

Public Transportation System

Financial Statements and
Independent Auditor's Report

**Fiscal Years Ended
September 30, 2008 and 2007**



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



**OFFICE OF THE STATE PUBLIC AUDITOR
YAP STATE GOVERNMENT**

Federated States of Micronesia

P.O. Box 927

Colonia, Yap FM 96943

Phone: (691) 350-3416 Fax: (691) 350-4987 Email: audit Yap @mail.fm

EXECUTIVE SUMMARY

**Financial Audit of the Public Transportation System
For the Years ended September 30, 2008 and 2007**

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, 2008 and 2007 which report is dated September 19, 2010.

The auditor's opinion on the financial statements presented on page 1, which is "unqualified", 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, 2008 and 2007 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.

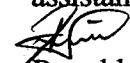
The report on internal control and compliance and other matters required by *Government Auditing Standards* on pages 13 to 14 discusses reportable conditions at PTS. These conditions and our recommendations are presented for the information of PTS management in the Schedule of Findings beginning on page 15. Of the eight findings, none is considered to be a material weakness. All of the eight findings were related to inadequate controls. Six of the eight findings were unresolved findings from prior years.

Following is a summary of the audit findings for the year ended September 30, 2008:

- Finding no.1 relates to improper accounting of grants revenue and expenditures.
- Finding no. 2 relates to unresolved prior year findings.
- Findings no. 3 thru 5 and 8 relates to internal control deficiencies.
- Findings no. 6 and 7 discusses missing or inadequate policies and procedures relating to:
 - Accounts receivable
 - Travel advances

We have met with the PTS Board of Directors and Management to discuss the findings and recommendations contained in this report. Their responses to the findings are presented on pages 22 to 23 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.


Ronald C. Yow
Yap State Public Auditor
September 19, 2010

PUBLIC TRANSPORTATION SYSTEM

Table of Contents Years Ended September 30, 2008 and 2007

Independent Auditor's Report	1
Management's Discussion and Analysis	2
Balance Sheets	3
Statements of Revenues, Expenses and Changes in Net Assets	4
Statements of Cash Flows	5
Schedule of Expenditures of Federal Awards	6
Notes to Financial Statements	7
Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based Upon the Audit Performed in Accordance With <i>Government Auditing Standards</i>	13
Schedule of Findings	15
Management's Response to Findings	22



OFFICE OF THE STATE PUBLIC AUDITOR
YAP STATE GOVERNMENT
Federated States of Micronesia
P.O. Box 927
Colonia, Yap FM 96943

Phone: (691) 350-3416 Fax: (691) 350-4987 Email: auditvap@mail.fm

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, 2008 and 2007, 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 statement 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, 2008 and 2007, 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 September 19, 2010 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 an 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.

Ronald C. Yow
Yap State Public Auditor

September 19, 2010



Public Transportation System
Yap State Government
P.O. Box 118 • Colonia, Yap • FSM 96943
Phone (691) 350-2118 • Fax 350-3895 • Email pts@mail.fm

Management's Discussion and Analysis
September 30, 2008

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, 2008 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. Even though the local fuel cost has dropped, but has remained at a point that Pubic Transportation 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.

PTS is currently working on plans to corprotize 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 2007 and 2008.

PUBLIC TRANSPORTATION SYSTEM

Balance Sheets For the Years Ended September 30, 2008 and 2007

ASSETS :	<u>2008</u>	<u>2007</u>
Current Assets		
Cash	\$ 120,884	\$ 75,620
Trade receivables, net (note 2)	6,050	1,399
Purchase order advance	149,421	-
Employees receivables	-	30
Prepaid insurance	12,250	12,404
Inventory (note 3)	40,932	44,162
	<hr/>	<hr/>
Total current assets	329,537	133,615
Property and equipment, net (note 4)	<u>120,588</u>	<u>144,326</u>
TOTAL ASSETS	<u>\$ 450,125</u>	<u>\$ 277,941</u>
LIABILITIES AND NET ASSETS :		
Current liabilities:		
Accounts payable - trade	\$ 6,241	\$ 4,491
Due to the State Government (note 5)	1,017	22,551
Deferred revenue	218,915	-
Customer deposits	2,550	330
Accrued payroll and others	7,704	6,593
	<hr/>	<hr/>
Total current liabilities	236,427	33,965
Contingencies		
Net Assets		
Invested in capital assets	120,588	144,326
Unrestricted	93,110	99,650
	<hr/>	<hr/>
Total net assets	<u>213,698</u>	<u>243,976</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 450,125</u>	<u>\$ 277,941</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, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Operating revenues		
Charges for transportation services	\$ 93,554	\$ 73,613
Auto shop service income	52,558	97,332
Fuel, parts & accessories sales	116,251	11,326
Other sales	<u>8,719</u>	<u>988</u>
	271,082	183,259
Cost of sales	<u>118,676</u>	<u>60,934</u>
Gross margin	<u>152,406</u>	<u>122,325</u>
Operating expenses		
Personnel services	108,074	115,278
Fuel, oil and lubricants	107,879	69,234
Depreciation	27,273	35,542
Parts, supplies & materials	10,278	24,771
Repair and maintenance	21,965	14,919
Insurance	14,854	13,774
Miscellaneous	14,707	13,340
Utilities and communication	8,271	8,761
Travel	<u>5,544</u>	<u>2,672</u>
	<u>318,845</u>	<u>298,291</u>
Loss from operations	(166,439)	(175,966)
Nonoperating revenues/(expenses)		
Yap State operating subsidy (note 7)	134,894	139,876
FEMA Grants (note 8)	-	78,618
Recovery of Bad Debts	1,089	-
Interest	<u>178</u>	<u>49</u>
	<u>136,161</u>	<u>218,543</u>
Changes in net assets	(30,278)	42,577
Net assets at beginning of year	<u>243,976</u>	<u>201,399</u>
Net assets - end of year	<u>\$ 213,698</u>	<u>243,976</u>

See accompanying notes to financial statements.

PUBLIC TRANSPORTATION SYSTEM

Statements of Cash Flows
For the Years Ended September 30, 2008 and 2007

Increase (Decrease) in Cash

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities		
Receipts from customers	\$ 119,259	\$ 184,065
Cash payments for goods and services	(297,039)	(194,179)
Cash payments to employees	(106,963)	(110,844)
Net cash used for operating activities	<u>(284,743)</u>	<u>(120,958)</u>
 Cash flows from noncapital financing activities		
Operating subsidy from Yap State Government	134,894	239,664
Recovery from bad debts	1,089	-
Increase/(decrease) in Due to State Government	(21,534)	-
Increase/(decrease) in Deferred Revenue	<u>218,915</u>	<u>-</u>
Net cash from non-capital financing activities	333,364	239,664
 Cash flows used for investing activities		
Interest Income	178	48
Acquisition of fixed assets	<u>(3,535)</u>	<u>(86,067)</u>
Net cash used for investing activities	(3,357)	(86,019)
 Net increase/(decrease) in cash	45,264	32,687
 Cash, beginning of year	<u>75,620</u>	<u>42,933</u>
 Cash, end of year	<u><u>\$ 120,884</u></u>	<u><u>\$ 75,620</u></u>
 Reconciliation of operating loss to net cash used for operating activities		
Operating Loss:	\$ (166,439)	\$ (175,966)
Adjustments to reconcile loss from operations to net cash used in operating activities		
Depreciation	27,273	35,542
(Increase)/Decrease in assets		
Trade receivables, net	(4,651)	224
Purchase order advance	(149,421)	-
Employees receivables, net	30	495
Prepaid insurance	154	(1,111)
Inventory	3,230	(22,830)
Deferred costs	-	34,246
Increase/(Decrease) in liabilities		
Accounts payable	1,750	3,921
Customer deposits	2,220	87
Accrued expenses	<u>1,111</u>	<u>4,434</u>
Net cash used in operating activities	<u><u>\$ (284,743)</u></u>	<u><u>(120,958)</u></u>

See accompanying notes to financial statements

PUBLIC TRANSPORTATION SYSTEM

Schedule of Expenditures of Federal Awards
September 30, 2008

Grantor/CFDA Grantor's Program Title	Federal CFDA #	Expenditures 2008
Amended Compact - Education Sector Grant	CFDA <u>15.875</u>	<u>60,360</u>
TOTAL FEDERAL AWARDS EXPENDED:		<u><u>\$ 60,360</u></u>

Note (1)

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

PUBLIC TRANSPORTATION SYSTEM

Notes To Financial Statements
September 30, 2008 and 2007

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, 2008 and 2007.

PUBLIC TRANSPORTATION SYSTEM

Notes To Financial Statements
September 30, 2008 and 2007

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

New Accounting Standards – During the year ended September 30, 2008, PTS implemented the following pronouncements:

GASB Statement No. 43, “*Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*”. GASB Statement No.43 establishes uniform financial reporting for other post employment benefit plans by state and local governments.

GASB Statement No. 45, “*Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*”. GASB Statement No.45 establishes standards for the measurement, recognition, and display of other postemployment benefits expense/expenditures and related liabilities, notes of disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employees. The provisions of this statement are effective for PTS for periods beginning after December 15, 2007.

GASB Statement No. 48, “*Sales and Pledges of Receivables and Future Revenues 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.

GASB Statement No. 49, “*Accounting and Financial Reporting for Pollution Remediation Obligations*”. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation.

GASB Statement No. 50, “*Pension Disclosures on Amendments of GASB Statement No. 25 and 27*”. GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits.

In June 2007, GASB issued Statement No.51, “*Accounting and Financial Reporting for Intangible Assets*”. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009.

In June 2008, GASB issued Statement No. 53, “*Accounting and Financial Reporting for Derivative Instruments*”. GASB Statement No.53 is intended to improve how the state and local governments report information about derivative instruments – financial arrangements used by governments to manage specific risks or make investments – in their financial statements. The provisions of this statement are effective for periods beginning after June 15, 2009.

The adoption of these pronouncements will not have material impact on the accompanying 2008 financial statements.

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, 2008 and 2007 are fully collateralized as such are subject to Federal Deposit Insurance Corporation (FDIC) coverage.

PUBLIC TRANSPORTATION SYSTEM

Notes To Financial Statements
September 30, 2008 and 2007

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

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, 2008 and 2007 is presented below:

	<u>2008</u>	<u>2007</u>
Current and former employees	\$ 1,821	\$ 5,383
Current and former board members	5,907	5,907
State departments and agencies	3,996	3,407
Other trade customers	<u>10,951</u>	<u>4,415</u>
	22,675	19,112
Less: Allowance for Doubtful Accounts	<u>(16,625)</u>	<u>(17,713)</u>
	<u>\$ 6,050</u>	<u>\$ 1,399</u>

3. INVENTORY

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

PUBLIC TRANSPORTATION SYSTEM

Notes To Financial Statements
September 30, 2008 and 2007

4. PROPERTY & EQUIPMENT

A summary of property and equipment as of September 30, 2008 and 2007 follows:

	<u>Beginning balance October 1, 2007</u>	<u>Transfers And Additions</u>	<u>Transfers And Disposals</u>	<u>Ending balance September 30, 2008</u>
Buildings	\$ 103,039	\$ --	4,639	\$ 107,678
Vehicles	669,334	--	--	669,334
Shop Equipment	49,432	2,539	(4,639)	47,332
Office Equipment	<u>77,347</u>	<u>996</u>	<u>--</u>	<u>78,343</u>
	899,152	3,535	--	902,687
Less accumulated depreciation	<u>(754,826)</u>	<u>(27,273)</u>	<u>--</u>	<u>(782,099)</u>
	<u>\$ 144,326</u>	<u>\$ (23,738)</u>	<u>\$ --</u>	<u>\$ 120,588</u>

	<u>Beginning balance October 1, 2006</u>	<u>Transfers And Additions</u>	<u>Transfers And Disposals</u>	<u>Ending balance September 30, 2007</u>
Buildings	\$ 34,656	\$ 68,383	--	\$ 103,039
Vehicles	721,111	--	(51,777)	669,334
Shop Equipment	47,635	1,797	--	49,432
Office Equipment	<u>61,460</u>	<u>15,887</u>	<u>--</u>	<u>77,347</u>
	864,862	86,067	(51,777)	899,152
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>

5. DUE TO STATE GOVERNMENT

At September 30, 2008, \$83 of the balance due to the State Government represents the unexpended balance of the FY08 supplemental budget appropriated from the State General Funds.

The other \$934 is the unexpended balance of a cash advance charged to the FY06 operating subsidy from the State General Fund which expired at September 30, 2006. Therefore, a total of \$1,017 and \$22,551 are due to the Yap State Government as of September 30, 2008 and 2007, respectively.

PUBLIC TRANSPORTATION SYSTEM

Notes To Financial Statements
September 30, 2008 and 2007

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

In fiscal year ended September 30, 2008, Yap State Legislature appropriated fund from the followings:

<u>Law No.</u>	<u>Fund Source</u>	<u>Amount</u>
YSL 7-20	General Fund – Supplemental Budget	\$60,000
YSL 7-23	Amended Compact – Education Sector Grant	\$260,072
YSL 7-29	Capital Improvement Programs & Dev. Fund	\$62,494
		<u>\$382,566</u>

Of the total Compact Education Sector grant appropriated through YSL No. 7-23, \$60,360 was expended and was recognized as revenue at September 30, 2008, \$149,421 was cash advanced to the supplier as per Contract Agreement No. C41891, which states that PTS has to pay in advance 75% of the total cost of two new buses. Yap State Finance obligated the remaining 25% or \$49,807 for the final payment upon arrival of the buses. As of September 30, 2008, such amount was yet to be transferred or paid out to PTS.

Yap State Legislature appropriated through YSL No. 7-20, the sum of \$60,000 as supplementary budget for the operations of PTS during fiscal year 2008. Of the total appropriated, PTS expended a total of \$52,917 for its annual insurance premium, personnel and other expense thus leaving a balance of \$7,083, which was presented as due to the Yap State Government at September 30, 2008.

In June 2008, the Yap State Legislature through YSL No. 7-29 appropriated the sum of \$62,494 from the State's Capital Improvement Program and Development Fund to PTS for freight of the new buses. Such appropriation was advanced to PTS through Pass-Thru-Grant/Sub-Grant Agreement No. P39913 in order to provide for uninterrupted schedule of planned activities of fiscal year 2008 and shall lapse on September 30, 2008. However, as of September 30, 2008, PTS had yet to disburse such amount and was included in the payable to Yap State Government

In addition to the above grants, PTS on September 30, 2007 had a total of \$22,551 unexpended FY2007 and 2006 grants of which \$21,617 was expended for fuel in FY2008 leaving \$934 unexpended and was presented as portion of PTS liability as of September 30, 2008.

Grants revenue in FY 2008 and 2007 totaled \$134,894 and \$139,876 respectively.

PUBLIC TRANSPORTATION SYSTEM

Notes To Financial Statements
September 30, 2008 and 2007

8. FEDERAL EMERGENCY MANAGEMENT AGENCY (FEMA) GRANTS

In fiscal year ended September 30, 2008, PTS did not receive nor record any expenditure from the Federal Emergency Management Agency grants as compared to \$78,618 worth of expenditure as of September 30, 2007.

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, 2008 and 2007 were \$7,728 and \$1,917, 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

Yap State Law Nos. 7-42 and 7-44 which were in effect as of October 1, 2008 appropriated \$14,784 from the State General Fund and \$208,962 from Education Sector Grants of the Amended Compact of the Federated States of Micronesia to subsidize the operations of PTS for fiscal year 2009. Such appropriation laws require that funds be administered by the Director of the Office of Administrative Service and any funds not obligated as of September 30, 2009 shall revert back to the respective Fund of Yap State.

YSL No. 7-44 also appropriated the sum of \$70,000 under Public Infrastructure Sector Grant of the Amended Compact through the FSM National Government to subsidize the \$150,000 appropriated under Education Sector Grants totaling \$220,000 to purchase two additional buses.

In February 2009, PTS received two new buses which increased its assets by \$255,551.



**OFFICE OF THE STATE PUBLIC AUDITOR
YAP STATE GOVERNMENT**

Federated States of Micronesia

P.O. Box 927

Colonia, Yap FM 96943

Tel. (691) 350-3416 Fax: (691) 350-4987 Email: audityap@mail.fm

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 years ended September 30, 2008 and 2007 and have issued our report thereon dated September 19, 2010. 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. 1 through 8.

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 did not disclose any instances of noncompliance that are required to be reported under *Government Auditing Standards*.

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 used by anyone other than these specified parties.


Ronald C. Yow
Yap State Public Auditor

September 19, 2010

PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings
September 30, 2008

Finding no.1 – Grants Revenue and Expenditure

Criteria: Government entities or “Grantees” are required to maintain accurate and sufficient records and be accountable for grants received. Additionally, generally accepted accounting principles requires recognition of revenues when earned and expenses when incurred.

Condition: Our review for fiscal year 2008 found the following:

1. On July 22, 2008, a Pass-Thru-Grant/Sub-Grant Agreement was executed between the Yap State Government and PTS for a \$62,494 fund authorized by Yap State Law No. 7-29. The Agreement provided that the mentioned amount will be advanced to PTS for freight and handling of new buses purchased.

A check for the amount was issued by Finance on July 24, 2008 and released to PTS on 07/28/08. It was only deposited to PTS’ account in January 2009 and was not recorded in their books from the time of receipt nor was it presented during our cash count on October 1, 2009.

2. PTS received a supplemental budget of \$60,000 from the State Legislature to pay for insurance, fuel, personnel, tire-repair machine and bus parts. The whole amount was recorded as grant revenue as of September 30, 2008, though \$7,000 was obligated for the outstanding purchase of tire-repair machine and bus parts and were not paid until December 2009. Out of the total amount, \$83 remained unexpended as of 9/30/08. Audit adjustment was made to present the obligated amount as deferred revenue and the unexpended portion as payable to the State Government.
3. Yap State Legislature Law No. 7-23 appropriated \$199,226 for purchasing two new buses. In August 2008, seventy five percent (75%) or \$149,421 of the total appropriation was given to PTS, who in turn immediately wire transferred the sum to the supplier based on their signed agreement. The payment was not recorded in the books of PTS. Audit adjustment was made to recognize such amount as deferred revenue.
4. As of 09/30/08, PTS still has in its books \$21,617 worth of deferred revenue though it has been totally used up during the fiscal year.
5. Several FY2007 proposed audit adjustments aggregating \$76,868 pertaining to the recognition of FEMA grants revenue were posted as such in FY2008 instead of posting it to the retained earnings thus misstating the account as of 9/30/08. Audit adjustments were made to properly state the grants revenue.

Cause: PTS failed to properly account for grants received and erroneously posted the FY2007 adjustment to FY 2008 revenues and expense accounts instead of retained earnings.

Effect: Adjustments totaling \$108,146 and \$76,868 were made to grants revenue accounts in order to fairly present them as of September 30, 2008. Bigger portions of the State’s appropriations were not properly accounted for.

PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings
September 30, 2008

Finding no.1- Grants Revenues and Expenditures (cont.)

Recipients of all grants appropriated or that comes through the Yap State Legislature are required to follow the State's Financial Management Act of 1983. Consequently, PTS accounting records do not accurately present the recognition of grants revenue and allowable expenditures as of September 30, 2008.

Recommendation: We strongly recommend management to require the accounting staff to ensure proper recording of grants revenue and presenting accurate and allowable grant expenditures in accordance with the Yap State's Financial Management Act and the State's Contract Act.

Finding no. 2 – Unresolved Prior Year Findings

Criteria: PTS should on a timely manner, adopt and implement audit recommendations to strengthen controls over its financial reporting and ensure full compliance with laws and regulations of the Yap State Government.

Condition: Out of the nine findings cited in fiscal year 2007, the Board and Management of PTS only managed to resolve three or 33%. Sixty seven percent (67%) of the FY2007 findings remained unresolved and will be repeated in the audit report for fiscal year ending September 30, 2008.

Cause: The Board of PTS failed to ensure that management perceives the importance of implementing and adopting audit recommendations accordingly and on a timely manner.

Effect: Due to continuous failure of the Board to address unresolved findings, PTS failed to correct deficiencies in improving its compliance with laws and regulations and to improve its controls over financial reporting. And therefore, we will continue to identify and address such deficiencies.

Recommendation: The Board and Management of PTS should find ways to improve its efficiency in addressing audit recommendations on a timely manner.

Finding no. 3 – Cash Discrepancies

Criteria: All cash transactions especially cash receipts should be recorded and deposited on a timely manner.

Condition: Our review of cash accounts found the following:

- 1) During our testing of grants revenue, we found that check no. 35716 in the amount of \$62,494 from Yap State Finance, which was issued in July 2008, was not recorded and was only deposited in January 2009 or 6 months upon receipt. Mentioned check was also not presented during our cash count on October 1, 2008.
- 2) The cash count performed by our office on October 1, 2008, revealed that there was a cash shortage of \$37.00 when the cash on hand of \$829.24, net of \$100 change fund, was compared with the cash on hand as per GL balance of \$866.22.

PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings
September 30, 2008

Finding no.3 – Cash Discrepancies (Cont.)

- 3) Petty cash balance per G/L showed a balance of \$300 while the cash count performed revealed that \$5.00 was used to pay for fuel on September 30, 2008. The purchase was not recorded to the general ledger to present the accurate balance at September 30, 2008.

Cause: PTS failed to ensure that all cash collections should be deposited to the bank immediately for better control and to avoid losses from theft. Also, there was no reconciliation done with regards to the manual cash records and the GL balances.

Effect: Due to PTS failure to reconcile its' cash records, the shortage of \$37 and the omission of the \$62,457 were not detected and as a consequence the financial statements were misstated by such.

Recommendation: Because PTS deposits its collections on a daily basis, we recommend that other receipts be treated in the same manner. Moreover, PTS management should require the accounting staff to ensure that general ledger balances are reconciled with the appropriate accounting records on a timely basis.

Finding no.4 – Inadequate Controls Over Spare Parts Inventory

Criteria: Sufficient controls over inventory should be in place in order to safeguard the System's assets from theft and pilferage. In addition, PTS is required by its regulations, section 13.4, to submit to the Board at the closing of each fiscal year, an inventory report of all PTS personal property, accounting for all property with ownership, possession, controls or use in conveyed to another person, agency, or organization.

Condition: Inventory physical count on spare parts for fiscal year ended September 30, 2008 was performed on October 1, 2008. After the count, another count was schedule to take place again as some inventory items were not recorded and some could not be located. Ending balance per valuation report did not agree with the ending inventory per general ledger by \$ 1,506.00. Value of items counted did not agree to the value of items per PTS records by \$3,808.

Additionally, our review of the Board meeting minutes revealed that inventory reports at the close of each fiscal year were not mentioned in any of meeting minutes provided to OPA office.

Cause: Based on their accounting system, PTS has been using the LIFO (last in first out) and FIFO (first in first out) valuation methods in costing their inventory and the non-uniform valuation could have contributed to the variance. Aside from the valuation issue, PTS does not reconcile its inventory records with the balances reflected in the general ledger as well as the physical quantity of inventory items on a timely manner.

Effect: Non-reconciliation of accounts and lack of controls over assets increases the risk of non-detection of errors and pilferage.

Recommendation: We recommend that management observe the proper matching of costs 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.

PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings
September 30, 2008

Finding no.4 – Inadequate Controls Over Spare Parts Inventory (Cont.)

In addition, we also recommend that management ensure inventory reports be submitted to the Board for its review. Such review from the Board together with the year-end physical count of inventory items will lessen errors and discrepancies in inventory records.

Finding no.5 – Bus Collection:

Criteria: Proper internal controls should be place to ensure accuracy of bus collections.

Condition: The follow-up on prior year findings led us to perform a closer review of the recording of cash overages/shortages of bus collections. In FY2007, the accountant began to record the overages/shortages into separate accounts. The overages were recorded as bus revenue while the shortages were recorded in the cash over/short expense account.

Additional procedures in reviewing the shortages/overages of bus collections reveal that as compared to previous years, the shortage in collection decreased. With regard to overages, it was noted that on 30 instances, the overage per bus is bigger than the actual collections for the day. The overage amounts range from 5% to 437% more than the actual collections based on the tally sheets.

Cause: The bus drivers failed to ensure that collectors were accurately and properly maintaining the tally sheets.

Effect: PTS accounting journals showed that there were some days that the bus collections have overages that exceeded \$20 and went as high as \$70 per single bus.

Recommendation: We recommend that PTS management require bus drivers be stricter in choosing responsible collectors, whose riding the buses for free as an incentive, to properly maintain the tally sheets.

Finding no.6 – Untimely Collections of Receivables:

Criteria: PTS Board of Directors and Management should establish stricter policies and procedures to ensure adequate and timely collections of receivables.

Condition: Receivable balances over a period of three fiscal years (FY2008, 2007 & 2006) went as high as approximately \$80,300. PTS was not successful in collecting its receivables which resulted in writing off some of the balances reserved as bad debts and as of the September 30, 2007, the receivable balance was \$19,113.

Receivable balance as of September 30, 2008 was \$22,675 or an increase of 19% or \$3,562 from the FY07 ending figures. Out of the total balance, \$15,384.50 or 68% represents receivables over 365 days. Subsequent collections only totaled \$4,809.69 and there were no collections against the accounts of former/current Board of Directors, whose total of \$5,907 represents 56% of the remaining balance in the “over 365 days” aging bracket.

PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings
September 30, 2008

Finding no.6 –Untimely Collections of Receivables (Cont.)

It is also noteworthy to note that from the total of the receivables under the “over 365 days” bracket, \$1,323.51 or 9% represents receivables from Government Agencies and out of this, only a small portion was settled.

Cause: Though PTS managed to decrease its receivables in FY2007, inadequate controls over receivable and untimely collections still existed in FY 2008. In fiscal year 2008, we found no evidence of repayment plans for the current Board members.

Furthermore, PTS allowed services to Government Agencies before ensuring the normal Government procedures in obtaining goods and services have taken place. That is – Government purchase order had been prepared with proper approvals and certification of funds availability and services be provided upon receipt of purchase order.

Effect: It would be difficult and very challenging to adopt policies and procedures of timely collections of receivables when outstanding receivable balances of Board Members are involved. As a result, much more write-offs will subsequently occur and this will be one of the factors that will contribute to the increase in dependence on government for subsidies. With the current policy of estimating uncollectible receivable, PTS only managed to collect approximately \$1,089 of outstanding balances over 1 year.

Recommendation: We recommend that The Board and Management of PTS device a strict payment and collection scheme, especially for the Board Members that have outstanding balances, so that they could maximize the collection of outstanding balances. Also, we further recommend a policy be in place that will minimize if not prohibit the Board Members and PTS employees from getting services/parts on credit. Lastly, we recommend that all outstanding balances due to PTS be cleared on a timely manner.

Finding no.7 – Travel Advances and Expenses

Criteria: PTS should establish and adopt travel policies that are consistent with the State’s travel policies and procedures. Moreover, Blanket cash advances should not be given to travelers without sufficient documentation of the actual costs to be incurred.

Condition: We reviewed documentations of three trips that took place during fiscal year 2008 and found the following:

- 1) The Board members approved these travels through memos from management explaining the purposes of the trips. However, these memos did not contain breakdowns of the travel costs. PTS had adopted and using the State Government’s travel voucher forms when submitting travel claims after such trips yet did not use the travel advance request forms in order to be in full compliance with the State’s travel policies and procedures.
- 2) Per diem and car rental for a trip that took place on October 11 to October 20, 2007 amounting to \$1,404 and \$585, respectively, were recorded directly to travel expenses instead of initially booking them under travel advances until such time that the traveler files his/her travel claims.

PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings
September 30, 2008

Finding no.7 – Travel Advances and Expenses (Cont.)

- 3) Travel claim for the trip mentioned in item no. 2, which should have been submitted 10 working days upon arrival, was only filed in February 2008 or 3 months after the completion of the travel. Furthermore, the travel voucher was not approved until May 2008 another two months after submission of the travel voucher.
- 4) Travel expenses for the trip that took place on May 16 to May 17, 2008 were recorded prior to the approval of the travel voucher.

Cause: Although PTS tried to follow the State's travel policies and procedures by using the travel voucher form and sometimes advanced 80% of per diem to traveler, the Board and management did not ensure that travel policies and procedures that are consistent with the State's are followed at all times. Furthermore, the accountant failed to ensure that travel advances and expenses were accurately and properly recorded.

Effect: Blanket cash advances given to travelers without sufficient documentation for the costs to be incurred increases the risk of abuse of travel funds. Without documentations as to the original authorized trip costs to be incurred, it will be difficult to determine which travel expenses were originally authorized in order to approve a travel claim.

Moreover, erroneous and inaccurate recording of travel expenses increases the risk of recording invalid and unauthorized travel expenses.

Recommendation: Although PTS have travel policies and procedures in place, we strongly recommend that PTS adopts the State's travel policies and procedures which requires that a travel authorization request be made and must consists, but not limited to, the following: 1) Name of the traveler; 2) Purpose of the Trip; 3) Itinerary of the Traveler; 4) Dates to Commence and Complete the Trip; 5) Mode of Transportation; and 6) Estimated Costs of the Trip. The travel authorization request shall be reviewed and approved by the appropriate member of the Board and the General Manager.

Finding no. 8 – Misclassification of Expenses

Criteria: Accounting principles require proper classification of all transactions in the general ledger.

Condition: Communication equipments and travel advances aggregating \$1,390 and \$1,989, respectively, were recorded as expenses when these should have been recorded as property and equipments and travel advances.

Cause: The accountant failed to ensure that transactions were properly classified in the general ledger.

Effect: The amounts above may seem immaterial but combining the two becomes material to the financial statement. When financial transactions are not properly classified in the accounting records, there is no assurance that account balances and financial condition or position of the entity are accurate.

PUBLIC TRANSPORTATION SYSTEM

Schedule of Findings
September 30, 2008

FINDING NO. 8 - MISCLASSIFYING EXPENSES (Cont.)

Recommendation: We strongly recommend that PTS management require the accountant to have a thorough understanding of account classifications and transactions before posting of entries in the general ledger.



RESPONSES TO AUDITORS REPORT (Findings)

Finding No. 1- Grants Revenue and Expenditures

Responses:

Check was not deposit until the buses were in place and the freights/handing were ready for payment. It was our oversight that check was not presented during cash count. Other posting issues will be carried out as recommended.

Finding No. 2 – Unresolved Prior Year Findings

Responses:

This has been discussed with management and implementation is in process.

Finding No. 3 – Cash Discrepancies

Responses:

This has been discussed with management and will be carried as recommended.

Finding No. 4 – Inadequate Controls Over Spare Parts Inventory.

Responses:

This has been discussed with management and will be carried as recommended.

Finding No. 5 – Bus Collection

Responses:

During the exit meeting, this issue was further discussed and additional cause for overage identified was due to fare paid by each rider at an access amount and return change could not be given back. For example, student fares are at \$0.75 per ride but most student drop in a dollar instead. However, this has been further discussed with management and seeking ways to resolve the matter along with recommendations.

Finding No. 6 – Untimely Collection of Receivables

Responses:

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

Finding No. 7 – Travel Advances and Expenses

Responses:

This has been discussed with management and has been implemented accordingly.

Finding No. 8 – Misclassification of Expenses

Responses:

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