

**OFFICE OF THE CHUUK STATE PUBLIC AUDITOR
CHUUK STATE, FSM**



Debt Relief Fund Payable: The Total Claims Payable to the Citizens Amounted to \$16 Million. \$7 Million of which not Booked and Significant Amount Reached the Statutory Limitation Within Which to Claim Court Judgement Against the State

FISCAL YEAR 2019-2021

AUDIT REPORT NO. 2022-03



**Manuel L. San Jose Jr.
Public Auditor**

Office of the Chuuk State Public Auditor
Audit Report 2022-03



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October 19, 2022

Honorable Alexander Narruhn
Governor, Chuuk State
Federated States of Micronesia

Honorable Arno Kony
President
House of Senate
Chuuk State Legislature

Honorable Lester D. Mersai
Speaker
House of Representatives
Chuuk State Legislature

RE: Follow-up Audit on Debt Relief Fund

We completed a follow-audit on Debt Relief Fund which was last audited in 2019. The follow up audit was conducted in accordance with the auditing standards for performance audit following the U.S. Generally Accepted Auditing Standards (GAGAS). The purpose of this audit was to determine whether the Department of Administrative Services and the Debt Relief Task Force had implemented corrective actions to address the findings and recommendations disclosed in the Audit Report 2019-02 issued on February 27, 2020.

Based on our follow up audit, we conclude that the Debt Relief Task Force did not completely take corrective actions to address ALL audit findings and recommendations from the previous audit report No. 2019-02. The details of such audit findings and recommendations can be found in Appendix A of this report. We noted though that the details of payable balances are now established based on court decision documents. The total amount that was newly established is \$8,770,378.98 which was lower than the \$13,242,002.87 that was reported in the previous audit report. However, these payables remained unrecorded in the books and not recognized in the financial statement for the Chuuk State government.

In another matter that was found during the follow up audit, we noted that in addition to the above payable, the Department of Administrative Services (Finance) has classified a related and recorded payable in the books for 'Land Acquisition Payable' amounting to \$8,564,795 under current liability in the financial statement. We questioned the classification for this payable under current liability, which is a liability that must have been paid in one year, because it did not actually reflect the financial position of the government with regard to current liability. The Chuuk State Government had actual control of the payment for this payable because the payment for the year is being limited by the Legislative appropriation, so, not all this liability is due and demandable within one year. These payables were originally part of the 2007 Financial Reform MOU under debt relief fund. An analysis of the movements of this payable for the last ten years based on audited financial statements

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revealed that there were minimal payments made in FY14 for \$53,750 and in FY18 for \$48,000. In addition to the unpaid and unrecorded judgment claims pointed out in Finding 1 amounting to \$7,945,725.13, the total payable, by the Chuuk State Government to citizens' claims, would amount to \$16,510,520. The current assets are the assets of the government that should easily be converted to cash to pay for current liabilities. In our analysis, the total \$16 million payable to citizen's claim represents 158% excess of the current assets (\$6 million, net of the restricted current assets) of the Chuuk State government and significant 30% of the total the Chuuk State government assets (\$54 million, net of the total restricted assets) at end of fiscal year September 30, 2020. This indicates a very poor financial position and cash solvency problem (ability to generate enough cash from the current assets to pay due obligation).

During the follow up audit, the auditor became aware of the Chuuk State law that limits the period of time an action could be initiated against the state. This law prescribed the period of time within which a cause of action could be enforced against the state. The law states that the cause of action shall be commenced within the prescribed time from the day that the cause of action arises. Section 9 of CSL No. 5-01-39 (Date Approved- 1/25/2001) limits the following actions: 1) an action upon a judgment, or (2) an action for the recovery of land or interest therein, to **20 years**. Section 10 provides limitation of **two years** for the actions specified in the section and Section 11 provides a limitation of **six years** for all other actions. Thus, of the \$16,510,520 total payable to the citizen's claim, the recovery of some claims from the state may have lapsed already due to the statutory limitation for action to collect against the state. The OCPA believes that further policy be provided by the Legislature for the payables reaching or that would reach the statutory limitation.

We discussed the contents of this report during the exit conference and later requested a formal management response on this audit both from the Director of Administrative Services and the Chairman of the Debt Relief Task Force. We received a formal management response from the Director of Administrative Services but did not receive from the Chairman of the Debt Relief Task Force. The response is attached to this report under the section for 'Management Response.' The Chairman of the Debt Relief Task Force verbally informed us that the task force agrees with the response of the DAS. The OCPA's evaluation of management response was indicated in the related section.

Sincerely,



Manuel L. San Jose Jr., CPA, CIA, CISA, CGAP, CRMA, CFIP
Public Auditor
Office of the Chuuk State Public Auditor
Federated States of Micronesia

**Office of the Chuuk State Public Auditor
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INTRODUCTION

Reason for Audit: The Office of the Chuuk State Public Auditor (OCPA) shall ensure that recommendations made to Department/Agency officials are adequately considered and appropriately addressed. It is through the implementation of recommended improvements that the OCPA could ensure that it is contributing value added services for the benefits of the citizens.

Background

Chuuk State Law on Debt Relief Fund

At the creation of the Debt Relief Task Force, the existing debt as of 2007 was approximately \$46 million: \$4 million short-term; \$7.6 million medium-term; and \$34.4 million long-term per Memorandum of Understanding between the FSM National Government and the Chuuk State Government. These payables include land leases, land purchases, and court judgments, among others.

The purpose of the Debt Relief law is to retire all or portion of the existing debts payable to citizens as creditors of the government. Sections 1 to 8 of the Chuuk State Law No. 9-07-09 (Date Approved-11/27/2007) provide the legal framework for the establishment of the Debt Relief of the Fund. Section 1 of the law states that “...*the purpose of this Act is to create and establish by law a Fund in the Treasury of the State in which appropriations intended to retire all or portion of the existing debts of the state including funds which may be gotten from portion of taxes earmarked as additional funds to supplement and finance the intent and purpose of this Act and all financial assistances received from outside the state which are intended to assist Chuuk State reform efforts...*”

Section 2 states that ... “*there is hereby created and established a Debt Relief Fund in the Treasury of the Chuuk State Government in the Department of Administrative Services which shall be accounted for separately from the General Fund...*”

Section 4 of the law specified the accounting and uses of fund. It states that ... “*the Head of the Department of Administrative Services shall establish an account in the Chuuk’s Branch of the*

Bank of the Federated States of Micronesia for the Fund established and created under this Act. All funds appropriated into and earmarked for deposit into the fund from any and all sources shall be deposited into such account and shall remain in such Fund in the Treasury of the State. The Legislature shall appropriate such sum or sums from the Fund solely for verified and lawful debts of the state as determined by the Joint State Government Restructuring Task Force (Task Force)...

Section 5 of the law states that “...monies in this Fund shall be utilized solely for retiring all verified, valid, and lawful debts of the State which debts are categorized as short-term, mid-term, and long-term debts.” Also, Section 5 of the law states that “...the funds in the account of the Fund shall never be subject to any decree by the Governor, except as may subsequently be authorized by Acts of the Legislature...”

Administrator of Debt Relief Fund

Section 5 [CSL 09-07-09 amended by CSL 15-19-06 (10/7/2019) ACT No 15-05] of the law provides for the creation of Task Force who shall administer the Debt Relief Fund. The Task force was created on November 27, 2007. The current four members of the debt relief task force are as follows:

Member	Remarks
Four Members	
1. <u>One</u> Representative from State Supreme Court (the Director of Administration or his designee)	Effective July 26, 2021, Former First Lady, Bersita Elimo, Director of Administration, Chuuk State Supreme Court
2. <u>Two</u> Representatives from the Executive Branch	Effective membership on October 10, 2019, both members from Department of Administrative Services: Chief of Finance (Vice Chairman, Roxalyn Kaminanga) and Chief of Budget Office (Linda Maipi)
3. <u>One</u> Representative from the Legislative Branch Jointly appointed by the President and the Speaker	Effective membership on October 10, 2019, Perez Graham (Chairman, Chief of Budget Office, Chuuk State Legislature) was appointed.

The Task Force shall have the authority and power to establish a priority of payments of the existing debts or obligations of the State, taking into account the priorities established pursuant

to law and as provided in the Memorandum of Understanding executed on July 19, 2007 between the President of the Federated States of Micronesia and the Governor of Chuuk State.

The Task Force shall be responsible for receiving, reviewing, and processing of claims. It shall also circulate payment requests. The process consists of the following steps:

- 1) The Task Force collects, verifies and examines the documents supporting the claims for validity and legality;
- 2) The Task Force finalizes a list based on the examined claim documents and requests for payment;
- 3) The Chuuk State Legislature appropriates funds into the Debt Relief Fund for payables under Debt Relief Fund;
- 4) The Director of Department Administrative Services (DAS) pre-approves payment request for processing; Reconciliation and Funds Division Section reviews and certifies the payment request. Then, Director DAS approves obligations and payment is made;
- 5) The claimants collect their checks from the Chuuk State Department of Treasury.

Reporting

Section 6 of the CSL 09-07-09 specifies the reporting requirement for the fund. It states that *"...the Director of the Department of Administrative Services shall, within five days after the end of each quarter, provide a quarterly report on the status of monies in the Fund to the Governor and Legislature and the Task Force. The Task Force shall endeavor to provide quarterly reports to the Governor and Legislature on the balance of the monies in the Fund and as to how much of the existing state debt obligations have been retired, and provide in such report the balances of the state debt to date..."*

Writ of Garnishment

To collect the past-due government debts, some creditors went to the court through their lawyers to obtain garnishment orders. As a result, the court directed the FSM Secretary of Finance and Administration (national government) to pay creditors. We confirmed from the court the writ of garnishments that were issued.

In fiscal years 2020 and 2021, the creditors presented the writ of garnishment issued by the ‘Supreme Court of the Federated States of Micronesia Trial Division – State of Chuuk’ to the FSM National Secretary of Finance and Administration. To pay these creditors, the following activities were done:

1. The FSM National Secretary of Finance and Administration instructed the national finance to deduct the amounts from the state revenue share which the Chuuk State should be receiving from the national government and directly pay the creditors for the garnishment order from the court.
2. The FSM National Finance sent notices of deductions (thru email) to the Chuuk State Finance to support the amounts deducted from the state revenue share.
3. The Chuuk State Finance (c/o Tax and Revenue Section) then prepared the Official Receipt (OR) to record the receipt of revenue share from the FSM National Finance. The deductions made by FSM National Finance for paying the garnishment order were reflected as negative amount in the OR.
4. The Chuuk State Accounting recorded the payments for garnishment in the Chuuk State government books through journal entries

However, the garnishment order was later discontinued upon the complaint of the Chuuk State Legislature.

Related to the garnishment of funds/other assets and payment of judgment against the state, both the FSM National Congress and the Chuuk State Legislature have existing laws (Source: Chuuk State Office of the Attorney General):

FSM National Congress

Law	Effective Date	Specific Provision
PL 10-142	1999	Section 707- <i>“Garnishment of Funds or Other Assets Owed by the National Government to a State.”</i> <i>“The National Government of the Federated States of Micronesia shall not be subject to writ of garnishment or</i>

Law	Effective Date	Specific Provision
		<i>either judicial process to apply funds or other assets owed by it to a state of the Federated States of Micronesia to satisfy an obligation of the State to a third person. Nothing herein shall imply that authority exists to issue a writ of garnishment or other process against the National Government in any circumstance."</i>
PL No. 22-33	8/23/2021	Amendment to Public law No. 10-142 enacted 6 F.S.M.C 1405. Section 707 – <i>"Garnishment of funds or other assets belonging to or owed to a state that are under the custody or control of the National Government is prohibited. A department or entity of the National Government of the Federated States of Micronesia shall under no circumstances be subject to writ of garnishment or other judicial process to apply funds or other assets that are in the custody or control of the department or entity, if such funds or other assets belong to or are owed to a state of the Federated States of Micronesia, to satisfy an obligation of the State to a third person. This prohibition includes funds and assets that would be garnished to satisfy an obligation of the state resulting from a cause of action expressly conferred by the national statute."</i>

Chuuk State Legislature

Law	Effective Date	Specific Provision
CSL No 5-01-39	1/25/2001	Section 17 specified that <u>'the money judgments against the State of Chuuk pursuant to this act shall be paid from funds as may be appropriated by the Chuuk State Legislature or the Congress of the Federated States of Micronesia, but in no event shall un-appropriated funds or funds appropriated for another purpose be used to satisfy a money judgment under this act.'</u>

In the Writ of Garnishment Order of the Supreme Court of the Federated States of Micronesia Trial Division-State of Chuuk, the court directed the FSM Secretary of Finance and Administration to pay the plaintiffs (creditors) explaining that a judgment was entered and *because the judgment was one based on a civil rights claims, it must be paid. (Chuuk v Davis, 13 FSM R. 178, 186 (App.2005). Furthermore, the Writ of Garnishment indicated that the parties have stipulated to an Order in Aid of Judgment, in which the parties agreed that the*

defendant State of Chuuk would make payments to the plaintiffs and the State of Chuuk has consented to a writ of garnishment.

The following payments were made to 15 creditors during the two-year period.

Table A – Payable Paid by Way of Writ of Garnishment				Audit Comment
Creditor	Payments		Total	
	2020	2021		
Mak Osaki	\$ 40,000.00	\$ 40,000.00	\$ 80,000.00	
Anthony Akuo		60,000.00	60,000.00	
Solomon M. Saimon (for the claim of Rosalinda Alafanso)		50,000.00	50,000.00	No attached Writ of Garnishment (Note: Writ of Garnishment was subsequently presented by the Chuuk State DAS on 10/17/22 after this report was finalized)
Rosalinda Alafanso	50,000.00		50,000.00	
Saan Soel and Family		45,000.00	45,000.00	
Ref CRJ # 368037 (Later identified by the DAS on 10/17/22 comprising various creditors)	31,559.99		31,559.99	No attached Writ of Garnishment (Note: Writ of Garnishment was subsequently presented by the Chuuk State DAS on 10/17/22 after this report was finalized)
CRJ # 373245 (Later identified by the DAS on 10/17/22 as John Engichy)	16,000.00		16,000.00	No attached Writ of Garnishment (Note: Writ of Garnishment was subsequently presented by the Chuuk State DAS on 10/17/22 after this report was finalized)
Ref: CRJ#353260 (Later identified by the DAS on 10/17/22 as Joakim Kaminanga)	10,000.00		10,000.00	No attached Writ of Garnishment (Note: Writ of Garnishment was subsequently presented by the Chuuk State DAS on 10/17/22 after this report was finalized)
Foustino Stephen		10,000.00	10,000.00	
Rutino Miochy		10,000.00	10,000.00	
Ersin Ruben & Moria Ruben	5,000.00	20,000.00	25,000.00	
Joakim Kaminanga		10,000.00	10,000.00	
Francis Santiago		2,505.60	2,505.60	
Edimun Hartman		2,431.50	2,431.50	
Mannix Marcus		7,419.36	7,419.36	
Total	\$ 152,559.99	\$ 257,356.46	\$ 409,916.45	
No attached Writ of Garnishment - \$107,559.49				
No indicated Names of Creditors- \$57,559.99				

Objectives, Scope and Methodology

Objective

The objective of this audit was to follow up the corrective actions taken by the Debt Relief Task Force to address the audit findings and recommendations on audit of Debt Relief Fund per audit report 2019-02.

Scope

This review covered the transactions in Debt Relief Fund from FY 2019 to FY 2022. The audit was conducted pursuant to Article VIII Section 9 of the Chuuk State Constitution and TSL 6-21 which states in part: *“The Auditor shall conduct audits of all financial transactions of all branches, departments, offices, agencies and instrumentalities of the government, and of all accounts kept by or for them.”*

Methodology

We conducted this performance audit in accordance with the Generally Accepted Government Auditing Standards (GAGAS) 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 on our audit objectives.

To determine the action taken as regards to the recommendations in the prior report, we reviewed the transactions and documents related to debt relief fund payments. We also interviewed the concerned officials to confirm the actions taken to implement the audit recommendations. Finally, we reviewed the laws related to payables of the state.

Related Prior Audit

This is a follow-up on audit report No. 2019-02 that was issued on February 27, 2020. Also, the Deloitte (external auditor) has been conducting an audit of the financial statement of the Chuuk State government which includes an audit of payables. The financial audit that was last conducted was for FY September 30, 2020 in which the report was issued on December 31, 2021. The audit opinion on the financial statement was qualified (not a clean opinion) due to unrecorded liability for land leases and related claims payable, which was the subject of this

audit. The Deloitte stated in its audit report that the liabilities for the said leases and judgments claims were undeterminable due to incomplete records.

Conclusion

Based on our follow up audit, we conclude that the Debt Relief Task Force lacked the necessary actions to implement the corrective actions to address all audit findings and recommendations from the previous audit report No. 2019-02.

FINDING AND RECOMMENDATION

Finding 1 – The Debt Relief Task Force did not take corrective actions to address all the audit findings and recommendations from the previous audit report No. 2019-02

An appropriate and timely implementation of audit recommendations agreed by management is an important part of realizing the full benefit of an audit to the citizens most especially in this follow up audit in which the subject matter concerns with debts payable to citizens as the creditors of the government.

Chuuk State law provides the statutory limitation within that period the action against the state may be brought or enforced. Section 9 of CSL No. 5-01-39 (Date Approved- 1/25/2001) limits the following actions: 1) an action upon a judgment, or (2) an action for the recovery of land or interest therein, to **20 years**. Section 10 provides limitation of **two years** for the actions specified in the section and Section 11 provides a limitation of **six years** for all other actions.

We reviewed the actions taken by the Debt Relief Task Force with respect to the audit findings and recommendations per audit report No. 2019-02 issued on February 27, 2020. The details of such audit recommendations can be found in Appendix A of this report. Compared to the previous audit, we noted that the details of payable balances were now established based on court decision documents. The established details amounted to \$8,770,378.98 which was lower than the \$13,242,002.87 (court judgments and claims) reported in the previous audit report. However, this payable remained unrecorded in the books. The types of debt established by the Debt Relief Task Force based on court decisions were as follows:

Types of Debts	Claimants	Amount
Court Judgment for Salary Issues (Dept of Agriculture)	261	\$ 568,313.78
Court Judgment for Salary Issues (Cost of Living Allowance COLA)	2,382	1,434,715.00
Court Judgment for Employee Related Issues	37	686,524.06
Court Judgment for Land Related Issues	88	3,978,614.15
Land Lease/Settlements/Land Purchase	86	2,102,211.90
Total		\$ 8,770,378.98
Source- Debt Relief Task Force		
Less: Payments in 2020 and 2021 (Appendix B)		824,653.85
Net Payable		\$ 7,945,725.13

During the fiscal years 2019 to 2021, the Chuuk Finance paid a total of \$ 824,653.85 using the debt relief fund and the revenue share from the FSM National Government. Of this amount, \$414,737.40 was paid using the Debt Relief Fund and \$409,916.45 was payment from writ of garnishment using the Chuuk State share of revenue from the FSM National government. These payments were charged to Debt Relief Expenses. The details of payment caused by writ of garnishment are shown in Table A – Payable Paid by Way of Writ of Garnishment (page 4 of this report). On the other hand, the details of payable that were paid using the Debt Relief Fund were indicated below:

Date of Judgment	Nature	Checks Issued		Unclaimed/Stale Checks		Net Paid	
		Claimants	Amount	Claimants	Amount	Claimants	Amount
4/18/2005	Court Judgment for Salary Issues-Cost of Living Allowance (COLA)	2,389	\$256,356.00	254	\$29,270.00	2,135	\$ 227,086.00
4/18/2005	Court Judgment for Salary Issues-Dept of Agriculture	231	85,731.09	11	4,442.70	220	81,288.39
Various	Court Judgment- Others- Settlement, Land & Salary	163	109,820.20	3	957.18	160	108,863.02
	Total	2,783	\$451,907.29	268	\$34,669.88	2,515	\$417,237.41

Source: OCPA Prepared Analysis from Transaction Documents

It should be noted that for payments of employees' claim on Cost of Living Allowance (COLA) above, the DAS issued checks with small amounts which were either \$99 or \$120 to 2,389 claimants or (checks). Of these checks, 254 checks worth \$29,270 became stale checks (not presented to the bank within six months); thus, the cash was restored back to the Debt Relief Fund. This indicated that there was no survey conducted whether the creditors still exist before preparing the checks.

The following audit recommendations in the previous report related to management of payables were not acted upon:

1. Strictly stick to budgeting and come up with target payment plan and schedule to ensure the regular payment of debt. (In the future, unpaid expenses caused by departments should be shouldered by other contingency account or by Legislative appropriations for each department's accounts payables).

2. Establish good relationship with creditors to be able to always re-negotiate a reasonable payment schedule and payment terms based on availability of expendable resources.
3. Examine the suggested possible revenue sourcing activities and request appropriate authority, if needed, to implement those activities not yet implemented.
4. Recognize the (\$13 million court judgments and claims)) payable in the books of accounts on the basis of the Supreme Court decisions and reflect them in the yearly financial statements to make the payable of the Chuuk Government transparent to public.

During the follow up audit, the auditor became aware of a Chuuk State law that limits the period of time an action could be initiated against the state. A law prescribed the period of time within which a cause of action could be enforced against the state. The law states that the cause of action shall be commenced within the prescribed time from the day that the cause of action arises. Section 9 of CSL No. 5-01-39 (Date Approved- 1/25/2001) limits the following actions: 1) an action upon a judgment, or (2) an action for the recovery of land or interest therein, to **20 years**. Section 10 provides limitation of **two years** for the actions specified in the section and Section 11 provides a limitation of **six years** for all other actions.

From the review of details supporting the \$8,770,378.98 un-booked payables for court judgments and claims, we noted that significant payables passed the prescribed period of time within which a cause of action could be enforced against the state. Based on the spread sheet listing of payables provided to auditor by the DAS, the court cases on many accounts were decided during the 1990s, and 2000s. These dates were beyond the prescription period within which a cause of action could be enforced against the state and therefore, the Chuuk State government appears seized to be liable for the amount due towards the payable.

The unrecorded liability for land leases and related claims payable resulted in the long years of qualification of opinion (unclean opinion) in the audited financial statement from the external auditor. This opinion means that the financial statements may not be reliable as they could be. The preferred auditor's opinion is unqualified opinion (clean opinion).

It appears that some liabilities of the Chuuk State government could be de-recognized due to statutory time prescription for the recovery of claims from the state.

Cause and Recommendations

There was lack of determination on the part of the Department of Administrative Services to resolve the issue on the recording of payables on the basis of court judgment. There has been qualified opinion in the financial statement for long years due to these unrecorded payables in the books.

Further, we noted that there was no study or consultation whether the time within which the action against the state for the payments of these payables had already reached the statutory limitation.

Recommendation

1. We reiterate our previous audit recommendation indicated in the Appendix A of this report.
2. We also recommend that the Director of Department of Administrative Services & the Debt Relief Task Force should look into these long outstanding payable with the objective of seeing whether they need to be recorded in the books to promote clean auditor's opinion in the financial statement.
3. We also recommend that the Director of Department of Administrative Services should obtain an opinion from the Office of the Attorney General whether these claims against the Chuuk State could still be enforced considering the statutory time limitation within which to claim a court judgement against the State.
4. We recommend that the Legislature should provide a clear policy guideline on disposition of these payables especially those valid and fully substantiated payables that reached the prescribed period without the fault of the creditors.

Finding 2 – Four payments amounting to \$107,559.49 described as garnished amount was not supported by Writ of Garnishment on file. No names were indicated on three payments amounting to \$57,559.99

The Chuuk State Financial Management Regulations require that an obligation of the Chuuk Government shall be supported by valid documentary evidence and/or any other transaction details.

Based on review of the documents at the Chuuk State Department Administrative Services which were attached to support the garnishment transactions, we noted that four payments amounting to \$107,559.49 described as garnished amount deducted from the revenue share was merely supported by an email to describe the transactions and was not supported by Writ of Garnishment. Of this amount, no names were indicated in the transactions for three payments amounting to \$57,559.99. During the fieldwork, we requested the DAS (especially the Tax and Revenue Section) to provide the auditor with such documents to establish the validity of payments but they were not provided. When requested for garnishment document, the Tax and Revenue Supervisor, who prepared the official receipt for the receipt of revenue share with deductions for writ of garnishment, informed us that he has no such document. There were no consistent supporting documents for the transactions involving garnishment. Some have attached garnishment documents and some did not have attachments.

Improper deduction could have been made from the revenue share of the Chuuk State government. The money could be lost through invalid, improper or illegal payments.

Cause and Recommendation

The Tax and Revenue Division did not require identification of creditors and presentation of Writ of Garnishment when the 'Official Receipt' for the collection of revenue share was prepared for the collection that included a deduction for garnished amount. In addition, the Accounting Section did not require identification and presentation of the 'Writ of Garnishment' when the transactions were recorded in the books.

We recommend that the Director of the Department of Administrative Services should require the proper documentation of the transactions to establish their validity and to check whether the the payments made (through garnishment) were for valid creditors. If they were found to be invalid payments, the amount should be collected back from the FSM National Finance.

Management Response - It appears that the Office of Chuuk State Public Auditor did not spend appropriate time or apply alternative audit procedures to obtain the supporting documents (i.e. contacting the right Officer from the FSM National Department of Finance and Administration). However, DAS has a copy of Writ of Garnishment for the indicted amount and has a ledger stating the names.

OCPA Assessment of Management Response - We maintain that the official receipts and the journal vouchers when prepared by the Chuuk State Department Administrative Services were not properly supported by documentary evidence. This was borne by the actual examination of the documents that were attached to the Official Receipts as well as the Journal Vouchers. We don't need to do the alternative audit procedure because the document should have been provided to auditor by the Chuuk State Department Administrative Services when they were requested. The Tax Revenue Supervisor who prepared the corresponding Official Receipt to recognize the deduction of the amounts from revenue share even formally confirmed to the auditor that there was no writ of garnishment document on his file. Furthermore, we went to the FSM National Supreme Court field Office at Chuuk State to get copies of the writ of garnishment and the court did not have some copies. Furthermore, we inquired twice from the FSM National Finance Field Office At Chuuk State about the copies of missing garnishment documents but they were not of help. Lastly, we discussed the finding with the Debt Relief Task Force Committee on September 14, 2022 during the exit conference and had requested for the documents until the final report for management response was issued on September 26, 2022. It was very clear that the auditor took time and effort and coordinated to get the requested documents.

Thus, we are retaining the finding because it is a weak internal control without seeing the supporting documentary evidence when recording a payment made.

Finding 3- 'Land Acquisition Payable' classified under the 'Current Liability' in the Financial Statement for \$8,564,795 has no movement since 2018 or for five years

Under the generally accepted principles, current liability is an obligation that is due and payable within one year. Liabilities can be broadly categorized as current and non-current liabilities. Liabilities that are payable in a duration of less than a year are referred to as current while those that are payable in a duration of more than a year are referred to as non-current. The distinction between non-current and current liabilities is of much importance to both creditors as well as to other stakeholders such as employees, creditors, vendors and others. The classification of liabilities plays a vital role in the construction of financial ratios and also in determining the long-term solvency and short-term liquidity of an organization. Organizations use these classifications to identify their current liabilities that are due in the near future so that strategies could be adopted that will assist in resolving them through operating cash flows, current assets or additional financing. This enables organization to avoid financial crises such as liquidity shortages that may subsequently impact payment of vendors, creditors, wages and default on debts.

Chuuk State provides a statutory time limitation period within which an action against the state may be brought or enforced. Section 9 of CSL No. 5-01-39 (Date Approved- 1/25/2001) limits the following actions: 1) an action upon a judgment, or (2) an action for the recovery of land or interest therein, to **20 years**. Section 10 provides limitation of **two years** for the actions specified in the section and Section 11 provides a limitation of **six years** for all other action

We noted that the Department of Administrative Services (Finance) has classified a recorded liability for 'Land Acquisition Payable' amounting to \$8,564,745 under current liability in the financial statement. This payables were originally part of the 2007 Financial Reform MOU under debt relief fund. An analysis of the movements of this payable for the last ten years based on the audited financial statements revealed that there were minimal payments made in FY14 for \$53,750 and in FY18 for \$48,000 indicating that the State can hold and control the payments.

FY ending September 30	Land Acquisition Payable	Changes Increase/(Decrease)
FY21	\$8,543,745	
FY18	\$8,543,745	(\$48,000)
FY17	\$8,591,745	
FY15	\$8,591,745	\$26,950
FY14	\$8,564,795	(\$53,750)
FY13	\$8,618,545	
FY12	\$8,618,545	

Some of the payables were based on court decision/settlement. The review of the details of the dates of judgment disclosed that some of the cases were decided in 2001s and 2002s and therefore an action to collect such payables from the State government apparently had lapsed already.

In addition to the unpaid and unrecorded judgment claims pointed out in Finding 1 amounting to \$7,945,725.13, the total amount payable by the Chuuk State Government to citizens' claims amounted to \$16,510,520. Of this amount, the recovery of some claims from the state may have lapsed already due to statutory limitation for action to collect against the state.

Comparison of the details supporting the unrecorded judgment claims in Finding 1 amounting to \$7,945,725.13 with the details supporting \$8,564,745 "Land Acquisition Payable" revealed duplicate creditors specifically on debts in Finding 1 classified under "court judgment for land related issues" and "land lease/settlements/land purchase".

The classification of liabilities under current liability did not play a vital role in the construction of financial ratios and also in determining the long-term ability to pay one's debts (solvency) and short-term cash (liquidity) of an organization. Besides, the Chuuk State Government had actual control of the payment for this payable because the payment for the year is being limited by the Legislative appropriation, so, not all this liability is due and demandable within one year.

There was no reconciliation of the details between the unrecorded judgment claims payable under finding 1 with the related details of 'land acquisition payable' under finding 3 to eliminate related and duplicate creditors.

It appears that some liabilities of the Chuuk State government could be de-recognized due to statutory time prescription for the recovery of such claims from the state.

Cause and Recommendations

There was no evaluation of the classification of liabilities in the financial statement. Further, we noted that there was neither study nor consultation with the legal office to determine whether the long outstanding and unpaid payables could be de-recognized based on the existing Chuuk State law.

1. We recommend that the Director of Department of Administrative Services should look into these long outstanding payable with the objective of seeing whether they need to be reclassified in the financial statement as non-current liability.
2. We also recommend that the Debt Relief Task Force and the Director of Administrative Services should reconcile the details of unbooked claim judgements payable under Finding 1 with the details of "Land Acquisition Payable" under finding 3 and eliminate redundant or duplicate creditors.
3. We also recommend that the Director of Department of Administrative Services and the Debt Relief Task Force should obtain an opinion from the Office of the Attorney General whether some of the Land Acquisition Payables against the Chuuk State could still be enforced considering the statutory time limitation period within which an action against the state may be brought or enforced.
4. We recommend that the Legislature should provide a clear policy guideline on disposition of these payables especially those valid and fully substantiated payables that reached the prescribed period without the fault of the creditors.

**Appendix A– Status of Action Taken on Previous Audit Findings and Recommendations
As at June 30, 2022**

	Previous Audit Finding Audit Report No. 2019-02	Previous Audit Recommendation Audit Report No. 2019-02	Action Taken	Reason for not Initiating Action Plan	Timeframe to Implement the Audit Recommendation
1	The Records of Debts or Payables under Debt Relief Fund are not properly maintained	The Debt Relief Task Force to hire bookkeeper who will <i>independently</i> perform accounting and record keeping functions. Debt Relief service needs an accountant with skills in accounting (in order to reconstruct the accounting subsidiary ledger for payables under debt relief, and closely monitor the Debt Relief fund);	None	The budget was not approved by Legislature	
		a. The Director of Administrative Service to Adopt/develop and implement accounting and record keeping procedures that would support the regular monitoring or tracking, aging and management of payables under debt relief;	Done		
		b. The Debt Relief Task Force to validate, reconstruct and establish	Done		

	Previous Audit Finding Audit Report No. 2019-02	Previous Audit Recommendation Audit Report No. 2019-02	Action Taken	Reason for not Initiating Action Plan	Timeframe to Implement the Audit Recommendation
		the accuracy amount of debt or payable (total and details) to each creditor under debt relief fund			
2	No Clear Plan on How to retire \$13 Million Liabilities for Claims and Judgments and Other Payables that have been accumulating. Further, this Amount is not Transparent to Public because it was not Reported and Reflected in the Financial Statement.	a. The Debt Relief Task Force to strictly stick to budgeting and come up with target payment plan and schedule to ensure the regular payment of debt. (In the future, unpaid expenses caused by departments should be shouldered by other contingency account or by Legislative appropriations for each department's accounts payables).	None		
		b. The Debt Relief Task Force to establish good relationship with creditors to be able to always re-negotiate reasonable payment schedule and payment terms based on availability of expendable resources	None		

Previous Audit Finding Audit Report No. 2019-02	Previous Audit Recommendation Audit Report No. 2019-02	Action Taken	Reason for not Initiating Action Plan	Timeframe to Implement the Audit Recommendation
	c. The Debt Relief Task Force to examine the suggested possible revenue sourcing activities and request appropriate authority, if needed, to implement those activities not yet implemented.	None		
	d. The Debt Relief Task Force to explore and suggest sources of revenue for debt relief fund. Seek donors and contributors.	None		
	e. The Director of Administrative Services to recognize the payable in the books of accounts on the basis of the Supreme Court decisions and reflect them in the yearly financial statements to make the payable of the Chuuk Government transparent to public.	None		

Appendix B – Balance Debt Relief Fund as of September 30, 2021

FY	Sources of Funds					Uses of Funds			Balance	Cash Balance per Bank Statement - Debt Relief Fund	Difference Bank Balance Over/(Under)	
	Beginning Balance	Appropriation	Transfer from General Fund Savings Account to Debt Relief Fund Acct	Share from the National Revenue Used to Satisfy Writ of Garnishment	Total Cash Available	Payments	Reversed Stale Checks	Net Payments (less stale checks)				
	A	A1	B	C	D=A+B+C		F	G=E-F	H=D-G	I	J=H-I	
2019	\$ 310,015.13		\$ 110,000.00		\$ 420,015.13				\$ 420,015.13	\$ 420,015.13	0	
2020	420,015.13	\$ 458,000.00	150,000.00	\$ 152,559.99	722,575.12	A B	449,407.28 152,559.99		601,967.27	120,607.85	159,648.73	(39,040.88)
2021	120,607.85		90,000.00	257,336.46	396,425.23	B	257,356.46	34,669.88	222,686.58	245,277.73	245,277.73	0
Total	\$ 310,015.13	\$ 458,000.00	\$ 350,000.00	\$ 409,916.45	\$ 1,020,353.77		\$861,823.74	\$34,669.88	\$824,653.85	\$245,277.73	\$245,277.73	0

Notes : A- Paid using Debt Relief Fund FY2020-\$449,407.28 Minus \$34,669.88 (reversed stale checks) = \$414,737.40

B- Writ of Garnishment paid using the 20% Revenue Share from the National Government FY2020-\$152,559.99, FY2021-\$257,356.46, Total-\$409,916.4

MANAGEMENT RESPONSE



**DEPARTMENT OF ADMINISTRATIVE SERVICES
CHUUK STATE GOVERNMENT
FEDERATED STATES OF MICRONESIA**

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Jonas M. Paul
Director

Restmena S. Nonumwar
Deputy Director

Mr. Manuel L. San Jose Jr.
Public Auditor
Office of Chuuk State Public Auditor
Weno, Chuuk, FM96942

Dear Mr. San Jose:

We thank you for giving us the opportunity to respond to the audit findings for the audit of Debt Relief Fund Payable your office has conducted.

Nevertheless, please find below our response to the audit findings:

Finding 1- The Debt Relief Task Force did not take corrective actions to address all the audit findings and recommendations from the previous audit report No. 2019-02.

Response: DAS already submitted the subsidiary ledgers of unrecorded payables to governor and is waiting for his approval for DAS to book such payables.

Finding 2- Five payments amounting to \$109,991.49 described as garnished amount was not supported by Writ of Garnishment. Of this amount, no names were indicated on three payments amounting to \$57,559.99.

Response: It appears that Office of the Chuuk State Public Auditor did not spend appropriate time or apply alternative audit procedures to obtain supporting documents (i.e. contacting the right officer from FSM NG's Department of Finance and Administration). However, DAS has a copy of Writ of Garnishment for the indicated amount and has the ledger stating the names.

Finding 3- 'Land Acquisition Payable' classified under the 'Current Liability' in the Financial Statement for \$8,564,795 has no movement since 2018 or for five years.

Response: DAS believes that this long outstanding payable is properly classified as current liability in the financial statement because it has been due for payment, it is only that CSG does not have the resources to settle such payable. The subsidiary ledgers submitted to the governor were reconciled based on the available supporting documents and records.

We recognize your efforts in conducting audits of Chuuk State Government's activities, it helps our department to improve and perform more efficiently and effectively.

Sincerely,


Jonas M. Paul
Director, DAS

Date Received OCPA
Oct 12 2022 PM

OCPA's EVALUATION OF MANAGEMENT RESPONSES

The DAS agreed on finding 1. However, the department was silent on the audit recommendations. The Chairman of the Debt Relief Task Force did not provide its management response but we were verbally informed that it would agree to whatever be the response of the Department of Administrative Services. The following were the evaluation of the management response:

Finding 1 – The Debt Relief Task Force did not take corrective actions to address all the findings and recommendations from the previous audit report No 2019-02.

Management Response from DAS – DAS already submitted the subsidiary ledgers of unrecorded payables to governor and is waiting for approval for DAS to book such payable.

Finding 2 – Five payments amounting to \$109,991.49 described as garnished amount was not supported by Writ of Garnishment. Of this amount, no names were indicated on three payments amounting to \$57,559.99.

Management Response from DAS - It appears that the Office of Chuuk State Public Auditor did not spend appropriate time or apply alternative audit procedures to obtain the supporting documents (i.e. contacting the right Officer from the FSM National Department of Finance and Administration). However, DAS has a copy of Writ of Garnishment for the indicted amount and has a ledger stating the names.

OCPA Assessment of Management Response - We maintain that the official receipts and the journal vouchers when prepared by Finance were not properly supported by documentary evidence. We don't need to do the alternative audit procedure because the document should have been provided to auditor when requested. The Tax Revenue Supervisor who prepared the corresponding Official Receipt to recognize the deduction from revenue share even formally confirmed to the auditor that there was no writ of garnishment document on his file. Furthermore, we went to the Supreme Court (the one that issued the writ of garnishment) to get copies of the writ of garnishment and the court did not have some copies. Furthermore, we inquired twice from the FSM National Finance Field Offices but they were not of help. Lastly, we discussed the finding with the Debt Relief Committee on September 14, 2022 during the exit conference and had been requesting for the documents until the final report for management response was issued on September 26, 2022. It was clear that the auditor took time and effort to get the requested documents.

Thus, we are retaining the finding because it is a weak internal control without seeing the supporting documentary evidence when recording a payment made.

Finding 3 - "Land Acquisition Payable" classified under "Current Liability" in the Financial Statement for \$8,564,795 has no movement since 2018 or for five years.

Management Response – DAS believes that this long outstanding payable is properly classified as current liability in the financial statement because it has been due for payment; it is only that the Chuuk State Government does not have the resources to settle such payable. The subsidiary ledgers submitted to the Governor were reconciled based on the available supporting documents and records.

OCPA Assessment of Management Response from DAS - The current liabilities is obligations that must be settled within a period of 12 months. The current assets are the assets to be converted to cash to pay for current liabilities. The total amount of current assets (net of restricted current assets) of the Chuuk State Government as of September 30, 2020 is \$6,396,581 (net of restricted current assets) while the total amount of current liabilities is \$16,479,593. The impending booking of court judgments and claims amounting to \$7,945,725 would further bring a massive excess of current liabilities to current assets amounting to \$18,298,737 (\$18 million) indicating a very poor financial position and cash solvency problem (ability to generate enough cash from the current assets to pay it due obligation).

Thus, the auditor does not see any point of retaining the long outstanding payable as part of the current payable when it could have been classified under long term debt. The reclassification would even improve the financial position of the Chuuk State Government. While these payables were already due, the Chuuk State Government can hold and control the payments. In fact, their payments were limited to the amount that would be appropriated by the Legislature for that purpose.

PUBLIC AUDITOR'S COMMENTS

We would like to thank the management and staff at Chuuk State Department of Administrative Services and the Debt Relief Task Force for their assistance and cooperation during the course of the audit.

We have provided copies of the final report to the Governor, Senate and Members of the Representatives, members of the Debt Relief Task Force for their use and information. Furthermore, we will make copies available to other interested parties upon request.

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



Manuel L. San Jose Jr.
Public Auditor
Office of Chuuk State Public Auditor

October 19, 2022

OCPA CONTACT AND STAFF ACKNOWLEDGEMENT

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

Rosalinda Mori, Senior Auditor

OCPA MISSION We conduct audits and investigations to improve government operations, efficiency, and accountability for the public's benefit.

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