

Southern Yap Water Authority

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

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



**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

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

EXECUTIVE SUMMARY

Financial Audits of the Southern Yap Water Authority Years ended September 30, 2007 and 2006

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, 2007 and 2006 which report is dated May 13, 2008. This is the third audit conducted by the Office of the State Public Auditor for the Southern Yap Water Authority. Because Southern Yap Water Authority still does not have a double-entry accounting system, the Independent Auditor's Report on page 1 is a disclaimer. Due to the lack of reliable accounting records for fiscal years 2007 and 2006, we were not able to audit the financial statements. Accordingly, we expressed no opinion on the fair presentation of the financial statements presented on pages 2 through 4.

The financial statements presented beginning on page 2 show that assets increased to \$68,924 at September 30, 2007 compared to \$62,050 in fiscal year 2006. 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, 2007 also increased over results for fiscal year 2006. Both fiscal year 2007 and 2006 showed operating deficits of \$13,032 and \$9,444, respectively, indicating that further actions are required of management to ensure the sustainability of the enterprise.

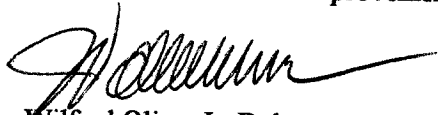
The report on internal control over financial reporting and compliance and other matters required by *Government Auditing Standards* on pages 12 thru 13 discusses reportable conditions found during the audit. These conditions and our recommendations are presented for the information of SYWA management in the Schedule of Findings beginning on page 14. Of the twelve findings, three are related to non-compliance with grant agreements, laws and regulations while the remaining nine are related to deficiencies in internal control over financial reporting. Three of the findings are considered material weaknesses.

Below is a summary of the findings for fiscal year 2007:

- 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.
- Finding No. 3 pertains to non-compliance with the reporting requirements of the Authority's enabling legislation.
- Findings No. 4 refers to non-compliance of the Authority with the Board decision stating that only board members can sign paychecks for the employees.
- Findings Nos. 5 and 9 pertains to the lack of proper procedures and documentation on customer ledgers that resulted in the inaccurate customer account balances.

- Findings Nos. 6 and 11 are related to inadequate controls over cash – bank reconciliation was not performed on a regular basis, there was no secondary review of cash collections and deposits, and collections were not deposited on a timely basis.
- Findings No. 7 pertains to the inadequacy of Personnel Policies.
- Findings No. 8 refers to the inadequate controls over the safekeeping of the Authority's fixed assets.
- Findings No. 10 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, 2007.
- Finding No. 12 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 22 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 herein. 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.



Wilfred Oliver L. Dolosa
Acting Yap State Public Auditor
February 12, 2009

SOUTHERN YAP WATER AUTHORITY

Table of Contents Years Ended September 30, 2007 and 2006

Independent Auditor's Report	1
Balance Sheets	2
Statements of Revenues, Expenses and Changes in Net Assets	3
Statements of Cash Flows	4
Notes to Financial Statements	5
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	12
Schedule of Findings	14
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: audityap@mail.fm

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Southern Yap Water Authority:


We were engaged to audit the accompanying balance sheets of the Southern Yap Water Authority (SYWA) as of September 30, 2007 and 2006, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the SYWA's management. Our 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, 2007 and 2006, and we were 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 2007, 2006, 2005, and 2004.

Since SYWA did not maintain adequate accounting records, and we were unable to satisfy ourselves about the opening balances in the financial statements as of October 1, 2004 and 2005 and 2006, or about the consistent application of accounting principles between fiscal year 2007, 2006, 2005 and 2004, the scope of our work were not sufficient to enable us to express, and we do not express, an opinion on its financial position as of September 30, 2007 and 2006 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.

SYWA did not present Management's Discussion and Analysis that, although is not a required part of the basic financial statements, is supplementary information required by the Governmental Accounting Standards Board Statement No. 34.

In accordance with *Government Auditing Standards*, we have also issued a report dated May 13, 2008 on our consideration of the Southern Yap Water Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and 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 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 our audits.


Wilfred Oliver L. Dolosa
Acting Yap State Public Auditor

May 13, 2008

SOUTHERN YAP WATER AUTHORITY

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

	<u>2007</u>	<u>2006</u>
ASSETS		
Current Assets		
Cash	\$ 61,227	\$ 54,459
Trade receivables, net (note 2)	<u>2,371</u>	<u>1,515</u>
Total current assets	63,598	55,974
Property and equipment, net (note 3)	<u>5,326</u>	<u>6,076</u>
TOTAL ASSETS	<u>\$ 68,924</u>	<u>\$ 62,050</u>
LIABILITIES AND DEFICIT		
Current liabilities:		
Accounts payable (note 4)	\$ 1,701	\$ 2,583
Accrued expenses (note 5)	1,292	882
Due to State Treasury (note 6)	3,636	3,636
Deferred revenues	<u>22,423</u>	<u>38,377</u>
Total current liabilities	29,052	45,478
Contingencies		
Net Assets		
Reserved for capital assets	5,326	6,076
Unreserved	<u>34,546</u>	<u>10,496</u>
Total net assets	<u>39,872</u>	<u>16,572</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 68,924</u>	<u>\$ 62,050</u>

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, 2007 & 2006**

	<u>2007</u>	<u>2,006</u>
Operating revenues		
Water usage and other fees	\$ 24,107	18,525
Other sales	774	2,221
	<hr/>	<hr/>
	24,881	20,746
 Operating expenses		
Salaries and taxes	14,458	5,639
Utilities	12,479	10,278
Supplies, repair and maintenance	4,528	8,824
Depreciation	2,587	2,695
Fuel and other expenses	2,355	2,471
Bad debt expense	1,506	283
	<hr/>	<hr/>
	37,913	30,190
 Loss from operations	(13,032)	(9,444)
 Nonoperating revenues		
Yap State operating subsidies (note 7)	35,629	20,648
FEMA Grants	-	4,950
Interest and other	703	291
	<hr/>	<hr/>
	36,332	25,889
 Changes in net assets	23,300	16,445
 Net assets at beginning of year	16,572	(522)
Add: Prior Period Adjustments	-	649
	<hr/>	<hr/>
Beginning Net Assets, restated	16,572	127
 Net assets - end of year	<u>\$ 39,872</u>	<u>16,572</u>

See accompanying notes to financial statements.

SOUTHERN YAP WATER AUTHORITY

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

Increase (Decrease) in Cash

	<u>2007</u>	<u>2006</u>
Cash flows from operating activities		
Receipts from customers	\$ 24,025	\$ 22,293
Cash payments for goods and services	(22,568)	(25,587)
Cash payments to employees	<u>(13,229)</u>	<u>(4,826)</u>
Net cash used for operating activities	<u>(11,772)</u>	<u>(8,120)</u>
Cash flows from noncapital financing activities		
Operating subsidies from Yap State Government	19,675	
Others	<u>93</u>	<u>63,975</u>
Net cash from non-capital financing activities	<u>19,768</u>	<u>63,975</u>
Cash flows used for investing activities		
Interest Income	610	291
Acquisition of fixed assets	<u>(1,838)</u>	<u>(6,584)</u>
Net cash used for investing activities	<u>(1,228)</u>	<u>(6,293)</u>
Net increase/(decrease) in cash	6,768	49,562
Cash, beginning of year	<u>54,459</u>	<u>4,897</u>
Cash, end of year	<u>\$ 61,227</u>	<u>\$ 54,459</u>
Reconciliation of operating loss to net cash used for operating activities		
Operating Loss:	\$ (13,032)	\$ (9,444)
Adjustments to reconcile loss from operations to net cash used in operating activities		
Depreciation	2,587	2,695
Other Expenses/Other Income	-	283
(Increase)/Decrease in assets		
Trade receivables, net	(856)	1,264
Increase/(Decrease) in liabilities		
Accounts payable	(882)	(3,731)
Accrued expenses	<u>411</u>	<u>813</u>
Net cash used in operating activities	<u>\$ (11,772)</u>	<u>\$ (8,120)</u>

See accompanying notes to financial statements

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements
September 30, 2007 & 2006

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 SYWA is to carry on the business of establishing, developing, maintaining, operating, and managing the Southern Yap Water System. The Authority currently serves the southern communities of Yap Proper comprising of the southern 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.

Currently, SYWA is governed by an eight-member Board of Directors, three of which were appointed by the Rull representative on the Council of Pilung. Two were appointed by the Chief of Kanifay, two appointed by the Chief of Gilman and One member shall be appointed by the Governor for a four year term. Except for the appointee of the Governor, the rest of the Board Member will serve for three years.

The daily operation of the Authority is currently the responsibility of a general manager, an administrative assistant 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:

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements
September 30, 2007 & 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

- (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.
- (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, 2007 and 2006.

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

New Accounting Standards - During fiscal year 2007, 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 2007 financial statements.

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements
September 30, 2007 & 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

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.

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, 2007 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 – Customer receivables are outstanding water utility bills from customers. 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 one year. 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	5 years

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements
September 30, 2007 & 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

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

Receivables as of September 30, 2007 represent revenue that is expected to be realized after September 30, 2007. Trade receivables are comprised of all outstanding bills as of September 30, 2007 which includes previous balances as of this month as well as current billings. Details of trade receivables for the years ended September 30, 2007 and 2006 are presented below:

	<u>2007</u>	<u>2006</u>
Trade receivables	\$ 4,160	\$ 1,798
Allowance for doubtful accounts	<u>(1,789)</u>	<u>(283)</u>
	<u>\$ 2,371</u>	<u>\$ 1,515</u>

3. PROPERTY & EQUIPMENT

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

	<u>Beginning balance October 1, 2006</u>	<u>Prior Period Adjustments</u>	<u>Transfers, Additions & (Deletions)</u>	<u>Ending balance September 30, 2007</u>
Vehicles	\$ 7,800	\$ —	\$ —	\$ 7,800
Office equipment and furniture	1,075	—	—	1,075
Other assets	<u>2,155</u>	<u>(8)</u>	<u>1,845</u>	<u>3,992</u>
	11,030	(8)	1,845	12,867
Less accumulated depreciation	<u>(4,954)</u>	<u>—</u>	<u>(2,587)</u>	<u>(7,541)</u>
Total	<u>\$ 6,076</u>	<u>\$ (8)</u>	<u>\$ (742)</u>	<u>\$ 5,326</u>

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements
September 30, 2007 & 2006

3. PROPERTY & EQUIPMENT (cont.)

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

A prior period adjustment was 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. Such costs are excluded from SYWA's assets at September 30, 2007 and 2006.

4. ACCOUNTS PAYABLE

Following is a breakdown of accounts payable as of September 30, 2007 and 2006:

	2007	2006
Vendors and suppliers	\$ 1,701	\$ 1,826
Officers and employees	--	757
	\$ 1,701	\$ 2,583

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements
September 30, 2007 & 2006

5. ACCRUED EXPENSES

	<u>2007</u>	<u>2006</u>
Accrued Wages	\$ 475	\$ 334
Accrued SS Taxes	817	479
Taxes Payable	<u>—</u>	<u>68</u>
	<u>\$ 1,292</u>	<u>\$ 882</u>

6. DUE TO STATE TREASURY

On September 8, 2005, the State assisted 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...." Reimbursement has not been made and accordingly, the amount of the electric bills paid by the Yap State Finance has been recorded as a payable to the State Treasury as of September 30, 2007 and 2006.

7. YAP STATE OPERATING SUBSIDIES

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 appropriation had an initial 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 \$38,337 not obligated as of September 30, 2006 was presented as deferred revenue on the balance sheet for the fiscal year 2006. Per YSL No. 6-83 and 7-12, the use of these funds was extended to September 30, 2008.

The Authority received the remainder of \$19,675 in the fiscal year 2007; this in addition to the \$38,337 unexpended as of September 30, 2006 represent \$58,052 in carryover appropriation funds. \$35,629 was expended during fiscal year 2007, resulting in deferred revenue of \$22,423 at September 30, 2007.

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.

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements
September 30, 2007 & 2006

9. SUBSEQUENT EVENTS

Per YSL No. 7-12, the authorized use of the unexpended funds has been extended until September 30, 2008. Total unexpended appropriation funds as of September 30, 2007 is \$22,423. In the fiscal year 2008, the Authority disbursed this entire amount.

In addition, it was determined that a total of \$8,151 of appropriation funding allotted to fixed assets had been disbursed towards consumable goods in FY2008. Moreover, a total of \$3,250 of appropriation funding allotted to contractual services were used to settle consumable goods expenditures and \$3,000 of appropriation funding allotted to the same purpose were used to issue paychecks for the Authority's three employees in FY2008.

Furthermore, SYWA received an appropriation in the amount of \$35,000 from the National Government, under Public Law No. 14-108 for the purchase of a backhoe for the Authority. Bids have been solicited without result.

The Authority is currently contemplating a rate increase. In addition, there is a new policy regarding delinquent customers. Customers who do not settle their bills by the due date are served with a delinquency notice; if after 15 days payment is not submitted, customers are served with a shut-off notice. If those customers still do not pay within another 15 days, water service is discontinued.



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: audit Yap@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
Southern Yap Water Authority:

We have audited the financial statements of the Southern Yap Water Authority (SYWA) as of and for the year ended September 30, 2007, and have issued our report thereon dated May 13, 2008 which opinion is a disclaimer due to inadequate accounting records and our inability to determine the consistent application of accounting principles between fiscal years 2007, 2006 and 2005. We conducted our 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 our audit, We considered SYWA's 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 SYWA's internal control over financial reporting. Accordingly, We do not express an opinion on the effectiveness of SYWA's 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 SYWA's 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 SYWA's financial statements that is more than inconsequential will not be prevented or detected by SYWA's 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 SYWA's 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. Of the deficiencies in internal control over financial reporting identified and reported to management in the accompanying Schedule of Findings, We consider Findings Nos. 5, 9 and 11 to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Southern Yap Water Authority'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 audit, and accordingly, We do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*, which are presented in the Schedule of Findings as Findings No. 3.

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


Wilfred Oliver L. Dolosa
Acting Yap State Public Auditor

May 13, 2008

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2007

Finding No. 1 – Utilization of Funds

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

Condition: During the fiscal year 2007, Southern Yap Water Authority disbursed a total of \$16,099 of State funds allotted to the fixed asset account for the purchase of consumable goods. In fiscal year 2008, SYWA disbursed the remaining \$8,151 of funding allotted to fixed assets towards consumable goods while \$6,525 allotted to contractual services were disbursed towards consumable goods and personnel services for \$3,000 and \$3,525 respectively.

Cause: The Authority did not fully understand or take notice of the terms and conditions stipulated by the Memorandum of Agreement or the laws set forth in the Yap State Code. In addition, the funds appropriated under YSL No. 6-60 had been cash advanced to the Authority since March 2006.

Effect: The Authority exhausted the funds allotted to their Consumable Goods account and tapped into funding allotted to other accounts. The prior year audit found significant question costs with regards to this same appropriation as well as a considerable lack of controls. When State funds are advanced to small entities, controls become decidedly lax and enforcement of the requirements set out in the appropriation law and the Financial Management Act becomes difficult.

Recommendation: We strongly recommend that with regards to appropriations, the Authority should strictly follow guidelines laid out in the appropriation law. In order to have stricter controls over State funds, we recommend that future appropriations be maintained at the Yap State Finance. These entities were created with each having specific purposes and may or may not be suited in ensuring accountability over State funds.

Prior Year Status: A similar finding was cited in the audit report for the Authority for the year ended September 30, 2006 (FY06 Finding No. 1).

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.”

Moreover, 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: Out of a representative sample of six transactions totaling \$3,739, there were no evidence of competitive purchasing.

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

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2007

Finding No. 2 – Competitive Procurement (cont.)

Effect: The Authority was not in compliance with Yap State Law and had not been comparing prices between vendors.

Recommendation: We strongly recommend that the Board and Management review the enabling legislation set forth in the Yap State Code and to continuously update their files with regards to new legislation. The SYWA needs to better understand its responsibilities, duties and requirements involving the operation of the authority in order to prevent future noncompliance with the laws and regulations of the State of Yap. It is the responsibility of the government's representative on the Board of Directors to keep the Authority informed and up to date on the requirements set forth in Yap State laws.

Prior Year Status: A similar finding was cited in the audit report for the Authority for the year ended September 30, 2006 (FY06 Finding No. 2). Towards the end of fiscal year 2008, the Authority have already implemented the competitive procurement procedure and as part of the supporting documents for purchases, a form noting the quoted price from each vendor is now attached to the invoice.

Finding No. 3 – Reporting Requirements

Criteria: Yap State Code Title 18 Section 749 requires the Board to present an annual report on the affairs of the Authority within sixty days after the end of each fiscal year and if requested by the governor or the Legislature, shall present special reports within thirty days after the end of each intervening year.

Condition: There were no reports prepared by the Board of the Southern Yap Water Authority for at least the fiscal years 2007 and 2006.

Cause: The SYWA was most likely unaware of this requirement.

Effect: By not ensuring the Authority's compliance with its reporting obligations, the Board of Directors indirectly condoned the Authority's poor accountability over public funds.

There have been no reports prepared on the affairs of the Authority. Without such reports, the stakeholders of the entity have very little idea of the operating and financial standing of the entity at each year end.

Recommendation: We recommend that the Board of Directors comply with the reporting requirements as set out in the SYWA's enabling legislation. The Authority should communicate with the government in order to determine exactly what is required to be reported and to whom the report is to be submitted to.



SOUTHERN YAP WATER AUTHORITY

P.O. Box 721
Colonia, State of Yap
Federated States of Micronesia 96943
TELEPHONE NO. 350-2711

RESPONSES TO AUDIT FINDINGS

Findings no.1 – Utilization of Funds

The SYWA should follow guidelines laid out in the appropriation law with regards to the utilization of funds. The System had its administrative assistant attending several work shops on island regarding accounting so that he will be able to control the disbursement of the funding accordingly.

Findings no.2 – Competitive Procurement

The system's management is tasked to ensure that all purchases comply with the laws and regulations of the state. The system is now practicing such competitive procurement requirements.

Findings no. 3 – Reporting Requirements

The Board of Directors recently became aware of such reports and has tasked the system's management to comply with the requirements as well as the enabling legislation. The Board of Directors will see to it that such report is submitted accordingly.

Findings no. 4 – Paycheck Signatories

The Board of Directors, in one of their meetings, agreed to designate the Chairman, Vice-Chairman and the manager to be the signatories of the checking account. Currently, members of the board are the only ones designated to be the signatories of the system's checking account.

Findings no. 5 – Customer Billings

The management is heeding the audit recommendation and is also tasked to create a file retention policy with regards to billing invoices. Also, an official meter reading form will be made and will be used during meter reading processes.

Findings no. 6 – Deposits

The management is assigned to make sure all deposits are done accordingly and complied for. As stated in the recommendation, the system is now filling out daily collection breakdown along with the daily cash count form. The manager reviews and approves the mentioned documents before any deposit is made.



SOUTHERN YAP WATER AUTHORITY

P.O. Box 721
Colonia, State of Yap
Federated States of Micronesia 96943
TELEPHONE NO. 350-2711

Findings no. 7 – Personnel Policies

The board of directors is yet to review and approve the personnel policies of the system. This will include additional compensation and other benefits for the three staffs.

Findings no.8 – Fixed Assets

The Board of Directors had installed policies and regulations with regards to the fixed assets and Management was tasked to implement them. The BOD will ensure that the policies and regulations are properly carried out.

Findings no.9 – Customer Accounts Receivable

The system is looking in to this matter. The Quick books accounting program was purchased and set-up to help the system to properly safe keep such information and allow for the effective and efficient retrieval of any needed information.

Findings no.10 – Long Outstanding Debt

The system is trying its very best to pay all outstanding debts, unfortunately, the system still falls short on funding. The system will communicate with the Governor's Office about the outstanding debt.

Findings no.11 - Reconciliation

Management to ensure such practice be implemented and enforced accordingly.

Findings no.12 – Tax Expense

The management is now familiarizing itself with the SS and Employee income taxes so as to post these correctly in the future.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2007

Finding No. 4 – Paycheck Signatories

Criteria: Per Board Resolution dated November 27, 2006, only board members can sign paychecks for the Authority's employees.

Condition: It was noted that the Manager is a frequent signatory on paychecks for the Authority's employees, even those for himself.

Cause: There was no enforcement of Board decisions.

Effect: There is non-compliance with Board decisions.

Recommendation: We recommend that the Authority comply with the Board's decision. If it is allowable for the Manager to sign paychecks, then the Board needs to document its approval.

Finding No. 5 – Customer Billings

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

Condition: Review of water billing records found that there was no form used to record meter readings and often-times, the sheets used to record readings were not retained after transferring details to the Customer Master List. In addition, the Authority doesn't maintain duplicate copies of invoices that were given to the customers, instead they rely on copies that the customers present upon payment thru the Authority's office or Bank of FSM. In most cases, clients pay-up without attaching the required part of the invoice.

Cause: Due to the incompleteness of supporting documents, checking as to accuracy of customer balances will be very hard to accomplish.

Effect: The risk of spurious and erroneous billings to customers exist due to the non-retention of meter readings and billing invoices.

Recommendation: We strongly recommend that the Board create a file retention policy with regards to the billing invoices as well as for the meter reading, and sees to it that the Authority will abide by such. We also recommend that the Authority come up with an official meter reading form that will be used in recording meter readings.

Prior Year Status: A similar finding was cited in the audit report for the Authority for the year ended September 30, 2006 (FY06 Finding No.11). Towards the end of FY2008, the Authority has already maintained an electronic file of the invoices and has begun filing the papers used to document the meter readings.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2007

Finding No. 6 – Deposits

Criteria: For proper controls and accountability over cash, collections should be deposited on a timely manner. In general, cash should not be kept in the office for more than three days. In addition, there should be evidence of independent review of the cashier's work prior to making deposits.

Condition: SYWA had cash on hand for up to nineteen days. The Authority had set a collection threshold of \$200 up before making any deposit. Moreover, there was no evidence of review of the cashier's work for the entire fiscal year 2007.

Cause: There were no controls in place that ensures cash deposits are made on a timely manner nor were there policies in place requiring independent review of the cashier's work.

Effect: The longer cash is kept in the office, the higher the risk of misplacing or misusing cash collections, whether or not the amount is larger or smaller than \$200. The lack of independent review compounds this risk.

Recommendation: We strongly recommend that the SYWA Board of Directors and Management ensure that collections are banked at least every three days. Note that in the FY 2008, the individual in charge of making deposits began preparing cash count reports which were reconciled with the total cash receipts issued for management to review and verify before making a deposit.

Prior Year Status: Similar findings were cited in the audit report for the Authority for the year ended September 30, 2006 (FY06 Findings No. 8, 9). In FY2008, to record the daily cash collection, the individual in-charge started using a daily cash count report. Before making any deposits, the cash count report will be submitted to management, who in turn will check and reconcile it with the daily receipts.

Finding No. 7 – Personnel Policies

Criteria: There should be adequate policies in place addressing personnel issues and in particular, maintaining complete personnel files and a representative timesheet.

Condition: One employee did not have a personnel action on file. In addition, SYWA allotted to its employees a full eight hours worked each day. Employees sign in/out at exactly 7:30-11:30 and 12:30-16:30 each day and handwriting for each sign in/out was consistent throughout the pay-periods and for all employees. Note that there were no sign-ins at odd times (e.g. 7:54a.m. or 12:05p.m.) that would indicate a more accurate timesheet. It is unlikely that everyone showed up at work at exactly 7:30-11:30 and 12:30-16:30 every day for several consecutive pay-periods without fail.

Cause: There were no policies in place addressing personnel issues. In addition, employees were not eligible for benefits (i.e. compensation time, overtime, annual leave, sick leave).

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2007

Finding No. 7 – Personnel Policies (cont.)

Effect: Without approved personnel actions, it becomes difficult to determine authorized pay-levels and duties for the employee which increases the risk of fraud. In addition, without adequate compensation of employees, there is greater pressure for employees to record a full eight hours worked for each day instead of accurately recording actual time worked; consequently, the risk of time-sheet fabrication and overstatement of hours paid increases.

Recommendation: We recommend that the Board of Directors require staff to update employee records and have all personnel actions on file. In addition, we recommend that the Board of Directors ensure that timesheets are accurate and representative of actual time worked. The Board may want to examine the possibility of providing employees with additional compensation as incentive to record actual time worked. Note that the risk of overstatement in hours paid is mitigated by the fact that the employees often-times work more than eight hours a day – fixing pumps, cleaning wells, etc. In noting the exact

time that they work, not only will they be paid based on actual time worked, employees may earn extra hours to make up short-falls in hours worked in other days.

Finding No. 8 – Fixed Assets

Criteria: The Authority should safeguard its fixed assets.

Condition: Fixed assets for the Authority were not assigned identification numbers or labeled as government assets. In addition, the fixed asset register was not updated on a timely manner; the register for fiscal year 2007 was only updated well into the fiscal year 2008. Also, two purchases made in the fiscal year 2007, a ladder worth \$128 and a water pump worth \$1,717, were not recorded on the fixed asset register prepared by the Authority. Furthermore, the Authority has been directly expensing their fixed asset purchases.

Cause: There were no policies in place that ensure that assets are safe-guarded against loss or abuse nor is there a capitalization policy where all items purchased over an established dollar threshold are capitalized. In addition, the Authority did not have a functional accounting system for the fiscal year 2007.

Effect: Fixed assets are susceptible to abuse and are being directly expensed which overstates expenses for the period and understates assets. In addition, the current value of the Authority's fixed assets is not immediately obvious since records have not been maintained in a way that facilitates the determination of the fixed assets' value.

Recommendation: We recommend that fixed assets be affixed with the government seal and assigned identification numbers which should also be noted on the fixed asset register. The Board of Directors should determine a threshold for capitalizing fixed asset purchases and record all applicable purchases on the register and in the accounting records. In addition, the register needs to be updated regularly and depreciation determined in order to correctly state fixed asset value as of year end.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2007

Finding No. 9 – Customer Accounts Receivable

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: There was no formal recording of account receivables balances for FY 2007. Reliance was placed on the Customer Master List which includes customers' remaining balances, which as per review doesn't correctly forward the previous months' ending balances. In addition, there was no estimation of bad debt nor has collections of outstanding balances been aggressive. There were customer accounts with large outstanding balances for months on end.

Cause: No one has required that accuracy of outstanding balances be observed nor were there any policies in place regarding the aging of the customer's unpaid balances.

Effect: SYWA did not determine bad debt as of September 30, 2007 and as a result, the customer receivable balances are overstated since it includes accounts which have been long outstanding and collections are improbable.

Recommendation: We recommend that the Authority establish a policy that would define the aging limits of customer's unpaid balances so that those long outstanding accounts that are deemed uncollectible be written-off as bad debts.

Prior Year Status: A similar finding was cited in the audit for the Authority for the year ended September 30, 2006 (FY06 finding No. 10). In FY 2008, the Authority purchased the accounting software "Quick Books" and has started posting the Authority's daily transactions including the customers' account ledger.

Finding No. 10 – Long Outstanding Debt

Criteria: All outstanding debt should be paid off in a timely manner.

Condition: During the fiscal year 2005, SYWA became indebted to the Yap State Government for the amount of \$3,636 which was used to pay for the Authority's utility bills. This amount was expended on behalf of SYWA with the understanding that it will be paid back in a timely manner when funds became available. However, per discussion with SYWA, the debt was still outstanding as of September 30, 2007.

Cause: There was no communication with the Governor's Office and/or the State of Yap after the loan was affected.

Effect: The Authority has been indebted to the Yap State Government since the fiscal year 2005 and as such, a liability to the State has been recorded on their financial statements since then.

Recommendation: The Authority needs to discuss the issue with the Governor's Office and seek ways to resolve the issue. If the debt has been forgiven, it should be documented and maintained on file.

Prior Year Status: A similar finding was cited in the audit for the Authority for the year ended September 30, 2006 (FY06 finding No. 14).

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2007

Finding No. 11 – Reconciliation

Criteria: Proper accounting principles require that monthly reconciliation of accounting records should be done at least once a month for proper control.

Condition: Reconciliation of cash received was not done. There were various immaterial variances in some month end passbook balances that were carried over to the next month/s balances.

There were also immaterial collection variances noted among the collections per passbook, per cash receipt register, and customer master list. Although these variances were relatively immaterial, it is important for SYWA to have its own records of collections agree especially since customer payments have been made in these amounts.

Furthermore, reconciliation of the checking account was being done inaccurately. For September 2007, checks issued in October 2007 were included in the list of outstanding checks and deposits in September were added again to the September ending balance.

Cause: There was no requirement to reconcile balances on a monthly basis thus errors committed were not detected in due time.

Effect: Inaccurate carryover balances increase the risk that SYWA may be billing customers for amounts not based on their actual water usage. Furthermore, inaccurate reconciliation of bank accounts may result in carrying forward the wrong balances in the books and may result in the non-detection of errors or fraud.

Recommendation: We recommend that the management sees to it that monthly reconciliation of accounts be undertaken, so that any variances and/or unusual balances be immediately investigated and addressed.

Prior Year Status: A similar finding was cited in the audit for the Authority for the year ended September 30, 2006 (FY06 finding No. 7). The Authority has already purchased the Quickbooks accounting system in the middle of FY2008 and has already inputted the transactions. Mentioned accounting system can do account reconciliation which could help the Authority in addressing this exception.

Finding No. 12 – Tax Expense

Criteria: Only 6% of social security payments made to the Social Security Office should be recorded as expense, representing the entity's contribution towards employees' social security. The other 6% SS payment and the 6% income tax should be treated as payroll liabilities, since these were deducted from employee's pay and will be remitted to the respective government agencies on there respective quarterly deadlines.

Condition: SYWA recorded the entire 12% of social security tax payments and the 6% income tax as expenses of the Authority.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2007

Finding No. 12 – Tax Expense (cont.)

Cause: Exception was due to human error. In addition, there was no accounting system in place and the Authority assumed that all cash out-flows should be considered as expenses.

Effect: SYWA's operating expenses were overstated by \$1,320; \$592 for SS and \$728 for income tax respectively. In addition, SYWA's liabilities were also understated by the same amount.

Recommendation: We recommend that Management familiarize themselves with existing tax laws and post transactions according to their nature.

Prior Year Status: A similar finding was cited in the audit for the Authority for the year ended September 30, 2006 (FY06 finding No. 15). Mentioned exception can be eliminated with the Quick books accounting system. Since the authority was able to set-up the payroll in the Quick books, the accounting system will automatically compute the Authority's tax expense.