

Southern Yap Water Authority

**Financial Statements and
Independent Auditor's Report**

**Fiscal Years Ended
September 30, 2006 and 2005**



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EXECUTIVE SUMMARY

Financial Audits of the Southern Yap Water Authority Years ended September 30, 2006 and 2005

The Office of the Public Auditor has released the final financial audit report of the Southern Yap Water System for the years ended September 30, 2006 and 2005 which report is dated February 20, 2008. This is the second audit conducted by the Office of the State Public Auditor for the Southern Yap Water Authority. The Independent Auditor's Report on page 1 is a disclaimer. Due to scope limitations presented by the lack of reliable accounting records for fiscal years 2006 and 2005, we were unable to form an opinion on the fair presentation of the financial statement amounts. Accordingly, we expressed no opinion.

The financial statements presented beginning on page 6 show that assets increased to \$62,050 at September 30, 2006 compared to \$9,428 in fiscal year 2005. The primary reason for the increase in assets is due to unexpended cash derived from the operating subsidy received from the State Legislature in fiscal year 2006. Revenues and expenses for the year ended September 30, 2006 also increased over results for fiscal year 2005 reflective of the full year of operation in fiscal year 2006. Both fiscal year 2006 and 2005 showed operating deficits of \$9,444 and \$10,253, respectively, indicating that further actions are required of management to ensure the sustainability of the enterprise.

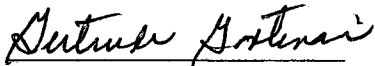
The report on internal control over financial reporting and compliance and other matters required by *Government Auditing Standards* on page 16 discusses reportable conditions found during the audit. These conditions and our recommendations are presented for the information of SYWA management in the Schedule of Findings beginning on page 18. Of the fifteen findings, two are related to compliance with grant agreements, while the remaining thirteen are related to deficiencies in internal control over financial reporting. One of the findings is considered a material weakness.

Below is a summary of the findings for fiscal year 2006:

- Findings 1 and 2 are related to noncompliance with the budget line-items as stipulated in the Memorandum of Agreement with the State of Yap for administration of the operating subsidy grant received from the State Legislature during fiscal year 2006. We also found no evidence that SYWA made the effort to obtain the best prices for its purchases by comparing prices from vendors as is the general practice for all departments and offices within the State government.
- Findings Nos. 3 and 4 were related to matters originally raised in the fiscal year 2005 audit – reimbursement claims for certain board members for which underlying documentation were inadequate and fiscal year 2005 findings which remained unresolved during fiscal year 2006.
- Findings Nos. 5 and 6 are related to inadequate documentation of expenditures – check payments were not always supported by vendor invoices. Moreover there were a few instances where the Authority settled its liabilities with cash, instead of check payments, leaving inadequate audit trail.

- Findings 7, 6, and 9 are related to inadequate controls over cash and bank accounts – no bank reconciliation was performed on a regular basis, there was no secondary review of cash collections and deposits, and collections were not timely banked on occasion.
- Findings 10-13 are related to deficiencies in the recording and maintenance of balances due from customers, billing of water usage, and changes to customers bills without sufficient justification and documentation.
- Findings No. 14 pertains to \$3,636 in electricity bills for the Authority paid by the State Finance as authorized by Lt. Governor Habuchmai in fiscal year 2005. The letter request to Finance instructing payment of the bill indicated that SYWA would reimburse the amount to the State when it was financially able. The balance was still outstanding as of September 30, 2006.
- Finding No. 15 discusses the correct method for recording social security taxes on the Authority's ledgers.

We have met with the Authority's management to discuss the above findings and they have provided written responses to the findings which are presented on page 32 of this report. Since we prepared the draft of this report, the SYWA has taken actions to implement the recommendations of this report, thereby correcting many of the deficiencies discussed in this report. We thank the management and Board of Directors of the Authority for their positive reaction to our audit recommendations and we commend them for the improvements they have initiated in fiscal years 2007 and 2008.



Gertrude Gootinan
Yap State Public Auditor
June 12, 2008

SOUTHERN YAP WATER AUTHORITY

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Southern Yap Water Authority:

I was engaged to audit the accompanying balance sheets of the Southern Yap Water Authority (SYWA) as of September 30, 2006 and 2005, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the SYWA's management. My responsibility is to express an opinion on these financial statements based on my audits.

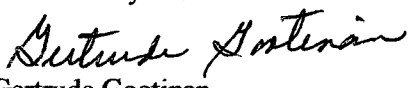
The SYWA has not maintained adequate accounting records for the years ended September 30, 2006 and 2005, and I was unable to apply procedures to determine whether the opening balances in the financial statements as of October 1, 2004 were fairly presented in conformity with accounting principles generally accepted in the United States of America or whether accounting principles have been consistently applied between fiscal year 2005 and 2006 and 2005 and 2004.

Since SYWA did not maintain adequate accounting records, and I was unable to satisfy myself about the opening balances in the financial statements as of October 1, 2004 and 2005, or about the consistent application of accounting principles between fiscal year 2006 and 2005 and 2004, the scope of my work was not sufficient to enable me to express, and I do not express, an opinion on its financial position as of September 30, 2006 and 2005 and the results of its operations and cash flows for the years then ended, or on the consistency of application of accounting principles with the preceding years.

Management's Discussion and Analysis on pages 2 thru 5 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. I have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurements and presentation of the required supplementary information. However, I did not audit the information and express no opinion on it.

The accompanying Schedule of Expenditures of Federal Awards on page 9 is presented for the purpose of additional analysis and is not a required part of the financial statements. This schedule is the responsibility of SYWA's management.

In accordance with *Government Auditing Standards*, I have also issued a report dated February 20, 2008 on my consideration of the Southern Yap Water Authority's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, and contracts. The purpose of that report is to describe the scope of my testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of my audits.


Gertrude Gootinan
Yap State Public Auditor

February 20, 2008



SOUTHERN YAP WATER AUTHORITY

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

The Southern Yap Water Authority is a component unit of the Government of the State of Yap by virtue of the level of financial control the State has over the operations of the entity.

The Southern Yap Water Authority (SYWA) was created under the enabling legislation of Yap State 1-221 in 1986, to be responsible for the administration and maintenance of the Southern Yap Water System (YSC, Title 18 – chapter 7). Two years later in 1988, the Southern Yap Water System was completed with TTPI-CIP Fund of \$2,000,000.00 with an estimated useful life of 20 years and annual depreciation of \$100,000.00.

The Southern Yap Water System serves the communities of Southern Rull and the Southern Villages of Dalipebinaw, plus the municipalities of Kanifay and Gilman. The Authority is responsible to ensure the delivery of safe, reliable potable water to the residents of Southern Yap at reasonable rates.

The Southern Yap Water Authority is responsible for establishing water rates and billing and collecting payments from customers. The Authority also assesses service charges for new meter hookups, reconnections and is responsible for maintenance of the water wells, pumps, storage tank, and the distribution system.

On or about April 2006, representatives from the communities affected took over the management of the Authority, leading to the formation of a new board. The new board then requested funding from the State Legislature to be used as an operation subsidy. This was the first time since the water system was turned over to the Authority, that it had received a subsidy from the State Government.

A Board of Directors was established to oversee operation and ensure the objectives of the Southern Yap Authority are met. The Board consisted of six (6) members which, one is appointed by the Governor for a term of 4-years. Chief of Rull Municipality shall appoint two each from Lamer and Luwech Villages. The municipal Chief of Gilman, Kanifay and Dalipebinaw shall each appoint on for the three remaining members.

Current Board Members:

1. Jack Moorow – appointed by the Governor
2. John Guswel, Chairman – appointed by Chief of Rull
3. Francis Gilpong, Vice-Chairman – appointed by Chief of Kanifay
4. Domingo Techur, Secretary/Treasurer – appointed by Chief of Gilman
5. Stanislaus Lubumad, Member – appointed by Chief of Rull
6. John Gilsowuth, Member – appointed by Chief of Kanifay



SOUTHERN YAP WATER AUTHORITY

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Financial Highlights

On or about April 2006:

The Southern Yap Water Authority had about four thousand eight hundred ninety-seven (\$4,897.00) in its saving account at the Bank of the FSM, Yap branch.

FEMA granted about \$4,950.00 fund to SYWA for Typhoon Sudal destruction in 2004.

The new elected Chairman, John Guswel offered help by using his own money of the amount of \$4002.28 to purchase materials to repair the broken water pump. The new Board agreed in July 03, 2006 meeting to refund Chairman Guswel when fund is available.

The new Board Members seek assistance from the Yap State Government for subsidiary fund of seventy-eight thousand seven hundred dollars (78,700.00) and received first portion on March 2006.

Plan of Action for 2006:

On or about April 2006, the communities comprised of Southern Rull, Southern Village of Dalipebinaw, plus the municipalities of Gilman and Kanifay came to gather at the Old Airport in Luwech to discuss the SYWA matters due to poor management and other related problems the previous years. After the meeting, the communities and its Chief agreed to create new Board Members to help the system.

The new Board Members first meeting took place on May 10, 2005.

1. Election new Officers among the new Board members
2. Seek funding to repair broken well pump
3. renovate the existing building by using the FEMA fund available
4. Hire new staffs
5. Resume billing customers of water usage (seek legal advise from AG Yap State)



SOUTHERN YAP WATER AUTHORITY

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Management's Discussion and Analysis

The following table summarizes the financial condition and operations of the Authority for 2006 and 2005

ASSETS	2006	2005
Current Assets	\$ 55,974	\$ 7,676
Property and Equipment	6,076	1,752
	<u>\$ 62,050</u>	<u>\$ 9,428</u>
LIABILITIES AND NET ASSETS		
Current Liabilities	\$ 7,101	\$ 9,950
Net Assets	54,949	(522)
	<u>\$ 62,050</u>	<u>\$ 9,428</u>
REVENUES, EXPENSES, & CHANGES IN NET ASSETS		
Operating Revenues	\$ 20,746	\$ 6,209
Operating Expenses	30,190	16,462
Net operating revenues (loss)	(9,444)	(10,253)
Nonoperating revenues and Interest income	25,889	42
Changes in net assets	16,445	(10,211)
Net assets (deficit) at beginning of year	(522)	9,689
Add: Prior period adjustments	649	-
Beginning net assets (deficit) as restated	127	9,689
Net assets (deficit) at end of year	<u>16,572</u>	<u>(522)</u>

SOUTHERN YAP WATER AUTHORITY

Balance Sheets
September 30, 2006 and 2005

ASSETS	<u>2006</u>	<u>2005</u>
Current Assets		
Cash	\$ 54,459	\$ 4,897
Trade receivables (note 2)	1,515	2,779
	<hr/>	<hr/>
Total current assets	55,974	7,676
Property and equipment	6,076	1,752
	<hr/>	<hr/>
TOTAL ASSETS	\$ 62,050	9,428
	<hr/> <hr/>	<hr/> <hr/>
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable	\$ 2,583	\$ 6,314
Accrued expenses	882	--
Due to State Treasury (note 5)	3,636	3,636
Deferred grant revenue (note 6)	38,377	--
	<hr/>	<hr/>
Total current liabilities	45,478	9,950
Contingencies		
Net assets/(deficit)		
Reserved for capital assets	6,076	1,752
Unreserved	10,496	(2,274)
	<hr/>	<hr/>
	16,572	(522)
TOTAL LIABILITIES AND NET ASSETS	\$ 62,050	\$ 9,428
	<hr/> <hr/>	<hr/> <hr/>

See accompanying notes to financial statements

SOUTHERN YAP WATER AUTHORITY

Statements of Revenues, Expenses and Changes in Net Assets For the Years Ended September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Operating revenues		
Water usage and other fees	\$ 18,525	\$ 5,306
Others	<u>2,221</u>	<u>903</u>
Total operating revenues	20,746	6,209
Operating expenses		
Utilities	10,278	8,110
Supplies, repair and maintenance	8,824	5,620
Salaries and wages	5,639	2,385
Depreciation	2,695	204
Fuel and other expenses	2,471	143
Bad debt expense	<u>283</u>	<u>--</u>
Total operating expenses	30,190	16,462
Loss from operations	(9,444)	(10,253)
Nonoperating revenues		
Operating subsidy (note 6)	20,648	--
FEMA grant	4,950	--
Interest income	<u>291</u>	<u>42</u>
Total nonoperating revenues	25,889	42
Changes in net assets	16,445	(10,211)
Net assets (deficit) at beginning of year	(522)	9,689
Add: Prior period adjustments	<u>649</u>	<u>--</u>
Beginning net assets (deficit) as restated	127	9,689
Net assets (deficit) at end of year	<u>\$ 16,572</u>	<u>\$ (522)</u>

See accompanying notes to financial statements.

SOUTHERN YAP WATER AUTHORITY

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

Increase (Decrease) in Cash

	<u>2006</u>	<u>2005</u>
Cash flows provided by (used for) operating activities		
Receipts from customers	\$ 22,293	\$ 6,209
Payments for goods and services	(25,587)	(7,941)
Cash payments to employees	<u>(4,826)</u>	<u>(2,243)</u>
Net cash used for operating activities	<u>(8,120)</u>	<u>(3,975)</u>
Cash flows provided by non-capital financing activities		
Due to State Government	35,688	--
Yap State Legislature operating subsidy	23,337	--
FEMA Grant	<u>4,950</u>	<u>--</u>
Net cash provided by non-capital financing activities	<u>63,975</u>	<u>--</u>
Cash flows provided by (used for) investing activities		
Interest income	291	42
Acquisition of fixed assets	<u>(6,584)</u>	<u>(1,956)</u>
Net cash used for investing activities	<u>(6,293)</u>	<u>(1,914)</u>
Net increase (decrease) in cash	<u>49,562</u>	<u>(5,889)</u>
Cash, beginning of year	4,897	10,786
Cash, end of year	<u>\$ 54,459</u>	<u>\$ 4,897</u>
Reconciliation of Operating Loss to Net Cash used for Operating Activities		
Operating Loss:	\$ (9,444)	\$ (10,253)
Adjustments to reconcile loss from operation to net cash used in operating activities		
Depreciation	2,695	204
Bad debt expense	283	--
(Increase)/Decrease in assets		
Trade receivables	1,264	--
Other receivables	--	(2,779)
Increase/(Decrease) in liabilities		
Accounts payable	(3,731)	8,853
Other liabilities	<u>813</u>	<u>--</u>
Net cash used in operating activities	<u>\$ (8,120)</u>	<u>\$ (3,975)</u>

See accompanying notes to financial statements

SOUTHERN YAP WATER AUTHORITY

**Schedule of Expenditures of Federal Awards
September 30, 2006 and 2005**

Grantor/CFDA Grantor's Program Title	Federal CFDA #	Expenditures	
		<u>2006</u>	<u>2005</u>
Federal Emergency Management Agency Grant (Note 1) DMR-FM-1511 Typhoon Sudal Public Assistance Grants	CFDA 83.516	\$ <u>4,950</u>	\$ <u>—</u>
TOTAL FEDERAL AWARDS EXPENDED:		\$ <u>4,950</u>	\$ <u>—</u>

Note (1)

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

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements
September 30, 2006 & 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity – The Southern Yap Water Authority (SYWA) was created in 1986 pursuant to Yap State Law (YSL) No. 1-221 which is codified as Chapter 7 of Title 18 of the Yap State Code. The primary purpose of the SYWS is to “carry on the business of establishing, developing, maintaining, operating, and managing the Southern Yap Water System”. The water system currently serves the southern communities of Yap Proper comprising of the southernmost villages of the municipalities of Rull and Dalipebinaw and the municipalities of Gilman and Kanifay. The SYWS is a legally separate unit of the Yap State Government.

SYWA is governed by a six-member Board of Directors, two of which are appointed by the Rull representative on the Council of Pilung. One of the Rull appointees has to be a resident of the village of Luwech or Lamer. The Council of Pilung representatives for the municipalities of Dalipebinaw, Kanifay and Gilman appoint the next three members – one each from their respective municipalities. The sixth member is appointed by the Governor for a four year term. The chiefs’ appointees serve three-year terms. The daily operation of the Authority is currently the responsibility of a general manager and a meter reader.

Basis of Accounting - SYWA 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. SYWA has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

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

- (a) **Invested in capital assets, net of related debt** - Capital assets, net of accumulated depreciation, and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets)
- (b) **Nonexpendable** – Net assets subject to externally imposed stipulations that require the SYWA to maintain them permanently.
- (c) **Expendable** – Net assets whose use by the SYWA is subject to externally imposed stipulations that can be fulfilled by actions of the Bureau pursuant to those stipulations or that expire by the passage of time.

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements
September 30, 2006 & 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

- (d) **Unrestricted** – Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

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

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

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

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

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

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

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

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

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 SYWA.

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements September 30, 2006 & 2005

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 SYWA.

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. \$100,000 of the cash balance for the year ended September 30, 2006 and 2005 is fully collateralized as such is subject to Federal Deposit Insurance Corporation (FDIC) coverage. The balances exceeding FDIC insurable limitations are characterized as uncollateralized.

Receivables – Due to the nature of receivables for the SYWA, balances not expected to be collected within one year from the balance sheet date are fully reserved as doubtful.

Depreciation – Property and equipment is stated at cost less accumulated depreciation. Routine maintenance and repairs are expensed as incurred. SYWA as a general rule capitalizes assets worth at least \$100 and useful lives in excess of two years. Depreciation is recorded in the financial statements using the straight-line method over the estimated useful lives of the assets as follows:

Furniture and fixtures	2-6 years
Office equipment	3-5 years
Automobile	3 years

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

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

2. RECEIVABLES

Receivables as of September 30, 2006 represent revenue that is expected to be realized after September 30, 2006. Trade receivables are comprised of unpaid balances as of September 30, 2006 as was determined and noted on the October Billing Summary as customer accounts' previous unpaid balances. Details of trade receivables for the years ended September 30, 2006 and 2005 are presented below:

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements September 30, 2006 & 2005

	<u>2006</u>	<u>2005</u>
Trade receivables	\$ 1,798	\$ 2,779
Allowance for doubtful accounts	<u>(283)</u>	<u>—</u>
	<u>\$ 1,515</u>	<u>\$ 2,779</u>

3. PROPERTY & EQUIPMENT

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

	<u>Beginning balance October 1, 2005</u>	<u>Prior Period Adjustments</u>	<u>Transfers, Additions & (Deletions)</u>	<u>Ending balance September 30, 2006</u>
Office equipment and furniture	\$ —	\$ —	1,075	\$ 1,075
Vehicles	—	7,800	—	7,800
Other assets	1,956	—	199	2,155
	<u>1,956</u>	<u>7,800</u>	<u>1,274</u>	<u>11,030</u>
Less accumulated depreciation	<u>(205)</u>	<u>(2,490)</u>	<u>(2,259)</u>	<u>(4,954)</u>
Total	<u>\$ 1,751</u>	<u>\$ 5,310</u>	<u>\$ (985)</u>	<u>\$ 6,076</u>

	<u>Beginning balance October 1, 2004</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Ending balance September 30, 2005</u>
Other assets	\$ —	\$ 1,956	\$ —	\$ 1,956
Less accumulated depreciation	—	<u>(204)</u>	—	<u>(204)</u>
Total	<u>\$ —</u>	<u>\$ 1,752</u>	<u>\$ —</u>	<u>\$ 1,752</u>

A prior period adjustment is required for the year ended September 30, 2006 to record estimated fair value and accumulated depreciation of the office vehicle purchased prior to fiscal year 2005 for which historical cost records are no longer available.

Costs of the SYWA water distribution system of \$2.0 million inclusive of the office building and warehouse is recorded by the State of Yap, therefore, such costs are excluded from SYWA's assets at September 30, 2006 and 2005.

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements
September 30, 2006 & 2005

4. ACCOUNTS PAYABLE

Following is a breakdown of accounts payable as of September 30, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Vendors and suppliers	\$ 1,826	\$ 6,314
Officers and employees	<u>757</u>	<u>--</u>
	<u>\$ 2,583</u>	<u>\$ 6,314</u>

5. DUE TO STATE TREASURY

Details of amounts due to the State Government are provided below:

	<u>2006</u>	<u>2005</u>
Reimbursement for utility payment	\$ <u>3,636</u>	\$ <u>3,636</u>
	<u>\$ 3,636</u>	<u>\$ 3,636</u>

On September 8, 2005, the State assisted the SYWA settle outstanding FY04 and FY05 electric bills in the amount of \$3,636. In a memo to the State Finance requesting payment of the SYWA electric bills, the Lt. Governor stated, "It is the general understanding of all concerned that the Southern Yap Water Authority will reimburse (the State) when funds are available...." Accordingly, the amount of the electric bills paid by the State Finance has been recorded as a payable to the State Treasury as of September 30, 2006 and 2005.

6. OPERATING SUBSIDY

Yap State Law No. 6-60, appropriated \$78,700 from the General Fund of the State of Yap for the purpose of providing funding the operation of the Southern Yap Water Authority. The grant had a lapse date of September 30, 2006. During the year ended September 30, 2006, \$59,025 of the appropriation was advanced to the SYWA. \$20,648 was expended during fiscal year 2006. The remaining \$38,377 unexpended as of September 30, 2006 is presented as deferred grant revenue on the accompanying balance sheet.

7. RELATED PARTY TRANSACTIONS

In the ordinary course of business, SYWA enters into transactions with the State Government and private businesses in which certain of the SYWA board members hold positions of influence.

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements September 30, 2006 & 2005

7. RELATED PARTY TRANSACTIONS (cont.)

During the year ended September 30, 2006, an officer of the SYWA received \$4,002 for expenses incurred on behalf of SYWA during fiscal years 2006 and 2005. Also during the year ended September 30, 2006, an officer won a contract in the amount of \$4,950 to repair the roof of the pump house and the office building and to replace certain contents of the office building. The contract was funded by FEMA Public Assistance Grants for Typhoon Sudal.

During fiscal year 2006, an employee received unauthorized payments in the amount of \$1,407. SYWA effected collection of the whole amount during fiscal year 2006.

8. RISK MANAGEMENT

SYWA is self-insured for all risks. Any loss or liability that may result upon occurrence of a natural disaster, accident or litigation will be borne entirely by SYWA. Management is of the opinion that no material losses have been sustained as a result of this practice.

9. PRIOR PERIOD ADJUSTMENTS

An adjustment of \$649 was required to correct errors in beginning net assets.

10. SUBSEQUENT EVENTS

In December 2006, the State Finance advanced the remaining \$19,675 of the \$78,700 appropriated under YSL 6-60 to the SYWA. The grant expired September 30, 2006 but was extended by YSL 6-83 to September 30, 2007 and YSL 7-12 to September 30, 2008.

In February 2007 the Chairman of the Board resigned as a member of the Board of the Southern Yap Water System. His replacement has not been named.

In April 2007, the Congress of the Federated States of Micronesia under PL 14-108 as amended by PL 14-108 authorized \$35,000 for the Southern Yap Water System for equipment purchases. The grant was unexpended as of February 20, 2008.

In June 2007, the Board approved the purchase of four submersible water pumps worth \$3,174.



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

To the Board of Directors of
Southern Yap Water Authority:

I was engaged to audit the financial statements of the Southern Yap Water Authority, as of and for the year ended September 30, 2006, and have issued my report thereon dated February 20, 2008, which report was a disclaimer due to scope limitations presented by inadequate accounting records and uncertainties relating to the consistent application of accounting principles between fiscal year 2005 and 2004. I conducted the audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

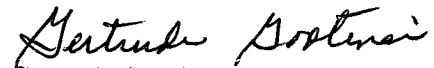
Internal Control Over Financial Reporting

In planning and performing my audit, I considered the SYWA's internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing my opinion on the financial statements and not to provide assurance on the internal control over financial reporting. My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. I noted matters involving the internal control over financial reporting that I have reported to management in the accompanying Schedule of Findings as Findings Nos. 3 through 15. Of the matters reported to management in the Schedule of Findings, I consider Finding No. 4 to be a material weakness.

Compliance

As part of obtaining reasonable assurance about whether the SYWA's financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit and accordingly, I do not express such an opinion. The results of my tests disclosed instances of noncompliance which are presented in the Schedule of Findings as Findings Nos. 1 and 2.

This report is intended for the information of the management and Board of Directors of the Southern Yap Water Authority and is not intended to be and should not be used by anyone other than these specified parties.


Gertrude Gootinan
Yap State Public Auditor

February 20, 2008

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2006

FINDING NO.1 – UTILIZATION OF FUNDS

Criteria: Funds shall only be obligated/disbursed for the purpose specified by the appropriation law and may not be obligated/disbursed in excess of funds allotted to each account.

- Per the March 2006 Memorandum of Agreement (MOA), “the Grantee shall not disburse nor obligate funds in excess of funds hereby allotted in each account as specified in the attached Advice of Allotment. Any excess disbursement shall be borne by the Grantee.”
- Title 13, Section 1261 states that no officer or employee of the State or allottee of a State appropriation shall incur an obligation, or authorize or order anyone to incur an obligation of funds from the General Fund or from a Special Fund unless at the same time there are funds appropriated and allotted.
- Title 13, Section 1262 states that no officer or employee of the State shall make or authorize any disbursement of money from the General Fund or from a Special Fund in advance of the appropriation and availability of funds.

Condition: For the first 75% portion of the appropriation cash advanced to the SYWA, there was \$14,875 allotted to the Consumable Goods account. As of September 30, 2006, the funds in this account were overspent by \$7,562.70. The SYWA then began to use the funds allocated to the Fixed Asset account.

Total Funds Overspent:

Consumable Goods funds overspent	<u>\$7,562.70</u>
----------------------------------	-------------------

Cause: The SYWA did not fully understand and/or take notice of the terms and conditions set forth in the Memorandum of Agreement or in the laws set forth in the Yap State Code.

Effect: The SYWA over spent the funds allotted to their Consumable Goods account in contradiction to both Yap State law and the MOA that it had endorsed.

Recommendation: The Authority had been provided with copies of the State Financial Management Act, the State Contracts Act, and the applicable laws in the Yap State Code. However, the SYWA has the responsibility to continuously update its files in regards to laws and regulations – a specific responsibility of the government’s representative on the Board of Directors. Having the funds maintained at Yap State Finance will create stricter controls over State funds made available to the Authority.

FINDING NO. 2 – COMPETITIVE PROCUREMENT

Criteria: The enabling legislation of SYWA, Section 748 of Title 18 of the Yap State Code States that: “purchases of all supplies and materials and the construction of all works, when the expenditures exceed \$2,500, shall be by contract let to the lowest responsible bidder in compliance with procedures of the State Contracts Act. Notice requesting bids shall be published at least ten (10) days before bids are received.”

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2006

FINDING NO. 2 – COMPETITIVE PROCUREMENT (cont.)

Moreover, the Yap State Law No. 6-53 states that “all other purchases shall be subject to competitive purchasing. Competitive purchasing as used herein means proof of price comparisons of at least three vendors, when possible, indicating that the lowest price possible is applied thereto before a purchase order may be processed.”

Condition: We judgmentally selected twenty transactions, aggregating \$15,512 from the check register for fiscal year 2006, targeting unusual transactions. For all applicable selections we found that there was no documentation on file regarding any bidding processes and/or price comparison from other vendors or contractors that should have taken place in accordance with Yap State Code Title 18, Section 748. A disbursement made to a local vendor for the amount of \$5,532.86 should have been done only after the bidding and/or price comparison processes justify the award of the bid.

In addition, there was nothing on file documenting any price comparison from other vendors or contractors that should have taken place in accordance with Yap State Law No. 6-53 for all other expenses. The total amount of \$4,424.11 has been determined to have been disbursed without price comparison. This amount excludes Utility and Refund expenses in which Yap State Law No. 6-53 does not apply.

Cause: There was no attempt to competitively procure the work and/or purchases.

Effect: With regards to FY06 expenses recorded in the Check Register SYWA has been disbursing government money without formally bidding all contracts exceeding \$2,500 despite SYWA enabling legislation Yap State Code Title 18, Section 748 nor has SYWA been comparing prices between vendors and contractors for all other expenses despite Yap State Law No. 6-53.

Recommendation: We strongly recommend that the Board and Management review the enabling legislation set forth in the Yap State Code which created SYWA, the Yap State Law No. 6-53, and to continuously update their files in regards to new legislation in order to better understand their responsibilities, duties and requirements involving the operation of the Authority, and to prevent future noncompliance with the laws and regulations of the State of Yap.

Prior Year Status: A similar finding was cited in the audit report for the SYWA for the year ended September 30, 2005 (FY05 Finding No. 3).

FINDING NO. 3 – QUESTIONABLE COSTS

Criteria: Control mechanisms should be in place to ensure that funds are only used towards legitimate and valid expenses. As such, checks should only be issued with adequate supporting documents that verify that the expense is valid. Also, it is a general government disbursement policy to not use governmental funds for personal reasons – including contributions to express condolences towards employees. In these situations, should a donation be desired, personal funds should constitute that donation.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2006

FINDING NO. 3 – QUESTIONABLE COSTS (cont.)

Condition: Three refunds, two paid out during FY2006 and one paid out during FY2007 had inadequate supporting documentation. The refund paid out during FY2006 totaled \$4,002.28 and was issued to a board member at the time due to FY05/FY06 expenses incurred on behalf of SYWA. Of this amount, \$1,758.72 was found during the prior year audit to be question costs – those costs which do not have adequate supporting documents verifying that the expense is valid and those costs which concern a related party. Moreover, the refund amount was \$5.69 more than the original amount (\$3,996.59) claimed by the board member and documented with invoices. Per discussion with SYWA Manager, we were told that although the total of invoices being claimed by the board member totaled \$3,996.59, the board member insisted that the actual amount was \$4,002.28 and thus the check was issued for this amount. The other refund paid out during FY2006 was a FEMA reimbursement to the same board member in the amount of \$4,950. The invoices submitted by the board member as evidence of payments made on behalf of SYWA were found during the prior year audit to be questionable and did not have adequate supporting documentation. The refund paid out during FY2007 was comprised of FY05 invoices totaling \$127.05. \$122.05 of this amount was found during the prior year audit to also be question costs.

Moreover, SYWA made a withdrawal totaling \$173.85 from its Savings Account to be given to well technician as both an expression of condolences for the passing of his wife and a purchase of coffee supplies to be used during the funeral. Again, this is considered a question cost.

Cause: There seems to be no control mechanisms and/or policies in place to ensure that all refunds are supported by adequate documentation. There also seems to be no control mechanisms and/or policies in place to prevent individuals from influencing the issuance of checks whether or not the expense is legitimate. In addition, there was no policy in place to follow general government disbursement policies especially those which prohibit the use of government funds for personal reasons.

Effect: Checks were issued to two board members although there was inadequate supporting documentation showing that the two board members had in fact paid cash in order to benefit SYWA. The FY2006 refund check of \$4,002.28 was also issued as reimbursement for payments made to a related party. Furthermore, government funds were used to settle personal expenses.

Recommendations: We strongly recommend that SYWA adopt policies that address the need for adequate supporting documentation – that which clearly shows that a payment had been made – before a refund check is issued. Also, under no circumstances should the influence of any individual be used as justification for issuing a check for any amount especially if the supporting documentation (i.e. invoices) shows a different amount than the one being claimed by the individual. Moreover, before refunds to the applicable individual are made, an extensive examination of the supporting documentation should be conducted in order to uncover any questionable activity (i.e. payments made to a related party). We also recommend that SYWA become acquainted with general government disbursement policies in order to better understand the allowable uses of government funds and to establish policies that government funds should not be used to settle personal expense.

FINDING NO. 4 – UNRESOLVED PRIOR YEAR FINDINGS

Criteria: It is the responsibility of the SYWA Board of Directors and management to ensure that all audit findings are discussed and resolved in a timely manner after audit findings are made available.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2006

FINDING NO. 4 – UNRESOLVED PRIOR YEAR FINDINGS (cont.)

Condition: During fiscal year 2006, we discovered that there had been no indication that SYWA had taken into consideration most of the recommendations made in regards to several prior year audit findings:

1. *Prior Year Finding No. 6 – Governor's Appointee to the Board.* Whereas the government's representative on the Board of Directors is responsible for ensuring that SYWA conducts its affairs in compliance with the state's laws and regulations, SYWA was not able to comply with its bidding threshold of \$2,500 and did not abide by the State Ethics Act and U.S. procurement standards that require officers and employees to avoid conflicts of interests. We had recommended that the Governor review the track record of the government representative and appoint a replacement as necessary to ensure that the incumbent fulfills his responsibility; that the Chairman of the Board ensure that future contracts meeting or exceeding the bid threshold of \$2,500 be reviewed by a quorum of the board and that selections of contractors/suppliers be documented in meeting minutes; and that Board members, employees and their immediate family members should be prohibited from participating in SYWS contracts.

2. *Prior Year Finding No. 8 – Lack of Accountability Over Grant Funds.* In order for costs to be allowable under U.S. Federal Grants, such costs should be supported by underlying documentation sufficient to establish the reasonableness and necessity of the costs claimed. However, it was found that a FEMA Grant of \$4,950.26 was disbursed to JG Construction for the renovation of SYWA office building but documentation provided to support this check had provisions that were inconsistent with actual events as was understood during the fiscal year 2005 audit. SYWA Board of Directors tried to explain the discrepancies by stating that their first priority when they took over the management of SYWA was to repair the office building to allow SYWA to resume normal

operations. Whatever the case, the inconsistencies and discrepancies showed very poor accountability over Grant Funds. We had recommended that the Board of Directors:

- Adopt a policy to prohibit companies in which employees or board members have financial interests from participating in contracts let by SYWA.
- Require that the Board as a whole approve, in advance, payments from personal funds made by a board member or employee on behalf of SYWA. If a situation should arise in which personal funds are needed to supplement the financial operations of the Authority, the transaction should be transacted as a loan describing the full scope of the transaction and explaining the terms and conditions in writing.
- Adopt a policy to accept nothing less than veritable proof of payments when Board members and employees submit claims for reimbursement against the Authority.
- Ensure that procurements abide by the threshold for competitive bidding called for by SYWA's enabling legislation of \$2,500.

3. *Prior Year Finding No. 10 – Missing Cash.* SYWA should be accountable for all its cash transactions; however, during the prior year audit, seven unusual checks were found aggregating \$1,302.70 which had been written by the clerk at the time to herself. There was also \$105.20 missing in cash. We had recommended that the Board of Directors review the duties and responsibilities of the three full-time employees to allow for adequate segregation of duties.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2006

FINDING NO. 4 – UNRESOLVED PRIOR YEAR FINDINGS (cont.)

Management has the responsibility to deter fraud, waste and abuse. In that regard, we had recommended that the Board of Directors formulate policies and procedures for the Authority to reduce the risk of fraud and to ensure that fraud or errors can be timely detected by employees in the normal course of performing their assigned functions. We had also recommended that management make the effort to hire the best person for its vacancies. Position descriptions and duties and responsibilities of vacancies, along with minimum qualification requirements should be advertised publicly for at least 30 days. Applications received should be reviewed with the aim of finding the best-qualified person for the job. According to this recommendation at least, has there been some improvement in the hiring of the current Administrative Assistant.

4. Prior Year Finding No. 12 – Lack of An Accounting System: SYWA management is responsible to ensure that the Authority maintains and makes available reliable and accurate accounting and financial records maintained in accordance with Generally Accepted Accounting Principles (GAAP). GAAP requires: the use of double-entry accounting where each transaction is recorded both as a debit and credit to at least two related accounts in the general ledger; the use of a general ledger (a set of accounts utilized to keep track of five essential categories of accounting data: assets, liabilities, net assets, revenues, expenses); that revenues be recorded when earned and measurable and liabilities at the time that expenses were incurred (goods and services received); the proper matching of revenues and expenses for each accounting period; and the consistent recording of accounting transactions from one period to the next. However, SYWA had no accounting system in place, with no trained accountant or bookkeeper, and as an effect had no records of its financial activities during fiscal year 2005. We had recommended that the Board of Directors immediately take appropriate action to purchase a simple accounting program such as *Quickbooks Pro* and hire someone to set up the program by creating a chart of accounts, establish beginning balances, and train the accounting clerk to post transactions.

5. Prior Year Finding No. 13 – Accounting Policies and Procedures: In order to ensure accurate and reliable financial information, accounting policies and procedures should be in place. However, the prior year audit found that SYWA did not have any accounting policies and procedures in place during fiscal year 2005 (i.e. no check register, cash was used to settle expenses, no receipts were found for cash collections). The lack of accounting policies was due to the lack of any real operation for the most part of fiscal year 2005. As a result, the Authority does not have the capability for internal and external financial reporting and there is no assurance that revenue generated by the entity would be spent for authorized purposes and that funds received from outside would be properly administered. We had recommended that the Board of Directors immediately formulate and adopt policies and procedures to ensure that adequate accounting controls are in place to safeguard and properly account for assets and to allow for reliable and accurate accounting and financial reporting:

- Ensure the availability of official pre-numbered cash receipts for the Authority.
- Require that all cash received are receipted and that receipts are issued in sequence
- Ensuring that cash received are safeguarded against theft or loss and that collections are timely banked.
- Require that a cash register is maintained of monthly collections.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2006

FINDING NO. 4 – UNRESOLVED PRIOR YEAR FINDINGS (cont.)

- Require a person independent of the cashier review deposits to make sure that all cash received are deposited in the bank.
- Require original invoices or other authoritative underlying documentation to support each and every disbursement of funds.
- Specify the dollar threshold or type of expenditures requiring prior board approval.
- Adopt a purchase order system to ensure funds availability and proper authorization before goods or services are acquired.
- Ensure that the stocks of blank checks are secured at all times.
- Cash flow management to prevent cost overruns and disruption to public services.

These particular Prior Year findings are being addressed again because it seems as if very few of the recommendations put forth by the Office of the Public Audit in the prior year audit was taken seriously nor has there been any indication of significant improvement. These findings are worth taking note of again because there is a very good possibility that without addressing these findings again, the situation will continue into the next fiscal year.

There were also several FY05 findings which had been incorporated into the current year findings, (FY06 Finding Nos. 4, 5, 6, 7, and 11). These findings incorporated those of the prior year because the Criteria and certain parts of the other four elements still applied although the Conditions had changed for the current year audit.

Cause: With the exception of some recommendations made under the Prior Year Finding No.13, there has been no real attempt to correct some of the Conditions and Causes mentioned in the Prior Year Findings as noted above. Taking the recommendations made by the Office of the Public Auditor into consideration and attempting to correct the situation is a responsibility that lies with the Board of Directors, firstly, and the General Manager, secondly.

Effect: SYWA has been operating for a full fiscal year under the same situations that they had been cited for in the previous audit. Specifically, the Governor's appointee to the Board has not been effective in allowing SYWA to operate in compliance with applicable laws and regulations; SYWA still exhibits poor accountability over Grant funds; the Authority still runs the risk of missing cash due to inadequate segregation of duties; SYWA is still unable to compile its own financial statements from the lack of an appropriate accounting system; and the Authority still does not have the capability for internal and external financial reporting and there is no assurance that revenue generated by the entity would be spent for authorized purposes and that funds received from outside would be properly administered.

Recommendations: We strongly recommend that the Board of Directors and the General Manager take a serious look at the prior year findings identified above and take steps to remedy the inadequate conditions that had been noted during the prior year audit. Our recommendations still operate along the lines of the prior year audit.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2006

FINDING NO. 5 – GENERAL DISBURSEMENT PROCEDURES

Criteria: All disbursements should be authorized by the Board to show that the expenses are necessary and reasonable to the operation of the Authority.

Condition: The expense file at SYWA Office was significantly incomplete. We found that there were several issued checks that were not supported by authoritative underlying documents (i.e. final sales receipts showing that the items/services listed on the pro forma invoices had actually been acquired). Moreover, there were some instances in which checks were photocopied before they had been fully completed and showed only one authorizing signature instead of the required two. In addition, the transaction in which a \$5,532.86 payment was made to Waab Company was made without an invoice showing the specific items that had been purchased. The invoice was later provided to SYWA.

Cause: There did not seem to be any controls in place to support the importance of acquiring authoritative documents, of showing that the expense transactions were authorized by the Board, and that the expense file needed to be complete, organized, and available for quick and easy retrieval.

Effect: There is increased risk of fraud or errors in the disbursement process when it becomes difficult to determine whether or not payment had been made or that the goods and/or services for which the check was issued was actually obtained. Without authoritative underlying documents, it is only clear that government funds were issued but determining what it was issued for becomes difficult and time-consuming. Moreover, copies of incomplete checks will be useless to file since it will just lead the reviewer to assume that it was issued as is – incomplete. In addition, issuing a check for an invoice that does not show the specific items increases the risk of unauthorized payments and/or the acquisition of unauthorized items.

Recommendation: We strongly recommend that management establishes control mechanisms in order to ensure that all authoritative underlying documentation for all checks issued are filed and that the expenses file is complete, organized, and available for quick and easy retrieval. Period examination of expense files should be done to make sure that all is in order. Moreover, an addition to SYWA policy to only issue checks when a specific and detailed invoice is at hand may prove beneficial.

FINDING NO. 6 - CASH PAYMENTS

Criteria: To maintain proper accountability over cash and to ensure complete and accurate recording of expenses, disbursement of company funds should be documented through issuance of check payments. SYWA policy is to issue checks for the settling of all expenses.

Condition: Our review of the saving and checking account activities for SYWA found that for the most part, withdrawals made from the savings account were traceable to deposits in the checking account of the same amount. However, there were a few instances in which withdrawals from the savings account, totaling \$2,290.01, were used to settle expenses without first being deposited into the checking account and issuing a check for the expense, though there seems to have been an attempt at documenting these withdrawals. Thus, contrary to policy, board members and management are authorizing withdrawals from the savings account to be used to settle expenses – personal and legitimate.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2006

FINDING NO. 6 - CASH PAYMENTS (cont.)

As noted in Finding No. 6, there was a \$173.85 withdrawal of cash to be paid to a well technician. Also, another withdrawal of \$2,116.16, documented only by a withdrawal slip, was made on 12/27/2005 and seems to have been used to pay for utility bills on the same day. We only made this connection after we had requested a Bill History for SYWA from YSPSC. Moreover, we suspect that a cash payment of \$10 may have been made as a cash deposit for the rental of the YFTI koyeng for a SYWA party. We were unable to determine where the cash for this deposit came from – whether from personal contributions or SYWA cash on hand at the time.

Cause: There is a lack of leadership from the board members and management. Per discussion with management, SYWA's policy is to issue checks for all expenditures but it seems that this policy is not being upheld in certain situations.

Effect: Policy at SYWA regarding the settling of expenses is being disregarded. Risk of misusing SYWA cash is increased when cash is used to settle expenses due to the relative lack of paper trails which would obstruct the process of payments. In addition, if SYWA had used cash to settle other official expenses – for instance that of Utilities as seen above – let alone unofficial and illegitimate ones, records of such receipts and expenditures were unavailable.

Recommendation: We strongly recommend that the Board of directors require that all cash collected by the Authority be receipted and banked to the savings account. At no time should collections be used to pay for expenses. Moreover, payment of expenses should only be settled through Authority checks. The practice of using cash to settle liabilities should be immediately stopped as that leaves behind no reliable records of the disbursement of Authority funds. We also recommend that the Board of Directors instruct the bank in writing to honor cash withdrawals only if the withdrawal is needed to affect a cash transfer between SYWA accounts. This will mitigate the risk of someone obtaining cash for unauthorized purposes.

Prior Year Status: A similar finding was cited in the audit report for the SYWA for the year ended September 30, 2005 (FY05 Finding No. 11).

FINDING NO. 7 – BANK ACCOUNT RECONCILIATION

Criteria: SYWA should ensure that bank reconciliation is performed each month as bank statements become available. Check register balances should always be recorded from the moment they are known, account statements should be available at all times and ready for retrieval, and all checks should be accounted for, or considered in the bank reconciliation.

Condition: SYWA had never reconciled its bank accounts during FY2006 and in prior years. The first attempts at bank account reconciliations took place for the month of November 2006. Before that, SYWA relied primarily on the bank to provide bank account balances as needed. Check register balances were not recorded until March 29th of 2006 – although checks were being issued since February 10, 2006. Moreover, checking account statements on file at SYWA were incomplete as the statement for March of 2006 was missing and there seems to have been no attempt at tracing the check # 4243 which was issued for a koyeng rental at Y.F.T.I. for the amount of \$100.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2006

FINDING NO. 7 – BANK ACCOUNT RECONCILIATION (cont.)

Cause: No one required bank accounts to be reconciled on a regular basis nor were there any control mechanisms in place to ensure that the correct balances are recorded, that all bank statements are kept on file and available for retrieval and that all checks issued were accounted for.

Effect: The Authority lost money due to negligence. SYWA was not able to timely detect unusual cash transactions nor was SYWA able to keep a correct running balance in their check register. This led to SYWA issuing checks that were not supported by sufficient funds in the checking account which led to a Not Sufficient Funds bank charge during the month of March 2006. In addition, SYWA was not aware of one check, see above, that had not cleared the bank as of September 30, 2006.

Recommendation: In order to account for all cash transactions, we strongly recommend that SYWA's General Manager requires that a monthly reconciliation of the checking account be made as soon as bank statements become available. The General Manager, then, should always review and approve reconciliations performed by the Administrative Assistant in order to timely detect errors and unusual activities. Those transactions recorded by the bank should be reviewed and recorded in the General Ledger. Bank statements should all be filed and those missing should be requested of the bank; moreover, SYWA should regularly follow up on the status of the checks that they have issued for the payment of expenses and to record and investigate such instances where checks do not clear that bank.

Prior Year Status: This is a repeat finding from the year ended September 30, 2005 (FY05 Finding No. 14).

FINDING NO. 8 – LACK OF INDEPENDENT REVIEW

Criteria: Proper controls require that there be evidence of independent review of the cashier's work. This is to ensure that the processes of counting and totaling pending deposits and depositing payments are carried out accurately, responsibly and legally.

Condition: There is no independent review of the cashier's work.

Cause: There were no policies in place requiring this particular control mechanism. This may be due to the small number of employees employed by SYWA and/or neglect.

Effect: There is increased risk that errors may have been committed due to various factors (i.e. human error, intention).

Recommendation: We recommend that SYWA designates an impartial individual to verify the work of the cashier in order to decrease the risk of errors. This individual will have the responsibility of reviewing the work of the cashier and then authorizing that it is accurate and has been verified.

FINDING NO. 9 – UNTIMELY CASH DEPOSITS

Criteria: For proper controls and accountability over cash, collections should be deposited into the savings account on a timely basis. In general, cash should not be kept in the office for more than three days.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2006

FINDING NO. 9 – UNTIMELY CASH DEPOSITS (cont.)

Condition: With very few exceptions, SYWA does not deposit its cash in a timely fashion. For the most part, SYWA keeps cash in the office for more than three days.

Cause: There are no controls in place that ensures cash deposits are made on a timely basis in accordance to SYWA policy.

Effect: The longer cash is kept in the office the higher the risk of misplacing or misusing cash collections.

Recommendation: We strongly recommend that the SYWA Board of Directors and Management establish controls that will ensure that the SYWA policy of depositing cash collections every three days is followed. Establishing controls is the responsibility of the manager and one such control might be to consistently follow up on deposit dates. This might even be as simple as constructing a deposit calendar and establishing a set time on each deposit date as to facilitate a habit of making deposits on set dates and times. Then after deposits have been made, the calendar might be initialed by the depositor and a verifier, copied and filed along with the deposit documents.

FINDING NO. 10 – MAINTENANCE OF CUSTOMER RECEIVABLES

Criteria: Customer accounts should be maintained in a way that would allow for the effective and efficient retrieval of outstanding balances for individual accounts.

Condition: As it currently stands, there is no formal recording of customer receivables. In order to retrieve customers' past due balances, one would need to determine which customers had unpaid balances as of September 30, 2006 (or at the end of each applicable period) and then trace each individual account into the subsequent months until the unpaid balance as of the period end is paid off. There is also no policy determining the length of time a customer's unpaid balance will be kept until it is deemed uncollectible and it becomes bad debt.

Cause: No one required that customer past due balances be segregated and accumulated at the end of each fiscal year and/or at the end of each applicable period.

Effect: SYWA did not determine bad debt as of 9-30-06 and as a result, valuable resources might have been expended in chasing down such customer accounts (i.e. time, money, invoices/bill copies).

Recommendation: SYWA should establish a policy that would delineate how far into the future to keep customer's unpaid balances before designating them as bad debt. At the end of each fiscal year, a schedule of customer receivables should be accumulated and analyzed for collectability. An allowance for bad debt should then be estimated and bad debt expense recorded accordingly.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2006

FINDING NO. 11 - CUSTOMER BILLINGS

Criteria: The Authority should maintain accurate and reliable records of customer accounts.

Condition: Our review of water billing found that there were no carbon copies of the invoices and entire invoices were given to customers. Customers were supposed to retain part of the invoice and bring the other part to either the SYWA Office or the Bank of the FSM with their payment. More often than not, payments were not accompanied by invoices. Furthermore, there was no systematic filing system for those invoices that did make their way back to SYWA Office. Invoices were "paper-clipped" together and stuffed into envelopes and desk drawers. Also, bills were still being completed manually and customer accounts suffered from inconsistent recording with previous account balances being carried forward to the next period incorrectly and paid off balances being treated in a variety of different ways (i.e. marking them as paid, erasing entries). There had also been instances when payments made in installments were treated and recorded on the Customer Master List as a single payment.

Cause: Customer accounts have not been maintained in a way that facilitates review – whether for the purpose of an audit or the purpose of SYWA operations. We found that it was extraordinarily hard to track individual customer payments during the course of our testing to determine when and how much had been paid.

Effect: There is increased risk of errors in the recording of water utility revenue. Without carbon copies of the invoices issued to customers, there is a risk that customers might have been billed amounts that were not based on the established utility rate, that customers might have been billed for amounts that were different than those recorded on the Customer Master List, that previous account balances were not reflected accurately on the invoices, and that the cash received from customers as payment was not the amount billed. The same risks apply to the lack of a systematic filing system for invoices/bills because not being able to retrieve the information needed due to its inaccessibility is the same as not having that information. Manually completing bills increase the risk of human errors and intentional fraud. Finally, the inconsistent recording of customer accounts has the potential risk of billing customers for the wrong amount.

Recommendations: We encourage SYWA to maintain a duplicate of all invoices that they issue to customers, even if the duplicate is just a photocopy of the original. Investment in carbon copy forms is highly recommended. It is also recommended that SYWA create and maintain at least a listing – a computerized one would be most beneficial – of all the invoices it issues with references to where the actual invoice copies can be found. The physical location of the invoices needs to be organized in such a way as to facilitate quick and efficient retrieval of individual invoice. SYWA should also make an attempt towards automating its billing process and setting it up so that the only part of the process any individual has control over will be the entering of current water usage. The rest of the process – calculating the amount to be billed, the bill itself, etc. – should be generated by the computer. We also recommend that SYWA adhere to one way of recording customer accounts. Under no circumstances should anything under any customer's account be erased with no accompanying documentation. It might be good practice to make another entry canceling out the previous one instead of erasing entries. Finally, we recommend that SYWA systematically file information on their individual customers in order to facilitate individual customer information – instead of aggregating them into one large manual Customer Master List. Again, automation will prove beneficial.

Prior Year Status: This is a repeat finding from the year ended September 30, 2005 (FY05 Finding No.19).

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2006

FINDING NO. 12 – INTENTIONAL ALTERATION OF CUSTOMER ACCOUNTS

Criteria: The Authority should only bill customers the amount that is owed based on services provided and all customers should be treated equally. The Authority was created to provide an essential service to the residents of Southern Yap and to charge said customers for this service. Basic business principles dictate that not only should accurate and reliable records of customer accounts be maintained, but that all like customers be subject to the same rates.

Condition: SYWA bills its metered customers based on a set utility rate: \$1 for every 1,000 gallon. As we understood it, there were no different customer groups in which different utility rates might have applied. Upon examination of SYWA's Customer Master List, we found that there was one customer account in which information seemed to have been intentionally altered. This customer was consistently charged a different amount regardless of his water usage; indeed, his water usage was normally significantly higher than what he had been billed for.

Cause: There seems to be no control mechanisms in place to ensure that the Customer Master List is completed accurately each month. The Authority maintains its Customer Master List manually and the List is stored in an unsecured location. There is also inadequate segregation of duties due to the small number of employees.

Effect: One customer account may have been intentionally altered for unknown reasons. Un-automated and unsecured, the Customer Master List becomes a liability and a risk when it can be easily subjected to unauthorized changes. Consistently billing customers the wrong amount can erode the customer base even if done unwittingly. If done intentionally towards a select number of customer accounts, whether in favor of or against, the larger portion of customer accounts will look unfavorably upon SYWA and further erosion of the customer base will result. With no segregation of duties, an individual may end up entering the customer's water usage onto the Customer Master List, calculate the amount owed and make out the bill for the customer. This increases the likelihood and risk of fraudulent practices especially if there is no review and verification of this individual's work.

Recommendation: SYWA should only bill customers based on their water usage and the current utility rate. The location of the master list should be secured and SYWA should look into automating the List so as soon as the current meter reading has been acquired by the meter reader, it is entered into the computer which generates the current water usage bill, pulls any applicable unpaid balances from the previous months, and generates the amount that should be billed. Ideally, the computer should also generate a bill that can be printed and delivered to the customer. This should significantly eliminate not only human errors, but intentional ones as well. This would also facilitate the uncovering of any fraudulent practices. Moreover, although we recognize that there are a small number of employees at the Authority, there should be adequate segregation of duties – or at least enough so that no two significantly vital consecutive steps in any process (be it billing, receipt of payment, etc.) be performed by any one individual.

FINDING NO. 13 – BANK CUSTOMER PAYMENTS

Criteria: With two locations accepting customer payments of SYWA bills, it becomes imperative for the SYWA Office to make sure that the records at SYWA and those compiled by the Bank correspond. With the customer base generating revenue, it is important that customer accounts be accurate in order to recognize trends – water usage, payments, bad debt, etc. – and be able to react to and anticipate such trends and how to deal with them.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2006

FINDING NO. 13 – BANK CUSTOMER PAYMENTS (cont.)

Condition: Recording of customer payments made at the bank in the Customer Master List has been inconsistent. There were times when SYWA recorded an amount paid on the Customer Master different from that noted on the bank report. Also, there were instances when separate payments made to the bank in different bank report periods was recorded on the Customer Master List as one payment – which made tracing that “single payment” very difficult. Moreover, SYWA is not able to provide information that would allow for the tracing of individual customer payments made at the bank to the subsequent deposit in the savings account – for lack of invoice stubs/copies, deposit slips, and/or receipts for the selections tested, lack of communication with the bank regarding bank report formats, etc. The savings passbook requested of the bank only notes that a “Deposit” has been made and attempts to match these transactions to the bank report in order to delineate those which were customer payments made at the bank proved to be difficult and time-consuming and would have been unnecessary had there been adequate upkeep of customer accounts.

Cause: There is inadequate and inconsistent upkeep of the accounts of those customers who make payments at the bank. The process of transferring information from the bank reports to the Customer Master List does not seem to be efficient.

Effect: Having no supporting documentation and relying solely on the bank reports for payment verification increases risk of customer payments being misplaced and/or mishandled.

Recommendation: We recommend that SYWA ensures that the information from the bank and those kept at SYWA office are reconciled. SYWA needs to record customers’ accounts correctly in order to protect that source of revenue. The reports provided by the bank should be used consistently – separate payments made to the bank in different bank report periods should be reflected as two different payments in the Customer Master List. Also, SYWA should be able to provide information that would allow for the effective and efficient tracing of individual customer payments made at the bank to the subsequent deposit in the savings account – it should be a simple process to identify individual customer payments made at the bank on the savings passbook. Utilization of invoice/bill duplicates or carbon copies and a systematic invoice filing system should prove beneficial. Communication with the bank is imperative in order to make sure that the information contained in the bank report is usable by SYWA Office. SYWA should instruct the bank to include on their report the dates of the individual customer payments.

FINDING NO. 14 – SYWA DEBT

Criteria: Any time a government entity takes on a debt, general government policies require that all the applicable paper work be acquired and filed in a way that will enable easy retrieval so that the debt can be paid off in a timely manner.

Condition: During FY2005, SYWA became indebted to the Yap State Government for the amount of \$3,636.05 that was used to pay for SYWS’ utility bills. Per discussion with the SYWA manager, we were told that the amount was taken care of by the Governor and that there was no obligation on the part of SYWA to pay it back. However, per examination of the prior year file, it seems that this amount was expended on behalf of SYWA with the understanding that it will be paid back in a timely manner when funds become available.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2006

FINDING NO. 14 – SYWA DEBT (cont.)

Cause: There was no subsequent communication between SYWA and the Governor's Office and/or the State of Yap after the loan was affected. The files at SYWA were incomplete as well in that there were no documents regarding this transaction or any subsequent discussions. There also seems to have been some misunderstanding regarding the terms of the amount used to pay SYWA's utility bills during FY2005. Not only was SYWA unaware of their obligation to pay back the government, but the State, at least as far as SYWA claims, has not called in the debt.

Effect: SYWA was not aware of the fact that they had to pay back this amount and so have been indebted to the Yap State Treasury since September 2005 without being aware of it.

Recommendation: We recommend that SYWA and the Governor's Office and/or the State of Yap open up channels of communication to prevent similar situations. All debts should be well documented, recorded in the accounting records, and systematically filed as to facilitate retrieval.

FINDING NO. 15 – SOCIAL SECURITY TAX EXPENSE

Criteria: Only 6% of the social security payment made to the Social Security Office should be recorded as Social Security Expense on SYWA's Check Register. This 6% represents SYWA contribution towards employees' social security. The other 6% employee withholdings should be recorded as salaries and wages.

Condition: SYWA records the entire 12% social security tax payment to the Social Security Office as SYWA social security tax expense.

Cause: This is probably due to human error on account of a lack of accounting knowledge.

Effect: For the two quarters in which social security tax was paid to the Social Security Office during fiscal year 2006, SYWA erroneously claimed as part of their expenses the entire 12% social security tax payment instead of the actual 6%. This overstated the amount that was SYWA's actual social security expense and understated salaries and wages expense.

Recommendation: We recommend that SYWA correct their expenses records to show that they only contributed 6% towards employees' social security. Also, it might be advisable for the Authority to familiar itself with accounting principles.



SOUTHERN YAP WATER AUTHORITY

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March 10th, 2008

Gertrude Gootinan
Chief of Public Auditor
Yap State Government
Colonia, Yap FSM 96943

Re: Audit Report for SYWA

Dear Ms. Gootinan,

This is to respond to your Memorandum of February 19th, 2008, draft Audit Report for the Southern Yap Water Authority for Fiscal Year ended September 30, 2006 and 2005.

First of I would like to Thank You and Your staff on behave of the Board of Directors of the Southern Yap Water Authority for Auditing the Southern Yap Water Authority. The system feels that it is very necessary and important to audit the system to put its operation in the right track especially with its accounting and bookkeeping matters. When the newly Board members and management came in sometimes mid-year 2006 there were nothing in place. The present Board and management would like to fulfill all government requirements and serve the people who are presently benefit from the service(s) the system is providing.

Following is the respond to findings stated in your draft Audit Report for FY ended 2006 and 2005.

Finding no. 01-Utilization of funds:

The management has been tasked to revise its present ledgers of each account and to make sure they do not over-spend or disburse fund allotted to each account as required by appropriate law.

Finding no. 02-Competitive Procurement:

The Board has tasked government representative to the system to open communication with the AG office to gain update appropriation of new legislation in order to better understand its responsibilities, duties and requirements involving its operation, to prevent future noncompliance with the laws and regulations of the State of Yap.

Finding no.03-Questionable Costs:

The Board and management are assigned to adopt policies related to the matter to insure no future disbursement of appropriate fund without adequate, correct and supporting documentation.

Finding no. 04-Unresolved Prior Year Funding:

SYWA is purchasing the Quick Book program which will solve the accounting matter mentioned in this finding. Board and management in their last meeting agreed to implement accounting policies and procedures to ensure all government requirement is practiced.

Finding no. 05-General Disbursement Procedures:

Board of Directors have assigned the management to established control mechanism in order to ensure all authoritative underlying documentation for all checks issued are filed and that the file is complete, organized, and available for quick and easy retrieval. Quick Book program is now utilized to ensure the problem is corrected.

Finding no. 06-Cash Payment:

Board of Directors have instructed the management to receipt and deposit any cash received on daily basis operation to its bank account no later then the next working day. In addition, management had been instructed not to use cash to pay any outstanding fees/bills but to disburse payment with checks only.

Finding No.07-Bank Account Reconciliation:

The General Manager had assigned Administrative Assistant to this task. Administrative Assistant should reconcile the system checking account with the FSM Bank statement on a monthly basis.

Finding No.08-Lack of Independent Review:

The General Manager is responsible to review and approve the works done by the Administrative Assistant and Field Operator.

Finding No.09-Untimely Cash Deposit:

As mentioned in Finding no.06, the management had been tasked to receipt and deposit any cash received on daily basis operation no later then the next working day.

Finding No.10-Maintenance of Customer Receivables:

The Board of Directors and General Manager were assigned to this task. Policies will to be established.

Finding No. 11-Customers Billings:

The system is very poor with funding to computerize all its operation but is willing to fulfill the recommendation imposed. The system is planning to purchase a Quick Book program to utilize and omit the present problem.

Finding No. 12-Intentional Alteration of Customers Account:

As mentioned in Finding no. 11, the system is working its way to purchase a Quick Book program to utilize and omit intentional alteration of customers account.

Finding No. 13-Bank Customer Payments:

The management is assigned to ensure the reconciliation of bank customer payments is done regularly to avoid inconsistency. As mentioned, the system is in process to purchase a Quick Book program to solve the present problems.

Finding No. 14-SYWA Debt:

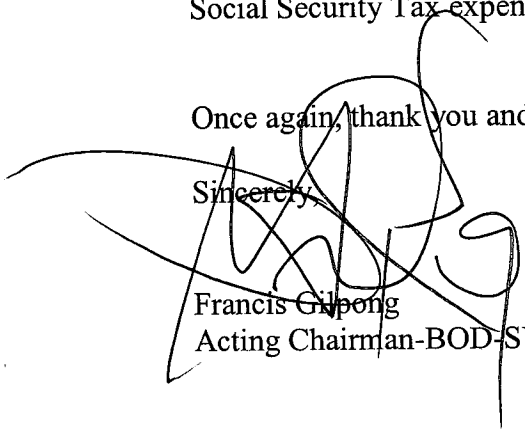
The System will be recorded in the accounting record, and systematically filed the debt from the Governors's Office to facilitate easier retrieval. Furthermore, the system do not have sufficient funds to pay back the debt now but planning to pay its debt in the future when availability of fund.

Finding No.15-Social Security Tax Expense:

The management was corrected and instructed the proper method to disburse payment of Social Security Tax expense. It is now properly practiced.

Once again, thank you and your good office for all the assistance provided to the system.

Sincerely,



Francis Gilpong
Acting Chairman-BOD-SYWA

Cc; file