

Public Transportation System

Financial Statements and
Independent Auditor's Report

**Fiscal Years Ended
September 30, 2007 and 2006**



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YAP STATE GOVERNMENT
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EXECUTIVE SUMMARY

Financial Audit of the Public Transportation System For the Years ended September 30, 2007 and 2006

The Office of the Yap State Public Auditor was engaged to audit the Public Transportation System for the years ended September 30, 2007 and 2006 and has issued its report dated April 5, 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, 2007 and 2006 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. Six findings were related to inadequate controls while three were non compliance with laws and regulations and grant agreements. Four findings were unresolved from the prior years.

Following is a summary of the audit findings for the year ended September 30, 2007:

- Findings No. 1 relates to the improper usage of POL appropriation. The appropriation was received in July 2007 and was totally applied against fuel charges, though some fuel charges were dated prior to the appropriation date.
- Findings Nos. 2 and 3 discusses the non-compliance against laws and regulations and grant agreements relating to:
 - ◆ Usage of appropriated funds beyond the 90 days from lapse date.
 - ◆ State procurement requirement as to the price comparison from a representative number of vendors
- Findings Nos. 4 and 5 discusses missing or inadequate policies and procedures relating to:
 - ◆ Accounts Receivable
 - ◆ Travel Advances
- Findings Nos. 6 to 9 relates to internal control deficiencies.

We have met with the PTS management to discuss the findings and recommendations contained in this report. Their responses to the findings are presented on pages 21 to 22 of this report.

We would like to thank the Board of Directors, the management and staff of PTS for their assistance and cooperation during the course of this audit.



Wilfred Oliver L. Dolosa
Acting Yap State Public Auditor
Dec. 15, 2008

PUBLIC TRANSPORTATION SYSTEM

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Public Transportation System:

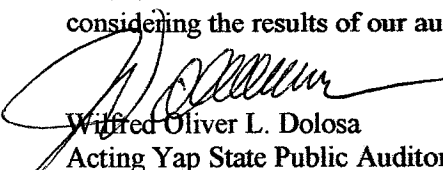
We have audited the accompanying balance sheets of Public Transportation System (PTS) as of September 30, 2007 and 2006, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the PTS management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our 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 we 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, we 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 presentation. We believe that our audits provide a reasonable basis for our opinion.

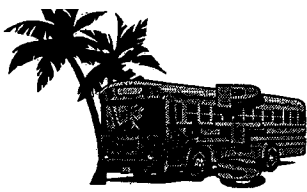
In our opinion, the financial statements referred to in the first paragraph, present fairly, in all material respects, the financial position of the Public Transportation System as of September 30, 2007 and 2006, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Management's discussion and analysis on page 2 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We 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, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 5, 2008 on our consideration of the Public Transportation System's internal control over financial reporting and our 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 our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide and opinion on the internal controls 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 our audits.


Wilfred Oliver L. Dolosa
Acting Yap State Public Auditor

April 5, 2008, except for Note 12 which date is June 4, 2008.



Public Transportation System

Yap State Government

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Management's Discussion and Analysis September 30, 2007

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.

This section of the Public Transportation System annual financial statement report presents our discussion and analysis of the System's financial performance for the year ended September 30, 2006 and 2007. Financial statement for PTS is attached hereto.

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 2006, the total revenue was \$116,027.00 with Government subsidy of \$163,415.00 and total expense for the same year was \$275,656.00. In fiscal year 2007 the total revenue was \$122,325.00 with Government Subsidy of \$218,543.00 and the Operation expense was \$298,291.00.

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 2006 and 2007.

PUBLIC TRANSPORTATION SYSTEM

Balance Sheets
For the Years Ended September 30, 2007 & 2006

ASSETS	<u>2007</u>	<u>2006</u>
Current Assets		
Cash	\$ 75,620	\$ 42,933
Trade receivables, net (note 2)	1,399	1,624
Employees receivables	30	525
Prepaid insurance	12,404	11,293
Inventory (note 3)	44,162	21,332
Deferred costs	-	34,246
	<hr/>	<hr/>
Total current assets	133,615	111,953
Property and equipment, net (note 4)	<hr/>	<hr/>
	144,326	93,801
TOTAL ASSETS	<u>\$ 277,941</u>	<u>\$ 205,754</u>
LIABILITIES AND DEFICIT		
Current liabilities:		
Accounts payable - trade	\$ 4,491	\$ 570
Due to the State Government (note 5)	22,551	1,383
Customer deposits	330	243
Accrued payroll and others	6,593	2,159
	<hr/>	<hr/>
Total current liabilities	33,965	4,355
Contingencies		
Net Assets		
Invested in capital assets	144,326	93,801
Unrestricted	99,650	107,598
	<hr/>	<hr/>
Total net assets	243,976	201,399
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 277,941</u>	<u>\$ 205,754</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, 2007 & 2006**

	<u>2007</u>	<u>2,006</u>
Operating revenues		
Charges for transportation services	\$ 73,613	75,279
Auto shop service income	97,332	69,552
Fuel, parts & accessories sales	11,326	8,210
Other sales	988	156
	<hr/>	<hr/>
	183,259	153,197
Cost of sales	<u>(60,934)</u>	<u>(37,170)</u>
Gross margin	<u>122,325</u>	<u>116,027</u>
Operating expenses		
Personnel services	115,278	122,375
Fuel, oil and lubricants	69,234	46,173
Depreciation	35,542	50,117
Parts, supplies & materials	24,771	11,851
Repair and maintenance	14,919	12,729
Insurance	13,774	13,552
Miscellaneous	13,340	7,213
Utilities and communication	8,761	7,537
Travel	2,672	3,370
Bad debt	-	739
	<hr/>	<hr/>
	298,291	275,656
Loss from operations	(175,966)	(159,629)
Nonoperating revenues/(expenses)		
Yap State operating subsidy (note 7)	139,876	164,688
FEMA Grants (note 8)	78,618	
Interest	49	-
Other expense	-	(1,273)
	<hr/>	<hr/>
	218,543	163,415
Changes in net assets	42,577	3,786
Net assets at beginning of year	<u>201,399</u>	<u>197,613</u>
Net assets - end of year	<u>\$ 243,976</u>	<u>201,399</u>

See accompanying notes to financial statements.

PUBLIC TRANSPORTATION SYSTEM

Statements of Cash Flows
For the Years Ended September 30, 2007 & 2006

Increase (Decrease) in Cash

	<u>2007</u>	<u>2006</u>
Cash flows from operating activities		
Receipts from customers	\$ 184,065	\$ 151,834
Cash payments for goods and services	(194,179)	(175,860)
Cash payments to employees	(110,844)	(124,365)
Net cash used for operating activities	<u>(120,958)</u>	<u>(148,391)</u>
Cash flows from noncapital financing activities		
Operating subsidy from Yap State Government	<u>239,664</u>	<u>166,071</u>
Net cash from non-capital financing activities	<u>239,664</u>	<u>166,071</u>
Cash flows used for investing activities		
Interest Income	48	-
Acquisition of fixed assets	<u>(86,067)</u>	<u>(19,236)</u>
Net cash used for investing activities	<u>(86,019)</u>	<u>(19,236)</u>
Net increase/(decrease) in cash	32,687	(1,556)
Cash, beginning of year	<u>42,933</u>	<u>44,489</u>
Cash, end of year	<u>\$ 75,620</u>	<u>\$ 42,933</u>
Reconciliation of operating loss to net cash used for operating activities		
Operating Loss:	\$ (175,966)	\$ (159,629)
Adjustments to reconcile loss from operations to net cash used in operating activities		
Depreciation	35,542	50,117
Bad debt	-	739
Prior period adjustments	-	(1,341)
(Increase)/Decrease in assets		
Trade receivables, net	224	1,111
Employees receivables, net	495	(525)
Prepaid insurance	(1,111)	-
Inventory	(22,830)	8,365
Deferred costs	34,246	(34,246)
Increase/(Decrease) in liabilities		
Accounts payable	3,921	(9,043)
Customer deposits	87	(1,949)
Accrued expenses	<u>4,434</u>	<u>(1,990)</u>
Net cash used in operating activities	<u>\$ (120,958)</u>	<u>\$ (148,391)</u>

See accompanying notes to financial statements

PUBLIC TRANSPORTATION SYSTEM

**Schedules of Expenditures of Federal Awards
September 30, 2007 and 2006**

Grantor/CFDA Grantor's Program Title	Federal CFDA #	Expenditures 2007	Expenditures 2006
Federal Emergency Management Agency Grant (Note 1) DMR-FM-1511 Typhoon Sudal Public Assistance Grants	CFDA 83.516	\$ 78,618	\$ --
TOTAL FEDERAL AWARDS EXPENDED:		\$ 78,618	\$ --

Note (1)

The FEMA Grant is passed through the FSM National Government to the State of Yap.

PUBLIC TRANSPORTATION SYSTEM

Notes To Financial Statements
September 30, 2007 and 2006

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 issued 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.

Government 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 PTS to maintain them permanently.
- (c) **Expendable** – Net assets whose use by 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 nonexpendable restricted net assets as of September 30, 2007 and 2006.

New Accounting Standards – During fiscal year 2007, PTS implemented the following pronouncements:

PUBLIC TRANSPORTATION SYSTEM

Notes To Financial Statements
September 30, 2007 and 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

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 2007 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, 2007 and 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

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, 2007 and 2006 are fully collateralized as such are subject to Federal Deposit Insurance Corporation (FDIC) coverage.

Accounts Receivables – Over half of PTS's accounts receivables are with current and former employees and board members.

Depreciation – Property and equipment is stated at cost less accumulated depreciation. Routine maintenance and repairs are expensed as incurred. PTS capitalizes assets with an original cost value of more than \$300 and an estimated useful life of more than two years.

Buildings	10-25 years
Vehicles	4-7 years
Shop Equipment	2-10 years
Office Furniture and Equipment	3-10 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.

2. TRADE RECEIVABLES

A summary of trade receivables at September 30, 2007 and 2006 is presented below:

	<u>2007</u>	<u>2006</u>
Current and former employees	\$ 5,383	\$ 26,004
Current and former board members	5,907	6,641
State departments and agencies	3,407	15,439
Other trade customers	4,415	32,177
	<u>19,112</u>	<u>80,261</u>
Less: allowance for doubtful accounts	<u>(17,713)</u>	<u>(78,637)</u>
	<u>\$ 1,399</u>	<u>\$ 1,624</u>

PUBLIC TRANSPORTATION SYSTEM

Notes To Financial Statements
September 30, 2007 and 2006

3. INVENTORY

Inventory is stated at specifically identified costs and consists primarily of spare parts for the buses and mechanics auto shop.

4. PROPERTY & EQUIPMENT

A summary of property and equipment as of September 30, 2007 and 2006 follows:

	Beginning balance October 1, 2006	Transfers And Additions	Transfers And Disposals	Ending balance September 30, 2007
Buildings	\$ 34,656	\$ 68,383	--	\$ 103,039
Vehicles	721,111	--	(51,777)	669,334
Shop Equipment	47,635	1,797	--	49,432
Office Equipment	61,460	15,887	--	77,347
	<u>864,862</u>	<u>86,067</u>	<u>(51,777)</u>	<u>899,152</u>
Less accumulated depreciation	<u>(771,061)</u>	<u>(35,542)</u>	<u>51,777</u>	<u>(754,826)</u>
	<u>\$ 93,801</u>	<u>\$ 50,525</u>	<u>\$ --</u>	<u>\$ 144,326</u>

	Beginning balance October 1, 2005	Transfers And Additions	Transfers And Disposals	Ending balance September 30, 2006
Buildings	\$ 34,656	\$ --	--	\$ 34,656
Vehicles	716,211	4,900	--	721,111
Shop Equipment	47,775	--	(140)	47,635
Office Equipment	49,097	14,336	(1,973)	61,460
	<u>847,739</u>	<u>19,236</u>	<u>(2,113)</u>	<u>864,862</u>
Less accumulated depreciation	<u>(722,386)</u>	<u>(50,117)</u>	<u>1,442</u>	<u>(771,061)</u>
	<u>\$ 125,353</u>	<u>\$ (30,881)</u>	<u>\$ (671)</u>	<u>\$ 93,801</u>

PUBLIC TRANSPORTATION SYSTEM

Notes To Financial Statements
September 30, 2007 and 2006

5. DUE TO STATE GOVERNMENT

Composition of the account are as follows:

a. Unexpended balance of FY07 operating subsidy from the State General Fund appropriated under YSL 7-5 for fuel. The Grant expired September 30, 2007	\$ 21,617
b. Unexpended balance of a cash advance charged to the FY06 operating subsidy from the State General Fund appropriated under YSL 6-67. The grant expired September 30, 2006	<u>934</u>
	<u>\$ 22,551</u>

6. 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.

7. YAP STATE OPERATING SUBSIDIES

Operating subsidies are presented as non-operating revenues on the accompanying Statements of Revenues, Expenses and Changes in Net Assets. For the fiscal year 2007, PTS received two appropriations from the Yap State Government. A total of \$112,447 was appropriated from the General Fund for the year ended September 30, 2007 under YSL 6-82. An additional \$44,000 was appropriated from the General Fund under YSL 7-5 for fuel. Both appropriations had a lapse date of September 30, 2007 and a provision for unexpended balances to revert to the General Fund upon expiration of the authority to obligate the funds. The funds appropriated under YSL No. 6-82 were paid to PTS on a reimbursement basis and the appropriation under YSL No. 7-16 was cash advanced to PTS on July 24, 2007.

The entire amount of \$112,447 had been disbursed in the fiscal year 2007. \$22,383 was disbursed out of the \$44,000 appropriation for fuel. An additional \$5,046 in FY06 subsidies was realized as revenue in the fiscal year 2007.

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 an 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.

PUBLIC TRANSPORTATION SYSTEM

Notes To Financial Statements
September 30, 2007 and 2006

8. FEDERAL EMERGENCY MANAGEMENT AGENCY (FEMA) GRANTS

There was a total of \$78,618 in expenditures of Federal Emergency Management Agency grants for the fiscal year 2007 under Project Worksheets #36 and #46. Funds were used towards repairs on the shop building in addition to the construction of the new office building and storage facility.

9. RELATED PARTY TRANSACTIONS

In the ordinary course of business, PTS enters into transactions with private businesses and State agencies in which certain board members hold positions of influence. PTS rented housing from one board member for one expatriate employee and made purchases from businesses owned by PTS employees. Cash disbursements to related parties for the years ended September 30, 2007 and 2006 were \$1,917 and \$8,988, respectively.

10. 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.

11. SUBSEQUENT EVENTS

For the fiscal year 2008, PTS requested a total of \$398,675 in operational funding. Under YSL No. 7-15, \$260,072, was appropriated to fund the System's operations. This appropriation will be paid out to PTS on a reimbursement basis per the Memorandum of Agreement (MOA) dated November 29, 2007. A supplementary budget for fiscal year 2008 of \$60,000 was appropriated under YSL No. 7-20 in February 2008.

12. June 4, 2008

The Yap State Legislature appropriated 62,494 to supplement an earlier appropriation of \$199,712 for the purchase of two additional buses. This brings total funding granted by the Legislature to PTS during FY08 to \$582,478 as of June 4, 2008. Also as of June 4, 2008, the proposed new bus fares set to take effect on April 28, 2008 was still in postponement until further notice. Under the proposed schedule, student fares was to increase from \$0.30 to \$0.75 and non-student fares was to increase from \$0.50 to \$1.00. The fare increase was still pending the Board's resolution of issues and questions raised by the public and state officials during the mandatory public hearing held by PTS to discuss the planned fare increase.



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

The Board of Directors of
Public Transportation System:

We have audited the financial statements of the Public Transportation System (PTS) as of and for the year ended September 30, 2007 and have issued our report thereon dated April 5, 2008. We conducted our audits 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 our audits, we considered PTS' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of PTS' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of PTS' internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or to detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects PTS' ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of PTS' financial statements that is more than inconsequential will not be prevented or detected by PTS' internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statement will not be prevented or detected by PTS' internal control.


Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, significant deficiencies identified are reported to management in the accompanying Schedule of Findings, as Findings Nos. 4 thru 9.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Public Transportation System's financial statements are free of material misstatement, we 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 our audits, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*, which are presented in the Schedule of Findings as Findings Nos. 1 thru 3.

This report is intended for the information and use of the management and Board of Directors of PTS and others within the entity, pass-thru entities, and federal awarding agencies and is not intended to be and should not be use by anyone other than these specified parties.



Wilfred Oliver L. Dolosa
Acting Yap State Public Auditor

April 5, 2008

PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings
September 30, 2007

Finding No. 1 – Improper Usage of POL Appropriation

Criteria: Yap State Law provides that “unless specified by law, all projects, programs, and operations financed by means of appropriation laws of the Legislature shall be contingent upon the availability of funds”.

Yap State Law No. 7-5 states that the authority to obligate the funds appropriated by this Act shall lapse as of September 30, 2007 and revert back to the General Fund any un-obligated balance.

Furthermore, the Pass-Thru-Grant/Sub Grant Agreement requires PTS to provide the State Government with quarterly reports no later than ten working days after the end of each fiscal quarter.

Condition: In July 2007, PTS received the \$44,000 appropriation and applied it against the FY2007 fuel charges which totaled \$72,733 as of July and recorded the same as revenue earned. Thus, no portion of the appropriation was reported as un-obligated as of September 30, 2007.

In addition, PTS did not submit a report concerning the year-end status of the appropriation in a timely manner to the appropriate authorities. The report was not prepared until well into the fiscal year 2008.

Cause: PTS used the appropriated funds to reimburse the entity by directly off-setting the appropriations with the POL account and these include fuel expenses prior to the appropriation’s date since they claimed that they requested the funds in January 2007.

Furthermore, there was no emphasis on the importance of preparing and submitting the report on a timely manner nor has there been consistent follow-up on the progress of the report.

Effect: There was non-compliance with Yap State Law and the Agreement endorsed by PTS and on the financial side, revenue is overstated and liability is understated by \$21,617.

Furthermore, delayed reports may have a detrimental effect on future budget requests as such are used to determine current and possible future funding need.

Recommendation: We recommend that management should ensure that PTS will only record revenue received from external sources to the extent of expenditure within the period of availability of funding and ensure the timely preparation and submission of required reports.

Finding No. 2 – Usage of Appropriated Funds Beyond 90 days from Lapse Date

Criteria: Under the Amended Compact, all valid obligations made as of the lapse date may be liquidated within ninety days of the lapse date. Those not liquidated within this period are considered cancelled and no lapsed funds may be used to settle outstanding obligations.

Condition: Included in the liability balance in FY 06 was a \$2,615 accounts payable to the State. This amount was cash advanced to PTS on September 1, 2006 for the purchase of an air compressor and accessories in Guam.

PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings
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Finding No. 2 – Usage of Appropriated Funds Beyond 90 days from Lapse Date (Cont.)

At the end of FY06, PTS wasn't able to purchase the parts and the cash advance was recorded as payable to the State.

In Oct. 2006 PTS was able to purchase the air compressor for \$1,120 and in January 2007, they bought the remaining spare part for \$804. Out of the total cash advanced, \$691 should have remained unexpended after the two purchases but according to PTS records, the unexpended amount was treated as a valid expenditure of the grant.

Cause: The items ordered were out of stock and it took the supplier more than 90 days to fill the order and submit the final invoice to PTS.

Effect: Controls over the use of the cash advance was lax. PTS still used \$804 of the appropriated funds beyond the required allowable time and did not return the \$691 balance of the cash advance.

Recommendation: We strongly recommend to management that they should strictly comply with all applicable requirements and laws. Strict monitoring of fund usage should always be observed to ensure compliance with the terms of appropriation laws and proper accounting of grant funds.

Finding No. 3 – State Procurement Requirements

Criteria: Before any purchases are made, there should be a price comparison from a representative number of vendors in accordance with procurement procedures of both the Amended Compact and Yap State Law No. 6.53.

Condition: During testing of a representative sample from PTS' check register, twelve selections with a total value of \$13,667 were not supported by documented evidence of price comparison. In addition, throughout the audit, it was noted that the System would acquire goods and services on credit and settle its accounts payables at the end of each month. PTS would then certify that funds were available at the end of the month when checks were issued to settle payables for the month.

Cause: For funds appropriated by the Yap State Law No. 6-82, the System was being paid on a reimbursement basis for expenses incurred; the appropriation was maintained at the Yap State finance. For PTS, being on a reimbursement basis allowed them to submit periodic expenditure reports to Finance and whatever expenses the System incurred and settled is reimbursed if Finance determined that they should have been.

Effect: PTS was not complying with Yap State Law in regards to documenting price comparisons; thus, price comparisons between vendors may not have been made. In addition, because PTS was on a reimbursement basis, it was relatively free to incur costs without going through the procurement procedures mandated by the FMA, as opposed to settling expenses through Finance. Furthermore, when it does incur questionable expenses (i.e. no price comparison), the Government may not reimburse the entity for those expenses and cash available to PTS decreases.

PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings
September 30, 2007

Finding No. 3 – State Procurement Requirements (Cont.)

Recommendation: We recommend that management ensure that all purchases, with the possible exception of disbursements of petty cash, price comparisons be performed and documented. For better control over State funds, all disbursements of future appropriations should comply with the requirements of the Financial Management Act. Furthermore, maintenance of credit accounts should be discontinued.

Prior Year Status: A similar finding was cited in the audit report for PTS for the year ended September 30, 2006.

Finding No. 4 – Receivables

Criteria: Adequate policies and procedures should be in place to ensure timely collection of balances owed by employees and board members. In addition, all records pertaining to receivables should be maintained accurately and reconciled periodically in order to facilitate collections of balances owed to PTS.

Condition: For the fiscal year 2007, a total of \$60,924 in accounts receivables were written off; this amount included a total of \$750 in related party receivables. Also, note that although cash advances to employees were being paid off, there was still a total of \$8,427 in employee receivables. Of this amount \$5,907 were owed by current board members and \$2,490 were owed by current employees.

Cause: There were inadequate controls in place to ensure timely collections on outstanding employee balances and employee cash advances. In addition, records were being maintained ineffectively.

Effect: Without adequate policies and procedures to ensure timely collections, more and more receivables are deemed uncollectible and written off. In addition, the current policy of estimating uncollectible receivables will only result in that much more write-offs and a smaller cash intake which greatly increases dependence on the government for subsidies. As it stands, PTS only expects to collect half of receivables that are less than a year old.

Recommendation: We recommend that the System adopt adequate policies and procedures in order to collect balances owed to PTS in a timely manner. With regards to related party receivables, if it is absolutely necessary for PTS to extend credit to its employees, repayment should be required of employees as soon as the next pay period. There should also be limits on credit extended to any employee or board member.

Prior Year Status: A similar finding was cited in the audit report for the year ended September 30, 2006.

Finding No. 5 – Travel Advances

Criteria: Travel advances should be limited to per diem and car rental and such other incidental expenses that could 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, 2007

Finding No. 5 – Travel Advances (Cont.)

Condition: In the fiscal year 2007, the manager sought and obtained authorization from the Board of Directors payment of the manager's car rental expense for a trip to Guam amounting to \$455. The manager's trip to Guam was for personal reasons although he had intended to take care of certain PTS business while he had the opportunity. Based on this, the Board of Directors approved the funding for the manager's car rental expense.

Cause: The Board of Directors did not require the traveler to provide a schedule of activities for the trip to Guam in order to limit car rental funding to only those days that the traveler would be spending time on PTS' business.

Effect: PTS paid full car rental to the traveler although it's not clear whether the vehicle had been used solely for the purpose of PTS business.

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.

Prior Period Status: A similar finding was issued in the audit reports for PTS for the year ended September 30, 2006.

Finding No. 6 – Inadequate Controls Over Inventory

Criteria: Sufficient controls over inventory should be in place in order to safeguard the System's assets.

Condition: There was a significant lack of control over inventory. We noted the following conditions:

- The inventory release log was managed manually and was missing for a long period of time from October 2007 to March 2008.
- PTS had been expensing out inventory items upon purchase instead of upon usage. In the fiscal year 2006, the System expensed a total of \$34,244 worth of inventory that wasn't received until November 2006.
- PTS only provided an ending value for the newly purchased bus spare parts well after the end of the fiscal year 2007 – in June 2008. Moreover, through review of the System's bus spare parts inventory listing, it was noted that there were 103 older spare parts, stored in the same location as the new ones, which were not assigned monetary values.
- Variances were noted with regards to the value of bus spare parts such as 1) \$5,632 variance, for spare parts located in the old container, between PTS' general ledger, inventory listing and audit results; 2) 3,053 variance, for new bus spare parts, between PTS' count and audit results.

Cause: PTS had been without an accountant from September 2007 through February 2008. Furthermore, there were several documents misplaced during the transfer of PTS from the temporary office space into the new office building.

PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings
September 30, 2007

Finding No. 6 – Inadequate Controls Over Inventory (Cont.)

Effect: Inadequate record-keeping together with the lack of controls over inventory increases the risk that some assets may have been used/or taken without proper authorization.

Recommendation: We strongly recommend that management observe the proper matching of cost and revenues with regards to the booking of inventory. Proper accounting controls should also be observed so that all assets are properly booked and safeguarded against loss or theft.

Finding No. 7 – Fixed Assets

Criteria: The System should safeguard its fixed assets.

Condition: While fixed asset registers were maintained for each asset type, there was no identification number assigned to the individual assets nor were locations noted with regards to where the assets were kept. Some of the assets were not physically secured as well. The buses were often-times parked at drivers' residences and the gate to the PTS complex was not locked.

In addition, during tests of other revenue, we found that the purchase of a FEMA-funded notebook with a value of \$1,750 was not recorded in PTS' books.

Cause: Loose control in safeguarding the System's assets. There were no asset identification numbers attached to the assets nor there were any locator listings to identify the area where assets were stored.

Effect: There is increased risk of abuse of the System's fixed assets when physical security of assets is questionable and records are inadequate.

Recommendation: We recommend that fixed assets be assigned identification numbers and locations for each recorded item on the applicable fixed asset register. Additionally, records should be maintained in a way that facilitates tracing of fixed assets value. All applicable records should be filed at the office for all grants that benefit the System.

Finding No. 8 – Bus Collection

Criteria: Internal controls should be established to ensure that all revenue earned is collected and properly recorded.

Condition: PTS' Cash Over & Short account represents the difference between the estimated fare as per daily passenger tally and the actual cash collections from the drivers. The mentioned account in previous years had shown credit balances (overages) which meant that cash collections exceeded the tally of passengers. In fiscal year 2007, PTS began booking the overages as part of the bus revenue while the shortages were posted in the Cash Over & Short account. Since the segregation was done in FY2007, the daily shortages have gone up as high as \$22 for a single bus. Total shortages for the year totaled \$1,661.

PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings
September 30, 2007

Finding No. 8 – Bus Collection (Cont.)

Cause: The present system for accounting for the number of paying passengers is deficient.

Effect: There is greater risk of errors in the collection and recording of bus fares which may lead to greater cash shortages in the future.

Recommendation: Per discussion with PTS, they are currently maintaining daily monitoring worksheets for each of the buses in order to improve collections. Additionally, the System does minimize the risk of theft by limiting access to the fare boxes. We would also recommend that PTS find a solution to ensure that passenger tallies are accurate and to further ensure that all passenger fares are properly recorded and banked. With regards to the recording cash overages and shortages, we would recommend that the overages be recorded in an account separate from bus revenues for control purposes and to make it more transparent just how much was collected above the passenger tally. It may benefit the System to have the driver tally and let the collector collect fares.

Prior Period Status: A similar finding was issued in the audit reports for PTS for the years ended September 30, 2006, 2005, 2004, 2003, 2002, 2001, 2000, 1999.

Finding No. 9 – Fuel Expenses

Criteria: Adequate controls are in place to ensure that all fuel expenses are reasonable and necessary.

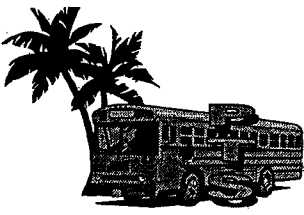
Condition: During the test of fuel expenses, there were conflicting details as to the fuel capacity of the buses and the service vehicles. Per discussion with the System, buses #1- #11 have fuel capacities of 40-50 gallons and bus #12 has a fuel capacity of 70 gallons. The service vehicles, a flatbed truck and a Pajero, have fuel capacities of approximately 25 gallons. However, we were unable to substantiate these claims. Valid documents were not available to substantiate quoted fuel capacities. As far as the buses are concerned, they are relatively old and the operating manual that was available on hand was not helpful.

Cause: There were inadequate controls over fuel expenses.

Effect: There is an increased risk of fuel abuse especially in periods of escalating fuel costs and limited supply.

Recommendation: We would recommend that the System establish a baseline for reasonable and necessary fuel usage. This may be done by determining an estimate of how long each route is – in time as well as distance – and the amount of fuel each bus requires upon refueling. We would also suggest that all buses be required to refuel according to the refueling schedule as to make estimates valid. This would establish a baseline for required fuel for each bus; there can also be a flexible range of acceptable variance from this baseline. For all extra fuel released outside this range, there should be some sort of document explaining the need for the additional fuel, signed by management, the individual releasing the fuel and the person receiving the fuel.

In regards to the service vehicles, a log for vehicle usage and approximate fuel consumption may prove helpful.



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RESPONSES TO AUDITORS REPORT (Findings)

Finding No. 1- Improper Usage of POL Appropriation

Responses:

Management assumed that the funding could be used back to the system's fuel shortfall date. However management and his staff have been advised to discuss this matter with the office of the Governor for appropriate extension and adapted the required recommendation; ensuring that records from external sources to the extent of expenditure within the available period and submission of required reports and request of extension when required.

Finding No. 2 – Usage of Appropriated Funds beyond 90 days from Lapse Date

Responses:

This requirement has been adapted by the management and his staff; ensuring to comply with applicable requirements and the terms of appropriation law with strict monitoring of fund usage.

Finding No. 3 – State Procurement Requirements

Responses:

This requirement has been adapted by the management and his staff.

Finding No. 4 – Receivables

Responses:

This has been discussed with the management. The Board is seeking ways to implement as recommended.

Finding No. 5 – Travel Advances

Responses:

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

Finding No. 6 – Inadequate Controls over Inventory

Responses:

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

Finding No. 7 – Fixed Assets

Responses:

Buses are kept at driver's residence after route and not brought back to PTS to minimize use of fuel and eliminate over time. Other aspect of this finding has been discussed with the management and his staff and will be carried out as recommended.

Finding No. 8 – Bus Collection

Responses:

Each fare box mounted on a bus has a lockable mechanism and the key is kept in the office. Only the secretary, office clerk or the accountant has access to the key and to retrieve collection each morning. Currently the tally system is done by the collector on each bus. If collector is not available then bus driver is required to complete the tally system on forms provided. Management has been advised adopt as recommended.

Finding No. 9 – Fuel Expenses

Responses:

This has been discussed with management and his staff. Currently, the management is implementing on locking all fuel cap of all buses to eliminate possible fuel draw from outside. Several buses do have locking caps.