

**OFFICE OF THE NATIONAL PUBLIC AUDITOR**  
**FEDERATED STATES OF MICRONESIA**

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**The FSM Trust Fund: Lack of Board's Oversight Contributed to  
Non-Compliance & Accountability Issues**

**Report No. 2015-08**



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



# FEDERATED STATES OF MICRONESIA

## Office of The National Public Auditor

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September 21, 2015

His Excellency Peter M Christian, President  
Honorable Members of the FSM Congress  
Federated States of Micronesia

### **RE: Audit of the FSM Trust Fund**

We have completed our audit of the FSM Trust Fund for period covering from inception (1999) to FY2014 and up to March 31, 2015. We conducted this audit in response to a request from the Speaker of the 18<sup>th</sup> FSM Congress in his letter dated January 29, 2015. The Speaker requested the National Public Auditor to conduct an audit of the FSM Trust Fund to ensure that all laws regarding the FSM Trust Fund were being adhered to and to account for all appropriations made to the FSM Trust Fund since its inception.

The objectives of the audit were to determine whether:

- the management and administration of the Trust Fund were performed in accordance with applicable FSM laws; and,
- all appropriations, donations, transfers, and investment earnings (losses) for the Trust Fund were accurately accounted for and reported.

Based on our audit, we found that:

- The Trust Fund lacks a Board of Trustees as required by law
- Lack of timely reporting on the Trust Fund status and operating results
- The Trust Fund lacks reconciliations
- The Trust Fund books of accounts not properly maintained
- \$10 million transferred from the General Fund to the Trust Fund without allotment as required by law

We discussed the findings with the Secretary of the Department of Finance and Administration and staff from the Division of Investment and International Finance.

Notwithstanding the above findings, we wish to acknowledge some positive actions performed by the Division personnel and the new Secretary to improve the operations of the FSM Trust Fund.

We provided copies of this report to the Secretary of the Department of Finance and Administration for her review and management response. The Secretary agreed with the audit findings and recommendations. The written response is included in this final report.

Respectfully submitted,



Haser Hainrick  
National Public Auditor

Xc: Vice President  
Secretary, Department of Finance & Administration  
Assistant Secretary, Division of Investment & International Finance

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## **INTRODUCTION**

On January 29, 2015, the then Speaker of the Eighteenth FSM Congress asked the National Public Auditor to audit the FSM Trust Fund. The Speaker asked for an audit to; (1) ensure that all laws regarding the FSM Trust Fund were being adhered to, and (2) account for all appropriations made to the Trust Fund since its inception.

### **Background**

The FSM Congress created the FSM Trust Fund in 1999 when it passed Congressional Bill No. 10-189 which later became Public Law No. 10-150. This Act is also known as the FSM Trust Fund Act. The purpose of the Act is to further amend Title 55 of the FSM Code by adding Chapter 12 for the purpose of establishing the FSM Trust Fund. The Trust Fund Act was subjected to several amendments. Congress created the Trust Fund with the following objectives;

- To contribute to the long-term financial viability of the FSM;
- To provide an additional source of revenue;
- To enhance the capacity of the National Government to receive and effectively utilize external resources in order to;
  - ✓ Assist the National Government and other participating governments to achieve greater financial autonomy in the management of their recurrent budgets;
  - ✓ Enable the FSM at all levels of government to meet long-term maintenance and operating costs of social and economic infrastructure; and,
  - ✓ Enable the FSM at all levels of government to improve existing levels of social and economic infrastructure.

The Trust Fund is governed by the applicable FSM laws and other regulations. It is to be administered by a Board of Trustees. The Board shall be composed of five trustees to be nominated by the President of the FSM with the advice and consent of the Congress for their appointment. Each trustee should serve for a term of four years or until a successor was appointed, provided that two of the five trustees on the initial Board were to be appointed for a two-year term of office. The functions of the Board include:

- obtaining, along with others contributions to the Fund;
- operation, supervision and management of the Fund; and
- investment and distribution of resources of the Fund.

There is currently no Board of Trustees, but attempt was made in the past to establish a Board. The Secretary of the Department of Finance & Administration administers some of the affairs of the Trust Fund during the absence of a Board. The Secretary should account for all transactions; keeps the accounting, financial, investment, and bank records; and should be the one to report to the President, Congress and other stakeholders concerning the operational and performance results of the Trust Fund. The law gives the Board the responsibility to appoint the Fund Custodians and Money Managers to invest the Trust Fund monies. However, because there was no Board, the Secretary did the appointment of and works with the fund custodians and the money managers. The Division of Investment and International Financing within the Department of Finance & Administration, which is headed by an Assistant Secretary, handles the day-to-day activities of the Trust Fund on behalf of and

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as per direction from the Secretary. However, there are still some required Trust Fund activities which are not performed due to the absence of a Board (more discussion on this in Finding No. 1).

Congress has been appropriating funds for the Trust Fund since 1998 and for almost every year thereafter until 2015. Total funding from Congress has reached \$57 million as of March 31, 2015 accounted for as follows:

- \$8,015,000 was transferred to the Compact Trust Fund in accordance with PL 13-48 (Table 1 item no. 5);
- \$1 million appropriated in 1999 was lapsed (Table 1 item no. 20); and
- \$48 million was deposited to the FSM Trust Fund, \$2 million of which was contributed by China (Table 1 item no. 19)

| <b>Table 1: Appropriations and Donations to the FSM Trust Fund</b>    |                               |             |               |                              |             |                      |
|---|-------------------------------|-------------|---------------|------------------------------|-------------|----------------------|
| <b>Item No.</b>   | <b>Original Appropriation</b> |             |               | <b>Amended Appropriation</b> |             |                      |
|   | <b>PL or CR No.</b>           | <b>Date</b> | <b>Amount</b> | <b>Public Law No.</b>        | <b>Date</b> | <b>Amount</b>        |
| 1   | PL 10-119                     | 8/13/1998   | \$ 2,000,000  |                              |             | \$ 2,000,000         |
| 2   | PL 12-12                      | 8/19/2001   | 2,200,000     | PL 12-21                     | 3/8/2002    | 2,015,000            |
| 3   | PL 12-50                      | 8/8/2002    | 3,000,000     |                              |             | 3,000,000            |
| 4   | PL 13-35                      | 2/19/2004   | 1,000,000     |                              |             | 1,000,000            |
| 5   | Sub-total                     |             |               |                              |             | \$ 8,015,000         |
| 6   | PL 13-46                      | 7/9/2004    | 250,000       |                              |             | 250,000              |
| 7   | PL 14-21                      | 9/30/2005   | 250,000       |                              |             | 250,000              |
| 8   | PL 14-80                      | 9/30/2006   | 500,000       | PL 15-04                     | 7/26/2007   | 1,000,000            |
| 9   | PL 15-11                      | 10/3/2007   | 1,000,000     | PL 15-26                     | 3/14/2008   | 1,500,000            |
| 10  | CR 15-88                      | 1/31/2008   | 1,000,000     |                              |             | 1,000,000            |
| 11  | PL 15-55                      | 9/30/2008   | 1,500,000     |                              |             | 1,500,000            |
| 12  | PL 16-07                      | 9/29/2009   | 1,500,000     |                              |             | 1,500,000            |
| 13  | CR 16-97                      | 5/30/2010   | 1,000,000     |                              |             | 1,000,000            |
| 14  | PL 16-43                      | 9/30/2010   | 1,000,000     |                              |             | 1,000,000            |
| 15  | PL 17-19                      | 10/3/2011   | 1,000,000     |                              |             | 1,000,000            |
| 16  | PL 17-64                      | 9/29/2012   | 1,000,000     |                              |             | 1,000,000            |
| 17  | PL 18-15                      | 9/30/2013   | 5,000,000     | PL 18-41                     | 2/18/2014   | 7,000,000            |
| 18  | PL 18-89                      | 9/29/2014   | 10,000,000    | PL 18-102                    | 1/5/2015    | 30,000,000           |
| 19  | Sub-total                     |             |               |                              |             | \$ 48,000,000        |
| 20  | PL 11-23                      | 8/27/1999   | \$ 1,000,000  |                              |             | \$ 1,000,000         |
| 21  | <b>Grand total</b>            |             |               |                              |             | <b>\$ 57,015,000</b> |
| <i>Source: Appropriation Laws and Resolutions adopted by Congress</i> |                               |             |               |                              |             |                      |

There is an appreciation in the market value of the Trust Fund as at March 31, 2015 based on the records provided to us by the FSM Division of Investment.

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| <b>Table No. 2: Market Value of the FSM Trust Fund<br/>As of March 31, 2015</b> |                  |
|---|------------------|
| <b>Description</b>  | <b>31-Mar-15</b> |
| Total Market Value of Funds with Bank Custodians                                | \$ 50,616,627    |
| Total Funding to the FSM Trust Fund   | \$ 48,000,000    |
| Unrealized Gain based on Market Value   | \$ 2,616,627     |

Basically, all of the funds for the FSM Trust Fund are currently with the bank custodians at Bank of Hawaii and at Bank of New York Mellon. The Department of Finance & Administration also administers other Trust Funds for the FSM National Government, Yap State and Pohnpei State.

**Objectives, Scope and Methodology**

Objectives

The objectives of the audit were to determine whether:

- the management and administration of the Trust Fund were performed in accordance with applicable FSM laws; and,
- all appropriations, donations, transfers, and investment earnings (losses) for the Trust Fund were accurately accounted for and reported.

Scope

The audit scope covered all Congress appropriations, all donations received, all earnings, and all transfer from the Trust Fund covering the period from inception in 1979 up to March 31, 2015 (which is our audit cut-off date).

We performed the audit fieldwork at the Division of Investment and International Finance and at the Division of the National Treasury at the Department of Finance & Administration main office in Palikir, Pohnpei. We also visited the Office of Statistics, Budget and Economic Management, Overseas Development Assistance and Compact Management (SBOC) also in Palikir.

Based on the objectives, this audit was limited to the review of compliance and accounting of the funding for the Trust Fund. As such, we did not assess if the Trust Fund achieved its target growth over the years.

We conducted this audit pursuant to the authority vested in the Public Auditor as codified under Chapter 5, Title 55 of the FSM Code, which states in part:

*“The Public Auditor shall inspect and audit transactions, accounts, books, and other financial records of every branch, department, office, agency, board, commission, bureau, and statutory authority of the National Government and of other public legal entities, including, but not limited to, States, subdivision thereof, and nonprofit organizations receiving public funds from the National Government.”*

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Methodology

We conducted this performance audit in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The audit procedures included the review of the appropriation laws and advice of allotments relating to the FSM Trust Fund. We also reviewed the fund status report, the books of accounts, and the bank statements from the fund manager/fund custodian that provided information on the accounting of the invested funds for the Trust Fund. Finally, we interviewed key staff and officials at both the Divisions of Investment and the National Treasury.

Further, we obtained and reviewed the Congressional Resolutions and other pertinent legislative documents relative to the \$2 million donations from the People's Republic of China.

We also reviewed appropriation laws and interviewed key staff regarding the \$8,015,000 transfer to the Compact Trust Fund which was approved by Congress and authorized under PL 13-48.

**Prior Audit Coverage**

This is the first audit of the FSM Trust Fund conducted by the Office of the National Public Auditor.

**Conclusion**

Based on our audit, we conclude that the Trust Fund was not administered in compliance with the requirements of the FSM Trust Fund Act. For example, we noted some issues and deficiencies regarding Trust Fund management and administration. The Board of Trustees was not created. Corporate powers and privileges were not established. The Books of accounts were not properly maintained. Annual audits and annual reports were not prepared. The Trust Fund objectives and operational targets were not set. Hence, managing the Trust Fund properly to achieve its goals and objectives were not taken on as priority.

Additionally, we conclude that the Trust Fund was not properly accounted for. For example, the funds for the FSM Trust Fund were comingled with other funds. There was a lack of reconciliation. Accounting entries were recorded yearly rather than when transactions are consummated.

Our audit disclosed some key weaknesses as follows;

- The Trust Fund lacks a Board of Trustees as required by law
- Lack of timely reporting on the Trust Fund status and operating results
- The Trust Fund lacks reconciliations
- The Trust Fund books of accounts not properly maintained

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- \$10 million transferred from the General Fund to the Trust Fund without allotment as required by law

The findings and recommendations are discussed in details in the following pages.

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## **FINDINGS AND RECOMMENDATIONS**

### **Finding No. 1: The FSM Trust Fund Lacks a Board of Trustees As Required by Law**

Title 55 of the FSM Code, Chapter 12, Section 1208 (1) requires that “The Fund shall have a Board of Trustees consisting of five trustees appointed and removable by the President of the FSM with the advice and consent of the Congress of FSM. All powers of the Fund shall be vested and exercisable by the Board.”

There is currently no Board of Trustees as required by the Enabling Law. In the past, there was an attempt to establish a Board. Presidential nomination of trustees was made. However, the legislative consent and approval was not performed. Sixteen (16) years later after the passage of the law and there is still no duly constituted Board of Trustees. On the other hand, there has not been any study to evaluate whether going forward without a Board is the option to go.

Without a Board, the Trust Fund has no governance system and lacks strategic direction. Goals and objectives were not developed. The necessary oversight roles to ensure monitoring and controlling of the Trust Fund operations were lacking. The Trust Fund growth target was not defined so there was no bench-mark against which to evaluate the Trust Fund financial performance. Without a Board, the Trust Fund was not provided with a management focus. In addition, the \$8,015,000 previously appropriated by Congress that was transferred to the Compact Trust Fund was due in part to the FSM Trust Fund not properly established, as required by law, to ensure operational effectiveness and efficiency.

Moreover, the Secretary of the Department of Finance and Administration currently performs other duties that would have otherwise been exercised by the Board of Trustees such as,

- Appointment of Fund Custodian (bank),
- Appointment of Fund Consultant and Fund Managers, and
- Authorizing the movement of funds from the Trust Fund bank account.

#### Cause and recommendation

The President and Congress are not taking action to either establish a Board of Trustees as required, or amend the law based on current, prevailing circumstances.

We recommend that the President and the Congress should establish a Board of Trustees as required, or amend the law if a Board is not needed.

### **Finding No. 2: Lack of Timely Reporting on the FSM Trust Fund Status and Operating Results**

The Secretary of the Department of Finance & Administration is required to prepare and submit annually the financial and operational reports on the Trust Fund to the President and Congress.

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The Trust Fund annual reporting to the President and Congress is not occurring.

As a result, the President and Congress lack the relevant and current information in order to make sound decisions concerning the Trust Fund.

Cause and Recommendation

The Secretary has not been prioritizing this responsibility. Annual reports and annual audits of the Trust Fund are required. It is the responsibility of the Board to appoint its auditor. Without any appointment, the annual audits have not been performed.

We recommend that the Secretary of the Department of Finance & Administration should;

- Annually submit a comprehensive status and operational reports on the Trust Fund to the President and Congress as required.
- On a regular basis, prepare and submit a composite Fund Status Report to the President and Congress highlighting at a minimum the total amount funded, earnings (losses), and the current fund balance at the end of each fiscal quarter. Thus, reconciliations should be performed monthly to facilitate the quarterly Fund Status Reports (Refer to Finding No. 3).
- Arrange for an annual audit of the Trust Fund as required.

**Finding No. 3: The Trust Fund Lacks Reconciliations**

The Trust Fund should be reconciled regularly and reported accurately to the stakeholders. Best practices dictate this and it's also consistent with the spirit of Title 55 of the FSM Code, Chapter 12, Section 1218 which requires, in part that "the Board shall cause the Fund Managers to keep all proper books and records of account of the assets, liabilities, income and expenditures and transactions of the Fund, and to produce these reports promptly in order to facilitate audit."

The Trust Fund account was not reconciled. As such, it did not provide an accurate balance of the account. The following examples illustrate the issues concerning lack of reconciliation;

Example #1

- \$2.3 million was not accounted for as part of the principal<sup>1</sup> amount of the FSM Trust Fund resulting in the understatement of the total principal amount contributed (appropriated) to the Trust Fund. The funds were either deducted from the FSM Trust Fund, or deposited in a non-FSM Trust Fund account. The details of the \$2.3 million un-reconciled amounts are as follows:
  - ✓ \$500,000 appropriated in fiscal years 2005 and 2006 was deposited into a non FSM Trust Fund account. Although the FSM Trust Fund bank account was subsequently established in 2007, the \$500,000 was not transferred under the accountability of the FSM Trust Fund account.
  - ✓ \$850,000 appropriated in fiscal year 2011 was not accounted for in the FSM Trust Fund account. This was not discovered due to lack of reconciliation.

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<sup>1</sup> Capital amount appropriated by Congress

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- ✓ \$954,298 worth of investment was deducted from the accountability of the FSM Trust Fund account, and was transferred to a non FSM Trust Fund account. The Department’s personnel acknowledged that the transfer was an error. However, this mistake has remained uncorrected. We were unable to trace whom and how the funds were returned back to the FSM Trust Fund account. Additionally, the Division personnel were unable to explain how and when the funds were accounted back to the FSM Trust Fund account.

Example #2

We found no reconciliation between the Trust Fund bank statements against the entries and amounts in the FMIS accounting system. For example, our test-reconciliation of the Trust Fund assets for two selected years showed some un-reconciled discrepancies as follows:

| Description                  | Per Trust Fund Bank Statement | Per FMIS      | Difference   |
|------------------------------|-------------------------------|---------------|--------------|
| FY2008 FSM Trust Fund Assets | \$ 3,174,763                  | \$ 3,684,665  | \$ 509,902   |
| FY2014 FSM Trust Fund Assets | \$19,419,674                  | \$ 22,532,201 | \$ 3,112,527 |

As a result, inaccurate reporting due to lack of reconciliations adversely impacts the decision making process by the key stakeholders. When errors and omissions are not timely discovered through normal reconciliations, then the risks associated with misuse of resources, use of resources for unauthorized purposes, and of making ill-advised decisions get even more pronounced.

Cause and Recommendation

Reconciliation of the Trust Fund transactions and accounts was not performed and hence it was not a priority within the Division of Investment. The necessary monitoring and controlling aspects within the division and the department itself is not getting the priority attention it so deserved.

We recommend that the Secretary of the Department of Finance & Administration should ensure that the Assistant Secretary and the Accountant within the Investment Division;

- Reconcile the Trust Fund accounts and produce accurate reports thereof regularly.

**Finding No. 4: The FSM Trust Fund’s Books of Accounts Not Properly Maintained**

The Financial Management Act mandates the maintenance of books and records for the FSM Trust Fund. FSMC Title 55 Chapter 12 Section 1218 requires that (1) the *Board shall cause the Fund managers to keep all proper books and records of account of the assets, liabilities, income and expenditures and transactions of the Fund, and to produce (report) these promptly in order to facilitate audit;* (2) *all records and reports of the Fund returns shall clearly segregate and identify gross returns, management fees and net returns;* and (3) *the books and records of the Fund shall separately account for each government’s account including the pro-rata application of expenses of the Fund.*

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Although the transactions affecting the FSM Trust Fund were being recorded in the FMIS maintained by the Department of Finance and Administration, the bookkeeping and financial reporting procedures were considered inadequate because of the following conditions:

- The accounting of the FSM Trust Fund was not separated from the General Fund as required by law. Instead, the FSM Trust Fund was accounted for as an investment account under the General Fund.
- There was no regular reporting of the basic financial statements<sup>2</sup> such as Balance Sheet, Income Statement and Cash Flow Statement to provide information on the results of operating the Trust Fund, its growth and financial position.

As a result, there was no full and accurate record, accounting and updated information of the total FSM Trust Fund for management and decision-making purposes. Also, there was no regular financial reporting which would help in determining the health of the fund and in anticipating any operational and financial issues.

### **Cause and Recommendation**

The Secretary of the Department of Finance and Administration did not ensure that separate books of accounts were maintained for the operation of the FSM Trust Fund with its own set of financial reporting requirements.

In addition, there were no accounting procedures in place to record the trust fund transactions in the FMIS. Thus, there was no consistency in the recording of the trust fund transactions.

Furthermore, the trust fund transactions were entered into the FMIS on yearly rather than on monthly basis. Thus, the FY2015 transactions were not yet recorded in the FMIS at this time.

We recommend that the Board of Trustees and the Secretary of the Department of Finance and Administration should:

- maintain separate (from the General Fund) books and accounts of the FSM Trust Fund as required by the law;
- develop and implement an accounting procedure on how to record the trust fund transactions into the FMIS; and,
- record the FSM Trust Fund transactions in the FMIS on monthly rather than on yearly basis.

### **Finding 5: \$10 million Transferred From the General Fund to the Trust Fund Without Allotment as Required by Law**

Title 55 of the FSM Code, Chapter 2, Section 215 (Financial Management Act of 1979) defines "*allotment as the delegation of authority to a person to create legally enforceable financial obligations in accordance with applicable law on behalf of the Federated States of Micronesia, within*

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<sup>2</sup> The Balance Sheet shows the accounting of the value of all assets, liabilities and equities of the Fund. The Income Statement shows the revenues and expenses generated and incurred by the Fund over a specified period of time while the Cash Flow Statement presents an analysis of all activities during the accounting period that affected cash, impacted primarily by investment.

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*specified limits set forth in an appropriation act of the Congress of the Federated States of Micronesia or as may be required by the terms of the funding available from other sources.”*

We found that \$10 million, taken from the General Fund for deposit to the FSM Trust Fund for investing purposes, was obligated and transferred in December 2014 without an approved advice of allotment. In March 2015, the Office of SBOC<sup>3</sup> subsequently approved the advice of allotment. It should be noted that this documentation was made after the fund was taken from the General Fund.

As a result, the transfer of \$10 million for the Trust Fund violated the law which prohibits the movement of funds out from the General Fund without any allotment.

#### Cause and Recommendation

According to the Division personnel, the Fund Managers were requesting the Division of Investment to transfer the fund to the bank for investing purposes. Thus, the fund was disbursed without an approved advice of allotment. Furthermore, the Secretary of Finance & Administration did not ensure that the requirement of the Financial Management Act was complied with before obligating (transferring) any money from the General Fund.

We recommend that the Secretary of Finance & Administration should observe and follow the requirement of the *Financial Management Act* that funds from the General Fund are obligated based on approved advice of allotment.

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<sup>3</sup> The authority to make allotments shall be vested in the President of the Federated States of Micronesia or his designee. The Office of SBOC was designated by the President with the authority to issue the advice of allotment.

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**MANAGEMENT RESPONSE**



Secretary of Finance  
&  
Administration

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

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September 18, 2015

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



Dear Mr. Hainrick:

We thank you for the opportunity to provide management responses to the draft audit report for the FSM National Government Trust Fund.

Firstly, may I state that the Department of Finance and Administration agree that it has not paid due attention to the FSM Trust Fund law and our responsibilities. With the recent National Congress appropriations, the Fund has grown rapidly in the last 12 months and this has seen an increased focus on the Fund and the Department has become aware of its shortcomings prior to this audit.

Additionally, we humbly request you to revisit the following statement mentioned on page 5:

**“Trust fund objectives and operational targets were not set”**. One of the main purposes of the Investment Policies is to set investment objectives and targets. The Investment Policy for the Trust Fund which was provided to your staff clearly set objectives and targets for the Trust Fund.

Overall, the Department acknowledges the Audit findings and does not challenge them. Our management action plan to address each recommendation is as follow:

**Finding No.1 – The FSM Trust Fund Lacks a Board of Trustees as Required by Law.**

**Response:** We agreed to your finding.

The Department has consulted with the President and he will be considering the merits of appointing a board or amending the law over the next couple of months. He intends to transmit his decision to Congress for their next sitting.

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September 18, 2015

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**Without a Board, the Trust Fund was not provided with management Focus. In addition, the \$8,015,000 previously appropriate by Congress that was transferred to the Compact Trust Fund was due in part to the FSM Trust Fund not properly established, as required by law, to ensure operational effectiveness and efficiency.**

**Response:** PL 13-48 section 1222 authorized the President to transfer previously appropriated funds from the Trust Fund to the FSM Compact Trust Fund. In addition, all non-compliance actions occurred due to timing of large appropriations. Please note that appropriations are based on revenue projections, not actual collections. Therefore, it is the responsibility of the Finance Department to manage cash flows. All non-compliances are not a result of unfocused management, but rather due to unavailability of resources at the time of fund transfer.

**Finding No.2 – Lack of Timely Reporting on the FSM Trust Fund Status and Operating Results**

**Response:** We concurred to this finding. Please note that the Department, under the direction of the new Secretary, has established reporting procedures requiring reporting of the FSM Trust Fund on a quarterly basis. A report was recently submitted to President and Congress covering third quarter 2015. This established reporting procedure will assist us in ensuring timely reporting of the Trust Fund status and Operating results.

This year, a report on FSM Fiscal and Economic Update was submitted to Congress along with the recommended budget. This report includes information on the FSM Trust Fund.

**Finding No.3 – The Trust Fund Lacks Reconciliations.**

**Response:** We concur to your finding, however, we need to emphasize again that reconciliations were done manually on a timely manner. This process requires staff to prepare a monthly Earning Distribution Worksheet in which we actually review and reconcile with the bank statements. Earning Distribution Worksheet is followed by preparation of NG Net Worksheets and NG Summary. Manual reconciliation was done to ensure that the following are maintained accordingly: (a) that all assets are accounted for (b) all income and expenses are accounted for (c) all deposits and withdrawals are recorded properly (d) at year end all assets reconciled and recorded accordingly.

We currently established a procedure that all transactions must be recorded in the system to chive with the manual reconciliation. All transactions must be recorded and accounted for to provide a good audit trail.

**Example #1 – 2.3million was not deposited to the Trust Fund and not reconciled with the Trust Fund balance recorded in the FMIS books of accounts by the Dept. \$500,000 appropriated in 2005&2006 was deposited into the Fund Manager's account since the FSM Trust Fund was not yet established. Although the FSM Trust Fund bank account was subsequently established in 2007, the 500,000 continued to remain with the Fund**

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**manager's account but not moved to the Trust Fund bank account even though it had already been established.**

**Response:** The Fund Manager (Atalanta Sosnoff) was the Trust Fund's manager when the FSM Trust fund was created by law. The \$500,000 was maintained in the account with Atalanta Sosnoff and was not transferred timely. However, the money was transferred and was in fact part of the investment account. We will ensure that these weaknesses will not happen again.

**\$850,000 appropriated in fy2011 was not accounted for in the Trust Fund. This was not discovered due to absence of reconciliation.**

**Response:** We did not agree to the statement that the \$ 850,000 was not accounted for in the Trust Fund with no further clarification. This kind of statement is misleading. We recommend that this statement be restated as follow: " \$ 850,000 appropriated in FY 2011 was not transferred into the FSM Trust Fund in a timely manner ". Again, we recommend your statement to be rephrased as we believe it is misleading to the general public.

**\$954,298 was transferred from the Trust Fund account and deposited to the National Government's Trust Fund. The department's personnel acknowledged that the transfer was an error. However, this mistake has remained uncorrected.**

**Response:** We agreed to the finding, however, we need to emphasize that this is a non cash contribution and this was an error that was detected later. This error has already been corrected when the fund was transferred to Whilshire.

**Finding No.4 – The FSM Trust Fund's Books of Accounts Not Properly Maintained**

**Response:** We did not fully agree to this finding, because there are subsidiary ledgers set up to maintain the account manually. The currently established procedure is that all investment accounts will be maintained accordingly and reconciled on a monthly basis. All supporting documents for the movement of the fund must be filed accordingly.

**Finding No.5 - \$10 million transferred from the General Fund to the Trust Fund without allotment as required by law. According to the Investment Accountant, the Fund Managers were requesting the Division of Investment to transfer the fund to the bank for investing purposes.**

**Response:** We have established a procedure to ensure that no transfer of funds shall be made in the absence of an allotment advice, as required by law. All subsequent transfers have been done in compliance with the law.

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We thank you for the opportunity to respond to the audit and we hope that our management plan provided you will satisfy all that we are addressing our previous shortfalls in the operation and management of the FSM Trust Fund.

Sincerely,

  
Eugene Amor  
Acting Secretary

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## ONPA EVALUATION OF MANAGEMENT RESPONSE

We requested for a management response from the Secretary of Finance and Administration. The management response generally agreed with findings and recommendations in the report. However, we would like to clarify some statements made in the management response as follows:

Management Response: “.....*Trust fund objectives and operational targets were not set. One of the main purposes of the investment policies is to set investment objectives and targets. The Investment Policy for the Trust Fund which was provided to your staff clearly set objectives and targets for the Trust Fund.*”

ONPA Comments: We would like to point out that the objectives for the Investment Policy are different from the objectives for the FSM Trust Fund. The Investment Policy serves as the guidelines that reflect the FSM's philosophy regarding the investment of the Fund assets and was intended as a stringent yet flexible framework to guide the investment managers toward the performance desired. On the other hand, the Enabling Law specified the objectives of the FSM Trust Fund which the Board should ensure their accomplishment through its management of the Fund. These objectives are as follows:

- To contribute to the long-term financial viability of the FSM;
- To provide an additional source of revenue;
- To enhance the capacity of the National Government to receive and effectively utilize external resources in order to;
  - ✓ Assist the National Government and other participating governments to achieve greater financial autonomy in the management of their recurrent budgets;
  - ✓ Enable the FSM at all levels of government to meet long-term maintenance and operating costs of social and economic infrastructure; and,
  - ✓ Enable the FSM at all levels of government to improve existing levels of social and economic infrastructure.

The performance measures for the FSM Trust Fund objectives and operational targets were not set and therefore not met.

Finding 3: The Trust Fund Lacks Reconciliation:

**A. \$500,000 was deposited into another trust fund (non FSM Trust Fund) account managed by the Investment Division**

- Management Response: “...*The \$500,000 was maintained in the account with Atalanta Sosnoff (Fund Manager) not transferred timely. However, the money was transferred and was in fact part of the investment account. We will ensure that these weaknesses will not happen again.*”

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ONPA Comments: During the audit fieldwork and, later, during the discussion of the draft audit report (exit conference), the ONPA requested for evidence showing the transfer of \$500,000 to the assets held by the FSM Trust Fund custodian but such evidence was not provided.

#### **B. \$850,000 appropriated in FY2011 but not accounted for as part of the FSM Trust Fund**

- Management Response: *“...we did not agree to the statement that the \$850,000 was not accounted for in the Trust Fund with no further clarification. This kind of statement is misleading. We recommend that this statement is restated as follows: “\$850,000 appropriated in FY 2011 was not transferred into the FSM Trust Fund in a timely manner.” Again, we recommend your statement to be rephrased as we believe it is misleading to the general public.”*

ONPA Comments: The ONPA was able to establish, from the trust fund bank account statement, that the \$850,000 appropriated in FY2011 was not deposited to become part of the assets held by the fund custodian. During the audit fieldwork and, later, during the discussion of the draft audit report (exit conference), the ONPA requested for reconciliation and evidence showing the deposit and accounting of \$850,000 to the assets held by the FSM Trust Fund Custodian but such reconciliation and evidence were not provided.

#### **C. \$954,298 that was transferred from the FSM Trust Account to another trust account**

- Management Response: *“... we agreed to the finding, however, we need to emphasize that this is a non-cash contribution and this was an error that was detected later. This error has already been corrected when the fund was transferred to Wilshire.*

ONPA Comments: The ONPA was able to establish that on 3/31/2013, an investment (units and equivalent market value) was deducted from the assets of the FSM Trust Fund and transferred to another trust fund (non FSM Trust Fund) managed by the Investment Division. Then, in January 2015, all the assets of the FSM Trust Fund were sold, converted to cash and reinvested by the new consultant (Wilshire). The sale did not include the units transferred to another trust fund (non FSM Trust Fund). During the audit fieldwork and, later, during the discussion of the draft audit report (exit conference), the ONPA requested for evidence on how the \$954,298 was returned back to the assets held by the FSM Trust Fund custodian but such evidence was not provided.

#### **Finding 4: The FSM Trust Fund's Books of Accounts Not Properly Maintained**

Management Response: *“We did not fully agree to this finding, because there are subsidiary ledgers set up to maintain the account manually. The currently established procedures are that all investment accounts will be maintained accordingly*

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*and reconciled on a monthly basis. All supporting documents for the movement of the fund must be filed accordingly.”*

ONPA Comments: We reiterate the findings in the audit report that the bookkeeping and financial reporting procedures were not properly maintained and considered inadequate based on the following:

1. The FSM Trust Fund did not have its own set of separate financial statements (i.e. Balance Sheet, Statement of Revenue and Expenditures)
2. The fund transactions were not recorded timely in the FMIS (note: the books of accounts for the fund were created in the FMIS). We noted that the Fund transactions were recorded on an annual basis rather than on regular basis (i.e. monthly).
3. The chart of accounts maintained for the FSM Trust Fund in the general ledger did not allow proper preparation of the financial statements of the Fund as required by law. The accounts created in the system contained similar nature of account titles that could cause confusion when recording the Fund transactions.
4. There was no regular reconciliation statements maintained.
5. The recording of the Trust Fund transactions in the FMIS requires special handling because only certain movements or changes in the composition of the Trust Fund based on the Trust Fund bank account statement have to be recorded in the FMIS. We also noted that the withdrawals in form of cash or investment (units) that were taken out of the custody of the Trust Fund custodian were not recorded in the FMIS for purposes of tracking and reconciling the Trust Fund assets.

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**NATIONAL PUBLIC AUDITOR COMMENTS**

We would like to thank the management and staff of the Department of Finance and Administration for their assistance and cooperation during the course of the audit.

We have provided copies of the final audit report to the President and members of the FSM Congress for their use and information. Furthermore, we will make copies available to other interested parties upon request.

If there any questions or concerns regarding this report, please do not hesitate to contact our Office. Contact information for the Office can be found on the last page of this report along with the National Public Auditor and staff that made major contributions to this report.



Haser H. Hainrick  
National Public Auditor

September 21, 2015

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**ONPA CONTACT AND STAFF ACKNOWLEDGEMENTS**

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

Manuel San Jose, Jr. CPA, CGAP, CIA, CISA, CRMA, Audit Manager  
Keller Phillip, Auditor-In-Charge  
Dane William, Staff Auditor

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