

**PUBLIC TRANSPORTATION SYSTEM**  
**Financial Statements and**  
**Independent Auditor's Report**  
**Years ended September 30, 2006 and 2005**



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# OFFICE OF THE PUBLIC AUDITOR

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## EXECUTIVE SUMMARY

### Financial Audit of the Public Transportation System for the Years ended September 30, 2006 and 2005

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, 2006 and 2005 which report is dated February 14, 2008.

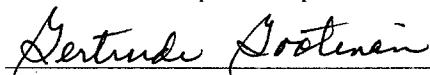
The auditor's opinion on the financial statements presented on page 1 states that the balance sheets, statements of revenues, expenses and changes in net assets and cash flows as of and for the years ended September 30, 2005 and 2004 are fairly presented in conformity with accounting principles generally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

The report on internal control and compliance and other matters required by *Government Auditing Standards* on page 12 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 14. Of the 9 findings, none is considered to be a material weakness. Seven findings were related to inadequate controls while two were noncompliance with laws and regulations and grant agreements. Three findings were unresolved from the prior years.

Following is a summary of the audit findings for the year ended September 30, 2006:

- Findings Nos. 1 and 9 relate to inadequate maintenance of personnel records. Not all permanent employees have a duly approved personnel action on file as per a prior year recommendation to that effect. Moreover, a review of daily time and attendance records on file at PTS showed inconsistent documentation of actual time worked.
- Findings Nos. 2 and 4 relate to the problems of collections for employee and board member receivables and insufficient justification for excessive cash advances to travelers.
- Findings No. 3 discusses potential conflicts of interest when businesses owned by PTS employees are allowed to participate in purchasing contracts with PTS.
- Findings No. 5 and 6 pertains to noncompliance with the MOU and State competitive procurement requirements to which PTS must adhere as terms and conditions of the operating subsidy it receives annually from the State Legislature.
- Findings No. 7 and 8 discusses weaknesses in the manner that PTS currently accounts for its liabilities and bus collections.

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

June 6, 2008

# PUBLIC TRANSPORTATION SYSTEM

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**INDEPENDENT AUDITOR'S REPORT**

To the Board of Directors of  
Public Transportation System:

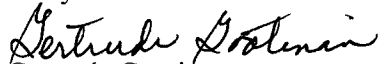
I have audited the accompanying balance sheets of Public Transportation System (PTS) as of September 30, 2006 and 2005, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the PTS management. 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, 2006 and 2005, 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 2 and 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.

In accordance with *Government Auditing Standards*, I have also issued a report dated February 14, 2008 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. The purpose of that report is to describe the scope of my testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of any 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

February 14, 2008



**Public Transportation System  
Yap State Government  
P.O. Box 118 • Colonia, Yap • FSM 96943**

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**Management's Discussion and Analysis  
September 30, 2005 and 2006**

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, 2005 and 2006. Financial statement for PTS 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 established 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, global increase cost in fuel has created financial difficulties for the system. Cost of maintenance for the current bus fleet has increased due mainly to each bus surpassing its useful life span and repeated budget cut by the state for purchase of new buses. In fiscal year 2005, the total revenue was \$155,195.00 with Government Subsidy of 89,120.00 and total expense for the same year was \$ 295,508.00. In fiscal year 2006 the total revenue was \$ 153,197.00 with Government Subsidy of \$ 164,688.00 and the Operation expense was \$ 295,656.00.

PTS is currently working on plans to corporatize the operation of the system. Included in the plans will be a five year development plan that would entail diversifying of PTS operation.

The accompanying financial statements present the financial condition and operation of the Public Transportation System for the fiscal year 2005 and 2006.

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Any complaint of discrimination, please write to,  
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P.O. Box 118, Colonia Yap, FM 96943

**Public Transportation System**  
Management's Discussion and Analysis  
September 30, 2006 and 2005

**Condensed Financial Statements**

	<u>2006</u>	<u>2005</u>
Assets		
Current Assets	\$ 111,953	\$ 88,214
Property and equipment, net	<u>93,801</u>	<u>125,353</u>
Liabilities and Net Assets	<u>\$ 205,754</u>	<u>\$ 213,567</u>
Current Liabilities	\$ 4,355	\$ 15,954
Net Assets	<u>201,399</u>	<u>197,613</u>
	<u>\$ 205,754</u>	<u>\$ 213,567</u>
Revenues, Expenses and Changes in Net Assets		
Operating Revenues	\$ 153,197	\$ 155,195
Cost of Sales	(37,170)	(24,532)
Operating Expenses	<u>(275,656)</u>	<u>(295,508)</u>
Loss from operations	(159,629)	(164,845)
Nonoperating revenues	<u>163,415</u>	<u>91,139</u>
Increase/(decrease) in net assets	<u>\$ 3,786</u>	<u>\$ (73,706)</u>

**PUBLIC TRANSPORTATION SYSTEM**

Balance Sheets  
September 30, 2006 and 2005

ASSETS	<u>2006</u>	<u>2005</u>
Current Assets		
Cash	\$ 42,933	\$ 44,489
Trade receivables, net (note 2)	1,624	2,735
Employees receivable	525	--
Prepaid insurance	11,293	11,293
Spare parts inventory	21,332	29,697
Deferred costs	<u>34,246</u>	<u>--</u>
Total current assets	111,953	88,214
Property and equipment, net (note 3)	<u>93,801</u>	<u>125,353</u>
<b>TOTAL ASSETS</b>	<u><u>\$ 205,754</u></u>	<u><u>\$ 213,567</u></u>
<b>LIABILITIES AND NET ASSETS</b>		
Current liabilities		
Accounts payable-trade	\$ 570	\$ 9,613
Due to the State Government	1,383	--
Customer deposits	243	2,192
Accrued payroll and others	<u>2,159</u>	<u>4,149</u>
Total current liabilities	4,355	15,954
Contingencies		
Net assets		
Invested in capital assets	93,801	125,353
Unrestricted	<u>107,598</u>	<u>72,260</u>
Total net assets	<u>201,399</u>	<u>197,613</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<u><u>\$ 205,754</u></u>	<u><u>\$ 213,567</u></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, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Operating revenues		
Charges for transportation services	\$ 75,279	\$ 70,772
Auto shop service income	69,552	80,964
Fuel, parts & accessories sales	8,210	3,179
Other sales	156	280
	153,197	155,195
Cost of sales	37,170	24,532
Gross margin	116,027	130,663
Operating expenses		
Personnel services	122,375	132,572
Depreciation	50,117	59,100
Fuel, oil and lubricants	46,173	30,957
Parts, supplies & materials	11,851	22,569
Insurance expenses	13,552	12,374
Repair and maintenance	12,729	13,551
Utilities and communications	7,537	5,256
Miscellaneous expenses	7,213	5,690
Travel expense	3,370	5,570
Bad debt expenses	739	7,869
	275,656	295,508
Loss from operations	(159,629)	(164,845)
Nonoperating revenues/(expenses)		
Yap State operating subsidy	164,688	89,120
Other expenses	(1,273)	2,019
	163,415	91,139
Changes in net assets	3,786	(73,705)
Net assets - beginning of year	197,613	271,318
Net assets- end of year	\$ 201,399	\$ 197,613

See accompanying notes to financial statements



**PUBLIC TRANSPORTATION SYSTEM**

Statements of Cash Flows  
For the Years Ended September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities		
Receipts from customers	\$ 151,834	\$ 159,327
Cash payments for goods and services	(175,860)	(113,045)
Cash payments to employees	<u>(124,365)</u>	<u>(132,572)</u>
Net cash used for operating activities	<u>(148,391)</u>	<u>(86,290)</u>
Cash flows from noncapital financing activities		
Operating subsidy from Yap State Government	166,071	89,120
FEMA grant reimbursement	<u>--</u>	<u>7,184</u>
Net cash provided by noncapital financing activities	<u>166,071</u>	<u>96,304</u>
Cash flows used for investing activities		
Acquisition of fixed assets	<u>(19,236)</u>	<u>(11,066)</u>
Net cash used for investing activities	<u>(19,236)</u>	<u>(11,066)</u>
Net decrease in cash	(1,556)	(1,052)
Cash, beginning of year	<u>44,489</u>	<u>45,541</u>
Cash, end of year	<u>\$ 42,933</u>	<u>\$ 44,489</u>
Reconciliation of operating loss to net cash used for operating activities		
Loss from operations	\$ (159,629)	\$ (164,845)
Adjustments to reconcile loss from operations to net cash used in operating activities		
Depreciation	50,117	59,100
Bad debt expense	739	7,869
Prior period adjustments	(1,341)	(354)
(Increase)/decrease in assets		
Travel advance	--	4,988
Employees receivable	(525)	--
Trade receivables	1,111	2,537
Prepaid Insurance	--	(1,177)
Inventory	8,365	(480)
Deferred costs	(34,246)	--
Increase/(decrease) in liabilities		
Accounts payable	(9,043)	4,123
Customer deposits	(1,949)	1,949
Accrued expenses	<u>(1,990)</u>	<u>--</u>
Net cash used in operating activities	<u>\$ (148,391)</u>	<u>\$ (86,290)</u>

See accompanying notes to financial statements

# PUBLIC TRANSPORTATION SYSTEM

Notes to Financial Statements  
September 30, 2006 and 2005

## 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*) established 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.

The PTS does not have nonexpendable restricted net assets as of September 30, 2006 and 2005.

**New Accounting Standards** – During fiscal year 2006, PTS implemented the following pronouncements:

## PUBLIC TRANSPORTATION SYSTEM

Notes to Financial Statements  
September 30, 2006 and 2005

GASB Statement No. 42, "*Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*", which establishes standards for impairment of capital assets when its service utility has declined significantly and unexpectedly.

GASB Statement No. 46, "*Net Assets Restricted by Enabling Legislation (an amendment to GASB Statement No. 34)*", which requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets.

GASB Statement No. 47, "*Accounting for Termination Benefits*", which establishes guidance for state and local government employees on accounting and financial reporting for termination of benefits.

GASB Technical Bulletin No. 2004-2, "*Recognition of Pension and Other Post-employment Benefit Expenditures/Expenses and Liabilities by Cost-Sharing Employers*", which clarifies the requirements of GASB Statements Nos. 27 and 45 for recognition of pension and other post-employment benefit expenditures/expenses and liabilities by cost-sharing employers.

The adoption of these pronouncements did not have a material impact on the accompanying 2006 financial statements.

In April 2004, GASB issued Statement No. 43, "*Financial Reporting for Post-employment Benefit Plans Other than Pension Plans*". GASB Statement No. 43 establishes uniform financial reporting for other post-employment benefits plans by state and local governments. The provisions of this Statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of PTS.

In July 2004, GASB issued Statement No. 45, "*Accounting and Financial Reporting by Employers for Post Employment Benefits Other than Pensions*". GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other post employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of Statement No. 45 will have a material effect on the financial statements of PTS.

In September 30, 2006, GASB issued Statement No. 48, "*Sales and Pledges of Receivables and Future Revenue and Intra-Entity Transfer of Assets and Future Revenues*". GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. The Statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. The provisions of this Statement are effective for periods beginning after December 15, 2006. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of PTS.

## PUBLIC TRANSPORTATION SYSTEM

### Notes to Financial Statements September 30, 2006 and 2005

collateralized as such are subject to Federal Deposit Insurance Corporation (FDIC) coverage.

**Accounts Receivable** – Substantially all of the PTS'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 capitalizes assets with costs of at least \$300 and useful lives of at least two years.

**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.

**Reclassifications** – Certain reclassifications have been made to the fiscal year 2005 balances in order to conform to the 2006 presentation.

## 2. TRADE RECEIVABLE

A summary of trade receivables at September 30, 2006 and 2005 is presented below:

	<u>2006</u>	<u>2005</u>
Current and former employees	\$ 26,004	\$ 21,945
Current and former board members	6,641	6,641
State departments and agencies	15,439	17,617
Other trade customers	<u>32,177</u>	<u>34,430</u>
	80,261	80,633
Less allowance for doubtful accounts	<u>(78,637)</u>	<u>(77,898)</u>
	<u>\$ 1,624</u>	<u>\$ 2,735</u>

## PUBLIC TRANSPORTATION SYSTEM

Notes to Financial Statements  
September 30, 2006 and 2005

### 3. DEFERRED COSTS

Deferred costs consist of \$34,246 worth of bus parts and supplies paid before September 30, 2006, but not received until November 8, 2006.

### 4. PROPERTY AND EQUIPMENT

A summary of property and equipment as of September 30, 2006 and 2005 is as follows:

	<u>Beginning Balance October 1, 2005</u>	<u>Transfers And Additions</u>	<u>Transfers And Disposals</u>	<u>Ending Balance September 30, 2006</u>
Buildings	\$ 34,656	\$ --	\$ --	\$ 34,656
Vehicles	716,211	4,900	--	721,111
Shop Equipment	47,777	--	(140)	47,637
Office Equipment	49,098	14,336	(1,973)	61,461
	<u>847,742</u>	<u>19,236</u>	<u>(2,113)</u>	<u>864,865</u>
Less accumulated depreciation	<u>(722,389)</u>	<u>(50,117)</u>	<u>1,442</u>	<u>(771,064)</u>
	<u>\$ 125,353</u>	<u>\$ (30,881)</u>	<u>\$ (671)</u>	<u>\$ 93,801</u>

	<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	50,549	540	(1,991)	49,098
	<u>839,401</u>	<u>11,066</u>	<u>(2,725)</u>	<u>847,742</u>
Less accumulated depreciation	<u>(663,609)</u>	<u>(59,100)</u>	<u>320</u>	<u>(722,389)</u>
	<u>\$ 175,792</u>	<u>\$ (48,034)</u>	<u>\$ (2,405)</u>	<u>\$ 125,353</u>

### 5. 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.

## **PUBLIC TRANSPORTATION SYSTEM**

Notes to Financial Statements  
September 30, 2006 and 2005

### **6. OPERATING GRANTS**

Operating grants received by PTS are presented as non-operating revenues on the accompanying Statements of Revenues, Expenses and Changes in Net Assets. PTS was authorized an operating subsidy of \$170,592 for fiscal year 2006 as appropriated by the State Legislature from General Fund monies under YSL 6-57 and 6-65. The grants had a lapse date of September 30, 2006 and a provision for unexpended balances to revert to the General Fund upon expiration of the grant. The funds were paid to PTS on a reimbursement basis under the terms of a Memorandum of Agreement with the Office of Administrative Services. At September 30, 2006, total grant payments received by PTS was \$166,071. \$1,383 in cash advanced for a off-island purchase order was not expended before September 30, 2006 and is therefore presented as a liability on the accompanying balance sheet. Other purchase orders worth \$4,919 were encumbered by the State Finance against the grant on behalf of PTS as of September 30, 2006.

The State Legislature appropriated under YSL 6-40, \$89,120 to defray the costs of PTS' operations for the year ended September 30, 2005.

### **7. 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. Check disbursements to related parties for the year ended September 30, 2006 was \$8,988.

### **8. 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.

### **9. SUBSEQUENT EVENTS**

Construction of the new PTS office building and repairs of the shop funded by FEMA Public Assistance Grants for Typhoon Sudal and managed by the Contracts Division of the Department of Public Works and Transportation commenced in October 2006. Repair of the shop was completed in December 2006 and construction of the office building in February 2007.



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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, 2006, and have issued my report thereon dated February 14, 2008. 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. Reportable conditions involve matters coming to my attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in my judgment, could adversely affect the Public Transportation System's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

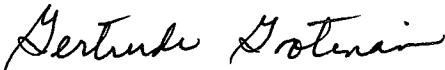
A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. My consideration on the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, I noted no matters involving the internal control over financial reporting and its operation that I considered to be material weaknesses. Other matters involving the internal control over financial reporting are reported to management of the Public Transportation System in the accompanying Schedule of Findings as Finding No. 1 thru 4 and 7 thru 12.

**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 instances of noncompliance that is required to be reported under *Government Auditing Standards*. These are presented in the Schedule of Findings as Findings Nos. 5 and 6.

This report is intended for the information of the Board of Directors and management of the Public Transportation System, 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

February 14, 2008



## PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings  
September 30, 2006 and 2005

### **Finding No. 1 – Daily Time & Attendance Records**

**Criteria:** Salaried employees are expected to perform a full-day's work for a full-day's pay much the same as employees who earn their pay on an hourly basis. In fact, the distinct difference between salaried employees and employees on wages is that salaried employees are generally not eligible for overtime pay.

**Condition:** Our tests of payroll transactions showed two employees who did not consistently record daily time and attendance during fiscal year 2006 – the general manager and a shop mechanic.

**Cause:** The Board had authorized a fixed salary for the general manager, therefore, it was believed that he did not have to document his time and attendance since it would not affect his biweekly salary. A review of the mechanics' standard contract showed that mechanics too were on a fixed biweekly income. But, the contract also stated that a full workweek consisted of 40 hours and that he would be eligible for overtime. There was no stated requirement for the mechanics to work 80 full hours to earn his biweekly compensation.

**Effect:** PTS personnel manual authorizes vacation leave benefits for permanent employees. Unused vacation leave hours are eligible to be paid in cash to employees upon their termination of employment with PTS. It is not clear whether the GM is a permanent employee of PTS, but if he were to earn vacation leave hours, it is important for him to document his daily time and attendance so that his leave accruals could be adjusted accordingly. Otherwise, PTS would pay him twice for each leave hour earned, once for undocumented time-off for personal business, and twice upon his termination of employment.

**Recommendation:** We recommend that the General Manager begin documenting his daily time and attendance and thereby serve as an example to his employees who may be on hourly wages. Moreover, we recommend that the Board and the GM review and clarify the following existing ambiguities relating to personnel:

- (1) Are the expatriate mechanics salaried or wage employees? We recommend that the language of the mechanics' standard contract be revised to clarify whether they are on hourly wages or salaries. If the mechanics are salaried, the references to overtime should be eliminated from their contracts.
- (2) Employment contracts for salaried employees should emphasize the need for employees to work a full workweek as a part of their salaried status. Such contracts should specify authorized paid time off such as for sick days or vacation, or holidays and the manner in which the employee should apply for such compensated absences.

### **Finding No. 2 – Employees Receivable**

**Criteria:** Policies and procedures should be in place to ensure timely collection of balances owed by employees and Board members.

**Condition:** Included in trade receivables of \$80,261 at September 30, 2005 were \$23,194 owed by former board members and employees of PTS, \$5,907 owed by current board members and \$4,069 owed by current employees. All the balances owed by board members and former employees were more than one year old. Of the balances owed by current employees, only \$1,509 was less than one year old.

**Cause:** There were no controls in place to ensure timely payments on employee outstanding balances and employee cash advances.

## PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings  
September 30, 2006 and 2005

### **Finding No. 2 – Employees Receivable (cont.)**

**Effect:** PTS is currently examining many of the old employees and directors accounts for possible write-off as uncollectible. Credit sales and cash advances from employees decrease the amount of cash available for PTS operation, further increasing its dependence on subsidies from the State Government.

**Recommendation:** We recommend the Board adopt a policy to prohibit cash advances and sales on credit to Board members and employees as collection on these accounts have historically been dismal. If it is absolutely necessary for PTS to front payments on behalf of employees, repayment should be required of employees as soon as the next pay period, thereby limiting the charges to amount; that employees could settle within one pay period.

### **Finding No. 3 – Conflict of Interest**

**Criteria:** Adopted in 2001 by the Board of Directors of PTS, 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’ efficiency or economy ...*”. (Emphasis added.)

**Condition:** The general manager and a mechanic each own personal businesses transact business with PTS. PTS purchased spare parts worth approximately \$268 during fiscal year 2006 from the mechanic’s store. Also during the year, the general manager’s business responded to and won a bid solicitation from PTS for hand-radios worth \$1,330. Other known transactions purchased through the GM’s business include \$878 worth of batteries and other supplies purchased for PTS.

**Cause:** Existing policies on avoiding conflicts of interest were not followed.

**Effect:** A mechanic at PTS who has access to PTS’ spare parts and who is also in the business of selling spare parts creates the appearance of conflicts of interests. Moreover, it increases the risk that PTS could be buying parts once held in its stockroom from its employee. Likewise, a general manager who is responsible for identifying suppliers for PTS should not himself create a company through which he can accomplish the tasks for which he is hired. It would be like the Public Auditor creating her own firm and channeling purchases for the Office through the firm.

**Recommendation:** We recommend the Board enforce the provisions of the PTS Policy and Regulations manual by prohibiting Board members and employees of PTS and their immediate family members from participating in purchasing and other contracts with PTS.

**Prior Year Status:** A similar finding was cited for in PTS audit reports for the years ended September 30, 2005 and 2004.

### **Finding No. 4 – Travel Advance**

**Criteria:** Travel advances should be limited to per diem and car rental and such other incidental expenses that can be reasonably estimated. To safeguard cash, blanket cash advances should not be given to travelers without sufficient documentation of the actual costs to be incurred.

## PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings  
September 30, 2006 and 2005

### **Finding No. 4 – Travel Advance (cont.)**

**Condition:** During the year ended September 30, 2006, the manager sought and obtained authorization from the Board of Directors for a trip to the Philippines. PTS paid full per diem and car rental for the two week trip when it was obvious that one purpose of the trip was unrelated to the traveler's position as an employee of PTS. In addition, \$4,500 was advanced to the employee for "office supplies, parts and equipment".

According to PTS employees, a religious associate of the manager who was originally from the Philippines was traveling to the Philippines. The manager took the opportunity to utilize the associate's knowledge of people and places in the Philippines to also travel at the same time to recruit a replacement mechanic and visit suppliers.

**Cause:** The board of directors did not require the traveler to provide a schedule of activities for the two-week trip in order to limit per diem and car rental to only those days that the traveler would be spending time on PTS business.

**Effect:** Despite the obvious dual purpose of the trip, PTS paid full per diem and car rental to the traveler for the two weeks. A trip report was not available for review, but a review of the travel voucher found that PTS incurred about \$3,502 in airfare, per diem and car rental but purchased only approximately \$792 in office supplies and car parts. Car rental receipts showed the manager's associate as additional driver for the vehicle rented and paid for by PTS. Upon his return, the traveler reimbursed PTS for \$3,912 in excess cash advanced to him for the trip. Such a large amount of cash advanced increased the risk of misuse of PTS funds.

**Recommendation:** We recommend that the Board of Directors adopt a policy to limit the amount of travel advances to costs that could be reasonably estimated or documented at the outset of travel. Moreover, the Board should prohibit 100% funding for a trip if the primary purpose of the trip is unrelated to PTS business. We also recommend that the Board should formulate policies and procedures for co-funding such trips to avoid future confusion.

### **Finding No. 5 – Memorandum of Agreements**

**Criteria:** PTS is responsible to ensure its compliance with grant agreements.

**Condition:** For the year ended September 30, 2006, PTS was allotted two grants from the State Legislature – an operating subsidy of \$115,430 appropriated by YSL 6-57 and a supplemental grant authorized in the amount of \$55,162 by YSL 6-65 specifically for the purchase of bus parts and supplies. The MOU for the operating subsidy required grant funds to be paid to PTS only a reimbursement basis, while the MOU for the supplement grant for bus parts authorized the grant funds to be advanced to PTS. Appropriation laws for both grants required unexpended balances to revert to the General Fund upon the expiration date of September 30, 2006.

Our review of the ledger maintained by PTS to account for the grants showed that the ledger was inadequate to ensure that cash was not requested in advance of purchases for the operating grant and to ensure that unexpended balances at year-end were accurately documented and remitted to the State General Fund.

# PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings  
September 30, 2006 and 2005

## **Finding No. 5 – Memorandum of Agreements (cont.)**

**Cause:** Information critical to identifying PTS checks submitted for reimbursement was not maintained on the ledger.

**Effect:** On at least one occasion, PTS did in fact receive a cash advance of the operating grant, despite the MOU requiring reimbursement payment only. In addition, because of inadequate documentation of reimbursement claim, PTS was not able to claim the total authorized operating subsidy even though actual operating expenses exceeded the amount of the grant. In contrast, the ledger contained inadequate documentation to show how much of the supplemental grant for bus parts remained unexpended as of September 30, 2006.

**Recommendation:** We recommend that records of reimbursement and expenditures of the grants received from the State are revised and improved to sufficiently ensure compliance with grant terms and conditions.

## **Finding No. 6 – Noncompliance With State Procurement Policy**

**Criteria:** Section 502 subsection (g) defines “Independent contractor means a person who contracts with another to do something for him who is not controlled by the other nor subject to the other’s right to control with respect to his physical conduct in the performance of the undertaking.”

The Yap State Code Title 9 section 521 subsection (b) states “all other purchases including those for services for independent contractors not otherwise included under subsection (a) of this section shall be subject to competitive purchasing. ‘Competitive purchasing’ as used herein means proof of price comparison of at least three vendors, when possible, indicating that the lowest price possible is applied thereto before a purchase order may be processed.”

**Condition:** On March 21, 2006, PTS issued a check to the manager of PC Outlet in Guam, in the amount of \$276 for printer cartridges without documenting that price comparison had been performed.

**Cause:** PTS did not comply with provisions stated in Memorandum of Agreement executed between the Office of Administrative Services and Public Transportation System “to assure prudent accountability of fiscal year funds appropriated or authorized by Yap State Law 6-57.

**Effect:** A component unit of the Yap State Government, PTS did not comply with State Law # 6-53 which identified competitive purchasing requirements.

**Recommendation:** We recommend the Board of Directors through formal review of financial operations to ensure applicable laws of the State are followed by PTS.

## **Finding No. 7 – Prior Year Invoices**

**Criteria:** Generally accepted accounting principles require that transactions are recorded in the proper period.

**Condition:** In January of 2007, PTS made a payment to EMI in the amount of \$569.85 for outstanding invoices dated June 21<sup>st</sup>, 2002, December 2<sup>nd</sup>, 2002, March 4<sup>th</sup>, 2003 and September 4<sup>th</sup>, 2003.

## PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings  
September 30, 2006 and 2005

### **Finding No. 7 – Prior Year Invoices (cont.)**

**Cause:** It is obvious that PTS had no procedures in place to ensure that unrecorded invoices were timely identified. Moreover, because employees were not required to initiate approval for purchases in writing such as occurs within a purchase order system, the accounting office was not aware of the existence of the invoices.

**Effect:** \$569.85 worth of fiscal year 2002 and 2003 expenses were recorded in fiscal year 2006. The amount is not material to the fiscal year 2006 financial statements.

**Recommendation:** To ensure that expenses are recorded in the proper period, we recommend that the accounting staff adopt as a standard year-end procedure the confirmation of accounts payable with vendors. Moreover, we recommend that management and the Board of Directors require the use of purchase order to ensure that purchases are properly approved by management before goods are acquired from vendors.

### **Finding No. 8 – Bus Collection**

**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 to support the variances by explaining why such discrepancies existed in bus collections records.

**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, 2005, 2004, 2003, 2002, 2001, 2000, 1999.

### **Finding No. 9 – 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.

## **PUBLIC TRANSPORTATION SYSTEM**

**Schedule of Findings**  
**September 30, 2006 and 2005**

### **Finding No. 9 – Employment Records (cont.)**

**Condition:** Per review on prior year finding, it was shown that employee records at PTS remain incomplete. The Personnel Action form had 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 consistently on standard personnel action forms.

**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, 2005, 2004, 2003, 2002, 2001, 2000, and 1999.



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**RESPONSES TO AUDITORS REPORT (Findings)**

**Finding No. 1- Daily Time & Attendance Records**

**Responses:**

Currently, the Board is formulating the Manger's contract to reflect the changes and will be carried out as recommended.

**Finding No. 2 – Employees Receivables**

**Responses:**

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

**Finding No. 3 – Conflict of Interest**

**Responses:**

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

**Finding No. 4 – Travel Advance**

**Responses:**

Approval of such travel was authorized by the Board in anticipation of financial savings by combining the trip with other interested organization to save cost on shipping charges. However, the Board sees the concerned as raised by the Auditor and concurs with the recommendation as presented by the Auditor.

**Finding No. 5 – Memorandum of Agreement**

**Responses:**

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

### **Finding No. 6 – Noncompliance with State Procurement Policy**

**Responses:**

The Management and staff have adopted this Procurement Policy.

### **Finding No. 7 – Prior Year Invoices**

**Responses:**

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

### **Finding No. 8 – Bus Collection**

**Responses:**

As a solution to this finding, PTS has placed in each bus, a secured fare box. We have encouraged riders through radio announcement to bring correct change for bus fares. Management and Board are discussing ways to come up with an efficient tally system

### **Finding No. 9 – Employment Record**

**Responses:**

PTS is in the process of implementing contracts for all of its employees and once completed, we should be in full compliances with the recommendation to this finding.