

Public Transportation System

Financial Statements and Independent Auditor's Report

Fiscal Years Ended
September 30, 2005 and 2004



**Office of the Public Auditor
State of Yap
Federated States of Micronesia**



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EXECUTIVE SUMMARY

Financial Audit of the Public Transportation System for the Years ended September 30, 2005 and 2004

The Office of the Yap State Public Auditor has released the final financial audit report of the Public Transportation System (PTS) for the years ended September 30, 2005 and 2004 which report is dated October 5, 2006.

The auditor's opinion on the financial statements presented on page 1 states that the balance sheets, statements of revenues, expenses and changes in net assets and cash flows as of and for the years ended September 30, 2005 and 2004 are fairly presented in conformity with accounting principles generally accepted in the United States of America.

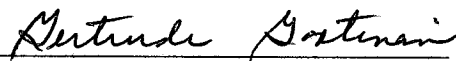
The Schedule of Federal Awards on page 8 shows that during fiscal year 2004 PTS expended \$7,184 in FEMA Public Assistance Grant Funds for Typhoon Sudal.

The report on internal control and compliance and other matters required by *Government Auditing Standards* on page 14 discusses reportable conditions at PTS. These conditions and our recommendations are presented for the information of PTS management in the Schedule of Findings beginning on page 16. Of the 8 findings, none is considered to be a material weakness. Five findings were related to inadequate controls while three were noncompliance with laws and regulations. Three findings were unresolved findings from the prior years.

Following is a summary of the audit findings for the year ended September 30, 2005:

- (1) Finding No. 1 cites PTS for noncompliance with its monthly financial reporting requirements.
- (2) Finding No. 2 relates to the lack of adequate reconciliation of PTS' general ledger.
- (3) Finding No. 3 pertains to potential conflict of interests. A mechanic at PTS is also a vendor occasionally selling spare parts to PTS.
- (4) Finding No. 4 discusses PTS' lack of a fixed asset capitalization policy.
- (5) Finding No. 5 relates to PTS' need to improve the accounting for its bus collections.
- (6) Finding No. 6 relates to the lack of a full Board for PTS. PTS currently has only three members whereas its enabling legislation calls for a five-member board of directors.
- (7) Finding No. 7 pertains to PTS inadequate maintenance of employment records.
- (8) Finding No. 8 is a noncompliance issue with PTS' Policies and Procedures manual that requires an amendment that has been discussed by the Board but has not been officially adopted.

The management of PTS has reviewed and agreed with the audit findings and related recommendations. PTS' written response is presented as part of the audit report beginning on page 21.


Gertrude Gootinan
Yap State Public Auditor
October 16, 2006

PUBLIC TRANSPORTATION SYSTEM
September 30, 2005 and 2004

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Public Transportation System:

I have audited the accompanying balance sheets of Public Transportation System (PTS) as of September 30, 2005 and 2004, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the PTS management. My responsibility is to express an opinion on these financial statements based on my audits.


I conducted my audits in accordance with auditing standards generally accepted in the United States and standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that I plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the PTS' internal control over financial reporting. Accordingly, I express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audits provide a reasonable basis for my opinion.

In my opinion, the financial statements referred to in the first paragraph, present fairly, in all material respects, the financial position of the Public Transportation System as of September 30, 2005 and 2004, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Management's discussion and analysis on pages 3 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. I have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurements and presentation of the required supplementary information. However, I did not audit the information and express no opinion on it.

The accompanying Schedule of Expenditures of Federal Awards (page 8) is presented for the purpose of additional analysis and is not a required part of the financial statements. This schedule is the responsibility of PTS's management. Such information has been subjected to the auditing procedures applied in my audit of the financial statements referred to in the first paragraph and, in my opinion, is fairly stated, in all material respects, when considered in relation to the financial statements taken as a whole.

In accordance with *Government Auditing Standards*, I have also issued a report dated October 5, 2006 on my consideration of the Public Transportation System's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, and contracts, grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of my audits.



Gertrude Gootinan
Yap State Public Auditor

October 5, 2006



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Management's Discussion and Analysis
September 30, 2005 and 2004

This section of Public Transportation System annual financial statement report presents our discussion and analysis of the System's financial performance for the year ended September 30, 2004 and 2005. Please read it in conjunction with the financial statements which is attached hereto.

Yap State Public Transportation System is the only public bus transportation operation that provides transportation to the public and private school students as well as the general public. The system was establish in 1984 under Yap State Law No. 1-170 as a component unit, an entity which the government is financially accountable and was tasked to provide reliable and affordable transportation for people living within and outside the Colonia area.

In addition to the financial difficulties that Public Transportation System faces annually, the devastation of Typhoon Sudal has been a major challenge. PTS has experienced a dramatic loss of revenue in the last two years. One of the major setbacks is the condition of our facility. In fiscal year 2004, the total revenue was \$218,029 and total expense for the same year is \$288,664. In fiscal year 2005 the total revenue was \$155,195 and the Operation expense was \$295,508. Government subsidy is inclusive under revenue for both fiscal years.

Currently, our shop and office facility is undergoing construction and should be completed in about five month's time.

The accompanying financial statements present the financial condition and operation of the Public Transportation System for the fiscal year 2005 and 2004.

Public Transportation System

Management's Discussion and Analysis

**Condensed Financial Information
September 30, 2005 and 2004**

	<u>2005</u>	<u>2004</u>
Assets		
Current assets	\$ 88,214	\$ 102,318
Property and equipment, net	<u>125,353</u>	<u>175,792</u>
	<u>213,567</u>	<u>278,110</u>
Liabilities and Net Assets		
Current liabilities	15,954	6,792
Net assets	<u>197,613</u>	<u>271,318</u>
	<u>\$ 213,567</u>	<u>\$ 278,110</u>
Revenues, Expenses and Changes in Net Assets		
Operating revenues	\$ 155,195	\$ 218,029
Operating expenses	<u>320,040</u>	<u>322,581</u>
Loss from operations	(164,845)	(104,552)
Nonoperating revenues	91,139	117,046
Increase/(decrease) in net assets	<u>\$ (73,706)</u>	<u>\$ 12,494</u>

PUBLIC TRANSPORTATION SYSTEM

Balance Sheets
September 30, 2005 and 2004

ASSETS	<u>2005</u>	<u>2004</u>
Current Assets		
Cash	\$ 44,489	\$ 45,541
Due from grantor	--	7,184
Travel advance, net	--	4,988
Trade receivables, net (note 2)	2,735	5,272
Prepaid expense	11,293	10,116
Spare parts inventory	<u>29,697</u>	<u>29,217</u>
Total current assets	88,214	102,318
Property and equipment, net (note 3)	<u>125,353</u>	<u>175,792</u>
TOTAL ASSETS	<u>\$ 213,567</u>	<u>\$ 278,110</u>
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable	\$ 9,613	\$ 5,490
Customer deposits	2,192	242
Accrued payroll and others	<u>4,149</u>	<u>1,060</u>
Total current liabilities	15,954	6,792
Contingencies		
Net assets:		
Invested in capital assets	125,353	175,792
Unrestricted	<u>72,260</u>	<u>95,526</u>
Total net assets	<u>197,613</u>	<u>271,318</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 213,567</u>	<u>\$ 278,110</u>

See accompanying notes to financial statements

PUBLIC TRANSPORTATION SYSTEM

Statements of Revenues, Expenses and Changes in Net Assets
For the Years ended September 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating revenues:		
Charges for transportation services	\$ 70,772	\$ 66,557
Auto shop service income	80,964	66,599
Fuel, parts & accessories sales	3,179	1,902
Other sales	280	75,540
Other revenue	<u> --</u>	<u> 7,431</u>
Total operating revenues	155,195	218,029
Cost of sales	<u>24,532</u>	<u>33,917</u>
Gross margin	<u>130,663</u>	<u>184,112</u>
Operating expenses		
Personnel services	132,572	141,844
Depreciation	59,100	67,407
Fuel, oil and lubricants	30,957	20,778
Parts, supplies & materials	22,569	6,247
Repair and maintenance	13,551	14,848
Insurance expenses	12,374	12,816
Bad debt expenses	7,869	1,797
Travel expense	5,570	--
Utilities and communications	5,256	9,019
Miscellaneous expenses	5,315	10,201
Board meeting expense	<u> 375</u>	<u> 3,707</u>
Total operating expenses	295,508	288,664
Loss from operations	(164,845)	(104,552)
Nonoperating revenues/(expenses)		
Yap State operating subsidy	89,120	133,038
Other expense	2,019	--
Other contribution	--	7,184
Loss on inventory	--	(17,978)
Typhoon Sudal loss	--	(4,848)
Loss from asset disposal	<u> --</u>	<u> (350)</u>
Total nonoperating revenues/(expenses)	91,139	117,046
Changes in net assets	(73,706)	12,494
Net assets - beginning of year	<u>271,318</u>	<u>258,824</u>
Net assets- end of year	<u>\$ 197,612</u>	<u>\$ 271,318</u>

See accompanying notes to financial statements

PUBLIC TRANSPORTATION SYSTEM

Statements of Cash Flows
For the Years Ended September 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Receipts from customers	\$ 159,327	\$ 163,852
Cash payments for goods and services	(113,045)	(131,694)
Cash payments to employees	(132,572)	(147,369)
Net cash used for operating activities	<u>(86,290)</u>	<u>(115,211)</u>
Cashflows from noncapital financing activities		
Operating subsidy from Yap State Government	89,120	133,038
FEMA grant reimbursement	7,184	(7,184)
Net cash provided by noncapital financing activities	<u>96,304</u>	<u>125,854</u>
Cashflows used for investing activities		
Acquisition of fixed assets	(11,066)	(12,771)
Net cash used for investing activities	<u>(11,066)</u>	<u>(12,771)</u>
Net decrease in cash	(1,052)	(2,128)
Cash, beginning of year	45,541	47,669
Cash, end of year	\$ <u>44,489</u>	\$ <u>45,541</u>
Reconciliation of operating loss to net cash used for operating activities:		
Loss from operations	\$ (164,845)	\$ (104,552)
Cash used in operating activities		
Depreciation	59,100	67,407
Bad debt expense	7,869	1,797
Prior period adjustments	(354)	(6,431)
(Increase)/Decrease in assets		
Travel advance	4,988	(4,227)
Trade receivables	2,537	6,964
Prepaid expense	(1,177)	(8,016)
Inventory	(480)	9,534
Increase/(Decrease) in liabilities		
Accounts payable	4,123	(15,248)
Customer deposits	1,949	--
Accrued expenses	--	(5,525)
Deferred revenue	--	(56,914)
Net cash used in operating activities	\$ <u>(86,290)</u>	\$ <u>(115,211)</u>
Supplemental disclosures of noncash transactions:		
1 Bad debt expense	\$ <u>7,869</u>	\$ <u>1,797</u>
2 Other revenue	\$ <u>--</u>	\$ <u>4,001</u>
3 Loss on inventory	\$ <u>--</u>	\$ <u>(17,978)</u>

See accompanying notes to financial statements

PUBLIC TRANSPORTATION SYSTEM

Schedule of Expenditures of Federal Awards
Years ended September 30, 2005 and 2004

<u>Grantor/CDFA Grantor's Program Title</u>	<u>Federal CFDA No.</u>	<u>Expenditures</u>	
		<u>2005</u>	<u>2004</u>
Federal Emergency Management Agency Grant (Note) FEMA-FM DR1511 Typhoon Sudal Public Assistance Grants Public Transportation System	83.516	\$ <u> --</u>	\$ <u>7,184.00</u>
TOTAL FEDERAL AWARDS EXPENDED		\$ <u> --</u>	\$ <u>7,184.00</u>

Note:

The amount above represents total reimburseable expenses incurred by PTS as of September 30, 2004 to set up and restore power to temporary office space in the aftermath of Typhoon Sudal. Work is covered under the scope of PW #46. FEMA Grants are received by PTS through the State of Yap.

PUBLIC TRANSPORTATION SYSTEM

Notes to Financial Statements
September 30, 2005 and 2004

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity – Prior to 1981, the Transportation and Construction Authority operated a transportation system with the assistance of the Yap Community Action Program. On October 29, 1981, a contract was executed by and between the Contractor, the Yap State Governor and the Chairman of the Bus System Board of Directors whereby the Yap State Government (State), through transfers from the General Fund, subsidized the operations. In fiscal year 1984, Yap State Law no. 1-170 established the Public Transportation System (PTS) as a component unit, an entity for which the government is financially accountable, to provide reliable and inexpensive transportation for those people living outside the Colonia area. PTS is not a legally separate entity from the State.

Basis of Accounting - PTS utilizes accounting principles generally accepted in the United States of America as is applicable to proprietary funds of governmental entities. Such funds are accounted for using the flow of economic resources measurement focus. Thus, revenues are recorded when earned and liabilities at the time expenses are incurred.

Accounting Standards – Government Accounting Standards Board (GASB) Statement No. 20, “*Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*” requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures on or before November 30, 1989. PTS has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

Governmental Accounting Standards Board (GASB) Statement No. 34 (*Basic Financial Statements – and Management’s Discussion and analysis – for State and Local Governments*) establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into four net asset categories:

- (a) **Invested in capital assets, net of related debt** – Capital assets, net of accumulated depreciation, and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- (b) **Nonexpendable** – Net assets subject to externally imposed stipulations that require the PTS to maintain them permanently.
- (c) **Expendable** – Net assets whose use by the PTS is subject to externally imposed stipulations that can be fulfilled by actions of the System pursuant to those stipulations or that expire by the passage of time.
- (d) **Unrestricted** – Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

PTS does not have restricted net assets as of September 30, 2005 and 2004.

PUBLIC TRANSPORTATION SYSTEM

Notes to Financial Statements
September 30, 2005 and 2004

GASB No. 34 establishes a new financial reporting model that includes management's discussion and analysis, which is required supplementary information to the basis financial statements, and the presentation of net assets and changes in net assets in comparative financial statements.

Concurrent with the implementation of GASB No. 34, PTS also adopted GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange Transactions*. Statement No. 33 defines and classifies non-exchange transactions into four categories and establishes the timing of recording of each category of transactions in the financial statements. Hence, operating grants PTS received from the State of Yap are classified as voluntary non-exchange transactions as defined by GASB Statement No. 33. Thus, the grants are reported on the accompanying Statements of Revenues, Expenses and Changes in Net Assets as non-operating revenue, regardless whether such grants are used to acquire capital assets. Before the adoption of these accounting pronouncements, PTS recorded as additions to contributed capital, the portion of operating grants used to acquire capital assets.

New Accounting Standards - For fiscal year 2005, PTS implemented GASB Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment to GASB Statement No. 3)*. The impact of GASB Statement No. 40 was not significant to the financial statements.

For fiscal year 2006, PTS will be implementing GASB Statement No. 46, *Net Assets Restricted by Legislation*. Management does not anticipate that implementation of GASB Statement No. 46 will have a material financial statement impact.

Cash - For purposes of the balance sheet and statement of cash flows, cash represents cash on hand and cash on deposit in a bank account. All of the balances at September 30, 2005 and 2004 are fully collateralized as such are subject to Federal Deposit Insurance Corporation (FDIC) coverage.

Accounts Receivable - Substantially all of the System's accounts receivable are with customers and government agencies based in the State.

Inventory - Inventory is stated at specific identification cost and is charged to expense as used.

Depreciation - Property and equipment is stated at cost less accumulated depreciation. Routine maintenance and repairs are expensed as incurred. Depreciation is recorded in the financial statements using the straight-line method over the estimated useful lives of the assets as follows:

Buildings	10 to 25 years
Vehicles	3 to 7 years
Shop equipment	2 to 7 years
Office furniture and equipment	2 to 10 years

PTS threshold for capitalizing fixed assets is \$100.00.

PUBLIC TRANSPORTATION SYSTEM

Notes to Financial Statements
September 30, 2005 and 2004

Reclassifications – Certain reclassifications have been made to the fiscal year 2004 balances and amounts in order to conform to the fiscal year 2005 presentation.

Use of Estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. TRADE RECEIVABLE

A summary of trade receivables at September 30, 2005 and 2004 is presented below:

	<u>2005</u>	<u>2004</u>
Current & former employees	\$ 21,945	\$ 16,371
Board members	6,641	6,641
State departments & agencies	17,617	29,969
Other trade customers	<u>34,430</u>	<u>23,004</u>
	80,633	75,985
Less allowance for doubtful accounts	<u>(77,898)</u>	<u>(70,713)</u>
	<u>\$ 2,735</u>	<u>\$ 5,272</u>

3. PROPERTY AND EQUIPMENT

A summary of property and equipment as of September 30, 2005 and 2004 is as follows:

	<u>Beginning Balance October 1, 2004</u>	<u>Transfers And Additions</u>	<u>Transfers And Disposals</u>	<u>Ending Balance September 30, 2005</u>
Buildings	\$ 34,656	\$ --	\$ --	\$ 34,656
Vehicles	716,211	--	--	716,211
Shop Equipment	37,985	10,526	(734)	47,777
Office Equipment	<u>50,549</u>	<u>540</u>	<u>(1,991)</u>	<u>49,098</u>
	839,401	11,066	(2,725)	847,742
Less accumulated depreciation	(663,609)	(59,100)	320	(722,389)
	<u>\$ 175,792</u>	<u>\$ (48,034)</u>	<u>\$ (2,405)</u>	<u>\$ 125,353</u>

PUBLIC TRANSPORTATION SYSTEM

Notes to Financial Statements
September 30, 2005 and 2004

PROPERTY & EQUIPMENT (cont.)

	Beginning Balance October 1, 2003	Transfers And Additions	Transfers And Disposals	Ending Balance September 30, 2004
Buildings	\$ 92,659	\$ --	\$ (58,003)	\$ 34,656
Vehicles	718,707	3,900	(6,396)	716,211
Shop Equipment	32,687	5,298	--	37,985
Office Equipment	57,488	3,573	(10,512)	50,549
	901,541	12,771	(74,911)	839,401
Less accumulated depreciation	(659,755)	(67,407)	63,553	(663,609)
	<u>\$ 241,786</u>	<u>\$ (54,636)</u>	<u>\$ (11,358)</u>	<u>\$ 175,792</u>

4. CONTINGENCIES

PTS does not hold title to the land or building in which it conducts current operations. Title to such property is held by the Yap State Government. No charges are assessed for the use of these facilities.

5. RELATED PARTY TRANSACTIONS

In the ordinary course of business, PTS enters into transactions with private businesses and State departments and agencies in which certain of PTS board members hold positions of influence. PTS rents housing from one board member for one expatriate employee. Sales to related parties for the year ended September 30, 2005 was \$5,170.85.

6. OPERATING GRANTS

The State provided under YSL 6-40 funds for operations of \$89,120 from General Fund moneys to PTS for fiscal year 2005. In fiscal year 2004, PTS received funds of \$133,038 from the State Legislature. Operating grants are recorded as nonoperating revenues in the accompanying Schedule of Revenues, Expenses, and Changes in Net Assets.

7. RISK MANAGEMENT

PTS carries general liability insurance on its bus fleet and its passengers, but is self-insured for all other risks. Management is of the opinion that no material losses have been sustained as a result of this practice.

PUBLIC TRANSPORTATION SYSTEM

Notes to Financial Statements
September 30, 2005 and 2004

8. OTHER CONTRIBUTION

On April 9, 2004, Typhoon Sudal struck Yap with destructive winds in excess of 125 miles per hour. PTS suffered major damages to its office building, shop, storage building, koyeng and its communication antennae. Damage estimates of \$93,487 were prepared and submitted for FEMA funding. FEMA approved funding for four project worksheets (#36, 37, 38 and 46) aggregating \$93,317 for PTS assets under FEMA FM-DMR1511 Public Assistance Grant for Typhoon Sudal during fiscal year 2004. The contracts to repair the office and storage buildings will be procured by the Department of Public Works and Transportation.

Also approved for reimbursement under PW #46 were \$7,184 incurred by PTS for the set up of and power restoration to the temporary PTS office. These costs shown as due from grantor on the accompanying balance sheet and other contributions on the statement of revenues and expenses for the year ended September 30, 2004 were reimbursed to PTS per Yap State check no. 15327 dated June 15, 2005.

9. TYPHOON LOSS

Typhoon loss of \$4,848 for the year ended September 30, 2004 represents the net book value of office equipment damaged by Typhoon Sudal. Adjustments made to record estimated damages to other assets such as buildings were absorbed by the accumulated depreciation for the assets requiring no additional losses to be recorded for fiscal year 2004.

10. SUBSEQUENT EVENTS

A local contractor is currently working on PTS Office, Shop, and storage building damaged from Typhoon Sudal. The koyeng project is completed.



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**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

To the Board of Directors
Public Transportation System:

I have audited the financial statements of the Public Transportation System, as of and for the year ended September 30, 2005, and have issued my report thereon dated October 5, 2006. I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

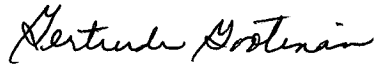
Internal Control Over Financial Reporting

In planning and performing my audit, I considered the Public Transportation System's internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing my opinion on the financial statements and not to provide assurance on the internal control over financial reporting. My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that might be material to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. I noted no matters involving the internal control over financial reporting and its operation that I consider to be material weaknesses. However, I noted other matters involving the internal control over financial reporting that I have reported to management of the Public Transportation System as Findings Nos. 2, 3, 5, 7 and 8 in the accompanying Schedule of Findings.

Compliance

As part of obtaining reasonable assurance about whether the Public Transportation System's financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit and accordingly, I do not express such an opinion. The results of my tests disclosed certain instances of noncompliance required to be reported under *Government Auditing Standards* which we have presented to management as Findings Nos. 1, 3, 4, and 6 in the Schedule of Findings.

This report is intended for the information of the Board of Directors and management of the Public Transportation System, the Governor and the State Legislature, federal awarding agencies, pass-through entities, the cognizant audit and other federal agencies, and is not intended to be, and should not be, used by anyone other than those specified parties. However, this report is a matter of public record, therefore, its distribution is not limited.



Gertrude Gootinan
Yap State Public Auditor

October 5, 2006

PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings
September 30, 2005 and 2004

Finding No. 1 – Financial Reporting Policy

Criteria: PTS Regulation and Policy on Financial Reporting stated that a written monthly financial report is to be submitted to the Board with details on the following:

- “11.1 The current fund balance of the General Account;
- 11.2 The amount and accountability of funds obligated or disbursed from the account;
- 11.3 The amount of funds received (generated, donated, or appropriated) by PTS;
- 11.4 The amount of funds deposited in the account and their sources;
- 11.5 The amount of funds receivable and their sources...”

Condition: Monthly financial reports were not prepared by accounting staff, reviewed by the General Manager and submitted to the Board for the Board of Directors update on the financial status of PTS.

Cause: Management was not required to submit monthly financial reports to the Board. Such reports would have the accounting staff prepare accurate, updated and complete reports to be verified by the General Manager for unusual variances before submitting to the Board.

Effect: Noncompliance with existing financial reporting policy increases the risk of misstatements in the accounting records.

Recommendation: We recommend the Board to follow the PTS Regulation and Policy they adopted in October 2001.

Finding No. 2 – Reconciliation of the General Ledger

Criteria: Controls should be in place to ensure that accounting records are periodically reconciled in a manner consistent with accounting principles generally accepted in the United States.

Condition:

1. Carry-over account balances were not properly adjusted in the following Accounts; Allotment Payable, Social Security Tax Payable, National Taxes W/Payable, Deferred Revenue, and Employee Housing Benefit Expense.
2. Prior year disputed balances were included in Accounts Receivable Listing at 9.30.05.
3. Spare Parts Inventory listing was misstated at 9.30.05 and was not reconciled to FY 05 Physical Count.

PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings
September 30, 2005 and 2004

Finding No. 2 (Cont.)

4. From November 2004 to December 2004, board meeting compensation were recorded as Legal and Professional Expense, then from January 2005 to September 2005, the same type of transactions were recorded to a different account - PTS Board Meeting account.

Cause: There was no formal review of accounting reports to ensure accurate, reliable and proper recording and posting of transactions to the general ledger and no verification to confirm that monthly reconciliation was completed on time.

Effect: Untimely reconciliation of accounts increases the risk of unreliable and misleading financial statements.

Recommendation: We recommend that the General Manager direct the accounting staff to reconcile the general ledger on a monthly basis and submit accurate financial reports to the Manager and Board for review. Moreover, the Board and Manager should review financial reports and ask for details on unusual items from accounting staff. We recommend that the General Manager make certain all reconciliation is accurately done on a timely manner for PTS to meet the reporting deadlines of the State Government.

Prior Year Status: Similar findings were issued in PTS audit reports for the years ended September 30, 2004 and 2003 on Spare Parts Inventory, Reconciliation of Accounts, Recording of Accrued Expense, and Chart of Accounts.

Finding No. 3 – Potential Conflict of Interests

Criteria: Section 14.1 of PTS Regulation and Policy states “Conflict or Improper Influence – No employee or manager of PTS may engage in any action which might result in or create the appearance of using his or her public office for private gain giving preferential treatment to any organization or person impeding PTS’s efficiency or economy, losing complete independence or impartiality of action, making a decision for PTS outside official channels or without proper authorization, or affecting adversely the confidence of the public in the integrity of PTS operation”.

Condition: PTS purchased from M & M Car Dealership auto spare parts worth \$1,528.34 in Fiscal Year 2005.

Cause: Existing policies to prevent conflict of interests were not followed.

Effect: A potential conflict of interest exists since a PTS full-time expatriate mechanic is part owner of M&M Car Dealership. The enterprise’s local partner is related by marriage to the board member on whose land the dealership is located. The PTS mechanic conducts his private business out of his apartment under lease by PTS from the Board member.

Recommendation: We recommend that the management and Board of PTS to acknowledge and abide by the PTS Regulation and Policy which they adopted in October 2001 and disentangle themselves from business arrangements with potential conflicts of interest.

PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings
September 30, 2005 and 2004

Finding No. 4 – Fixed Asset Capitalization Policy

Criteria: There should be a policy in place on capitalization of fixed assets stating the threshold for amounts to be capitalized and ones to be expensed in order to have consistent accounting records.

Condition: PTS currently follows an unofficial capitalization threshold for fixed assets of \$100. Yet we found that fixed assets new additions in FY05 included 8 chairs worth \$140.

Cause: The accounting staff was not required to have consistent financial records.

Effect: The lack of an official policy increases the risk of inconsistent and misleading financial statements.

Recommendation: We recommend the General Manger to direct accounting staff by making sure that a fixed asset capitalization policy is applicable.

Finding No. 5 – Bus Collections

Criteria: Internal controls should be established to ensure that revenues are properly recorded.

Condition: PTS recorded in its general ledger bus collections of \$64,398 for the year ended September 30, 2004 and \$70,772 for the year ended September 30, 2005. PTS also had a revenue account called "Cash Over/Short". Differences between the daily passenger tally and the cash collections from the drivers were recorded in the account. The credit balance of \$2,159 in FY04 and \$6,178.47 in FY05 in the "Cash Over/Short" account suggested that during these two fiscal years, cash collected exceeded the tally of passengers. Collections are determined from collector's information on the cash collection versus passenger tallies.

Cause: The Board of Directors did not require Management and staff to submit a monthly report on revenues earned and support the variances by explaining why they had such variance in bus collections.

Effect: There is greater risk of errors in the collection and recording of bus fares.

Recommendation: We recommend the Board and General Manager to find a solution in ensuring that passenger tallies are accurate and to further ensure that all passenger fares are properly recorded and banked.

Prior Year Status: A similar finding was issued in the audit reports for PTS for the years ended September 30, 2004, 2003, 2002, 2001, 2000, 1999.

PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings
September 30, 2005 and 2004

Finding No. 6 – Board Nomination

Criteria: Title 25 Subsection 1002: Board of Directors states “*there is hereby established a Board of Directors of the Public Transportation System which shall consist of five members*”.

Condition: In FY 05, PTS Board of Directors had only three members with two seats vacant since FY04.

Cause: The Board and the General Manager had not meet with the Governor to address the issue on having two appointees to the Board of PTS.

Effect: PTS is in noncompliance with its enabling legislation.

Recommendation: We recommend the Board of Directors to officially communicate with the Governor to appoint two more individuals to the Board.

Prior Year Status: A similar finding was issued in PTS audit report for the year ended September 30, 2004.

Finding No. 7 – Employment Records

Criteria: The PTS Personnel Manual adopted in August 2003 called for the use of personnel action forms for all individuals considered to be permanent employees of PTS.

Condition: Our follow up on a prior year finding found that employee records at PTS remain incomplete. The Personnel Action form has not been filled out with the necessary information for all the employees.

Cause: Management did not require accounting staff to have a completed personnel action form in each employee file. Important employee information is not formally documented in a comparable personnel action form.

Effect: The Personnel Manual entitles permanent employees to earn a certain number of vacation leave hours each pay period. The leave benefit also increases depending on length of service. Pertinent employee information required to properly track leave accruals is not readily available given PTS’ current method of maintaining employee records.

Recommendation: We recommend that the General Manager require staff to update PTS employee records by including completed personnel action forms in all employee files.

Prior Year Status: A similar finding was cited in the audit reports for PTS for the years ended September 30, 2004, 2003, 2002, 2001, 2000, and 1999.

PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings
September 30, 2005 and 2004

Finding No. 8 – Board Approval of Transactions

Criteria: Policies adopted by the Board should be enforced. Otherwise, impractical and unrealistic policies should be revised to meet the needs of the organization.

Condition: Section 10.2 of PTS Regulation and Policy adopted in October 2001 states, “No transaction may be had, or funds drawn from PTS accounts, if the amount involved is over \$500 unless the board by majority decision, authorizes the transaction...” As written, the policy basically requires the board to meet on a daily basis to vote on the transactions, according to the General Manager. Otherwise, PTS would have had to defer processing of payables until after the Board had had a chance to meet and approve transactions. Consequently, PTS was not following this policy.

Cause: The Board had intended to amend the particular provision in the draft regulations, but did not assign a time frame to have the official draft for review and approval on the modification to be made to the PTS Regulation and Policy.

Effect: Per PTS Board Meeting on May 10, 2005, the Board has assigned to the Vice-Chairman the task to formulate a resolution to modify the PTS Regulation and Policy to increase the amount of \$500 to \$2,000 requiring Board approval with the exception to fuel and oil purchases.

Recommendation: A formal modification to the PTS Policy and Regulation has not been documented. Therefore, this finding remains unresolved. We recommend the Board to ensure the revision is made through a formal communication as was decided in a board meeting dated May 10, 2005.

Prior Year Status: A similar finding was issued in the audit report for PTS for the year ended September 30, 2003 and 2002.



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July 19, 2006

To : Ms. Gertrude Gootinan, Yap State Public Auditor

Thru : Mr. Peter Garamfel, Chairman of the Board

Subject : Audit Response and MD&A

Dear Auditor:

We would like to thank you and your staff for your time during our exit meeting on our fiscal year 2005 and 2004 draft audit review and allowing time to complete our audit response and MD&A

Please find attached to this letter our MD&A and audit response to your draft audit report for fiscal year 2005 and 2004.

Respectfully,

Jeffrey Adalbai
General Manager
Public Transportation System



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RESPONSES TO AUDITORS REPORT (Findings)

Finding No. 1- Financial Policy

Responses:

PTS Management submits financials report to the board on every meeting. However, this has been discussed with management and will be carried out as recommended.

Finding No. 2 – Reconciliation of General Ledger

Responses:

This has been discussed with the management and his staff and will be carried out as recommended.

Finding No. 3 – Potential Conflict of Interests

Responses:

As discussed in the exit meeting, the board will discuss this issue with the management and find ways to resolve this finding.

Finding No. 4 – Fixed Asset Capitalization Policy

Responses:

This has been discussed with the management and his staff and will be carried out as recommended.

Finding No. 5 – Bus Collections

Responses:

This has been discussed with the management and his staff and will be carried out as recommended.

Finding No. 6 – Board Nomination

Responses:

This has been discussed with the management and his staff and will be carried out as recommended.

Finding No. 7 – Employment Record

Responses:

PTS has implemented as recommended and should reflect in 2005/6 audit.

Finding No. 8 – Board Approval of Transaction

Responses:

The board has assigned a member to draft a resolution to its regulation and should be carried as recommended.