

**INSPECTION OF  
CHUUK SECTOR GRANT FUNDS  
FISCAL YEAR 2006**

**AUDIT NO. 2007 - 1**



**Haser H. Hainrick**  
**National Public Auditor**



# **FEDERATED STATES OF MICRONESIA**

***Office of The National Public Auditor***

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April 17, 2007

Honorable Members of the FSM Congress  
His Excellency Joseph J. Urusemal, President  
Federated States of Micronesia  
Palikir, Pohnpei FM 96941

RE: Inspection of Chuuk Compact II funds

We have completed our review of several aspects of Chuuk Compact II funds for fiscal year 2006. This review started because of a U.S. Department of Interior (DOI) finding that resulted in FSM repaying some Compact II funds. Chuuk received \$1,058,309.78 of Compact II funds that were not deposited into the Chuuk Compact II checking account. DOI considered this a misused of Compact II funds and FSM repaid the funds. Our objectives were to 1) describe the flow of information and flow of funds from the request for the draw down of Compact II funds to the repayment to DOI and 2) determine if expenditures paid from Compact II funds were actually used for Compact II authorized expenses. We conducted our review in accordance with the Quality Standards for Inspections issued by the U.S. President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency.

In June 2006 Compact II funds amounting to \$2,058,309.78 were transferred into the Chuuk State saving account and co-mingled with other funds. Only \$1 million was deposit to the Compact II checking account (Sector Grant checking account), because there were not enough funds in the Saving account, due to transfers from the Chuuk State Saving account to other accounts. Chuuk State Compact Funds Control Commission (CFCC) discovered the missing funds when bank statements were obtained, and notified Chuuk State Department of Administrative Services (DAS) and DOI. DOI considered the missing \$1,058,309.78 as misused Compact II funds and required that the funds be repaid. FSM made the payment on December 6, 2007. The funds in the Sector Grant checking account were properly expended, since CFCC provides oversight to DAS expenditures from the Sector Grant checking account. However, we cannot determine specifically what was purchased with the \$1,058,309.78 since these expenditures were made outside of the Sector Grant checking account. The findings and recommendations are described in greater detail in the attachment to this letter.

In summary, because Compact II funds were not directly transferred in the Chuuk's Sector Grant checking account, funds were co-mingled with funds from other sources in the Chuuk State Saving account and misdirected to other accounts. And CFCC's review of Chuuk's Compact II expenditures ensure that the funds paid out from the Sector Grant checking account are used only for Compact II activities.

Respectfully yours,

A handwritten signature in black ink, appearing to read "Haser Hainrick".

Haser Hainrick  
National Public Auditor

## TABLE OF CONTENTS

BACKGROUND.....	1
OBJECTIVES, SCOPE, AND METHODOLOGY.....	2
PRIOR AUDIT COVERAGE.....	2
FINDINGS AND RECOMMENDATIONS:	
Compact II Funds Co-mingled in Savings Account.....	3
CFCC Does Not Reconcile Expenditures with DAS .....	4
APPENDICES:	
Appendix I—Summary of Allotments and Expenses by Sector for FY 2006.....	7
Appendix II—Comments by Chuuk State Department of Administrative Services .....	8
Appendix III—Comments by Chuuk State Compact Funds Control Commission.....	9
Appendix IV—Comments by the FSM Department of Finance and Administration.....	11
NATIONAL PUBLIC AUDITOR’S COMMENTS.....	12
ONPA CONTACT AND STAFF ACKNOWLEDGEMENT.....	13

**Office of the National Public Auditor  
Chuuk Sector Grant Funds  
Audit Report No. 2007 – 1**

**BACKGROUND**

The Compact of Free Association is the agreement that established the relationship between the Federated States of Micronesia (FSM) and the United States. Under the terms of the Compact, the U.S. provides the FSM with economic assistance, defense, and other services and benefits. In exchange, the FSM grants the U.S. certain operating rights in the FSM, denial of access to FSM territory by other nations, and other agreements. The U.S. Congress adopted the Compact in 1986, and President Reagan signed it into law on November 13, 1986. The Compact also mandated the renegotiation of certain terms of the agreement after a fixed period. This negotiation took place in 2003 and resulted in the Amendments Act of 2003. President Bush signed this into law on December 17, 2003. After the four FSM states ratified the amendments, the FSM Congress approved the Amended Compact (Compact II) on May 26, 2004.

Under the Compact II, to assist the FSM in its efforts to promote the economic advancement, budgetary self-reliance, and economic self-sufficiency, the United States will provide assistance on a sector grant basis for a period of twenty years. The grants will be used in the sectors of education, health care, private sector development, the environment, public sector, capacity building, and public infrastructure, with priority in education and health sectors. The grants are distributed to the National Government and the four FSM States for implementation.

The following table shows Compact II funds for the State of Chuuk for fiscal year 2006 provided by the FSM Department of Finance and Administration (DoF&A). The data is broken into the six sector grants under the Compact II Fund.

<b>Sector</b>	<b>Amount</b>
<b>Education Sector</b>	9,432,618
<b>Health Sector</b>	6,292,745
<b>Capacity Building Sector</b>	2,724,099
<b>Environment Sector</b>	798,428
<b>Private Sector Development</b>	1,498,616
<b>Public Infrastructure</b>	0
<b>TOTAL FUNDS</b>	20,746,506

The Chuuk State Department of Administrative Services (DAS) manages the Compact II funds for the State. DAS is responsible for receipts and disbursements of Compact II funds allocated to Chuuk State. It ensures that disbursements are accurate and related to Compact II activities and maintains documentation for its transactions.

The Chuuk State Compact Funds Control Commission (CFCC) was established the Chuuk State Legislature to provide greater reliability in Compact II expenses paid by DAS. The Director of DAS is also the Chairman of the Board of Directors for CFCC, which meets biweekly to discuss issues concerning the operation of CFCC. An independent consultant hired by the FSM President to manage the day-to-day activities of CFCC is also the Vice Chairman of the Board. The consultant is assisted by staff paid by Chuuk State. CFCC reviews and approves individual

**Office of the National Public Auditor  
Chuuk Sector Grant Funds  
Audit Report No. 2007 – 1**

requisitions, purchase documentation, and disbursements. CFCC recently received the authority to obtain Compact II checking account bank statements for reconciliation purposes and has started co-signing Chuuk Compact II checks for additional assurance that funds are available and expenditures are proper.

**OBJECTIVES, SCOPE, AND METHODOLOGY**

This inspection started because of a discovery made by the CFCC Vice Chairman that Chuuk received \$2,058,309.78 of Compact II funds but only deposited \$1,000,000 into the Chuuk Compact II account (Sector Grant checking account). CFCC reported this to DOI who considered the amount that was not transferred as misused Compact II funds. Chuuk repaid the Office of Insular Affairs, DOI on December 6, 2006 for the missing Compact II funds. Our inspection objectives were to 1) describe the flow of information and flow of funds from the request for the draw down of Compact II funds to the repayment to DOI and 2) determine if expenditures paid from Compact II funds were actually used for Compact II authorized expenses.

The review covers allotments and expenditures for fiscal years 2006. The review was conducted pursuant to the authority vested in the National Public Auditor as codified at Title 55 FSMC Chapter 5 of the FSM Code and it was conducted in accordance with the Quality Standards for Inspections (QSI)<sup>1</sup>. In accordance with the QSI we were alert to possibilities of fraud and illegal acts and assessed internal controls to the extent they applied to the inspection objectives. This inspection assignment was added to ONPA's Fiscal Year 2006 Annual Audit Plan because of the nature of DOI's finding and its financial impact on FSM.

We performed our fieldwork from January 22 to February 2, 2007 at Chuuk State DAS and Chuuk State CFCC in Weno, Chuuk State. We also obtained information and data from the FSM DoF&A. Inspection procedures included analyzing and compiling data such as deposit and drawdown schedule, bank statements, advice of allotments, and award letters gathered at DoF&A. We reviewed CFCC recorded allotments and detailed expenditure disbursements. We also reviewed bank statements for DAS Saving and Sector Grant checking account, and reports of allotments and expenditure. We also interviewed the staff to validate our analysis. To determine if DAS was properly spending Compact II funds for authorized activities, we obtained CFCC recorded expenditures and those of DAS for comparison. Finally, we summarized the results of our review procedures based on the inspection objectives. We held entrance and exit conferences with each of the entities.

**PRIOR AUDIT COVERAGE**

This review of the Chuuk Sector Grant Funds represents the first undertaken by the Office of the National Public Auditor (ONPA). Previous audits of the Chuuk Sector Grant Funds were

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<sup>1</sup> The QSI, as amended on January 2005, was issued by the U.S. President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency.

**Office of the National Public Auditor**  
**Chuuk Sector Grant Funds**  
**Audit Report No. 2007 – 1**

covered under the single audits done by Deloitte and Touch for the FSM and State Amended Compact for fiscal years 2004 and 2005. The findings for both years are related to missing documentation for most of the non-payroll and payroll transactions selected. This review does not address these issues.

**FINDINGS AND RECOMMENDATIONS**

**Compact II Funds**  
**Co-mingled in Savings Account**

This section describes the flow of information and funds concerning DOI's finding that Compact II funds were misused. In June 2006 Compact II funds were transferred into the Chuuk State saving account and co-mingled with other funds. Due to transfers from the Chuuk State saving account to other accounts, there was not enough funds in the account to transfer the entire amount of the Compact II deposit to the Sector Grant checking account.

In fiscal year 2006 the Chuuk's Compact II account (referred to as the Sector Grant checking account) received nine deposits of Compact II funds. The first three transfers for the months of October 2005, December 2005, and January 2006 went directly into the Sector Grant checking account. The remaining six transfers went first to a Chuuk State Saving account and then were later transferred to the Sector Grant checking account.

DAS and the DoF&A disagree regarding which account the Compact II funds should be transferred. DAS believes that the funds should have been deposited in the Sector Grant checking account based on 2 correspondences: 1) a DAS letter dated March 7, 2006 which authorizes transfers for all funds except for Federal Emergency Management Agency and Sector Grants (i.e. Compact II funds) to be deposited to the Chuuk State Savings Account and 2) a DAS letter dated May 23, 2006 which specifically requests the transfer of Compact II funds for June 2006 to the Sector Grant checking account. However, DoF&A says that since the DAS letter of March 2006 does not specify into which account the Compact II funds should be deposited, DoF&A is relying on a letter from DAS dated January 14, 2004 that authorized Compact II funds to be deposited into the Chuuk State saving account.

Transfers of co-mingled funds from the Chuuk State savings account prohibited the original Compact II fund deposit amount from being transferred out. The first transfer of Compact II funds into the Chuuk State saving account instead of the Sector Grant checking account was done on June 2. Compact II funds of \$2,058,309.78 were co-mingled with other Chuuk funds. From June 2-19, 2006, \$950,453.25 was transfers out of the saving account into other accounts. Seventy-four percent of these funds were transferred to the general fund. Therefore, on June 19, 2006 when the Sector Grant checking account had a negative balance, the Chuuk State saving account balance was too small to transfer the entire \$2,058,309.78 to the Sector Grant checking account and only \$1 million was transferred. Because the \$1,058,309.78 was co-mingled in the general funds, we cannot determine specifically what was expended with the funds.

**Office of the National Public Auditor  
Chuuk Sector Grant Funds  
Audit Report No. 2007 – 1**

CFCC discovered the missing funds and requested an explanation from DAS with a copy sent to DOI. DAS provided an explanation and the missing funds were repaid to the DOI. In November 2006, CFCC obtained copies of the bank statements for the Sector Grant checking account and discovered the missing deposit. On November 5, 2006 the CFCC Vice Chairman wrote to the Director of DAS (with a copy to the Office of Insular Affairs of DOI) and requested an explanation for missing funds. On November 17, 2006, the Director of DAS explained the discrepancy by stating that the Sector funds were deposited into the savings account which handles Compact I funds and revenue share and other federal programs, therefore, Compact I expenses were continuously being charged to it. DOI considered the missing funds as misuse of Compact II funds and requested that the funds be repaid. On December 6, 2006, DoF&A repaid DOI \$1,058,309.78 from “FSM Compact Funds – Chuuk” account. This account contains funds left over from Compact I Capital Improvement Projects (CIP) for Chuuk State. According to DoF&A Secretary, the decision to use this fund for repayment was made by the FSM President, the Governor of Chuuk State and himself.

We recommend that DAS authorize DoF&A to transfer Compact II funds directly into the Sector Grant checking account. The direct transfer would reduce the risk that Compact II funds would be used for non-Compact purposes.

**CFCC Does Not Reconcile Expenditures with DAS**

CFCC’s oversight of DAS’ expenditures ensures that the Sector Grant checking account payments are made only for Compact II activities. CFCC reviews and approves DAS’ expenditures from the Sector Grant checking account and keeps its own separate set of records for these expenditures. However, CFCC does not summarize its expenditure data so that it can easily reconcile its records with those of DAS. In addition, CFCC lacks access to budget reprogramming information to update its records.

CFCC reviews requisitions, purchase orders and vendor payments to ensure that documentation is complete and payments are for Compact II authorized expenditures. Specifically, CFCC review activities included 3 checks points: 1) during the review of requisitions, CFCC verifies and certifies availability of funds and review and approve the requisition, 2) during the review of the purchase order, CFCC review and approve the purchase documentation (requisition, purchase order, receiving report, invoice, CFCC inspection report and accounts payable vouchers), and 3) before payment of accounts payable vouchers, CFCC review and approve vendor payment.

CFCC keeps a set of records that is completely separate from the records maintained by DAS. When we did our fieldwork in January 2007, CFCC and DAS were considering trying to reconcile their records.

- CFCC keeps detailed spreadsheet records of expenditures by cost center and allotment but does not summarize its data by sector.
- CFCC decided not to keep track of payroll, benefits and overtime payments because of the bulk of the work to input the number of expenditures into an excel spreadsheet.

**Office of the National Public Auditor  
Chuuk Sector Grant Funds  
Audit Report No. 2007 – 1**

Further, CFCC does not keep a pay period summary of salary amounts by cost center and allotment. Therefore, CFCC must rely on DAS records for salary expenditures.

- CFCC does not summarize its data by sector and it cannot easily reconcile its data with Chuuk State’s Compact II spending data.
- CFCC does not receive notices that some funds were reprogrammed from one allotment category to another.

The table below reflects the authorized amount recorded by FSM, and the allotment and expenditures recorded by DAS and CFCC are different from each other. See Appendix I for schedule of allotments and expenditures by sector.

**Comparison of DAS and CFCC Totals for Compact II Funds  
For Fiscal Year 2006**

Description	FSM	DAS	CFCC
Authorized Grant Amounts	20,746,506.00		
Funds Drawn Down	15,475,537.77		
Recorded allotments including reprogrammed amounts		21,395,426.00	18,428,793.79
Expenses		18,599,957.66	24,744,289.66 <sup>a</sup>
Additional Draw Downs Available:			
For each sector expenses are less than authorized grant amount, additional draw downs equal expenses less funds already drawn down		3,124,419.89	
For 5 of the 6 sectors, expenses are less than authorized grant amount, additional draw downs equal expenses less funds already drawn down. For the education sector, the expenses are greater than authorized grant amount, so additional draw downs equal remaining grant award not drawn down.			4,115,761.12

Note <sup>a</sup>: CFCC expenses were calculated by ONPA using CFCC’s spreadsheets and adding salary expenses calculated by DAS.

CFCC does not summarize its detailed records of Compact II expenditures and cannot easily determine the amount of funds remaining to be transferred for Compact II expenditures. CFCC does not reconcile its records with DAS records, and it does not obtain all the information it needs to do proper oversight. For example, CFCC does not routinely get information on



**Office of the National Public Auditor**  
**Chuuk Sector Grant Funds**  
**Audit Report No. 2007 – 1**

reprogrammed allotments, and therefore, it may approve expenditures that exceed the reprogrammed authorized amount.

We recommend that:

- CFCC works more closely with DAS and reviews and reconciles the CFCC records with the DAS's summary expenditure sheets and status reports on a routine basis.
- CFCC keeps a summary record of salaries paid by sector, account number and cost center. The records would be complete and reconciliation would be easier.
- DAS provides copies of all budgets reprogramming to CFCC so they have correct and complete data to support their management decisions.

We believe these actions will enhance CFCC ability to provide better oversight of the Chuuk Compact II expenditures.

**Office of the National Public Auditor  
Chuuk Sector Grant Funds  
Audit Report No. 2007 – 1**

**Appendix I**

**Summary of Allotments and Expenses by Sector for FY 2006**

	Sector 72	Sector 73	Sector 74	Sector 75	Sector 76	
Description	Education	Health	Capacity Building	Environment	Private	Total
<b>Authorized Amount</b>	9,432,618.00	6,292,745.00	2,724,099.00	798,428.00	1,498,616.00	20,746,506.00
Total Transfers to Chuuk	6,958,979.90	4,807,369.94	2,063,044.47	518,111.75	1,128,031.71	15,475,537.77
<b>DAS TOTALS</b>						
Allotments	9,432,618.00	6,681,375.00	2,833,099.00	893,773.00	1,554,561.00	21,395,426.00
Balances	1,179,503.83	839,139.20	402,967.29	178,562.46	195,295.56	2,795,468.34
Expenses (allotments less balances)	8,253,114.17	5,842,235.80	2,430,131.71	715,210.54	1,359,265.44	18,599,957.66
<b>Additional transfers needed for expenses</b>	1,294,134.27	1,034,865.86	367,087.24	197,098.79	231,233.73	3,124,419.89
<b>CFCC TOTALS</b>						
Allotments	10,978,255.00	4,730,528.72	1,359,938.75	516,051.00	844,020.32	18,428,793.79
Balances	1,895,700.32	1,968,302.83	990,868.45	155,892.39	422,517.97	5,433,281.96
Expenses recorded by CFCC <sup>a</sup>	9,082,554.68	2,762,225.89	369,070.30	360,158.61	421,502.35	12,995,511.83
Salaries recorded by the state	5,503,054.09	2,852,784.38	2,040,082.15	359,977.72	992,879.49	11,748,777.83
<b>Total expenses</b>	14,585,608.77	5,615,010.27	2,409,152.45	720,136.33	1,414,381.84	24,744,289.66
<b>Additional transfers needed for expenses</b>	2,473,638.10 <sup>b</sup>	807,640.33	346,107.98	202,024.58	286,350.13	4,115,761.12

Note <sup>a</sup>: Expenses are allotments less balances for all categories except salaries.

<sup>b</sup>: Since expenses are greater than authorized amount, the additional funds needed is the authorized amount less the funds already transferred.

Office of the National Public Auditor  
Chuuk Sector Grant Funds  
Audit Report No. 2007 – 1

Appendix II



**WINIPLAT BISALEN**  
Director

Mr. Haser Hainrick  
FSM Public Auditor  
Palikir, Pohnpei FM 96941

*Haser*  
*4.3.2007*  
April 2, 2007



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**JONAS PAUL**  
Deputy Director

Dear Mr. Auditor:

This is my response to the findings of your staff relative to the alleged unauthorized Compact II expenditure of \$1,058,309.78. We concurred with your staff's findings that the amount was inadvertently used for some non-sector expenditure. We also concur with the finding that this took place because of the co-mingling of funds despite my repeated request not to deposit Sector Cash into the General Fund Saving Account.

We had communicated with DoFA on two occasions, the latest was in March 2006, requesting that all draw downs should be deposited to the Chuuk State Saving Account "except Sector Grants". I am merely indicating the fact here and not accusing DoFA of any intended wrongdoings. The reason for our repeated request to separate sector cash from all others was a result of OIA demand and our own resolve to safeguard against inadvertent use of that cash for other non-sector expenditure, such as this.

Additionally, I wish to bring to your attention that the Accountant who is responsible for bank reconciliation and transfer to/from all accounts was off-island at that time for medical reason. I am not saying that this occurred because of her absence, but it could not have taken place had she been there to monitor such transfers and deposits.

Regarding the figures at the end of the report, we stand by our figures and wish that we would have enough time to reconcile our figures with those of the CFCC to enable your staffs to have a conclusive finding.

Thank you.

Sincerely,

Winiplat A. Bisalen  
Director, DAS Chuuk

Cc: Governor  
Reconciliation Section  
File

Office of the National Public Auditor  
Chuuk Sector Grant Funds  
Audit Report No. 2007 – 1

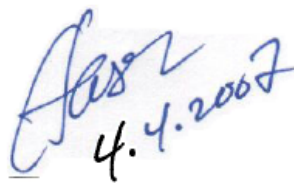
Appendix III

**COMPACT FUNDS CONTROL COMMISSION**

P.O. BOX 1345 • WENO, CHUUK • FM 96942  
PHONE: 691.330.4605 • FAX: 691.330.4763

April 2, 2007

Haser Hainrick  
National Public Auditor  
Federated States of Micronesia  
P.O. Box PS-05  
Palikir, Pohnpei FM 96941



Dear Mr. Hainrick:

Concerning the fiscal year 2006 Inspection Report dated March 8, 2007 issued by your office, our responses to the recommendations are as follows:

Finding 1: Compact II Funds Co-mingled in Savings Account.

Recommendation: DAS should authorize DF&A to transfer Compact II funds directly into the Sector Grant checking account. The direct transfer would reduce the risk that Compact II funds would be used for non-Compact purposes.

Response: We agree with this recommendation and will work with Chuuk DAS to provide proper authorization to DF&A to always transfer Compact Sector Grant and Supplemental Education Grant funding directly into the Sector Grant checking account.

As additional controls over Compact II cash management, beginning early in fiscal year 2007 CFCC assumed full responsibility for reconciling the Sector checking account at Bank of the FSM used to process vendor payments and was also added as a signatory on the account. An authorized CFCC signatory signs all checks payable to various vendors along with a signer from Chuuk Treasury.

Finding 2: CFCC Does Not Reconcile Expenditures with Chuuk DAS.

Recommendation: CFCC should work more closely with DAS and review and reconcile the CFCC records with the DAS's summary expenditure sheets and status reports on a routine basis:

**Office of the National Public Auditor**  
**Chuuk Sector Grant Funds**  
**Audit Report No. 2007 – 1**

Appendix III (continued)

- 2 -

April 4, 2007

Response: We agree with the recommendation and have attempted to work with DAS on an ongoing basis since inception with mixed results and will continue these efforts. Since the date of ONPA fieldwork, CFCC accounting staff has reconciled its fiscal year 2007 budget/expenditure records by sector, cost center and account number with the state's Funds Status Report through March 13, 2007. CFCC plans to reconcile its records to the state's funds status report on a quarterly basis. CFCC has not completed the FY 2006 reconciliation of its records to the state's Fund Status Report but is continuing work to complete the reconciliation.

Recommendation: CFCC should keep a summary record of salaries paid by sector, account number and cost center. The records would be complete and reconciliation would be easier.

Response: We agree with the recommendation and have begun using salary expense recorded in the Funds Status Report as the source of data for our fiscal year 2007 reconciliation. We will continue using the same data for future quarterly reconciliations.

Recommendation: DAS should provide copies of all budget reprogrammings to CFCC so they have correct and complete data to support managerial decisions.

Response: We also agree with this recommendation. During its startup period, CFCC had difficulty in obtaining new allotment advices concerning reprogramming from the Budget Office. CFCC staff have begun spending more time with Budget personnel in order to obtain new allotment advices as soon as they become available with improved results.

The finding also states that CFCC "may approve expenditures that exceed the reprogrammed authorized amount". Although this is a possibility, we believe this type of event has occurred rarely if at all because of the daily communication between CFCC staff and Treasury Funds Certification staff. Additionally, even though CFCC has had problems in obtaining new allotment advices as soon as issued by the Budget Office, copies of the new advices are normally provided as an attachment to the various procurement documents allowing CFCC to update its records at that point and before approving the expenditure.

CFCC would like to thank the Office of the National Public Auditor for its work and the foregoing recommendations. We solicit any advice that will enable us to provide a more effective and efficient service to the Chuuk State Government in monitoring the expenditure of Compact II funding.

Very truly yours,



Alan W. Burnham, CPA  
Vice Chairman

Office of the National Public Auditor  
Chuuk Sector Grant Funds  
Audit Report No. 2007 – 1

Appendix IV



Secretary of Finance  
&  
Administration

GOVERNMENT OF THE  
FEDERATED STATES OF MICRONESIA  
Department of Finance and Administration

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March 22, 2007

Haser Hainrick  
National Public Auditor  
Office of the National Public Auditor  
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Palikir, Pohnpei  
FSM 96941

Subject: Comments on Draft Inspection Report of Chuuk Sector Grant Funds

Dear Mr. Hainrick,

We have carefully reviewed the inspection draft report of the Chuuk Sector Grant Funds for Fiscal Year 2006 that your office submitted for review. We have found some discrepancies in regard to CFCC claimed allotments, and FSM total transfer amounts as they relate to the five U.S Compact sector grants of Education, Health, Capacity Building, Environment, and Private sectors.

Please see the attached *Appendix I* of the draft report that shows the differences in the corresponding rows for *Total Transfers* and the row that reflects *CFCC Allotments*. These numbers should match.

Also take note that the expenditure figures will be finalized after April 30, 2007.

Should you have any further questions, feel free to contact us.

Thank you,

A handwritten signature in black ink, appearing to read "Nick Andon".

Nick Andon  
Secretary, Department of Finance & Administration

ONPA Note: numbers in the report were updated based on this information.

**Office of the National Public Auditor  
Chuuk Sector Grant Funds  
Audit Report No. 2007 – 1**

**NATIONAL PUBLIC AUDITOR’S COMMENTS**

We wish to thank the staff at the DoF&A, CFCC, and DAS for their assistance and cooperation during the review.

In conformity with general practice, we presented our draft findings to officials from DoF&A, CFCC, and DAS. These officials generally agreed with our findings and recommendations and provided written comments, which are attached.

In addition to providing copies of this report to the President and Members of the FSM Congress, we also sent copies of this report to the DoF&A, CFCC, and DAS. We will make copies available to other interested parties upon request.

If you or your staffs have any questions regarding this report, please contact me at (691)-320-2862/2863 or [hhainrick@fsmpublicauditor.fm](mailto:hhainrick@fsmpublicauditor.fm). Contact points for our office may be found on the last page of this report. The ONPA staffs that made major contributions to this report are listed on the last page.



Haser H. Hainrick  
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April 17, 2007

**Office of the National Public Auditor  
Chuuk Sector Grant Funds  
Audit Report No. 2007 – 1**

**ONPA CONTACT AND STAFF ACKNOWLEDGEMENT**

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**ONPA CONTACT**

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---

**ACKNOWLEDGEMENTS**

In addition to the contact named above, the following staff made key contributions to this report:

Ann Walker, Audit Supervisor  
Yolanda Leben, Auditor-In-Charge  
Aisi Mori, Staff Auditor

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