

OFFICE OF THE CHUUK STATE PUBLIC AUDITOR

CHUUK STATE, FSM



**CHUUK STATE DEBT RELIEF FUND: No Clear Plan on how to Retire \$13 Million
Liabilities for Claims and Judgments and Other Payables
FISCAL YEAR 2009 to 2018
AUDIT REPORT NO. 2019-02**



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February 27, 2020

Honorable Johnson Elimo
Governor
Chuuk State, FSM

Honorable Ishiro Choram
President
House of Senate
Chuuk State Legislature

Honorable Innocente Oneisom
Speaker
House of Representatives
Chuuk State Legislature

RE: Audit on the Chuuk State Debt Relief Fund

We have completed the audit on the Chuuk State Debt Relief Fund (DRF) under the supervision and management of Chuuk State Government Restructuring Task Force (Task Force). We conducted this audit in accordance with the U.S. generally accepted auditing standards. The audit objectives were to determine whether the records of debt payments and payables under the DRF are properly maintained; and, to determine whether the Task Force was effective in retiring all the Chuuk State debts and payables under the DRF.

The results of the audit disclosed the following findings:

- Finding 1 – The Records of Debts or Payables under Debt Relief Fund were not properly maintained
- Finding 2 –No clear plan on how to retire \$13 Million Liabilities for Claims and Judgments and other Payables which have been accumulating.
Further, this amount was not transparent to Public because it was not reported and reflected in the Financial Statement.

The records of debts or payable under Debt Relief Fund were not properly maintained. An accurate amount of payable/debt under Debt Relief Fund was not established for tracking and managing purposes. The Debt Relief Task Force started to manage an existing debt in 2007 amounting to \$46 million in 2007. Because of lack of record, we were unable to analyze historical balances and how this amount had decreased through the years.

During our audit, the Reconciliation Officer provided an outstanding payable amounting to \$13 million. However, the accuracy of this payable amount is very much doubtful. The Reconciliation Officer was unable to vouch its accuracy because she said she did not keep complete records of supporting documents per claim. Additionally, she did not reconcile the system records with bank reports.

Though the details are questionable, we have decided to report the \$13 million payable as part of this audit report but with reservation. This payable has long been an outstanding issue, so, by reporting in the audit, reconciliation could start, accurate and supported balances could be established and reasonable payment schedule could be followed to finally retire all the debts.

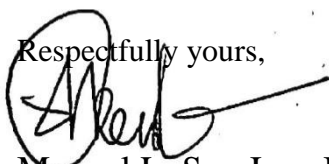
Since the accuracy of details of \$13 million payable were subject to question, we have decided to omit its details from publicly available reports because of the unnecessary conflict it might create for any differences. We have provided, though, such details to the members of the Debt Relief Task Force and to the Department of Administrative Services (DAS) for their reconciliation and so that an accurate amount of payable for each creditor could be established, recorded in the books and reflected in the Financial Statement; and, to the Governor and Legislature for their reference.

The Debt Relief Task Force was not effective in retiring debts. The reported outstanding liability, stood at \$13 million, is still very significant. There has been no clear plan on how this liability amount for claims and judgments would be retired. The payable has been accumulating as new obligations have been added. Further, this outstanding payable amount is not transparent to public because it was not reported and reflected in the yearly Financial Statement.

The Task Force should work towards implementing and reconstructing the accounting records of liabilities to establish firmed Accounts Payable for recording and payment purposes. This is the ultimate result and expectation of the DRF system and must be reported and monitored regularly (e.g., quarterly and yearly) to ensure the retirement of debt. Additionally, and most importantly, the Task Force should work towards implementing the defined activities in the Memorandum of Understanding between the Chuuk State Government and the Federated States of Micronesia National Government that would generate additional revenue for the Debt Relief Fund. The system management's achievements will strongly impact the improvement in the collection of revenues, therefore, the debt relief fund.

We discussed this report with the current members of the Debt Relief Task Force and with the management of the Department of Administrative Services. They agree with our findings and recommendations.

Respectfully yours,



Manuel L. San Jose Jr., CPA, CIA, CISA, CRMA, CGAP, CFIP
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INTRODUCTION

Background

This audit was requested by the Honorable Innocente I. Oneisom, Speaker of 14th Chuuk State Legislature, House of Representatives. On behalf of the House of Representatives, the Speaker requested an audit to understand how the funds for the Debt Relief Fund were handled.

Conditions that Led to the Creation of Task Force on Chuuk State Financial Restructuring

In 2007, the Chuuk State was having difficulty paying its financial obligations which have accumulated beyond its capacity to pay based on their existing revenues. On July 19, 2007, the FSM National Government entered into a Memorandum of Understanding (MOU) with the Chuuk State Government to establish a Joint National Government and Chuuk State Government Task Force on Chuuk State Financial Reform (Task Force) that remained effective for ten (10) years and, after which, the collaboration was not extended.

The purpose of the Task Force was to provide a collaborative effort to achieve financial and structural reform for Chuuk State. Part of the reform was to create a stabilization fund to retire the existing Chuuk State Debt and a task force to take responsibility to monitor and manage the Debt Relief Fund (DRF) and activities.

The Task Force¹ submitted a report to the leadership of both governments that Chuuk State has a total debt of \$46 million (\$4 million short-term; \$7.6 million medium-term; and \$34.4 million long-term).

In 2008, the FSM National Government deposited a \$518,129.00 into Chuuk State's Debt Relief Fund Account at the Bank of the Federated States of Micronesia (BoFSM) as starting money to initiate retiring of Chuuk's DRF payables and obligations. There were no further deposits from the FSM National Government except for the two deposits made below.

- 1st installment as opening deposit \$125,000.....February 2008
- 2nd installment as second deposit \$393,129.....November 2008

Upon the expiration of the MOU in 2017, the Chuuk State took the responsibility for managing the DRF. The funding for the DRF now comes from locally generated tax collection, which is \$30,000 per quarter.

The payables or debts under DRF represent mostly liabilities in the form of claims and judgments which have accumulated. The Chuuk State Debt Relief Task Force started its own documentation and records of debts.

¹Task Force: a Chuuk and Federated States of Micronesia Joint Financial Stability Program (FSP) established in February has three members from both the State and the National Government. The Economic Management Policy Advisory Team (EMPAT) was involved. The Joint FSP was set up to study, make recommendations and develop disciplined management to avoid a total financial collapse for Chuuk.

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Chuuk State Law on Debt Relief Fund

Sections 1 to 8 of the Chuuk State Law No. 9-07-09 provides 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...*” Further, 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 debt 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.*”

Section 2 of the same law 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.*” Additionally, all funds received as part of Chuuk State’s financial reform shall be deposited into the Debt Relief fund. This section of the law continues that “...*any and all appropriations made by the Legislature or the Congress for the purpose of retiring portion of or all of the existing debts of state shall be deposited into this Fund. Any portion of any tax earmarked for the purposes of the Act shall also be deposited into the fund including all financial assistances received from outside the State, which are intended to assist Chuuk State’s reform efforts. All revenues raised, as part of the Chuuk State’s reform, shall also be deposited into the account for the Fund. Any interests earned on the principal shall remain and become part of the Fund.*”

Furthermore 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 debts² of the state as determined by the Joint State Government Restructuring Task Force (Task Force).*”

Administrator of Debt Relief Fund

Section 5 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. It consisted of seven members³ as follows:

² Monies in the Fund shall be utilized solely for retiring all verified, valid, and lawful debts (Section 5 CSL No. 9-07-09)

³ There were seven (7) members of the DRF Task Force required by law CSL 9-07-07; CSL No. 15-19-06, an amendment to CSL No. 9-07-09 requires only four (4 members): Director of Administration of the State Supreme Court or his designee, two representatives; the Chief of the Finance Division and the Chief of Budget from the Executive Branch and one from the Legislature to be jointly appointed by the President and the Speaker

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Member	Remarks
Seven Members	
1. Chuuk State Attorney General or his designee	On 10/07/19, Chairman, Sabino Asor, Esq., was replaced by Perez Graham (Chief of Budget Office, Chuuk State Legislature)
2. The Chuuk State Public Auditor or his designee	Never participated due to impairment of the job against the audit functions
3. The Director of Administration of the State Supreme Court or his designee	Isauro Kuena, Director of Administration, Chuuk State Supreme Court
4. Representatives from the Executive Branch – 2 members	Non-elective & non-appointive Effective membership October 10, 2019, both members from Department of Administrative Services: Chief of Finance (Vice Chairman, Roxalyn Kaminanga) and Chief of Budget Office (Linda Maipi)
5. Representative from the Legislative Branch Jointly appointed by the President and the Speaker – 2 members	Non-elective & non-appointive Per amendment, on October 10, 2019, only one representative is required, and Perez Graham 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;
- 3) The Chuuk State Department of Treasury: Director of Finance pre-approves payment request for processing; Reconciliation and Funds Division review and certify the payment request. Then, Director of Finance finally approves obligations and payment is made; [Under Section 5 of CSL No. 9-07-09, *the Chuuk field Office of the FSM Department of Finance and Administration has the sole power to disburse and issue checks against the account. Checks drawn against the account for the Fund shall be valid only if signed by designated representatives⁴ of the State and the National Governments.* However, since the expiration of the MoU between Chuuk State and the FSM National Government on July 17, 2017, the Debt Relief Fund responsibility has rested on the state to resolve its financial crisis. Accordingly, the Director of Administrative Services now has the sole power to disburse and issue checks against the account.⁵]
- 4) The claimants collect their checks from the Chuuk State Department of Treasury.

⁴ Chuuk State Finance Director and FSM National Government Secretary of Finance

⁵ Section 5 of CSL No. 15-19-06, an amendment to 9-07-09, states that The Director of Department of Administrative Services has the sole power to disburse and issue checks against the account

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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.”*

Processing of Payables under Debt Relief fund

The “Debt Relief Fund” is accounted for separately from the “General Fund” (GF) within the Finance Accounting System (Fundware). The payment of payable under DRF is also processed using existing accounting system. The only difference in processing of payable under the GF is the absence of accrual before paying any payable under the DRF. It is directly Debited to Expense and Credited to Cash in Bank upon payment. On the other hand, there is general accrual for payable under the GF. The payment will first be accrued (Debit to Expense, Credit to Accounts Payable) before making the actual payment (Debit Accounts Payable and Credit Cash in Bank).

At year-end, the accountant has to search for unrecorded payables under the DRF to completely record and reflect the payables in the Financial Statement.

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Objectives, Scope and Methodology

Objectives

The objectives of the audit on the Chuuk State Debt Relief Fund were:

1. To determine whether the historical records for debt relief fund such as debtors, payables and payments were properly maintained.
2. To determine whether the Joint State Government Restructuring Task Force (Task Force) was effective in retiring all or portion of the debts existing at the time the debt relief fund was created.

Scope

The review covered the fiscal years from 2009 to 2018⁶. 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 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.

To determine whether the records of debt payables and payments made from Chuuk State Debt Relief Fund were properly maintained, we judgmentally selected transactions and reports to test their compliances with the requirements of relevant laws and regulations on record management. We also tried to establish the total payable amount and the history of detailed transactions from records.

To determine whether the Joint State Government Restructuring Task Force (Task Force) was effective in retiring all or portion of the debt existing under debt relief fund, we established the beginning debt balances at the start of the creation of debt relief fund and reviewed, tested, and analyzed the payments made during the scope of the audit.

⁶ History of payments and deposits in Fiscal Years 2009-18, excluding prior years, were retrieved from Finance Department and examined. Scope became FY 2009-18

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Prior Audit or Related Examination to this Area

Deloitte & Touche has been performing financial audits of the financial statement of Chuuk State Government. Related liabilities (Long term Liability of the Government) amounting to \$902,605 were booked for claims and judgments and reflected in the Financial Statement (FS) for several fiscal years from FY 2014 to FY 2017.

In fiscal year 2018 FS, however, no related long term liability was accrued, recorded and reflected in the Financial Statement in spite of the fact that the Chuuk Government had unpaid claims and judgments at fiscal year-end 2018 amounting to about \$13 million (Appendix D).

It appears that in 2018 FS, there was \$13 million unrecorded liability of the government but not transparent to public because of lack of disclosure in the FS.

Conclusion

We found that records for debt relief fund such as debtors, payables and payments were not properly maintained. We were not able to fully examine the documents pertaining to the Debt Relief Fund due to inadequate filing system. However, we were able to examine some worksheets kept by the Reconciliation officer, the payment history in the accounting (Fundware) system as well as the bank statements from the Bank of Federated States of Micronesia.

We also found that the Joint State Government Restructuring Task Force (Task Force) was not effective in retiring all or portion of the debts. The debt payable under Debt Relief Fund stood at about \$13 million has remained a significant amount. There was insufficient fund in the Debt Relief Fund to service the debt payment.

FINDINGS AND RECOMMENDATIONS

Finding 1 – The Records of Debts or Payables Under Debt Relief Fund are not Properly Maintained

Section 2 of the Chuuk State Law No. 9-07-09 provides 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.”*

Prudent practices dictate that the managing of payable/debt should include:

- a. Tracking payables in accounts payable/debt total, summary and subsidiary ledgers
Typically, these are used with aging to monitor overdue accounts
- b. Budgeting to ensure regular payable/debt payment
- c. Maintain creditor relationship
- d. Arrange for acceptable payment terms

Furthermore, prudent practices dictate that *“...Debt management activities should be supported by an accurate and comprehensive management information system with proper safeguards. Countries who are beginning the process of building capacity in government debt management need to give a high priority to developing accurate debt recording and reporting systems. This is required not only for producing debt data and ensuring timely payment of debt service⁷, but also for improving the quality of budgetary reporting and the transparency of government financial accounts. The management information system should capture all relevant cash flows, and should be fully integrated into the government's accounting system...”* (Section 35, Guidelines for Debt Management⁸).

We found the Accounts/Debt Payable under Debt Relief Fund was not properly tracked or monitored. It was learned that a former Reconciliation Officer used an Excel spreadsheet (or worksheet) to record, monitor and maintain the summary and detailed transactions for the Debt Relief Fund from 2006 and prior years. This worksheet, however, when transferred to a new Reconciliation officer, has never been updated for transactions from year 2007 up to present. Thus, there was no way to analyze the history of debt relief accounts/debt payable, and the account balances based on historical amounts plus new court judgment claims.

As a result, an accurate amount of payable/debt under Debt Relief Fund was not established for tracking and managing purposes. We were unable to analyze how the original payable amount of \$46 million reported in the MOU had increased or decreased. The Reconciliation Officer, however, provided an outstanding payable under Debt Relief Fund amounting to \$13,242,002.87 (Refer to Appendix D). The Reconciliation Officer was unable to vouch the accuracy of the payables because she does not keep records of supporting documents per claim; additionally, she does not reconcile system records with bank reports.

⁷ In this report, all debts mentioned are Debt Relief Fund debts/liabilities/payables

⁸ Guidelines for Public Debt Management – Prepared by the Staffs of the International Monetary Fund and the World Bank – March 21, 2001

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Since the accuracy of details of Appendix D were subject to question, we have decided to omit such details from publicly available reports because of the unnecessary conflict it might create in public for any differences. We have provided such details, though, to the members of the Debt Relief Task Force and the Department of Administrative Services (DAS) for their reconciliation and to force them to establish an accurate amount of payable to each creditor that should be recorded in the books and reflected in the Financial Statement. The details of payable were also provided to the Governor and Legislature for their reference.

Cause and Recommendations

Ineffective Internal Control System in Record Keeping

Because there has been ineffective internal control system in place, there were no written internal control policies and procedures to provide for a reasonable assurance of complying with and maintaining the requirements with laws and regulations to properly track and monitor payables under the Debt Relief fund including its fund balance. The following issues of lack of internal control were noted:

1. There were no written policies and procedures for the processing of Debt Relief Fund and updating of records.
2. The Reconciliation Officer who is currently handling the processing of Debt Relief Fund was not properly trained to handle the recordkeeping requirements to monitor the payables under Debt Relief Fund. Besides, the Reconciliation Officer cannot handle her current multi-tasking job. She did not maintain records to monitor and track the total, the summary and the details of payables under the debt relief fund. Additionally, the Reconciliation Officer did not perform monthly bank reconciliation to reconcile the Debt Relief Fund bank account balance with its controlling account.

We recommend to the Debt Relief Task Force the following improvements in the operations of Debt Relief Fund:

- a. Hire bookkeeper who will *independently* perform accounting and recordkeeping functions. Debt Relief service needs an accountant with skills in accounting (in order to reconstruct the accounting system, utilize an accounting software to maintain and closely monitor the Debt Relief funds);
- b. Adopt/develop and implement accounting and recordkeeping procedures that would support the regular monitoring or tracking, aging and management of payables under debt relief;
- c. Validate, reconstruct and establish the accuracy amount of debt or payable (total and details) to each creditor under debt relief fund

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Finding 2 – No Clear Plan on How to Retire \$13 Million Liabilities for Claims and Judgments and Other Payables Which Have been Accumulating. Further, this Amount is not Transparent to Public Because it was not Reported and Reflected in the Financial Statement.

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.

The purpose of the Debt Relief law is to retire all or portion of the existing debts of the state. Section 1 of the Chuuk State Law No. 9-07-09 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.*”

Figure 1. History of Transactions within the Debt Relief Fund Account

The table shows the history of deposits and payments from the Debt Relief Fund. It illustrates the Debt Relief Fund account based on payments reflected in the Accounting System records in comparison with periodic statements from the Bank of the Federated States of Micronesia where the bank account for Debt Relief Fund is maintained. Payments are summarized in Appendix B.

Fiscal Year	Beginning Budget	New Deposit	Payments	Ending Balance	Ending Balance (Per Bank)
FY09	\$ -	\$ 518,129.00	\$ 464,790.27	\$ 53,338.73	\$ 61,719.36
FY10	\$ 53,338.73	\$ 732,867.70	\$ 554,751.82	\$ 231,454.61	\$ 793,297.06
FY11	\$ 231,454.61	\$ 145,213.40	\$ 304,200.69	\$ 72,467.32	\$ 111,448.10
FY12	\$ 72,467.32	\$ 340,000.00	\$ 293,941.20	\$ 118,526.12	\$ 45,746.53
FY13	\$ 118,526.12	\$ 120,354.58	\$ 68,094.50	\$ 170,786.20	\$ 195,000.00
FY14	\$ 170,786.20	\$ 412,658.12	\$ 554,038.68	\$ 29,405.64	\$ 59,357.64
FY15	\$ 29,405.64	\$ 40,000.00	\$ 57,190.51	\$ 12,215.13	\$ 20,015.13
FY16	\$ 12,215.13	\$ 70,000.00	\$ -	\$ 82,215.13	\$ 210,015.13
FY17	\$ 82,215.13	\$ 127,800.00	\$ -	\$ 210,015.13	\$ 310,015.13
FY18	\$ 210,015.13	\$ 90,000.00	\$ -	\$ 300,015.13	\$ 330,015.13
FY19	\$ 300,015.13	\$ 30,000.00	\$ -	\$ 330,015.13	
Total		\$2,627,022.80	\$2,297,007.67	\$ 330,015.13	

Source: Data gathered from Treasury, Department of Administrative Services, Chuuk State Government and the Bank of the Federated States of Micronesia, and the Bank of the FSM. This table was prepared by OCPA.

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The total payment of \$2 Million in Figure 1 showed a difference of about \$6 Million compared to \$8 million total payment accounted for in Appendix D. The difference was explained as payments made in year 2008 and prior years (recorded in Appendix D). The payments accounted for in Figure 1 started in Fiscal Year 2009.

The terms of the MOU and outputs derived from the Debt Relief Fund law define the outcome for the Debt Relief service; details of the activity goals per the MOU for Financial Restructuring are indicated under Appendix A of this report all in which were envisaged to contribute to the improvement in the cash flow.

We found that, for the 10-year period, the Debt Relief Task Force was not effective in retiring the existing debt of claims and court judgments. From fiscal year 2009 to 2018, it was only able to retire debt amounting to \$2,297,007.67. There were years with insufficient funds and lack of approved budget or appropriations from the Legislature (FY 2016 to 2018).

As a result, debts under the DRF have been accumulating and the situation is creating a group of unsatisfied creditors/citizens. If there will be no proper management of DRF, time will come that the court will come in to force payment, garnishment or liens to government property.

Cause and Recommendation

There was no clear plan on how the government would be able to retire the debts from settled claims and judgments determined at \$13 million (Appendix D). Contributing also to the difficulty in retiring all debts was the certainty that there was not enough money to properly schedule the retirement of debts.

Because of the fact that there has been no effective monitoring and updating of the Debt Relief Account, it has been also difficult to effectively schedule payments. Lack of monitoring further contributed to the circumstances of these payables not being recognized in the books of accounts and reflected in the yearly financial statement as payable of the State.

Moreover, there has been no effective collaboration before between the Task Force (together with the Legislature and Executive of Chuuk State Government) and the FSM National Government to continuously implement the debt restructuring activities and actively seek the source of funding for the DRF.

Some of the proposed activities in Appendix A to generate resources for the Debt Relief Fund did not materialize or are not implemented. For example, the activity that “...*Within three years of the date of execution of this MOU, sell the Chuuk House in Honolulu, Hawaii*” was not implemented.

There was problem in prioritizing debt payment. We noted that majority of payments that were charged to the Debt Relief Fund account were actually department expenses. We also learned that each time there was a disbursement, payments were made according to a priority list which

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was intended not only for the verified and legitimate claims and court judgments⁹ but also for what was considered *most urgent*. Other obligations await another batch of disbursement depending on the availability of funds. These were the obligations that accumulated and had gone long overdue. Appendix B illustrates all payees from fiscal year 2009 to 2015.

We recommend that the Debt Relief Task Force should:

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 reasonable payment schedule and payment terms based on availability of expendable resources.
3. Examine the suggested possible revenue sourcing activities in Appendix A and request appropriate authority, if needed, to implement those activities not yet implemented.
4. Explore and suggest sources of revenue for debt relief fund. Seek donors and contributors.
5. Recognize the payable in the books of accounts and reflect them in the yearly financial statements to make the payable of the Chuuk Government transparent to public.

We also recommend that the Legislature, in coordination with the Executive, to increase yearly appropriation of funds to the Debt Relief Fund to provide enough buffer a steady source of resources.

⁹ Judgments are the court's decision on the rights and liabilities of parties in a legal action or proceeding (Chuuk State Rules of Civil Procedure, statutory law on the enforcement of judgments and debts, Chuuk State Judiciary Act of 1990).

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APPENDICES

APPENDIX A– Responsibility of the Parties

**Chuuk State and FSM National Government
July 19, 2007**

	Chuuk State Agrees to:		FSM Agrees to:
1	On a one-time basis and within one year of the date of execution of this MOU, divest its investments in the Bank of Guam and the Bank of the FSM and allocate those proceeds to a stabilization fund, to be established by law and jointly administered by the parties. This measure should yield approximately \$1,840,000 in revenues.	1	Make a good faith effort to expedite the implementation of Compact infrastructure projects for the State.
2	Within three years of the date of execution of this MOU, sell the Chuuk House in Honolulu, Hawaii.	2	Immediately allocate to Chuuk State the 20% revenue-sharing balance from Fiscal years 2002 and 2003, to reduce the existing debt. [Contingent upon approval by the Fifteenth FSM Congress.]
3	Immediately undertake to adopt certain austerity measures to control General Fund expenditures (which, for FY 2007, exceed gross revenues by \$2 million) for the remainder of Fiscal year 2007. These measures shall include a moratorium on hiring, salary increases, and other spending, such as travel. Chuuk State shall aim to reduce the budget deficit for FY 2006 by \$500,000.	3	Establish, a local financial institution, stabilization account (the Chuuk State Financial Stabilization Account). All revenues raised as part of Chuuk State’s reform efforts shall be deposited into this account. Funds from the account shall be disbursed from the Chuuk field office of the FSM Department of Finance and Administration. A separate MOU (to be executed by the Secretary of the Department of Finance and Administration and the Chuuk State Department of Administrative Services) shall govern the administration of the stabilization account.
4	No later than October 1, 2007, balance its FY 2008 annual budget. This means that annual expenditures shall not exceed gross revenues for a given fiscal year. The FY 2008 balanced budget shall include a provision for reducing the budget deficit by at least \$1 million.	4	Seek any available financial and technical assistance from outside sources (e.g. foreign nations and regional financial institutions/donors) to assist Chuuk State in satisfying its financial obligations. Such financial support may take the form of grants or soft loans. The FSM’s obligation to seek and allocate foreign assistance shall be contingent upon a satisfactory showing of progress by Chuuk state on the reform measures set forth in this MOU.
5	Eliminate 400 personnel positions from the operations budget. Phase I of the reduction effort shall result in the elimination of 200 positions by March 31, 2008, for savings of approximately \$1 million. Phase II of the reduction effort shall result in the elimination of an additional 200 positions by March 31, 2009, for a cumulative total savings of approximately \$2 million. Chuuk State will make a good faith effort to provide ERP compensation equivalent to one year’s salary for the departing employees. This may necessitate a change in the State laws and/or regulations.	The parties further agree that:	
		1	Deposits into and appropriations from the stabilization fund shall be subject to relevant State and National Government appropriation laws.
		2	This MOU may be amended at any time upon agreement by both parties
		3	The consolidated adjustment program (a.k.a. “Matrix), as last amended on July 19, 2007, is incorporated into and made a part of this MOU.

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	Chuuk State Agrees to:		The parties further agree that:
6	Adjust its Fiscal Year 2008 General Fund budget to reflect a 64-hour biweekly pay period. This will result in a savings of approximately \$341,000.	4	The parties will periodically meet to discuss Chuuk State's progress under this MOU. If, after one year, Chuuk State has not shown satisfactory progress under this MOU, the FSM <u>will cease its efforts to seek financial assistance</u> on the State's behalf. Additionally, the FSM will take whatever action it deems necessary.
7	Restructure the executive and legislative branches of the State government within five years. The first component of restricting will involve a shift from a bicameral to unicameral legislature. The second component will involve a reorganization/merger of existing executive branch departments, division, and offices. The parties understand that both of these measures will require constitutional amendments. These combined measures will result in savings of approximately \$1,000,000. Voting on the proposed constitutional amendments will begin with the General Election 2009.	5	The MOU shall remain in effect for ten years, unless extended by the parties of unless Chuuk State should resolve its financial crisis prior to that time.
8	Immediately understand to amend its Financial Management Act to restrict allotment and certification of funds based on cash availability – irrespective of the existence of an appropriations act. This means that no allotments shall be processed without confirmation of cash availability. This should result in a savings of at least \$500,000. (This will not apply to the first quarter of FY 08.)		
9	By September 1, 2008, privatize services already identified, for target cost savings of \$500,000.		
10	Within ninety (90) days of the date of execution of this MOU, review the State's medical referral liability and write off any liabilities that are more than six years old.		
11	Immediately operate a Chuuk State Public Auditor's Office		
12	Immediately establish a <u>Joint State Government Restructuring Task Force</u> , which shall consist of seven members, as follows: the Chuuk State Attorney General; the Chuuk State Public Auditor; two additional representatives of the executive branch, two representatives from the legislative branch; and 1 representative from the judiciary. The Task Force will establish a <u>priority of payments</u> , taking into account the priorities established pursuant to Chuuk State law.		
13	No later than October 1, 2007, develop a public awareness program to educate the public about the imminent need for reform. Chuuk State will use all available means (radio, newspaper, etc.) of providing notice to the public about the program.		

Source: Memorandum of Understanding obtained from the Office of the Attorney General

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APPENDIX B- Analysis of Payments: Fiscal Year 2009 to 2015

Categories	No	Amount Paid
Court Judgments	67	\$ 931,916.92
Private Businesses and Companies	80	\$ 798,701.73
Church	2	\$ 4,000.00
Schools	5	\$ 23,347.50
Chuuk Gov't Employee	1	\$ 41,048.19
FSM Finance	1	\$ 74,155.79
Lending Institutions	4	\$ 21,750.07
Chuuk Health Care Plan	1	\$ 108,247.76
Chuuk Housing Authority	1	\$ 12,434.18
Chuuk State Hope '09 Association	1	\$ 780.00
Chuuk Utility Commission	2	\$ 1,296.80
FSM GHI Plan	1	\$ 36,522.76
FSM Telecom Chuuk	1	\$ 7,995.50
Housing Preservation	1	\$ 1,284.00
Housing Rehabilitation	1	\$ 6,628.46
Municipalities	2	\$ 4,126.00
Weno Housing Authority	1	\$ 7,379.02
Penta Ocean Construction	6	\$ 213,902.48
Correction Check/Stale Dated Checks/Unidentified Checks	3	\$ 1,490.51
 TOTAL		 <u>\$ 2,297,007.67</u>

Source: OCPA Auditor's observation

APPENDIX C - Court Settlement

The satisfaction of court judgment generally works as follows:

1. The Court issues judgment against the losing party. The losing party is required to pay the winning party the full amount of the judgment including any interest the court may have imposed on that amount.
2. If the judgment is not satisfied, the winning party may seek to have the judgment enforced by filing for a motion in aid of judgment, or an execution of attachment.
3. The parties may also satisfy a judgment by settling.
4. Or the losing party may file a timely appeal (if appropriate) and motion to stay the judgment.
5. However, if there is no settlement and the judgment remains unsatisfied, the winning party may file for the enforcement of the judgment.

Source: Chuuk State Supreme Court Attorney

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APPENDIX D – Payables Under Debt Relief Fund

(The table is disclosed only to the Governor, Legislature, Department of Administrative Services, and the Debt Relief Task Force for their review).

Source: Reconciliation Division, Finance Department

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MANAGEMENT RESPONSES

JOINT GOVERNMENT RESTRUCTURING TASK FORCE

**CHUUK STATE GOVERNMENT
WENO, CHUUK STATE, FSM 96942**

February 11, 2020

Mr. Manuel L. San Jose, Jr.
Public Auditor
Office of the Public Auditor
Chuuk State Government
Weno, Chuuk State FSM 96942

RE: Audit of the Chuuk State Debt Relief Fund

Dear Mr. San Jose:

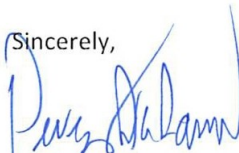
On behalf of all members of the Joint Government Restructuring Task Force, I would like to thank your office for conducting and completing the audit of Chuuk State's Debt Relief Fund.

Although we're practically new appointed members of the Task Force, we sincerely appreciate having the chance hear and learned a lot from the detailed information relating to the findings and recommendations rendered therein. As discussed during the Exit Conference, we have already worked on a draft Regulation to further define the role of the Task Force and its meeting procedures while setting the guideline of prioritizing debts and procedures from the Debt Relief and surely will take into consideration some of the recommendations made by your office in order for the Task Force to be able to maintained and provide an effective and efficient debt management services going forward.

We agree to the findings and will seriously consider your recommendations. We will work in close collaboration with all relevant stakeholders as we venture into the very important undertaking.

Kinisou chapwur!

Sincerely,



Perez Graham
Chairman, JGRTF

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DEPARTMENT OF ADMINISTRATIVE
SERVICES
STATE OF CHUUK

P.O. BOX 849
WENO, STATE OF CHUUK
F.S.M. 96942

TEL: (691) 330-2230/2239
FAX: (691) 330-2233

JESSE MORI
Director
TESIME KOFOT
Deputy Director

February 18, 2020

To: Mr. Manuel L. San Jose, Jr.
Chuuk State Public Auditor

From: Jesse Mori, Director
Department of Administrative Services

Subject: Management Response on Audit of Chuuk State Debt Relief Fund

Dear Mr. San Jose:

Hereunder are the following management response to the corresponding audit findings on Chuuk State Debt Relief Fund Audit.

Finding 1 - The records of debts or payables under debt relief fund are not properly maintained

Management Response:

We agree with the audit finding and recommendations to hire a bookkeeper or an accountant who will solely perform debt relief accounting, record keeping and monitoring functions for Debt Relief funds. The inadequate employees at DAS Finance caused the difficulty to assign handling debt relief accounting, monitoring and safekeeping documents. Accordingly, assigned employees who handle Debt Relief recording also had regular tasks indispensable to perform, thus in effect adversely affect the close monitoring of Debt Relief transactions.

Finding 2 – No clear plan on how to retire \$13 Million liabilities for claims and judgements and other payables which have been accumulating. Further, this amount is not transparent to public because it was reported and reflected in the financial statements

Management Response:

We agree with the audit finding and recommendations for the Debt Relief Task Force to have a plan or proposal on how the government would be able to identify, validate, and retire liabilities in accordance with the purpose provided by the Debt Relief Law. Subsequently, validated liabilities would then be recorded in Chuuk State Financial Statements.

A handwritten signature in black ink, appearing to read "J. Mori".

Jesse Mori
Director, DAS

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OCPA's EVALUATION OF MANAGEMENT RESPONSES

Public Auditor's counter response to the Chuuk State Department of Administrative Services
Management Response

We received a management response from the Department of Administrative Services which was in agreement with the audit findings and observations. We characterized the comments as responsive because they focused well on the issues raised in the audit report with much positivity in moving towards improvement in the Finance Department.

Public Auditor's counter response to the Chuuk State Joint Government Restructuring Task
Force Management Response

We received a management response from the Joint Government Restructuring Task Force (or Debt Relief Task Force) which was in agreement with the audit findings and observations. We characterized the comments as responsive because they focused well on the issues raised in the audit report with much positivity in moving towards improvement in the Debt Relief Task Force.

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PUBLIC AUDITOR'S COMMENTS

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

We have provided copies of the final report to the Governor, Members of the House of Representatives and House of Senate 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 can be found on the last page of this report along with the Public Auditor and staff that made major contributions to this report.



Manuel L. San Jose Jr., CPA, CIA, CISA, CRMA, CGAP, CFIP
Public Auditor
Chuuk State, FSM

February 27, 2020

CHUUK STATE DEBT RELIEF FUND: NO CLEAR PLAN ON HOW TO RETIRE \$13 MILLION LIABILITIES FOR
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OCPA CONTACT AND STAFF ACKNOWLEDGMENT

OCPA CONTACT: Manuel L San Jose, CPA, CGAP, CIA, CISA, CRMA, CFIP Public Auditor
Email: publicauditor@fmocpa.com

ACKNOWLEDGEMENTS

In addition to the contact named above, the following staff made key contributions to this report:
Rosalinda Mori, Auditor-In-Charge
Troy Richardson Chiwi, Audit Assistant

OCPA MISSION

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

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