

Southern Yap Water Authority

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

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



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

- Finding No. 3 pertains to non-compliance with the reporting requirements of the Authority's enabling legislation.
- Finding No. 4 refers to non-compliance of the Authority with the Board's decision stating that only board members can sign paychecks for the employees.
- Findings No. 5 pertains to the lack of proper procedures and documentation on customer ledgers that resulted in inaccurate customer account balances.
- Finding No. 6 pertains to the inadequacy of Personnel Policies.
- Finding No. 7 refers to the inadequate controls over the safekeeping of the Authority's fixed assets.
- Finding No. 8 refers to the absence of monitoring procedures and inadequacy of Accounts Receivable policies with regards to the aging of accounts receivables.
- Finding No. 9 pertains to \$3,636 in electricity bills for the Authority paid by the State Finance as authorized by then Lt. Governor Habuchmai in fiscal year 2005. The letter request instructed finance to pay the mentioned bill and it was also indicated in the letter that the Authority will be reimbursing Yap State Government when it was financially able. The balance was still outstanding as of September 30, 2008.
- Finding no.10 discusses the absence of regular reconciliation of accounts resulting to several account variances.

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 pages 22 thru 24 of this report. Since we prepared the draft of the report, the Authority has taken actions to implement the recommendations of this report, thereby correcting many of the deficiencies discussed herein. We thank the management and the 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 2008 and 2009.



Ronald C. Yow
Yap State Public Auditor
September 23, 2010



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YAP STATE GOVERNMENT

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EXECUTIVE SUMMARY

**Financial Audit of Southern Yap Water Authority
For the Years ended September 30, 2008 and 2007**

The Office of the Yap State Public Auditor has issued its audit report on the audit of the financial statements of Southern Yap Water Authority for the years ended September 30, 2008 and 2007 which report is dated September 17, 2010. The Independent Auditor's Report on page 1 thru 2 gave a "qualified opinion" and a "disclaimer opinion" on the financial statements ending September 30, 2008 and 2007 respectively. For the past years, Southern Yap Water Authority had always been given "disclaimers" because they didn't maintain any books to record their day to day transactions. During FY2008, they started using the accounting software "quickbooks" to post their daily transactions, thus they were able to get a "qualified" opinion.

The financial statements presented beginning on page 5 show that assets decreased to \$57,591 as of September 30, 2008 as compared to \$68,924 in fiscal year 2007. The primary reason for the decrease was due to the total depletion of the unexpended cash derived from the operating subsidy from the Yap State Government in fiscal year 2006. Revenues and expenses for the year ended September 30, 2008 also decreased as compared to the results in fiscal year 2007. Both fiscal year 2008 and 2007 showed operating deficits of \$11,622 and \$13,032, respectively, indicating that further actions were required of management to ensure the sustainability of the Authority.

The report on internal control over financial reporting and compliance and other matters required by the *Government Auditing Standards* on pages 14 thru 15 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 16. Of the ten findings, three are related to non-compliance with grant agreements, laws and regulations while the remaining seven are related to deficiencies in internal control over financial reporting. Five of the ten findings are repeated from the prior years.

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

- Finding No.1 is related to non-compliance with the budget line-items as stipulated in the Memorandum of Agreement with the State of Yap for administration of the operating subsidy received during fiscal year 2006.
- Finding No. 2 is about non-compliance to Yap State Law no. 6-53. We found no evidence that SYWA made any effort to obtain the best prices for its purchases by comparing prices of different vendors.

SOUTHERN YAP WATER AUTHORITY

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Southern Yap Water Authority:

We have audited the accompanying balance sheets of Southern Yap Water Authority (SYWA) as of September 30, 2008 and 2007, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the SYWA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraph, we conducted our audits in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to audits contained in Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the SYWA's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

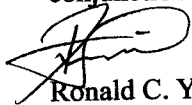
Due to inadequate accounting records, we were unable to audit the balance sheet, related statement of revenues, expenses and changes in net assets and cash flows for the year ended September 30, 2007. Because of the poor state of the accounting records, we were unable to satisfy ourselves about the fair presentation of the 2007 financial statement by means of alternative auditing procedures and we were unable to satisfy ourselves about the opening balances in the financial statements as of October 1, 2007 and 2006 or the consistent application of accounting principles between fiscal year 2008 and 2007.

Because of the matter discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on its financial position as of September 30, 2007 and the results of its operations and cash flows for the year then ended, or on the consistency of application of accounting principles with the preceding years.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary in the fiscal year 2008 financial statements had we been able to satisfy ourselves with the beginning balances as discussed in paragraph three, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of Southern Yap Water Authority as of September 30, 2008, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis on pages 3 and 4 is not a required part of the basic financial statements but is supplementary information required by the Government Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurements and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 17, 2010 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, and contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal controls 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 audit.



Ronald C. Yow
Yap State Public Auditor

September 17, 2010



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**Management's Discussion and Analysis
September 30, 2009 and 2008**

The Southern Yap Water Authority was created pursuant to Yap State Law (YSL) 18, section 702 as to operate and maintain the Southern Yap Water System. The Southern Yap Water System is responsible of supplying water services to all interested residential, businesses, organization and government as well.

During the past two fiscal years, the authority managed to operate within the revenues generated, there are some left-over funds from the state appropriation that also supplement the revenue generated in order to continue the operation of the authority. The authority has managed to utilize the \$60,000. grant appropriated by the FSM Congress since fiscal year 2004 to purchase a Caterpillar Backhoe, Isuzu Mini Dump, however, the total cost of these two equipments are \$44,108.00, there are some left over from the \$60,000.00 appropriation which the board members as well as the management decided to use by purchasing a 4x4 Truck to use for the operation of the authority and parts necessary for the back-hoe.

During the course of fiscal year 2009, the management and the board was decided to increase the water rate per gallon. Perhaps, they decided to increase from the existing rate, \$.001 to .0025 per gallon, the board members agreed to conduct a public hearing in order to seek an opinion from the general public which it turns out that the general public is in favor of the proposed rate. In July 2009, the proposed new rate was in place.

The management hired a person to assist the authority in mostly field works under the work force enrichment's program for three months time period.

This particular apprentice was paid at \$1.75 per hour from the work force enrichment program. His contract agreement ended on December 2009.

The management was tasked to prepare a policy and regulation for the board members to review and adopt. It was done in Septembers 2009 after the members reviewed and adopted, it was zeroxed and file a copy with the Attorney General office and the Legislature, chief clerk.

There was no grant awarded to the authority since after the appropriation from the state in fy 2006 and the appropriation from the FSM congress in fy 2005. As stated above, the authority managed to cover their expenses on a monthly basis of their revenues generated. There is one grant that the authority applied which is from the South Pacific Global Corporation which has not heard any reply from foundation.

SOUTHERN YAP WATER AUTHORITY

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

	<u>2008</u>	<u>2007</u>
ASSETS		
Current Assets		
Cash	\$ 52,082	\$ 61,227
Trade receivables, net (note 2)	<u>2,056</u>	<u>2,371</u>
Total current assets	54,138	63,598
Property and equipment, net (note 3)	<u>3,453</u>	<u>5,326</u>
TOTAL ASSETS	<u><u>\$ 57,591</u></u>	<u><u>\$ 68,924</u></u>
LIABILITIES AND DEFICIT		
Current liabilities:		
Accounts payable (note 4)	\$ 1,615	\$ 1,701
Accrued expenses (note 5)	1,253	1,292
Due to State Treasury (note 6)	3,636	3,636
Deferred revenues	<u>-</u>	<u>22,423</u>
Total current liabilities	6,504	29,052
Contingencies		
Net Assets		
Reserved for capital assets	3,453	5,326
Unreserved	<u>47,634</u>	<u>34,546</u>
Total net assets	<u>51,088</u>	<u>39,872</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 57,591</u></u>	<u><u>\$ 68,924</u></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, 2008 & 2007

	<u>2008</u>	<u>2007</u>
Operating revenues		
Water usage and other fees	\$ 22,552	24,107
Other sales	<u>1,488</u>	<u>774</u>
	24,040	24,881
Operating expenses		
Salaries and taxes	14,915	14,458
Utilities	11,337	12,479
Supplies, repair and maintenance	4,493	4,528
Depreciation	2,808	2,587
Fuel and other expenses	2,109	2,355
Bad debt expense	<u>-</u>	<u>1,506</u>
	<u>35,662</u>	<u>37,913</u>
Loss from operations	(11,622)	(13,032)
Nonoperating revenues		
Yap State operating subsidiaries (note 7)	22,423	35,629
Interest and other	<u>415</u>	<u>703</u>
	22,838	36,332
Changes in net assets	11,216	23,300
Net assets at beginning of year	<u>39,872</u>	<u>16,572</u>
Beginning net assets, restated	39,872	16,572
Net assets - end of year	<u>\$ 51,088</u>	<u>39,872</u>

See accompanying notes to financial statements.

SOUTHERN YAP WATER AUTHORITY

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

Increase (Decrease) in Cash

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities		
Receipts from customers	\$ 24,355	\$ 24,025
Cash payments for goods and services	(18,901)	(22,568)
Cash payments to employees	<u>(14,079)</u>	<u>(13,229)</u>
Net cash used for operating activities	<u>(8,625)</u>	<u>(11,772)</u>
Cash flows from noncapital financing activities		
Operating subsidies from Yap State Government	-	19,675
Others	<u>2</u>	<u>93</u>
Net cash from non-capital financing activities	<u>2</u>	<u>19,768</u>
Cash flows used for investing activities		
Interest Income	413	610
Acquisition of fixed assets	<u>(935)</u>	<u>(1,838)</u>
Net cash used for investing activities	<u>(522)</u>	<u>(1,228)</u>
Net increase/(decrease) in cash	(9,145)	6,768
Cash, beginning of year	<u>61,227</u>	<u>54,459</u>
Cash, end of year	<u>\$ 52,082</u>	<u>\$ 61,227</u>
Reconciliation of operating loss to net cash used for operating activities		
Operating Loss:	\$ (11,622)	\$ (9,444)
Adjustments to reconcile loss from operations to net cash used in operating activities		
Depreciation	2,808	2,695
Other Expenses/Other Income	-	283
(Increase)/Decrease in assets		
Trade receivables, net	315	1,264
Increase/(Decrease) in liabilities		
Accounts payable	(87)	(3,731)
Accrued expenses	<u>(39)</u>	<u>813</u>
Net cash used in operating activities	<u>\$ (8,625)</u>	<u>\$ (8,120)</u>

See accompanying notes to financial statements

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements
September 30, 2008 & 2007

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:

- (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, 2008 & 2007

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, 2008.

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 2008, SYWA implemented the following pronouncements:

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

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

GASB Statement No. 48, "*Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*". GASB Statement No.48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. The statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components.

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

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

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements
September 30, 2008 & 2007

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT.)

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

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

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

Cash – For purposes of the balance sheet and statement of cash flows, cash represents cash on hand and cash on deposit in a bank account. \$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

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.

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements
September 30, 2008 & 2007

2. TRADE RECEIVABLES

Receivables as of September 30, 2008 represent revenue that is expected to be realized after September 30, 2008. Trade receivables are comprised of all outstanding bills as of September 30, 2008 which includes previous balances as of this month as well as current billings. Details of trade receivables for the years ended September 30, 2008 and 2007 are presented below:

	<u>2008</u>	<u>2007</u>
Trade receivables	\$ 3,845	\$ 4,160
Allowance for doubtful accounts	<u>(1,789)</u>	<u>(1,789)</u>
	<u>\$ 2,056</u>	<u>\$ 2,371</u>

As of September 30, 2008, there were no write-offs made, instead the authority has been making efforts in collecting those delinquent accounts.

3. PROPERTY & EQUIPMENT

A summary of property and equipment as of September 30, 2008 and 2007 are presented below:

	<u>Beginning balance October 1, 2007</u>	<u>Prior Period Adjustments</u>	<u>Transfers, Additions & (Deletions)</u>	<u>Ending balance September 30, 2008</u>
Vehicles	\$ 7,800	\$ --	\$ --	\$ 7,800
Office equipment and furniture	1,075	--	345	1,420
Other assets	<u>3,992</u>	<u>--</u>	<u>590</u>	<u>4582</u>
	12,867	--	935	13,802
Less accumulated depreciation	<u>(7,541)</u>	<u>--</u>	<u>(2,808)</u>	<u>(10,349)</u>
Total	<u>\$ 5,326</u>	<u>\$ --</u>	<u>\$ (1,873)</u>	<u>\$ 3,453</u>

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements
September 30, 2008 & 2007

3. PROPERTY & EQUIPMENT (cont.)

	Beginning balance October 1, 2006	Prior Period Adjustments	Transfers, Additions & (Deletions)	Ending balance September 30, 2007
Vehicles	\$ 7,800	\$ --	\$ --	\$ 7,800
Office equipment and furniture	1,075	--	--	1,075
Other assets	2,155	(8)	1,845	3,992
	<u>11,030</u>	<u>(8)</u>	<u>1,845</u>	<u>12,867</u>
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>

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, 2008 and 2007.

4. ACCOUNTS PAYABLE

Following is a breakdown of accounts payable as of September 30, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Vendors and suppliers	\$ 1,615	\$ 1,701
Officers and employees	<u>--</u>	<u>--</u>
	<u>\$ 1,615</u>	<u>\$ 1,701</u>

5. ACCRUED EXPENSES

	<u>2008</u>	<u>2007</u>
Accrued Wages	\$ 475	\$ 475
Accrued SS Taxes	778	817
Taxes Payable	<u>--</u>	<u>--</u>
	<u>\$ 1,253</u>	<u>\$ 1,292</u>

SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements
September 30, 2008 & 2007

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, 2008 and 2007.

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 for the operation of the Southern Yap Water Authority. The appropriation had an initial lapse date of September 30, 2006. As of September 30, 2007, the total amount unexpended was \$22,423 and the use of this fund was extended to September 30, 2008 as per YSL No. 6-83. The unexpended amount was presented as deferred revenue as of September 30, 2007.

The remaining \$22,423 was expensed out in the first and second quarter of 2008, thus it was reclassified as non-operating revenue as of September 30, 2008.

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. ACCOUNTING RECORDS

In fiscal year 2008, Southern Yap Water Authority has started using the quickbooks accounting system for the proper maintenance of their accounting records, using the fiscal year 2007 audited ending account balances as their beginning balances.

10. SUBSEQUENT EVENTS

SYWA received an appropriation in the amount of \$35,000 from the National Government, under Public Law No. 14-108 for the purchase of necessary equipments for the operation of the Authority. An additional appropriation for \$25,000 for equipment purchase, thru Public Law No. 15-32, was received on July 8, 2008. Bids for the backhoe were already received and they have already selected the seller that will provide the backhoe. The seller have already submitted the Purchase Order amounting to \$37,180 to finance and the latter have already encumbered it against the appropriation as of March 31, 2009.

On March 20, 2009, Mark Mangarfir resigned as the General Manager and was replaced by John Guswel.



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

The Board of Directors of
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, 2008, and have issued our report thereon dated September 17, 2010. 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. Deficiencies in internal control over financial reporting that we considered to be material weaknesses are described in the Schedule of Findings (pages 16 - 21) as findings no. 4 to 10.

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 (pages 16-21) as Findings Nos. 1 to 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 used by anyone other than these specified parties.


Ronald C. Yow
Yap State Public Auditor

September 17, 2010

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2008

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 2008, Southern Yap Water Authority disbursed a total of \$7,806 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 fiscal years ended 2007 and 2006.

Finding No. 2 – Competitive Procurement

Criteria: 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 twenty two transactions totaling \$4,428.00, there were no evidence of competitive purchasing.

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

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

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2008

Finding No. 2 – Competitive Procurement (cont.)

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 in 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 fiscal years ended September 30, 2007 and 2006.

The Authority started doing the competitive procurement in the middle of FY2009.

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 was no annual report prepared by the Board of the Southern Yap Water Authority for fiscal year 2008.

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.

Prior Year Status: A similar finding was cited in the audit report for the Authority for the fiscal years ended September 30, 2007 and 2006.

The Authority was able to submit their FY2009 annual report on December 23, 2009.

Finding No. 4 – Paycheck Signatories

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

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2008

Finding No. 4 – Paycheck Signatories (cont.)

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.

Prior Year Status: A similar finding was cited in the audit report for the Authority for the fiscal years 2007 and 2006.

Review of subsequent events revealed that on April 4, 2009, during SYWA's Board meeting, the Board officially included the Manager as one of the signatories in the Authority's checking account.

Finding No. 5 – Customer Billings

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

Conditions:

1. Review of water billing records revealed that there was no official form being used for the meter reading. They used some sheets to record the meter reading and these are not being retained after transferring the details to the Customer Master List.
2. Billings as per master list differs with the total as per Quickbooks. Even if the amount is immaterial, the Account Master List balances should tally with the Quickbooks' balance since it is the source document in posting to the accounting system.

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

Effect: The risk of erroneous and un-posted billings to customers exist due to the non-retention of meter readings as well the non-reconciliation of account balances.

Recommendation: We strongly recommend that the Board create a file retention policy with regards to the meter reading, and sees to it that the Authority regularly reconcile its accounts. We also recommend that the Authority comes up with an official meter reading form that will be used in recording meter readings.

Prior Year Status: A similar finding , with regards to the non-maintenance of the meter reading, was cited in the audit report for the Authority for the fiscal years 2007 and 2006.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2008

Finding No. 6 – 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: SYWA allotted to its employees a full eight hours each day. Timesheets seem to be clearly fabricated since for each payday, the time sheets will show that 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. It is unlikely that everyone showed up at work at exactly 7:30-11:30 and 12:30-16:30 every day for all 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).

Effect: Without adequate compensation given to 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 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.

Prior Year Status: A similar finding was cited in the audit report for the Authority for the fiscal year 2007.

As of July 2008, actual hours worked are being properly reflected in the time sheets.

Finding No. 7 – Fixed Assets

Criteria: A fixed asset register and depreciation schedule should be properly maintained for proper accountability over physical assets.

Condition: Fixed asset register was not updated on a timely manner; the register for fiscal year 2008 was only updated well into the fiscal year 2009 and there was no depreciation expense booked in FY2008. Also, two purchases made in the fiscal year 2008 totaling \$935.00 were expensed outright instead of including them as part of the fixed assets.

Cause: The Board did not require management to maintain an accurate and reliable fixed asset register nor there is any capitalization policy in place where all items purchased over an established dollar threshold are capitalized. Further, since the quickbooks accounting system was only set-up in 2008, the accountant is still in the process of familiarizing himself with the features of the mentioned accounting system.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2008

Finding No. 7 – Fixed Assets (cont.)

Effect: Fixed assets are more susceptible to abuse. Also, due to the direct expensing and non-depreciation of fixed assets, expenses and fixed assets accounts are misstated.

Recommendation: 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. Management should also look into ways to make the personnel handling the accounting system more familiar with its features.

Finding No. 8 – Accounts Receivable Collection

Criteria: There should be adequate policy in place in determining up to what period the clients can be delinquent before the water services are cut-off.

Condition: There have been instances that customer balances have remained outstanding for several months without being disconnected.

Cause: There were no effective monitoring procedures, nor any policies, regarding the aging of the customers' unpaid balances, in place.

Effect: The customer receivable balances is overstated and the Authority is extending services to some clients that should have been disconnected thus using up some of the Authority's resources.

Recommendation: We recommend that the Authority establish an effective monitoring procedure as well as receivable aging policies. The Authority was able to establish a more stringent policy with regards to the collections of accounts receivable in May 2009.

Finding No. 9 – 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, 2008.

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 debt. 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 fiscal years 2007 and 2006.

SOUTHERN YAP WATER AUTHORITY

Schedule of Findings
September 30, 2008

Finding No. 10 – Reconciliation

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

Condition: SYWA was not able to properly reconcile their savings account and accounts receivable balances . There were several immaterial variances noted among the collections per passbook as against collections per cash receipt and collections per Quickbooks. Although these variances were relatively immaterial, it is important for SYWA to have its own records of collections agree especially since payments have been made to customers' accounts.

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 fiscal years 2007 and 2006.



SOUTHERN YAP WATER AUTHORITY

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May 4, 2010

Mr. Ronald C. Yow
Public Auditor, Yap State
Office of the State Public Auditor
Yap State Government, FSM 96943

Dear Mr. Yow

This is a response to your Draft Audit Report Fiscal Year Ended September 30, 2008 and 2007 basically on your findings;

1. Findings #1, Utilization of Funds- It is an understanding that during our pre-conference at the SYWA's office regarding all the findings and we were informed of the above matter and after our meeting, our staffs were instructed to comply with any future appropriations law. A meeting was set with the governor and some of the board members were present and it was discussed and explained to the governor of the noncompliance of the authority and apologized of the matter.
2. Findings #2, Competitive Procurement- The compliance of the issue is in affect now, management and staffs were already informed of such requirements.
3. Findings #3, Reporting requirements- The annual report was submitted to the governor's office late last year, the new manager was instructed by the board members to make sure such reports must be prepare and submit to the appropriate agencies with unnecessary delay.

4. Findings #4, Paycheck Signatories- The issue was implemented when the new manager was designated as one of the signatories of the authority's checking/saving account.
5. Findings #5, Customer Billings- The issue was implemented now. There is a form created for that purposes and it was filed when all readings are transferred into the billing system.
6. Findings #6, Personal Policies- There are some that fully completed and some were still working on it. The personal action, Job Descriptions, Files of all personals are completely done and the rest are still working on it.
7. Findings #7, Fixed Assets- The manager was tasked to look into it to make-sure all the fixed assets of the authority are fully registered properly into the system, which already implemented.
8. Findings#8, Accounts Receivable Collection - There is a Policy in place dealing with such, the board members tasked the management to implement the policy which already started serving customers of their delinquencies and shut-off notices as well. There is a form that also created for those customers that been disconnected from the services but still has an outstanding with the authority, in the same line of notice, it was informing all customers those that still has an outstanding with the authority to pay by no later than 30 calendar days. Those that not in compliance will be referred to the attorney general's office for prosecution if necessary.
9. Findings#9, Long Outstanding Debt- After our pre-conference, the board members decided to meet with the governor discussing this issue and Findings#1. The meeting was arranged with the governor, during the meeting with the governor regarding these two issues, Mr. Governor advised that he will consult the matter with the Attorney General and the Director of Finance. The purposes of the meeting is mainly for the governor to understand the situation of the authority to at least forgive the debt.

Respectfully submitted by;



John Guswel
Gen. Manager,

Xc: All Board of Directors
SYWA's File