities	273,854	974,715	-	-	1,248,569
Goods and services	182,765	102,022	-	-	284,787
Subsidies and contributions	12,994	118,688	-	-	131,682
Medical referrals	-	147,124	-	-	147,124
Medical supplies	-	1,492,837	-	-	1,492,837
Contractual services	567,861	4,495,880	-	127,737	5,191,478
Professional services	-	516,360	-	-	516,360
Housing allowance	60,234	-	-	-	60,234
Compensation non-payroll	21,107	23,245	-	-	44,352
Scholarships and allowances	-	395,946	-	-	395,946
Training	3,436	885,978	-	-	889,414
Official allowance	632,223	-	-	-	632,223
Meeting fees and allowance	2,120	123,784	-	-	125,904
Insurance	-	1,960	-	-	1,960
Leased housing, buildings and land	47,272	627,281	-	-	674,553
Equipment	24,934	551,090	-	-	576,024
Furniture and fixtures	1,548	161,803	-	-	163,351
Vehicles	129,912	270,212	-	-	400,124
Land	193,220	-	-	-	193,220
Principal repayment	440,975	-	-	-	440,975
Interest payments	108,115	-	-	-	108,115
Miscellaneous	22,403	-	-	-	22,403
	<u>\$ 8,705,325</u>	<u>\$ 30,526,565</u>	<u>\$ -</u>	<u>\$ 127,737</u>	<u>\$ 39,359,627</u>

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

GENERAL FUND

September 30, 2017

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.

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, 2017
(with comparative totals for the year ended September 30, 2016)

	<u>2017</u>	<u>2016</u>
Revenues:		
FSM revenue sharing:		
Gross revenue taxes	\$ 1,447,776	\$ 1,280,809
Import taxes	1,360,428	1,170,790
Income taxes	1,071,124	1,051,538
Other taxes	<u>179,052</u>	<u>131,270</u>
FSM revenue sharing	<u>4,058,380</u>	<u>3,634,407</u>
State taxes:		
Sales tax	2,349,134	2,238,850
Other excise taxes	<u>610,669</u>	<u>580,553</u>
	<u>2,959,803</u>	<u>2,819,403</u>
Fees and charges:		
Licenses and permits	1,381,643	1,276,827
Leases and other rentals	<u>162,381</u>	<u>187,671</u>
	<u>1,544,024</u>	<u>1,464,498</u>
Departmental charges:		
Transportation collections	<u>698,080</u>	<u>726,875</u>
Net change in the fair value of investments	<u>394,879</u>	<u>(144,209)</u>
Other revenues	<u>845,322</u>	<u>721,433</u>
Total revenues	<u>10,500,488</u>	<u>9,222,407</u>
Expenditures:		
Current:		
General government:		
Office of the Governor	603,267	564,496
State Legislature	2,520,786	2,383,761
Department of Administrative Services	658,044	840,352
Office of Public Auditor	<u>12,557</u>	<u>16,940</u>
	<u>3,794,654</u>	<u>3,805,549</u>
Health:		
Department of Health	<u>102,004</u>	<u>85,953</u>
Economic development:		
Department of Marine Resources	25,342	52,795
Historic Preservation Office	31,313	-
Division of Business and Trade	8,247	-
Division of Labor and Manpower	26,854	-
Division of Commerce and Industries	<u>10,178</u>	<u>-</u>
	<u>101,934</u>	<u>52,795</u>
Public safety:		
Office of the Attorney General	217,025	239,925
Department of Public Safety	<u>880,302</u>	<u>809,751</u>
	<u>1,097,327</u>	<u>1,049,676</u>
Public works and transportation:		
Department of Transportation	<u>894,111</u>	<u>888,635</u>
Community affairs:		
Public Affairs	82,451	83,887
Youth Affairs	21,983	24,711
Broadcast	<u>42,756</u>	<u>34,463</u>
	<u>147,190</u>	<u>143,061</u>

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, 2017

(with comparative totals for the year ended September 30, 2016)

	<u>2017</u>	<u>2016</u>
Expenditures, continued:		
Current, continued:		
Boards, commissions and other:		
Land Commission	143,419	141,014
Public Service Commission	169,847	150,198
Election Commission	270,000	122,979
Farmers Home Administration	14,441	13,979
Peace Corps	10,900	15,600
Micronesian Legal Services Corporation	20,000	40,000
Micro Games	29,040	34,826
Youth Constitution Day	9,298	25,702
Goodwill Games	48,488	-
Land Management	58,519	-
Overseas Development Assistance	43,195	34,477
Political Status Commission	90,750	15,900
Chuuk Women	-	-
Solid and Hazardous Waste Management	33,258	41,186
SEPDIC	22,173	91,062
Chuuk Small Business Development Center	22,770	(8,906)
	<u>986,098</u>	<u>718,017</u>
Judiciary:		
State Court	<u>546,453</u>	<u>481,286</u>
Payments to component units:		
Chuuk State Housing Authority	<u>65,134</u>	<u>114,001</u>
Municipal affairs:		
Payments to municipalities	<u>419,732</u>	<u>413,757</u>
Other	<u>1,598</u>	<u>40,572</u>
Debt service:		
Principal repayment	440,975	365,935
Interest	108,115	51,179
	<u>549,090</u>	<u>417,114</u>
Total expenditures	<u>8,705,325</u>	<u>8,210,416</u>
Excess (deficiency) of revenues over (under) expenditures	<u>1,795,163</u>	<u>1,011,991</u>
Other financing uses:		
Operating transfers out	<u>(506,054)</u>	<u>(507,600)</u>
Special item:		
Compact Sector close out	<u>298,936</u>	<u>-</u>
Net change in deficit	1,588,045	504,391
Deficit at the beginning of the year	<u>(5,176,588)</u>	<u>(5,680,979)</u>
Deficit at the end of the year	<u>\$ (3,588,543)</u>	<u>\$ (5,176,588)</u>

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

**Statement of Revenues, Expenditures and Changes in Deficit
Budget and Actual - General Fund
Year Ended September 30, 2017**

	Budgeted Amounts		Actual Budgetary Basis	Variance with Final Budget
	Original	Final		Positive/(Negative)
Revenues:				
Local revenues	\$ 8,187,708	\$ 8,187,708	\$ 10,105,609	\$ 1,917,901
Net change in fair value of investments	-	-	394,879	394,879
Total revenues	8,187,708	8,187,708	10,500,488	2,312,780
Expenditures:				
Current:				
General government:				
Office of the Governor	538,503	694,004	620,845	73,159
State Legislature	2,586,752	2,804,557	2,696,657	107,900
Department of Administrative Services	565,440	597,563	677,324	(79,761)
Office of Public Auditor	-	15,000	12,557	2,443
	3,690,696	4,111,125	4,007,383	103,742
Education:				
Department of Education	92,847	92,667	102,004	(9,337)
Economic development:				
Division of Marine Resources	13,500	13,500	25,342	(11,842)
Historic Preservation Office	-	-	31,313	(31,313)
Division of Business and Trade	503	503	9,049	(8,546)
Division of Manpower and Labor	826	826	27,040	(26,214)
Division of Commerce and Industry	1	1	10,179	(10,178)
	14,830	14,830	102,923	(88,093)
Public safety:				
Office of the Attorney General	238,439	242,654	219,967	22,687
Department of Public Safety	910,553	948,110	884,763	63,347
	1,148,992	1,190,764	1,104,730	86,034
Public works and transportation:				
Department of Transportation	970,919	1,007,201	957,219	49,982
Community affairs:				
Department of Public Affairs	5,048	10,048	148,830	(138,782)
Boards, commissions and other:				
Chuuk Recreation Board	48,637	-	48,488	(48,488)
Land Commission	160,123	357	144,185	(143,828)
Public Service Commission	177,575	944	170,041	(169,097)
Election Commission	266,675	50	270,050	(270,000)
Farmers Home Administration	24,532	18,314	14,441	3,873
Peace Corps	15,600	15,600	10,900	4,700
Micronesian Legal Services Corporation	20,000	20,000	20,000	-
Micro Games	-	50,000	29,040	20,960
Youth Constitution Day	-	-	9,298	(9,298)
Guandong Province	2,000	2,000	2,000	-
Chuuk EPA	-	-	33,258	(33,258)
Land Management	2,213	2,213	58,554	(56,341)
Overseas Development Assistance	44,063	50,313	43,390	6,923
Chuuk Small Business Development Center	1,676	1,676	22,770	(21,094)
COM Land Grants	-	3,657	-	3,657
Political Status Commission	124,589	124,589	102,990	21,599
Economic Policy Development and Implementation	127,725	62,725	22,173	40,552
	1,015,408	352,438	1,001,578	(649,140)
Judiciary:				
State Court	621,189	641,199	581,079	60,120
Payments to component units:				
Chuuk State Housing Authority	58,429	58,590	65,699	(7,109)
Municipal affairs:				
Payments to municipalities	432,749	432,749	432,481	268
Other	-	-	1,598	(1,598)

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures and Changes in Deficit
Budget and Actual - General Fund, Continued
Year Ended September 30, 2017

	Budgeted Amounts		Actual Budgetary Basis	Variance with Final Budget Positive/(Negative)
	Original	Final		
Debt service:				
Principal repayment	-	-	440,975	(440,975)
Interest payments	-	-	108,115	(108,115)
	-	-	549,090	(549,090)
Total expenditures	8,051,107	7,911,611	9,054,614	(1,143,003)
Excess (deficiency) of revenues over (under) expenditures	136,601	276,097	1,445,874	1,169,777
Other financing uses:				
Operating transfers out	(506,054)	(506,054)	(506,054)	-
Special item:				
Compact Sector close out	-	-	298,936	298,936
Net change in deficit	(369,453)	(229,957)	1,238,756	1,468,713
Other changes in fund deficit:				
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary purposes but in the year the supplies are received for financial reporting purposes	-	-	349,289	349,289
Fund deficit at the beginning of the year	(5,176,588)	(5,176,588)	(5,176,588)	-
Fund deficit at the end of the year	\$ (5,546,041)	\$ (5,406,545)	\$ (3,588,543)	\$ 1,818,002

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

NONMAJOR GOVERNMENTAL FUNDS - SPECIAL REVENUE FUNDS

September 30, 2017

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, 2016, follows:

Hospital Revolving Fund

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

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet
September 30, 2017

	Education Sector	Health Sector	Environment Sector	Private Sector Development	Capacity Building Sector	Supplemental Education	Enhanced Reporting Accountability	Infrastructure Maintenance	Infrastructure	U.S. Federal Grants	Foreign Assistance	CFSM Grants	Total
ASSETS													
Receivables:	\$ 2,772,660	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 231,507	\$ -	\$ 268,086	\$ 307,097	\$ 29,573	\$ 349,565	\$ 3,958,488
Advances	27,811	36,981	5,621	292	4,993	33,343	-	-	-	14,876	-	388	124,305
Prepayments	313,922	64,330		300	13,418	180,047	14,547	-	-	-	-	-	586,564
Due from other funds	-	690,756	37,264	396,669	3,612,413	3,630,728	-	1,561,342	-	-	134,032	-	10,063,204
	<u>\$ 3,114,393</u>	<u>\$ 792,067</u>	<u>\$ 42,885</u>	<u>\$ 397,261</u>	<u>\$ 3,630,824</u>	<u>\$ 3,844,118</u>	<u>\$ 246,054</u>	<u>\$ 1,561,342</u>	<u>\$ 268,086</u>	<u>\$ 321,973</u>	<u>\$ 163,605</u>	<u>\$ 349,953</u>	<u>\$ 14,732,561</u>
LIABILITIES AND FUND BALANCES													
Liabilities:													
Accounts payable	\$ 231,908	\$ 287,823	\$ 3,263	\$ 3,832	\$ (17,745)	\$ 166,798	\$ (1,491)	\$ -	\$ 35,349	\$ 38,264	\$ 719	\$ 13,923	\$ 762,643
Accrued liabilities	320,266	174,191	17,611	18,811	20,459	45,484	25,835	69	-	61,775	738	-	685,239
Unearned revenues	-	153,192	22,011	374,618	2,357,515	1,916,669	-	-	-	-	-	-	4,824,005
Due to other funds	2,562,219	-	-	-	-	-	221,710	-	232,737	209,415	-	336,030	3,562,111
Total liabilities	<u>3,114,393</u>	<u>615,206</u>	<u>42,885</u>	<u>397,261</u>	<u>2,360,229</u>	<u>2,128,951</u>	<u>246,054</u>	<u>69</u>	<u>268,086</u>	<u>309,454</u>	<u>1,457</u>	<u>349,953</u>	<u>9,833,998</u>
Fund balances:													
Non-spendable	-	64,330	-	-	13,418	180,047	-	-	-	-	-	-	257,795
Restricted	-	112,531	-	-	1,257,177	1,535,120	-	1,561,273	-	12,519	162,148	-	4,640,768
Total fund balances	<u>-</u>	<u>176,861</u>	<u>-</u>	<u>-</u>	<u>1,270,595</u>	<u>1,715,167</u>	<u>-</u>	<u>1,561,273</u>	<u>-</u>	<u>12,519</u>	<u>162,148</u>	<u>-</u>	<u>4,898,563</u>
Total liabilities and fund balances	<u>\$ 3,114,393</u>	<u>\$ 792,067</u>	<u>\$ 42,885</u>	<u>\$ 397,261</u>	<u>\$ 3,630,824</u>	<u>\$ 3,844,118</u>	<u>\$ 246,054</u>	<u>\$ 1,561,342</u>	<u>\$ 268,086</u>	<u>\$ 321,973</u>	<u>\$ 163,605</u>	<u>\$ 349,953</u>	<u>\$ 14,732,561</u>

See Accompanying Independent Auditors' Report.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances
Year Ended September 30, 2017

	Education Sector	Health Sector	Environment Sector	Private Sector Development	Capacity Building Sector	Supplemental Education	Enhanced Reporting Accountability	Infrastructure Maintenance	Infrastructure	U.S. Federal Grants	Foreign Assistance	CFSM Grants	Total
Revenues:													
Compact funding	\$ 12,245,457	\$ 9,718,429	\$ 623,925	\$ 361,685	\$ 660,580	\$ 3,106,080	\$ 639,913	\$ -	\$ 268,086	\$ -	\$ -	\$ -	\$ 27,624,155
Federal and other grants	-	-	-	-	-	-	-	-	-	2,448,558	54,131	115,593	2,618,282
Total revenues	<u>12,245,457</u>	<u>9,718,429</u>	<u>623,925</u>	<u>361,685</u>	<u>660,580</u>	<u>3,106,080</u>	<u>639,913</u>	<u>-</u>	<u>268,086</u>	<u>2,448,558</u>	<u>54,131</u>	<u>115,593</u>	<u>30,242,437</u>
Expenditures by function:													
Current:													
General government	-	-	-	-	660,580	-	639,913	-	-	-	54,131	-	1,354,624
Health services	-	9,718,429	-	-	-	-	-	-	-	1,544,933	-	-	11,263,362
Education	12,245,457	-	-	-	-	3,106,080	-	-	-	903,625	-	-	16,255,162
Economic development	-	-	623,925	361,685	-	-	-	284,128	-	-	-	-	1,269,738
Public safety	-	-	-	-	-	-	-	-	-	-	-	115,593	115,593
Capital projects	-	-	-	-	-	-	-	-	268,086	-	-	-	268,086
Total expenditures	<u>12,245,457</u>	<u>9,718,429</u>	<u>623,925</u>	<u>361,685</u>	<u>660,580</u>	<u>3,106,080</u>	<u>639,913</u>	<u>284,128</u>	<u>268,086</u>	<u>2,448,558</u>	<u>54,131</u>	<u>115,593</u>	<u>30,526,565</u>
Excess (deficiency) of revenues over (under) expenditures	-	-	-	-	-	-	-	(284,128)	-	-	-	-	(284,128)
Other financing sources:													
Operating transfers in	-	-	-	-	-	-	-	506,054	-	-	-	-	506,054
Net change in fund balances	-	-	-	-	-	-	-	221,926	-	-	-	-	221,926
Fund balances at the beginning of the year	-	176,861	-	-	1,270,595	1,715,167	-	1,339,347	-	12,519	162,148	-	4,676,637
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ 176,861</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,270,595</u>	<u>\$ 1,715,167</u>	<u>\$ -</u>	<u>\$ 1,561,273</u>	<u>\$ -</u>	<u>\$ 12,519</u>	<u>\$ 162,148</u>	<u>\$ -</u>	<u>\$ 4,898,563</u>

See Accompanying Independent Auditors' Report.

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

GRANTS ASSISTANCE FUND

Combining Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances
Year Ended September 30, 2017

	Education Sector	Health Sector	Environment Sector	Private Sector Development	Capacity Building Sector	Supplemental Education	Enhanced Reporting Accountability	Infrastructure Maintenance	Infrastructure	U.S. Federal Grants	Foreign Assistance	CFSM Grants	Total
Revenues:													
Compact funding	\$ 12,245,457	\$ 9,718,429	\$ 623,925	\$ 361,685	\$ 660,580	\$ 3,106,080	\$ 639,913	\$ -	\$ 268,086	\$ -	\$ -	\$ -	\$ 27,624,155
Federal and other grants	-	-	-	-	-	-	-	-	-	2,448,558	54,131	115,593	2,618,282
Total revenues	<u>12,245,457</u>	<u>9,718,429</u>	<u>623,925</u>	<u>361,685</u>	<u>660,580</u>	<u>3,106,080</u>	<u>639,913</u>	<u>-</u>	<u>268,086</u>	<u>2,448,558</u>	<u>54,131</u>	<u>115,593</u>	<u>30,242,437</u>
Expenditures by account:													
Salaries and wages:													
Regular	5,550,342	3,196,483	363,038	144,189	79,396	370,549	379,346	-	36,701	1,262,305	31,086	67,674	11,481,109
Overtime	43,946	577,280	5,517	-	4,927	-	26,144	-	-	-	-	-	657,814
Fringe benefits	719,223	471,601	47,845	19,612	19,957	50,764	58,050	-	4,202	160,322	3,264	686	1,555,526
Travel and transportation	34,321	206,222	11,895	12,758	18,416	108,259	19,902	-	-	167,388	-	12,866	592,027
Books and library materials	259,321	-	-	-	16	-	-	-	-	-	-	-	259,337
Communications	18,111	29,174	9,398	15,059	21,544	50,576	2,137	-	1,470	29,404	-	-	176,873
Dues, memberships, and subscriptions	97,764	2,350	55	891	1,950	48,811	130	-	-	-	-	-	151,951
Food stuffs	105,107	378,970	-	-	-	6,276	-	-	-	-	-	-	490,353
Freight and port charges	2,362	5,915	250	600	-	19,015	-	-	-	384	-	-	28,526
Office supplies and materials	717,630	395,346	37,837	35,210	55,030	1,184,231	35,148	-	35,908	256,109	1,467	2,375	2,756,291
POL	110,992	211,227	40,515	12,154	11,163	98,551	6,858	-	2,825	72,978	4,357	5,882	577,502
Printing and reproduction	-	58,191	45	452	36,750	17	-	-	-	21,400	1,969	-	118,824
Rental services	24,554	51,692	818	3,497	3,820	502	1,873	-	3,122	69,794	4,990	-	164,662
Repairs and maintenance	180,608	202,664	20,052	2,759	22,051	167,250	5,618	-	-	9,166	-	2,629	612,797
Construction materials	-	12,604	1,444	-	-	-	-	-	-	-	-	-	14,048
Utilities	163,365	674,035	14,670	9,894	12,426	39,491	29,381	-	4,231	26,723	-	499	974,715
Goods and services	26,622	4,437	-	-	34,194	5,242	-	-	-	29,229	1,298	1,000	102,022
Subsidies and contributions	105,000	-	-	-	-	13,688	-	-	-	-	-	-	118,688
Medical referrals	-	147,124	-	-	-	-	-	-	-	-	-	-	147,124
Medical supplies	-	1,480,319	-	-	-	-	-	-	-	12,518	-	-	1,492,837
Contractual services	2,308,312	995,520	42,385	92,343	278,757	345,108	52,116	284,128	-	90,983	-	6,228	4,495,880
Professional services	412,410	-	-	-	-	16,450	-	-	87,500	-	-	-	516,360
Scholarships and allowances	356,200	-	-	-	-	39,746	-	-	-	-	-	-	395,946
Fees and meeting allowances	820	-	-	-	-	-	-	-	-	117,664	-	5,300	123,784
Training	568,255	5,055	-	-	-	304,858	-	-	1,000	6,810	-	-	885,978
Insurance	-	-	-	1,960	-	-	-	-	-	-	-	-	1,960
Leased housing, buildings and land	202,543	169,658	15,120	8,500	60,183	116,550	21,960	-	25,679	7,088	-	-	627,281
Compensation non-payroll	-	3,920	-	-	-	-	1,250	-	-	2,875	5,700	9,500	23,245
Equipment	140,988	305,500	4,084	1,807	-	44,200	-	-	15,628	38,883	-	-	551,090
Furniture and fixtures	62,268	6,658	-	-	-	49,446	-	-	-	42,477	-	954	161,803
Vehicles	34,393	126,484	8,957	-	-	26,500	-	-	49,820	24,058	-	-	270,212
Total expenditures	<u>12,245,457</u>	<u>9,718,429</u>	<u>623,925</u>	<u>361,685</u>	<u>660,580</u>	<u>3,106,080</u>	<u>639,913</u>	<u>284,128</u>	<u>268,086</u>	<u>2,448,558</u>	<u>54,131</u>	<u>115,593</u>	<u>30,526,565</u>
Excess (deficiency) of revenues over (under) expenditures	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(284,128)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(284,128)</u>
Other financing sources:													
Operating transfers in	-	-	-	-	-	-	-	506,054	-	-	-	-	506,054
Net change in fund balances	-	-	-	-	-	-	-	221,926	-	-	-	-	221,926
Fund balances at the beginning of the year	-	176,861	-	-	1,270,595	1,715,167	-	1,339,347	-	12,519	162,148	-	4,676,637
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ 176,861</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,270,595</u>	<u>\$ 1,715,167</u>	<u>\$ -</u>	<u>\$ 1,561,273</u>	<u>\$ -</u>	<u>\$ 12,519</u>	<u>\$ 162,148</u>	<u>\$ -</u>	<u>\$ 4,898,563</u>

See Accompanying Independent Auditors' Report.

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

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

We have audited, 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, the financial statements of the governmental activities, the aggregate discretely presented component units and each major fund of State of Chuuk as of and for the year ended September 30, 2017, and the related notes to the financial statements, which collectively comprise State of Chuuk's basic financial statements, and have issued our report thereon dated June 21, 2018. Our report was qualified with respect to governmental activities expenses and General Fund expenditures and a liability for land leases and related claims payable in the governmental activities and the General Fund, and includes an emphasis-of-matter paragraph concerning collectibility of receivables.

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

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered State of Chuuk's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of State of Chuuk's internal control. Accordingly, we do not express an opinion on the effectiveness of State of Chuuk's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Questioned Costs as items 2017-002 and 2017-003 that we consider to be material weaknesses.

Compliance and Other Matters

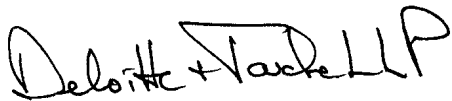
As part of obtaining reasonable assurance about whether State of Chuuk's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material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

State of Chuuk's Response to Findings

State of Chuuk's response to the findings identified in our audit are described in the accompanying corrective action plan. State of Chuuk's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Deloitte + State LLP". The signature is stylized, with the "D" and "S" being particularly large and prominent.

June 21, 2018

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS REQUIRED BY THE UNIFORM GUIDANCE

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

Report on Compliance for Each Major Federal Program

We have audited State of Chuuk's compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of State of Chuuk's major federal programs for the year ended September 30, 2017. State of Chuuk's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs.

As discussed in Note 3B to the Schedule of Expenditures of Federal Awards, State of Chuuk's basic financial statements include the operations of certain entities whose federal awards are not included in the accompanying Schedule of Expenditures of Federal Awards for the year ended September 30, 2017. Our audit, described below, did not include the operations of the entities identified in Note 3B as these entities conducted separate audits in accordance with Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the Uniform Guidance), if required.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of State of Chuuk's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the Uniform Guidance. Those standards and the Uniform Guidance 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 State of Chuuk's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of State of Chuuk's compliance.

Opinion on Each Major Federal Program

In our opinion, State of Chuuk complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2017.

Other Matters

The results of our auditing procedures disclosed instances of noncompliance which are required to be reported in accordance with the Uniform Guidance and which are described in the accompanying Schedule of Findings and Questioned Costs as item 2017-001. Our opinion on each major federal program is not modified with respect to these matters.

State of Chuuk's response to the noncompliance findings identified in our audit are described in the accompanying corrective action plan. State of Chuuk's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of State of Chuuk is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered State of Chuuk's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, 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 State of Chuuk's internal control over compliance.

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

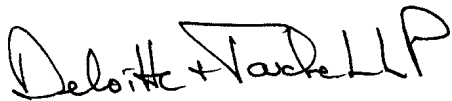
Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in the accompanying Schedule of Findings and Questioned Costs as item 2017-001 that we consider to be significant deficiencies.

State of Chuuk's response to the internal control over compliance findings identified in our audit are described in the accompanying corrective action plan. State of Chuuk's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units and each major fund of State of Chuuk as of and for the year ended September 30, 2017, and the related notes to the financial statements, which collectively comprise State of Chuuk's basic financial statements. We issued our report thereon dated June 21, 2018, which contained qualified opinions on those financial statements with respect to governmental activities expenses and General Fund expenditures and a liability for land leases and related claims payable in the governmental activities and the General Fund, and included an emphasis-of-matter paragraph concerning collectibility of receivables. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of Federal Awards is fairly stated in all material respects in relation to the basic financial statements as a whole.



June 21, 2018

STATE OF CHUUK
FEDERATED STATES OF MICRONESIA

Summary Schedule of Expenditures of Federal Awards, by Grantor
Year Ended September 30, 2017

<u>Agency/Program</u>	<u>Expenditures</u>
U.S. Department of the Interior	\$ 27,908,282
U.S. Department of Education	903,625
U.S. Department of Health and Human Services	<u>1,544,934</u>
 GRAND TOTAL	 \$ <u>30,356,841</u>
 Reconciliation to the basic financial statements:	
Grants Assistance Fund expenditures	\$ 30,526,565
Less: CFSM Grants Fund expenditures	(115,593)
Foreign Assistance Fund expenditures	<u>(54,131)</u>
	 \$ <u>30,356,841</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2017

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	CFDA#	Pass-Through Entity Identifying #	Expenditures
U.S. DEPARTMENT OF THE INTERIOR			
Pass-Through Federated States of Micronesia National Government:		A2	
Economic, Social and Political Development of the Territories:	15.875		
Compact Sector Grants - Education Sector			\$ 12,245,456
Compact Sector Grants - Health Sector			9,718,429
Compact Sector Grants - Environment Sector			623,925
Compact Sector Grants - Private Sector Development			361,685
Compact Sector Grants - Capacity Building Sector			660,580
Supplemental Education Grant			3,106,080
Compact Sector Grants - ERA			639,913
Compact Sector Grants - Infrastructure			268,086
Compact Sector Grants - Infrastructure Maintenance			<u>284,128</u>
Total Compact Sector Grants Fund			<u>27,908,282</u>
TOTAL U.S. DEPARTMENT OF THE INTERIOR TOTAL			<u>\$ 27,908,282</u>
U.S. DEPARTMENT OF EDUCATION			
Pass-Through Federated States of Micronesia National Government:		A2	
Special Education Cluster (IDEA):			
Special Education - Grants to States	84.027		\$ <u>903,625</u>
Total Special Education Cluster (IDEA) and			
TOTAL U.S. DEPARTMENT OF EDUCATION TOTAL			<u>\$ 903,625</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES			
Pass-Through Federated States of Micronesia National Government:		A2	
Affordable Care Act (ACA) Personal Responsibility Education Program	93.092		\$ 30,809
Maternal and Child Health Federal Consolidated Program	93.110		
Project Grants and Cooperative Agreements for Tuberculosis			
Control Programs	93.116		
Family Planning Services	93.217		69,602
Health Center Program Cluster:			
Community Health Center	93.224		<u>310,037</u>
Total Health Center Program Cluster			310,037
Oral Health Care	93.236		12,960
Substance Abuse and Mental Health Services - Projects of Regional and			
National Significance	93.243		345,517
Universal Newborn Hearing Screening	93.251		15,288
Immunization Cooperative Agreements	93.268		206,288
CDC and Prevention - Investigations and Technical Assistance	93.283		136,173
Preventive Health and Health Services Block Grant	93.758		3,586
HIV Care Formula Grants	93.917		154,225
Block Grants for Community Mental Health Services	93.958		7,099
Block Grants for Prevention and Treatment of Substance Abuse	93.959		159,913
Maternal and Child Health Services Block Grant to the States	93.994		<u>93,437</u>
TOTAL U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES TOTAL			<u>\$ 1,544,934</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 30,356,841</u>

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, 2017

1. Scope

The State of Chuuk is one of the four States of the Federated States of Micronesia. All significant operations of the State of Chuuk are included in the scope of the Single Audit. The U.S. Department of the Interior has been designated as the State of Chuuk's cognizant agency for the Single Audit.

2. Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards (the Schedule) includes the federal grant activity of the State of Chuuk under programs of the federal government for the year ended September 30, 2017. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the State of Chuuk, it is not intended to and does not present the financial position or changes in financial position of the State of Chuuk.

3. Summary of Significant Accounting Policies

A. Basis of Accounting

Expenditures reported on the Schedule are reported on the modified accrual basis of accounting, consistent with the manner in which State of Chuuk maintains its accounting records. All expenditures and capital outlays that represent the federal share are reported as expenditures. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Pass-through entity identifying numbers are presented, where available.

B. Reporting Entity

For purposes of complying with the Single Audit Act of 1984, as amended in 1996, the State of Chuuk's reporting entity is defined in Note 1A to its September 30, 2017 basic financial statements; and all of the discretely presented component units are excluded. Accordingly, the accompanying Schedule presents the federal award programs administered by the State of Chuuk, as defined above, for the year ended September 30, 2017.

C. Matching Costs

Matching costs, i.e., the non-federal share of certain program costs, are not included in the accompanying Schedule.

D. Subgrantees

Certain program funds are passed through the State of Chuuk to subgrantee organizations. The Schedule does not contain separate schedules disclosing how the subgrantee outside of the State of Chuuk's control utilizes these funds.

E. Indirect Cost Allocation

The State of Chuuk did not receive any indirect cost allocation and does not elect to use the de minimis indirect cost rate allowed under the Uniform Guidance. State of Chuuk did not charge indirect costs against federal programs.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2017

3. Summary of Significant Accounting Policies, Continued

F. 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 for purposes of major program determinations.

G. Component Units

The State of Chuuk's component units are to separately satisfy the requirements of the Uniform Guidance, if applicable. The following presents information concerning the State of Chuuk's component units:

Chuuk Public Utility Corporation

The Chuuk Public Utility Corporation (CPUC), a discretely presented component unit, is the recipient of various pass-through funds. The CPUC is to separately satisfy its 2017 reporting responsibilities under the Single Audit Act. CPUC's total federal award expenditures for the year ended September 30, 2017 is \$2,417,210.

Chuuk State Housing Authority

The Chuuk State Housing Authority (CSHA), a discretely presented component unit, is the recipient of various pass-through funds from the State of Chuuk in a prior year and certain direct grants. CSHA's total federal award expenditures for the year ended September 30, 2017 is undetermined.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2017

Section I - Summary of Auditors' Results

Financial Statements

- | | |
|---|--------------------------|
| 1. Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP: | Unmodified and Qualified |
| Internal control over financial reporting: | |
| 2. Material weakness(es) identified? | Yes |
| 3. Significant deficiency(ies) identified? | None reported |
| 4. Noncompliance material to financial statements noted? | No |

Federal Awards

Internal control over major federal programs:

- | | |
|---|------------|
| 5. Material weakness(es) identified? | No |
| 6. Significant deficiency(ies) identified? | Yes |
| 7. Type of auditors' report issued on compliance for major federal programs: | Unmodified |
| 8. Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? | Yes |
| 9. Identification of major federal programs: | |

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
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15.875	Economic, Social and Political Development of the Territories – Compact of Free Association, As Amended, Compact Sector Grants
--------	--

- | | |
|--|------------|
| 10. Dollar threshold used to distinguish between Type A and Type B Programs: | \$ 910,705 |
| 11. Auditee qualified as low-risk auditee? | No |

Section II – Financial Statements Findings

<u>Finding #</u>	<u>Finding</u>
2017-002	Timely and Accurate Reconciliations
2017-003	Land Leases

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2017

Section III - Federal Award Findings and Questioned Costs

<u>Finding #</u>	<u>CFDA #</u>	<u>Finding</u>	<u>Questioned Costs</u>
2017-001	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, 2017

Finding No.: 2017-001
Federal Agency: U.S. Department of the Interior
Pass-Through Entity: Federated States of Micronesia National Government
CFDA Program: 15.875 Economic, Social and Political Development of the Territories -
Federal Award No.: Compact of Free Association, As Amended, Compact Sector Grants
Requirement: Equipment and Real Property Management
Questioned Costs: \$0

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

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

Cause: The cause of the above condition appears to be a potential weakness in internal control requiring that fixed assets be periodically maintained.

Effect: The effect of the above condition is the expected life of fixed assets may be lessened. However, no questioned costs result from this finding as no specific instances came to our attention in fiscal year 2017 of unnecessary expenditures that occurred due to this condition.

Identification as a Repeat Finding: Finding No. 2016-001.

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

Views of Auditee and Planned Corrective Actions: The auditee agrees with the finding and recommendation.

See the auditee-prepared corrective action plan.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2017

Finding No.: 2017-002
Area: Timely and Accurate Reconciliations

Criteria: Reconciling subsidiary ledgers to the general ledger on a regular basis is fundamental and critical to maintaining accurate financial records and to minimizing the opportunity for misappropriation of funds or fraudulent activities.

Condition: We determined subsidiary records, particularly cash and equivalents, contained variances that are not timely reconciled.

Cause: The cause of this condition is an absence of timely or accurate bank reconciliations and subsidiary ledgers reconciliations.

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

Recommendation: The State of Chuuk should perform monthly reconciliations of all cash accounts and subsidiary ledgers.

Identification as a Repeat Finding: Finding No. 2016-002.

Views of Auditee and Planned Corrective Actions: The auditee agrees with the finding and recommendation.

See the auditee-prepared corrective action plan.

**STATE OF CHUUK
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2017

Finding No.: 2017-003
Area: Land Leases

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

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

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

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

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

Identification as a Repeat Finding: Finding No. 2016-003.

Views of Auditee and Planned Corrective Actions:

See the auditee-prepared corrective action plan.



DEPARTMENT OF ADMINISTRATIVE
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 Federated States of Micronesia

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JESSE MORI
 Director
 JONAS PAUL
 Deputy Director

Summary Schedule of Prior Audit Findings and Questioned Costs
 Year Ended September 30, 2017

<u>Finding Number</u>	<u>CFDA Number</u>	<u>Questioned Costs</u>	<u>Status</u>
2013-001	15.875	\$ -	Resolved based on Grantor correspondence dated March 7, 2018
2013-002	15.875	19,940	Resolved based on Grantor correspondence dated March 7, 2018
2013-003	15.875	160,270	Resolved based on Grantor correspondence dated March 7, 2018
2013-004	15.875	14,028	Resolved based on Grantor correspondence dated March 7, 2018
2014-001	15.875	-	Resolved based on Grantor correspondence dated March 7, 2018
2014-002	15.875	82,298	Resolved based on Grantor correspondence dated March 7, 2018
2014-003	15.875	32,620	Resolved based on Grantor correspondence dated March 7, 2018
2015-002	15.875	6,800	Resolved based on Grantor correspondence dated March 7, 2018
2015-003	15.875	13,006	Resolved based on Grantor correspondence dated March 7, 2018
2015-004	84.027	35,486	Resolved based on Grantor correspondence dated March 7, 2018
2016-001	15.875	-	Not Corrected or Resolved. See corrective action plan - Finding 2017-001
2016-002		-	Not Corrected or Resolved. See corrective action plan - Finding 2017-002
2016-003		-	Not Corrected or Resolved. See corrective action plan - Finding 2017-003
		\$ <u>364,448</u>	



**DEPARTMENT OF ADMINISTRATIVE
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JESSE MORI
Director
JONAS PAUL
Deputy Director

**CORRECTIVE ACTION PLAN
2 CFR § 200.511(c)
Year Ended September 30, 2017**

Finding Number	Corrective Action Plan	Anticipated Completion Date	Responsible Person (Contact details)
2017-001	<p>We agree with the audit finding and recommendation, please note that Chuuk State Equipment and Real Property Maintenance Plan is already in place. However, documented procedures for maintenance activities review and monitoring are still not completed. We will work on this immediately.</p> <p>DAS Supply and Procurement staff designated by the Chief of finance in collaboration with corresponding staff responsible for fixed asset of other departments, agencies and offices receiving fixed assets from sector funding will work together to make sure that implementation of the documented procedures and documentation of periodic reviews and maintenance activities of fixed assets and monitoring undertaken</p>	September 30, 2018	Roxalyn Kaminanga – Acting Chief of Finance roxalynkami@yahoo.com
2017-002	<p>As with prior reconciliation findings, we agree with the 2017 finding and recommendation. DAS has hired a CPA to assist with reconciliation problems and who is currently concentrating efforts on reconciliation and adjustment of all bank accounts to general ledger accounts. During FY 2017 numerous adjustments were made by the banks to correct bank errors and DAS to correct accounting errors occurring during FY 2017 and previous years. In addition, DAS has initiated recruiting efforts to locate an individual to assist with the reconciliation process. DAS plans to have all bank accounts reconciled and adjusted on a monthly basis, where appropriate for 2017.</p>	September 30, 2018	Roxalyn Kaminanga – Acting Chief of Finance roxalynkami@yahoo.com
2017-003	<p>Funding for this project was provided during this year's budget and procurement of the services was done on time and in compliance with requirements. However, when the final selection was made and the contract was drafted, OIA disapproved the selected individual for some unknown reasons. We will hire an attorney and will continue to work with OIA to assist in the resolution of this finding.</p>	September 30, 2018	Sabino Asor – State Attorney General Sab.asor@hotmail.com