

**YAP COMMUNITY ACTION PROGRAM
(A NONPROFIT CORPORATION)**

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

**For the years ended
September 30, 2005 and 2004**



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



OFFICE OF THE 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 Audit of the
Yap Community Action Program
for the Years ended September 30, 2005 and 2004

The Office of the Yap State Public Auditor was engaged to audit the Yap Community Action Program for the years ended September 30, 2005 and 2004 and has issued the report dated January 20, 2006. The Independent Auditors Report on page 1 gives an 'unqualified opinion' on the financial statements, meaning that in the auditor's opinion, the financial statements were fairly presented in accordance with U.S. generally accepted accounting principles.

The Schedule of Expenditures of Federal Awards on page 5 shows that for the years ended September 30, 2005 and 2004, YCAP expended \$206,183 and \$72,749, respectively, in Compact and other federal financial assistance.

The report on internal control and compliance and other matters required by *Government Auditing Standards* on page 13 discusses reportable conditions at YCAP. These conditions and our recommendations are presented for the information of YCAP management in the Schedule of Findings beginning on page 15. Of the eight findings, seven findings are related to inadequate controls while one pertains to noncompliance with laws and regulations. Five of the eight findings were repeat findings from the prior years.

Following is a summary of the significant audit findings for the year ended September 30, 2005:

- (1) Finding No. 1 cites YCAP inadequate documentation of compliance with federal competitive procurement requirements.
- (2) Finding No. 2 relates to the improper recording of grant expenditures. Purchase order advances were directly charged to grants, even though the transactions did not yet qualify as grant expenses.
- (3) Findings No. 3, 4 and No. 5 discusses the need for YCAP to make available accurate and timely financial information.

We met and reviewed the draft report with YCAP Executive Director and Deputy Director/Fiscal Officer and the YCAP Board of Directors and they agreed with our findings and recommendations. YCAP's written response to the above findings is presented as part of the audit report beginning on page 15.

Gertrude Gootinan
Yap State Public Auditor
September 29, 2006

YAP COMMUNITY ACTION PROGRAM
(A NON-PROFIT CORPORATION)

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OFFICE OF THE PUBLIC AUDITOR

STATE OF YAP

FEDERATED STATES OF MICRONESIA

P.O. BOX 927, Colonia, Yap 96943

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

INDEPENDENT AUDITOR'S REPORT

Board of Directors of
Yap Community Action Program:

I have audited the accompanying statements of financial position of Yap Community Action Program (YCAP) as of September 30, 2005 and 2004, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the YCAP's management. My responsibility is to express an opinion on these financial statements based on my audits.

I conducted my audits in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that I 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 YCAP's internal control over financial reporting. Accordingly, I express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audits provide a reasonable basis for my opinion.

In my opinion, the financial statements referred to above, present fairly, in all material respects, the financial position of the Yap Community Action Program as of September 30, 2005 and 2004, 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.

The accompanying Schedule of Expenditures of Federal Awards (page 5) is presented for the purpose of additional analysis and is not a required part of the financial statements. This schedule is the responsibility of YCAP's management. Such information has been subjected to the auditing procedures applied in my audit of the financial statements referred to in the first paragraph and, in my opinion, is fairly stated, in all material respects, when considered in relation to the financial statements taken as a whole.

In accordance with *Government Auditing Standards*, I have also issued a report dated January 20, 2006 on my consideration of the YCAP's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, and contracts. The purpose of that report is to describe the scope of my testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of my audits.


Gertrude Gootinan
Yap State Public Auditor

January 20, 2006,
Except for Note 11 which date is July 1, 2006

YAP COMMUNITY ACTION PROGRAM
(A NONPROFIT CORPORATION)

Statements of Financial Position
September 30, 2005 and 2004

ASSETS	<u>2005</u>	<u>2004</u>
Current Assets:		
Cash, unrestricted	\$ 326,131	\$ 756,104
Cash, restricted	747,864	656,140
Short term investment	900,000	500,000
Receivables		
Loans receivable, current portion (note 2)	176,997	140,341
Purchase order advance	9,310	--
Interest receivable (note 2)	7,056	1,871
Accrued interest receivable - TCD	--	688
Travel advance and other receivable	<u>4,486</u>	<u>5,806</u>
Total current assets	2,171,844	2,060,950
Long-term portion of loans receivable (note 2)	391,561	345,554
Property and equipment, net (note 3)	50,055	44,754
TOTAL ASSETS	\$ <u><u>2,613,460</u></u>	\$ <u><u>2,451,258</u></u>
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable	\$ 11,274	\$ 19,901
Accrued expenses	13,372	12,619
Accrued annual leave	8,583	7,572
Due to Yap State Treasury (note 8)	18,351	--
Due to other grantors (note 4)	<u>102,639</u>	<u>102,639</u>
Total current liabilities	154,219	142,731
Commitments and contingencies (note 6)		
Net assets:		
Unrestricted	\$ 54,753	\$ 14,199
Temporarily-restricted	377,855	373,933
Permanently-restricted	<u>2,026,633</u>	<u>1,920,395</u>
Total net assets	<u>2,459,241</u>	<u>2,308,527</u>
TOTAL LIABILITIES AND NET ASSETS	\$ <u><u>2,613,460</u></u>	\$ <u><u>2,451,258</u></u>

See accompanying notes to financial statements

YAP COMMUNITY ACTION PROGRAM
(A NONPROFIT CORPORATION)

Statements of Activities
For the years ended September 30, 2005 and 2004

	Unrestricted	Temporarily Restricted	Permanently Restricted	Totals	
				2005	2004
REVENUES, GAINS, AND OTHER SUPPORT (NOTE 5)					
Grants and contracts	\$ 475	\$ 214,049	\$	\$ 214,524	\$ 266,449
Interest	58,868		38,688	97,556	49,827
Other income	15,000	18,288		33,288	32,103
Net assets released from restriction					
Satisfaction of program restriction	<u>212,572</u>	<u>(212,572)</u>		-	-
Total revenues, gains, and other support	<u>286,915</u>	<u>19,765</u>	<u>38,688</u>	<u>345,368</u>	<u>348,379</u>
EXPENSES AND LOSSES					
Program services					
Federal and Compact programs	8,090	4,054		12,144	4,812
Other nonprofit and local programs	13,477			13,477	52,535
Management and general					
Salaries and fringe benefits	146,089			146,089	149,707
Contractual services	16,608			16,608	18,755
Depreciation expenses	-		14,286	14,286	13,143
Miscellaneous (note 9)	13,738			13,738	16,268
Communications and utilities	9,562			9,562	6,856
Fuel	9,029			9,029	6,048
Supplies and materials	7,799			7,799	10,157
Travel	7,348			7,348	3,878
Other costs	1,921			1,921	3,479
Total expenses and losses	<u>233,661</u>	<u>4,054</u>	<u>14,286</u>	<u>252,001</u>	<u>285,638</u>
Other changes in net assets					
Acquisition of property and equipment	(12,700)	(6,950)	19,650	-	-
Grant funds disbursed as housing loans		(4,839)	4,839	-	-
Recovery			57,347	57,347	61,523
Change in net assets	40,554	3,922	106,238	150,714	124,264
Net assets at beginning of year	<u>14,199</u>	<u>373,933</u>	<u>1,920,395</u>	<u>2,308,527</u>	<u>2,184,263</u>
Net assets at end of year	<u>\$ 54,753</u>	<u>\$ 377,855</u>	<u>\$ 2,026,633</u>	<u>\$ 2,459,241</u>	<u>\$ 2,308,527</u>

See accompanying notes to financial statements

YAP COMMUNITY ACTION PROGRAM
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Statements of Cash Flows
September 30, 2005 and 2004

Increase (Decrease) in Cash

	<u>2005</u>	<u>2004</u>
Cash flows provided by (used for) operating activities:		
Receipts from operating activities	\$ 18,289	\$ 10,226
Cash received from other revenues and support	260,817	267,567
Cash payments for goods and services	(89,892)	(116,446)
Cash payments to employees	<u>(144,324)</u>	<u>(146,208)</u>
Net cash provided by operating activities	<u>44,890</u>	<u>15,139</u>
Cash flows from lending activities:		
Principal and interest payments received	213,539	206,231
Housing loans disbursed	<u>(204,603)</u>	<u>(78,533)</u>
Net cash provided by noncapital financial activities	<u>8,936</u>	<u>127,698</u>
Cash flows from (used for) investing activities:		
Purchase of time-certificates of deposits	(491,724)	(134,783)
Interest income	27,575	20,760
Acquisition of fixed assets	<u>(19,650)</u>	<u>--</u>
Net cash used for investing activities	<u>(483,799)</u>	<u>(114,023)</u>
Net increase (decrease) in cash	(429,973)	28,814
Cash, beginning of year	756,104	727,290
Cash, end of year	\$ <u>326,131</u>	\$ <u>756,104</u>
Reconciliation of Changes in Net Assets to Net Cash used for Operating Activities		
Changes in net assets	\$ 150,714	\$ 124,264
Adjustment to reconcile net loss to net cash used in operating activities		
Loan interest income presented as lending activity	(31,642)	(44,591)
Interest income presented as investing activity	(34,621)	(25,995)
Depreciation	14,286	13,143
Recovery of bad debts	(57,347)	(61,523)
(Increase/decrease in assets)		
Travel advance and other receivables	1,320	(638)
Purchase order advance	(9,310)	--
Increase/(decrease) in liabilities		
Accounts payable	(8,627)	6,980
Accrued expenses	754	4,292
Annual leave	1,012	(793)
Due to Yap State Treasury	<u>18,351</u>	<u>--</u>
Net cash used in operating activities	<u>44,890</u>	<u>15,139</u>
Supplemental disclosures of noncash transactions:		
Loss on disposal of assets which decreased property & equipment	\$ <u>0</u>	\$ <u>16,973</u>

See accompanying notes to financial statements

YAP COMMUNITY ACTION PROGRAM
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Schedule of Expenditures of Federal Awards
September 30, 2005 and 2004

<u>Grantor/CFDA Grantor's Program Title</u>	<u>Federal CFDA No.</u>	<u>2005</u>	<u>Expenditures</u> <u>2004</u>
Amended Compact of Free Association			
Environmental Sector Grant			
Yap Community Action Program	15.875	\$ 184,134	\$ 67,937
<i>(Passed through FSM National Government and Yap State)</i>			
Compact of Free Association			
Section 212 Special Development			
Yap Community Development Program	15.875	5,721	3,213
<i>(Passed through FSM National Government and Yap State)</i>			
USDA Rural Development			
Rural Housing			
Housing Preservation Grant (Note 1)	10.433	4,447	1,599
<i>(Direct through Yap Rural Development Office)</i>			
U.S. Department of State			
Pacific Island Fund Grant (Note 2)	None		
YCAP Water Watch Program		<u>11,881</u>	<u>--</u>
<i>(Direct from the U.S. Embassy in Kolonia, Pohnpei)</i>			
TOTAL FEDERAL AWARDS EXPENDED:		<u>\$ 206,183</u>	<u>\$ 72,749</u>

Note 1: Only 50% Federal share is reflected herein.

Note 2: The Pacific Island Fund Grant is a small grant scheme and does not have a CFDA number.

YAP COMMUNITY ACTION PROGRAM
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Notes to Financial Statements
Fiscal Years Ended September 30, 2005 and 2004

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Reporting Entity - The Yap Community Action Program (Yap CAP) is a nonprofit organization created in fiscal year 1968 by the Trust Territory Government. By virtue of the extent of control exercisable by the state, YCAP is a component unit of the State. An eight-member Board of Directors governs Yap CAP; the Governor appoints two members from his cabinet and one each from the Councils of Tamol and Pilung. These four board members then determine the process of selecting the remaining four members. The mission of Yap CAP is to "operate and support programs aimed at environmental and cultural preservation and other sustainable economic and social development programs in pursuit of self-reliance for Yap citizens."

Accounting Standards: YCAP has adopted the provisions of Statement of Financial Accounting Standards No. 116, "Accounting for Contributions Received and Contributions Made" (SFAS 116), Statement of Financial Accounting Standards No. 117, "Financial Statements for Not-for-Profit Organizations" and SFAS 124 "Accounting for Certain Investments held by Not-for-Profit Organizations." SFAS 116 establishes standards for accounting for contributions. SFAS 117 establishes broad standards for reporting information in financial statements issued by not-for-profit organizations and requires those organization's financial position and activities to be reported in three classes of net assets: unrestricted, temporarily-restricted and permanently-restricted. SFAS 124 requires certain investments to be carried at market value.

These statements must classify an organization's assets, revenues, expenses, gains and losses based on the existence or absence of donor-imposed restrictions. The three classes of net assets are therefore classified as one of the following types:

Unrestricted
Temporarily restricted
Permanently restricted

Yap CAP has determined that all assets, revenues, expenses, gains and losses resulting from local government contributions and federal grants are unrestricted and temporarily restricted, respectively. Yap CAP has determined that equipment and related transfers and depreciation expense are permanently restricted. Assets and activities of the revolving housing loan program are also classified as permanently restricted.

Net Assets - Yap CAP reports grants or gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Net assets were released from restrictions due to satisfaction of donor-imposed restrictions in the amount of \$212,572 and \$255,238 for the years ended September 30, 2005 and 2004, respectively.

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Notes to Financial Statements
Fiscal Years Ended September 30, 2005 and 2004

Contributions - All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Unrestricted funding is recognized as support when received when the only limits on its use are the broad limits resulting from the nature of Yap CAP, the environment in which it operates, and the purposes specified in its articles of incorporation and by-laws and limits resulting from contractual agreements entered into by Yap CAP in the course of its business. Amounts received that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support that increases those net asset classes.

Cash and Equivalents - Cash includes cash on hand as well as cash in various bank accounts and time certificates of deposits with an initial maturity date of 90 days or less. All of the YCAP's bank accounts and certificates of deposits for fiscal year 2005 and 2004 are with a federally insured bank, approximately \$100,000 of which is subject to coverage by federal insurance with the remaining balance exceeding insurable limits. Restricted cash represents cash restricted for the revolving housing loan programs.

Short-Term Investments - Short-term investment at September 30, 2005 consists of a \$500,000 two-year deposit agreement with the Yap Cooperative Association (YCA), a local importer/retailer, with a maturity date of September 12th, 2007. The deposit earns interest at 5.5% per annum for the first twelve (12) months and six (6%) for the last twelve months, but such interest will be forfeited if funds are withdrawn prior to the maturity date. In addition, withdrawals made within the first three months of the deposit are subject to a 1% penalty on the amount drawn. The deposit is secured by YCA assets and property.

On October 10, 2004, YCAP deposited \$400,000 with the AYUW Credit Services under the terms of a deposit agreement. The deposit has a maturity date of October 10, 2005 and earns interest at 5%, but such interest would be forfeited if funds are withdrawn prior to the maturity date. Moreover, withdrawals made within the first three months of the deposit are subject to a 1% penalty on the amount drawn. The deposit is collateralized by AYUW Credit Services' property and assets. AYUW Credit Services is a non-federally insured credit union, affiliated with the Pacific Savings Bank in Koror, Republic of Palau, and offers a wide range of financial services to the general public.

Property and Equipment - Property and equipment is stated at cost less accumulated depreciation. Routine maintenance and repairs are expensed as incurred. Depreciation is recorded in the financial statements under the straight-line method based on the estimated useful lives of the assets as follows:

Office furniture & fixtures	3 - 5 years
Office equipments	5 -10 years
Vehicles	4 - 6 years
Other equipment	4 - 25 years
Building	25 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

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Notes to Financial Statements
Fiscal Years Ended September 30, 2005 and 2004

estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications – Certain reclassifications have been made to the fiscal year 2004 balances and amounts in order to conform to the fiscal year 2005 presentation.

2. LOANS RECEIVABLE

Details of receivables under the housing loan program are presented below:

	<u>2005</u>	<u>2004</u>
Community Development Block Grant Loans	\$ 601,800	\$ 642,075
Yap State Legislature Loans	725,804	654,704
Yap State Housing Authority Loans	185,509	189,053
Housing Preservation Grant Loans	4,419	6,384
	<u>1,517,532</u>	<u>1,492,216</u>
Add: Accrued interest	144,124	135,611
Total loan principal and interest	<u>1,661,656</u>	<u>1,627,827</u>
Less: Allowance for doubtful loans and interest	<u>(1,086,042)</u>	<u>(1,140,061)</u>
Loans receivable, net	575,614	487,766
Less: Current portion – loans	(176,997)	(140,341)
Current portion – interest	<u>(7,056)</u>	<u>(1,871)</u>
Long-term portion	<u>\$ 391,561</u>	<u>\$ 345,554</u>

3. PROPERTY AND EQUIPMENT

A summary of property and equipment as of September 30, 2005 and 2004 is as follows:

	<u>Beg Balance October 1, 2004</u>	<u>Transfers And Additions</u>	<u>Transfers And Disposals</u>	<u>Ending Balance September 30, 2005</u>
Vehicles	\$ 141,266	\$ 6,950	\$	\$ 148,216
Office furniture & equipments	49,516	7,700	(4,424)	52,792
Other assets	12,652	5,000	(4,424)	17,652
	<u>203,434</u>	<u>19,650</u>	<u>(4,424)</u>	<u>218,660</u>
Less: accum. depreciation	<u>(158,680)</u>	<u>(14,286)</u>	<u>4,361</u>	<u>(168,605)</u>
	<u>\$ 44,754</u>	<u>\$ 5,364</u>	<u>\$ (63)</u>	<u>\$ 50,055</u>

YAP COMMUNITY ACTION PROGRAM
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Notes to Financial Statements
Fiscal Years Ended September 30, 2005 and 2004

3. PROPERTY AND EQUIPMENT (CONT.)

	<u>Beginning Balance October 1, 2003</u>	<u>Transfers And Additions</u>	<u>Transfers And Disposals</u>	<u>Ending Balance September 30, 2004</u>
Vehicles	\$ 141,266	\$	\$	\$ 141,266
Office furniture & equipments	49,516			49,516
Other assets	<u>12,652</u>			<u>12,652</u>
	203,434	--	--	203,434
Less: accum depreciation	<u>(145,537)</u>	<u>(13,143)</u>		<u>(158,680)</u>
	<u>\$ 57,897</u>	<u>\$ (13,143)</u>	<u>\$ --</u>	<u>\$ 44,754</u>

4. DUE TO GRANTORS

Amount due to grantors represent unexpended balances from expired grants from the prior years. The amount is classified by funding source as follows:

	<u>2005</u>	<u>2004</u>
U.S. Federal grants	\$ 40,307	\$ 40,307
State Legislature grants	31,251	31,251
Other private grants	<u>31,081</u>	<u>31,081</u>
	<u>\$ 102,639</u>	<u>\$ 102,639</u>

5. NET ASSETS

The components of ending net assets are presented below:

	<u>2005</u>	<u>2004</u>
Unrestricted net assets		
CAP Admin	\$ 156,314	\$ 116,235
Miscellaneous	(103,636)	(103,636)
YCAP Indirect	<u>2,075</u>	<u>1,600</u>
Subtotal	<u>54,753</u>	<u>14,199</u>

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Notes to Financial Statements
Fiscal Years Ended September 30, 2005 and 2004

5. NET ASSETS (CONT.)

Temporarily-restricted net assets

YSL CAP	(10)	713
CFSM Matching Funds	28,284	28,284
Environment Student Intern	10,070	--
Housing Preservation Grants	12,753	17,200
Yap State Legislature matching funds	9,756	14,203
Australian matching	38,500	38,500
Senior Grant	17,846	17,846
Office miscellaneous	63,879	58,687
Rare project	239	239
Wottegai Seawall	475	475
Wacholab	471	471
Rumung water catchment	9,300	9,300
Tagreng/Bileyuw project	1,441	1,441
Yap community development program	157,938	163,659
Agriculture & Forestry Fire Project	236	709
MRMD Reef project	2,056	2,056
CFSM Kaday youth project	152	152
CFSM Dalipebinau recreation project	3,992	3,992
YESC	7,185	6,300
Seacology	538	1,338
YBSAP	5,378	1,310
Sudal	1,492	1,492
TNC Computer Training	1,167	1,167
Waterwatch	637	319
Pacific Diabetes	4,080	4,080
Subtotal	377,855	373,933

Permanently restricted net assets

HPG revolving loan fund	95,473	88,713
CDBG revolving loan fund	870,345	845,595
YSHA revolving loan fund	95,823	91,900
YSL revolving loan fund	914,606	849,166
CFSM capital assets	6,466	8,301
YSL capital assets	8,754	13,322
Other capital assets	16,983	-0-
Housing capital assets	18,183	23,398
Subtotal	2,026,633	1,920,395
	\$ 2,459,241	\$ 2,308,527

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Notes to Financial Statements
Fiscal Years Ended September 30, 2005 and 2004

6. COMMITMENTS

As of September 30, 2005 and 2004, housing loans are granted, but are undisbursed in the amount of \$267,963 and \$255,500, respectively. Funding for projects under the Yap Community Development Program are approved but not disbursed in the amount of \$86,615 and \$92,336 as of September 30, 2005 and 2004, respectively.

7. RELATED PARTY TRANSACTIONS

Employees and directors of YCAP or their immediate family members owed \$67,090 and \$80,544 of the loan receivables outstanding at September 30, 2005 and 2004, respectively.

8. GRANTS AND CONTRACTS

YCAP received \$202,484 from the State of Yap from funds allocated to Environmental Sector Grants of the Amended Compact for fiscal year 2005. The grant expired at September 30, 2005 with \$18,351 unexpended but encumbered for an off-island purchase order. The purchase order did not clear within the required 90 days after expiration of the grant, therefore, only \$184,134 is recognized as grant revenue for FY05 and the unexpended balance of \$18,351 is presented as a liability due to the State Treasury as of September 30, 2005

For the year ended September 30, 2004, YCAP received \$197,463 in operating subsidies from the State of Yap General Fund. The amount was originally budgeted by Yap State under the Environmental Sector Grant of the Amended Compact, however, due to the initial unavailability of Compact funds for fiscal year 2004, Yap State General Fund monies were first expended for programs budgeted for Compact II funding. When Compact funds became available, \$67,937 of the \$197,463 advanced to YCAP was reimbursed to Yap State from the Environmental Sector Grant funds. The \$67,937 is, therefore, reflected as federal grant expenditures in the accompanying Schedule of Expenditures of Federal Awards.

In addition to the operating subsidies above, YCAP also received \$30,390 and \$57,269 in other grants and contracts in FY05 and FY04 respectively.

9. MISCELLANEOUS EXPENSES

Provided below is a breakdown of miscellaneous expenses for the years ended September 30, 2005 and 2004:

Expense Account	FY05	FY04
Other expenses	\$ 5,257	\$ 11,660
Cost of equipment rental sales	6,146	2,740
Repair and maintenance	2,335	1,868
	<u>\$ 13,738</u>	<u>\$ 16,268</u>

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Notes to Financial Statements
Fiscal Years Ended September 30, 2005 and 2004

10. SUBSEQUENT EVENTS

At September 30, 2005, YCAP had an outstanding purchase order for GIS equipments worth \$18,351. YCAP deposited half of the cost with the other half due upon receipt of the equipment.

On the 19^h of January 2006, a pick-up truck was purchased for \$18,300 from a local vendor.

11. July 1, 2006:

YCAP successfully obtained a waiver from the Honolulu Office of Insular Affairs (OIA) of the Department of Interior to allow the use of remaining FY05 Compact Environmental Sector Grant funds to be expended after December 31, 2005 in payment of a purchase order worth \$18,351 obligated before September 30, 2005. Compact Fiscal Procedures Agreement require obligations of Compact funds to be liquidated within 90 days after expiration of grant funds. Without the waiver, YCAP would have been liable to return the encumbered but unexpended balance of Compact Funds to OIA through Yap State. The unexpended funds are presented as a liability due to Yap State on YCAP's balance sheet as of September 30, 2005.



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

FEDERATED STATES OF MICRONEISA
P.O. BOX 927, COLONIA, YAP 96943

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

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

The Board of Directors of
Yap Community Action Program:

I have audited the financial statements of Yap Community Action Program (YCAP) as of September 30 2005 and 2004 and for the years then, and have issued my report thereon dated January 20, 2006. I conducted my audits in accordance with auditing standards generally in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

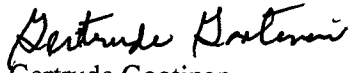
In planning and performing my audit, I considered the YCAP's internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing my opinion on the financial statements and not to provide assurance on the internal control over financial reporting. My consideration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

However, I noted certain matters involving the internal control over financial reporting and its operation that I consider to be reportable conditions and are described in the accompanying Schedule of Findings as Findings Nos. 2 to 8.

Compliance

As part of obtaining reasonable assurance about whether YCAP's financial statements are free of material misstatement, I performed tests of the YCAP's compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audits, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, I noted certain immaterial instances of noncompliance that I have reported to the management of the YCAP in the accompanying Schedule of Findings as Finding No. 1.

This report is intended for the information of the management and Board of Directors of Yap Community Action Program and is not intended to be and should not be use by anyone other than these specified parties. This report, however, is a matter of public record and its distribution is not limited.


Gertrude Gootinan
Yap State Public Auditor

January 20, 2006

YAP COMMUNITY ACTION PROGRAM
(A NON-PROFIT CORPORATION)

Schedule of Findings
September 30, 2005

FINDING NO. 1 – COMPETITIVE PROCUREMENT REQUIREMENTS

Criteria: OMB Circular A-102 or the “Common Rule” requires that grantees follow U.S. formal and informal procurement procedures as may be applicable. The Common Rule requires transactions less than \$100,000 to contain evidence of price comparison from a representative number of vendors. The Yap State financial management regulations require goods worth at least \$5,000 to be purchased through sealed bids.

Condition: YCAP received \$12,200 from the U.S. Department of State through the U.S. Embassy in Pohnpei for a one-year pilot Water Watch Program. The funding proposal stated that water quality kits and macroinvertebrate kits would be purchased from an Australian vendor. Our review found supporting documentation of the payment of \$12,016 (including \$75 wire-transfer fee) to the vendor but found no evidence of informal or formal vendor selection procedures.

Cause: Because this was the sole transaction found without proper documentation, we believe it was due to oversight of the person responsible to ensure that evidence of competitive procurement were in place before proceeding with the purchase.

Effect: The above transaction may be in noncompliance with the Common Rule procurement requirements. The Common Rule requires grantees to follow the more stringent of local or federal procurement policies and procedures, therefore, YCAP should have purchased the water monitoring kits through sealed bids as required by the Yap State Financial Management Regulations.

Recommendation: We recommend that management ensure that YCAP policies and procedures for informal and formal procurement are followed for all transactions.

RESPONSE: *The agency agrees with this recommendation and will ensure that similar transactions in the future are well documented and files properly maintained. It is noted that Yap CAP was initially awarded a similar grant in March 2004 by the Australian Embassy in Pohnpei and we endeavored to locate a supplier for the Water Watch Kits from known vendors in Guam, Hawaii and the west coast to no avail. The only known vendor willing to supply the Kits was Vendart PTY, LTD from Australian and so we did purchase a Kit from them. When we applied for the grant form the US Embassy in Pohnpei, we specified that the Kits will be purchased from the same vendor (Vendart) as we've already done the search and found that they are the only supplier within the region.*

FINDING NO. 2 – ENCUMBRANCE VERSUS EXPENSE

Criteria: Generally accepted accounting principles require expenses to be recorded only when the cost is incurred (the goods or services have been received).

Condition: YCAP prepared a purchase order of \$18,351 for an order of GIS equipments in fiscal year 2005 from an off-island vendor. At September 30, 2005, YCAP was not in receipt of the

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FINDING NO. 2 – ENCUMBRANCE VERSUS EXPENSE (CONT.)

equipment, but expensed the cost of the purchase order to its Compact Environmental Sector Grant funds.

Another purchase of \$12,016 for water kits for the Water Watch Project was also made on September 7, 2005. Payment was advanced to the vendor in Australia upon receipt of the price quotation. The cost of the kits was expensed even though by year-end YCAP still had neither the goods nor a final invoice.

Cause: The above conditions occurred because YCAP improperly recorded expenses to show total funding received had been disbursed by the lapse dates. This was made possible by recording encumbrances (purchase commitments) as payables. Expenses were further misstated by allowing disbursement of funds supported only by vendor quotations and not actual invoices. Furthermore, YCAP was unaware of its responsibility to liquidate all purchase orders within 90 days after expiration of federal grants, therefore, it did not take actions necessary to ensure that outstanding purchase orders charged against Compact II funds were cleared before December 31, 2005.

Effect: \$18,351 improperly recorded as expenses for the expired Compact Environmental Sector Grant Fund had to be reversed and recorded as a liability to the Yap State Government.

Recommendation: We recommend that management require accounting staff to identify and quantify purchase commitments and include the information in its year-end report to the Grantor for both local and Federal funding. At no time should YCAP record as expenses the cost of goods or services not yet received.

RESPONSE: *The agency agrees with this recommendation. In the course of the audit field work this particular issue was discussed extensively and therefore it is safe to assume that it is now well understood and should not happen again. The Fiscal Officer will be personally responsible to ensure that it does not happen again.*

FINDING NO. 3 – CLASSIFICATION OF EXPENSES

Criteria: Expenses should be classified for external reporting purposes in a manner to provide meaningful information to management, grantors and the general public.

Condition: YCAP classified a large part of its administrative and general expenses in its trial balance to “other costs” CAP admin and YSL CAP. Expenses recorded as “other costs” aggregating \$27,233 and \$30,439 for the years ending September 30, 2005 and 2004, respectively. We required YCAP to provide breakdowns for the two (2) years expenses recorded as “other costs” and found that YCAP did not utilize its fuel, contractual services, supplies & materials, utilities and communications expense accounts that existed in its general ledger.

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FINDING NO. 3 – CLASSIFICATION OF EXPENSES (CONT.)

Cause: YCAP's utilized a manual general ledger and several manual subsidiary ledgers for most of its accounting tasks, therefore, it may have been inexpedient to create too many expense sub accounts.

Effect: Trial balance information on expenses was not adequately presented to provide meaningful information to interested parties.

Recommendation: We believe that YCAP can vastly improve its accounting and reporting of financial information by automating its general ledger. Therefore, we recommend that Executive Director purchase and put in use an automated general ledger system that will facilitate the accumulation and reporting of financial data.

RESPONSE: *While we agree with the recommendation to fully automate the agency's accounting system; this is not as simple a task as it would appear and definitely not something you can do overnight when all factors are considered. The agency has just completed its computer upgrade whereby we now have compatible desktop computers for those personnel needing them. We purchased a long time ago the Peachtree Accounting Software which we have been using for payroll. We are enrolling our accounting staff in a training program being offered by the Yap State Small Business Center (Quick Book & Peachtree). We are slowly working our way toward automated accounting including the need to build capacity amongst the staff that will be responsible to operate and manage the system. The Executive Director will ensure that the needed baby steps are taken to fully automated the system by FY 2008.*

FINDING NO. 4 – INACCURATE FINANCIAL DATA

Criteria: Management is responsible to make available accurate and timely financial information at the least possible cost to the Agency.

Condition: We estimate that it is costing YCAP approximately \$46,000 a year to maintain the general ledger. The amount was derived by guesstimating the percentage of pertinent employees' time spent preparing checks, issuing receipts, journalizing transactions in subsidiary ledgers and transferring the summary information to the general ledgers and preparing financial reports for management's use.

Cause: YCAP attempted more than fifteen years ago to automate its general ledger. The agency purchased an accounting software but only used the payroll module. Use of the general ledger module was delayed because accounting staff felt inadequately trained to utilize the program. Since then, the general and subsidiary ledgers of YCAP has continued to be maintained manually, necessitating that five other personnel assist the fiscal officer either full-time or part time with his bookkeeping and accounting tasks.

Effect: Not only was it costing YCAP more than necessary to maintain its accounting system, but YCAP also provided FY05 schedules that were not properly reconciled to the general ledger

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FINDING NO. 4 – INACCURATE FINANCIAL DATA (CONT.)

balances. Although the variances found were not material overall to the financial statements, the errors nonetheless affected the quality of YCAP's financial reports. The variances were as follows:

Loan Programs	Balance per Schedules	Balance per General Ledger	Variance
HPG	6,247.05	4,419.44	1,827.61
CDBG	602,761.28	601,799.61	961.67
YSL	726,363.87	725,804.17	559.70
YSHA	185,508.64	185,508.64	-0-
	<u>1,520,880.84</u>	<u>1,517,531.86</u>	<u>3,348.98</u>

The limitations of a manual accounting system made it very difficult to trace and correct minor errors, especially with YCAP maintaining loan receivable balances and other loan information for over 200 borrowers, in addition to its maintaining accounting information for grants and projects. Unfortunately, these differences, if not soon corrected, would continue to accumulate until the variances become material to the financial statements.

Recommendation: As we recommended previously in Finding No. 4, the Executive Director should require that an automated accounting program be obtained to replace the manual accounting system. This would allow the fiscal officer greater opportunity to review and to ensure that financial information prepared by the accounting staff are accurate and complete. In addition, an automated accounting program would facilitate the detection and correction of errors towards better and more accurate financial information.

Prior Year Status: In fiscal year 2003 and 2004, the finding of untimely reconciliation of accounts has been discussed with YCAP Management and the Board of Directors. Recommendations were given to YCAP to require accounting staff to develop a periodical schedule to ensure that financial transactions are posted, reviewed and reconciled on a regular basis. Furthermore, an automated accounting program was also recommended to make the process more efficient and cost effective.

RESPONSE: *We agree with the recommendation and as indicated in our response to Finding No. 3, we are aiming to have the accounting system fully automated by 2008. It is unreasonable to expect a quick conversion of the system when related personnel capacities or the lack thereof are taken into consideration. Additionally, even with the manual system in place, vast improvements have been made in accounts reconciliation and we applaud the auditors for their determination to continuously seek out and find minor weaknesses in our processes and keeping us on our toes as we strive to improve our systems, processes and ourselves.*

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FINDING NO. 5 – LOAN INTEREST INCOME

Criteria: Proper accounting principles require income to be recorded in the period when it was earned and became measurable.

Condition: Our review of loan interest income for fiscal year ending September 30, 2005 found recovery of bad loans of \$57,347 was recorded as interest income. Unfortunately, the reversal and accrual of interest income was done improperly with the result that the effect of prior year interest income received in the current year was not corrected.

Cause: Two unrelated closing entries were combined into a single entry – the recording of accrued interest and adjustment of the allowance for doubtful loans. Instead of reversing 100% of the FY04 accrual for loan interest income receivable, and then booking the estimated loan interest receivable for fiscal year 2005 with corresponding entries to income and interest receivable, YCAP improperly recorded allowance for doubtful loans as interest income.

Effect: This finding was first issued for the audit year ended September 30, 2003. It was also a problem in FY04 but with an immaterial effect on the financial statements. For the year ended September 30, 2005, interest income was materially overstated by \$57,347.

Recommendation: We recommend that the fiscal officer ensure that year-end entries are properly recorded to present accurate financial information in the general ledger.

Prior Year Status: This finding was also issued in the audit report for fiscal year ended September 30, 2003.

RESPONSE: We do agree with the recommendation, although puzzled as to why the Finding continues to remain unsettled for three consecutive years. However, the Executive Director has discussed the Finding with the Fiscal Officer and learned that his has been discussed with the auditing staff and adjustments were made during the early course of the FY'05 Audit. Now, the Executive Director has tasked the Fiscal Officer to learn the proper entries as recommended by the auditors and ensure that we do not repeat the same Finding in FY'06.

FINDING NO. 6 – FORFEITURE OF LOANS

Criteria: YCAP Housing Loan Policy requires that loans shall be cancelled if no disbursement of the loan has been made, three (3) months after the loans has been approved.

Condition: In fiscal year 2004, YCAP was cited for new loans that remained undisbursed for periods in excess of three months and for unexpended funds from completed housing projects. Most of the loans related to completed projects were closed in January 2005 with the exception of two loans needing additional changes to the scope of works. As per discussion with YCAP Management and the Board of Directors, the Executive Director was to draft an amendment to the Housing Loan Policy that would allow him to extend the grace period of new loans and to extend the closure of loans for completed projects for the Board's review and approved by the end of fiscal year 2006.

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FINDING NO. 6 – FORFEITURE OF LOANS (CONT.)

Our review for year ended September 30, 2005 found three loans of \$30,000 each aggregating to \$90,000 still undisbursed more than three months after award. One of the loans was approved in May 2002, one was approved in October 2004, and the third one was approved in March 2005.

Cause: The current policy to begin disbursement of funds three months after loan approval was formulated before YCAP began approving loans for projects costing in excess of \$30,000. The total costs for each of the three housing projects exceeded the maximum loan amount of \$30,000. The loans were approved with the understanding that the borrowers would start construction using their own funds to cover the amounts in excess of \$30,000. The housing policy was not revised to cover the new types of loans.

Effect: The housing loans costing in excess of \$30,000 are outside the scope of the existing loan policies. The seeming lack of enforcement of the grace period of the Housing Loan Programs increases the risk of non-compliance with other provisions.

Recommendation: YCAP Management and the Board of Directors should add additional guidelines to Section XVI in the Housing Loan Policies to address the special circumstances involving loan projects costing more than \$30,000 and to also provide discretion to the Executive Director to waive or extend the grace period based on formal request by applicant.

Prior Year Status: This finding was first raised in the audit report for YCAP for the year ended September 30, 2004.

RESPONSE: *We agree with this recommendation now just like we similarly agreed to the same in our FY2004 audit. As part of our response to the 2004 Audit we stated that we will propose the appropriate changes to the applicable policies for the Board's approval before the end of FY 2006. We are still working toward exactly that and we are confident that the needed changes will be in place before the end of the current FY.*

FINDING NO. 7 – EMPLOYEE RECEIVABLES

Criteria: Proper internal controls should require that receivables be collected on a timely manner.

Condition: During our review of receivables for fiscal year 2005, we found that 81% of the FY04 employee receivables remained uncollected at September 30, 2005.

This finding was raised in our audit for the year ended September 30, 2004. YCAP management was responsible to ensure that schedules of payments are made for employees and members of the Board of Directors owing money to YCAP in order to clear all receivables at the end of fiscal year ended September 30, 2006. The Executive Director was to take responsibility for ensuring that repayment schedules were carried out.

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FINDING NO. 7 – EMPLOYEE RECEIVABLES (CONT.)

Cause: YCAP did not have policies in place to ensure timely collection of employee receivables.

Effect: Since YCAP footed all charges to its accounts; employees did not make the effort to pay what was owed to YCAP. Such practice increases the risk of YCAP paying for unallowable expenses.

Recommendation: I recommend that the executive director require immediate payment of personal expenses charged to YCAP's account. The Executive Director should consider whether the employee would be able to afford the charges made to YCAP before allowing the charges. Furthermore, payment schedule should be made for those employees for those employees with outstanding balances.

Status: Repeated FY04 Finding for discussion and update on the repayment schedules and will not carry over to our FY05 Audit Report.

RESPONSE: *While we agree with the Finding as can be attested to in our response to the same item last year, we do not fully agree with the Recommendation. Since the release of the 2004 audit report no new employee receivables have been incurred. We have been collecting from the affected employees at the rate they can afford without causing too much hardship on themselves and their families. We are willing to work with these employees to have them increase their payments toward their debts but we are somewhat hesitant to demand for a full one time payment as being recommended. Should anything happen to these employees such as termination, resignation or even death, the amount we will owe them in unpaid hours earned, leave encashment would be more than enough to cover the amount they owe to Yap CAP.*

FINDING NO. 8 – OUTSTANDING TRAVEL ADVANCE

Criteria: YCAP considers loans receivable balances with payments delinquent over 90 days as bad debt. This should be applied consistently to other receivables for YCAP.

Condition: Our audit for fiscal year ending September 30, 2005 found that the travel advance of \$1,884 for FY2002 was still outstanding. In our previous audits, we found that YCAP had made several attempts to collect from the traveler but were not successful. We recommended to YCAP in our audit for fiscal year 2004 to record the advance as bad debt and then continue its attempt to collect from the traveler.

Cause: YCAP had sought advice from the Office of the Attorney General hoping for legal action towards Government employees but was not successful. This left YCAP with no other options but to continue its attempt to collect through written communications.

Effect: With the above causes, it is unlikely that YCAP will collect the above travel advance.

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Schedule of Findings
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FINDING NO. 8 – OUTSTANDING TRAVEL ADVANCE (CONT.)

Recommendation: We recommend that YCAP should fully reserve the amount of the advance as doubtful and to continue its attempt to collect from the traveler.

Prior Year Status: The above finding was first issued in the audit reports for YCAP for fiscal years 2004 and 2003.

RESPONSE: *We agree with the recommendation and happy to report that the amount has already been reserved.*