

YAP FISHING AUTHORITY

**Financial Statements and
Independent Auditor's Report
Years Ended
September 30, 2004 and 2003**



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



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EXECUTIVE SUMMARY

**Financial Audit of the
Yap Fishing Authority
for the Years ended September 30, 2004 and 2003**

The Office of the Yap State Public Auditor was engaged to audit the Yap Fishing Authority for the years ended September 30, 2004 and 2003 and has issued the report dated November 16, 2005. Due to scope limitations presented by inadequate accounting records and other factors explained in the Independent Auditor's Report on page 2, I was unable to determine whether the financial position of YFA as of September 30, 2003 and 2004 or the results of its operations and cash flows for the years then ended were fairly presented. Fiscal year 2004 is the second consecutive year that I have not been able to form an opinion on YFA's financial statements.

Moreover, YFA was unable to prepare *Management's Discussion and Analysis* which is supplementary information required by Governmental Accounting Standards Board (GASB) Statement No. 34, "*Basic Financial Statements and Management's Discussion and Analysis – for State and Local Governments*" to be presented with the basic financial statements.

The Schedule of Expenditures of Federal Awards on page 6 shows that for the years ended September 30, 2004 and 2003, YFA incurred \$10,278 in expenses related to recovery efforts after Typhoon Sudal and \$103,028 for Typhoon Mitag, respectively.

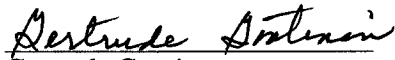
The report on internal control and compliance and other matters required by *Government Auditing Standards* on page 16 discusses reportable conditions at YFA. These conditions and our recommendations are presented for the information of YFA management in the Schedule of Findings beginning on page 18. Of the nineteen findings, four are considered to be material weaknesses. Seventeen findings are related to inadequate controls while two pertain to noncompliance with laws and regulations. Ten of the nineteen findings were repeat findings from the prior years.

Following is a summary of the significant audit findings for the year ended September 30, 2004:

- (1) Finding No. 2 relates to \$13,677 unexpended funds from the Japanese Grant for Fishing Village Recovery Projects that was advanced to two local vendors and remained with the local vendors after September 30, 2004. We have recommended that YFA request the vendors to return the funds to YFA for proper accountability.
- (2) Findings No. 3 and No. 5 cite YFA for disbursing \$19,955 for seemingly personal expenses of the former general manager and a foreign fishing vessel that required port services during fiscal year 2004.
- (3) Finding No. 4 discusses YFA's inadequate accounting of property and equipment that comprises approximately \$2 million of YFA's \$2.5 million balance sheet at September 30, 2004.

- (4) Findings No. 6 and 7 pertains to \$10,992 in missing fish and ice sales receipts. We found from sales reports that \$10,992 was collected from fish and ice sales but the cash was not deposited to the bank. We also found that beginning late fiscal year 2003 and extending to April 2005, YFA delayed banking of collections for periods of 11 days to almost two months. This condition indicated that employees were borrowing from collections.
- (5) Finding No. 10 cites YFA employees for using the Petty Cash Fund of \$300 as a personal loan fund. Funds borrowed were not returned but were recorded to employee receivables accounts in order to allow continued replenishment of the Petty Cash Fund.
- (6) Findings No. 14 and 15 discusses the need for YFA to follow State policies and procedures for travel and leave accrual given that YFA has not formulated its own policies related to such expenditures.
- (7) Finding No. 17 pertains to inadequate supporting documentation of YFA's reimbursement claims for Typhoon Sudal FEMA funds resulting in \$1,719 of unsubstantiated costs paid by the State to YFA.
- (8) Finding No. 18 is related to an YFA employee who received salaries of \$4,160 from YFA and \$3,500 from YFTI during FY04 seemingly for the same hours worked.

A copy of our draft report was provided to the Office of the Attorney General for further action relating to certain of the above findings. Moreover, we met and reviewed the draft report with the acting manager and new board of YFA and they agreed with our findings and recommendations. YFA's written response is presented as part of the audit report beginning on page 31.


Gertrude Gootinan
Yap State Public Auditor
June 14, 2006

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Yap Fishing Authority:

I was engaged to audit the accompanying balance sheets of the Yap Fishing Authority (YFA) as of September 30, 2004 and 2003, 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 YFA management.

I was unable to obtain a properly reconciled trial balance for the years ended September 30, 2003 and 2004. The general ledger beginning balances for the year ended September 30, 2003 did not agree with the fiscal year 2002 ending balances. Due to inadequate accounting records for the years ended September 30, 2004 and 2003 and the lack of concrete action taken by management to address findings and recommendations reported in an agreed-upon-procedures engagement dated October 12, 2005, I was unable to form an opinion on whether operating revenues and expenses for the years ended September 30, 2004 and 2003 were valid, complete and recorded in accordance with accounting principles generally accepted in the United States of America.

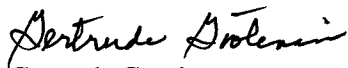
Documentation to determine the carrying value of fixed assets reported on the financial statements as of September 30, 2003 and 2004 was not available. The fiscal year 2004 and 2003 financial statements for Yap Fresh Tuna, Inc. (YFTI), a 50% owned subsidiary in which YFA is deemed to have controlling interest have not been audited. In my opinion, the financial statements of YFA should be consolidated with the financial statements of YFTI to conform with accounting principles generally accepted in the United States of America.

YFA did not present *Management's Discussion and Analysis* that, although not a required part of the basic financial statements, is supplementary information required by the Governmental Accounting Standards Board.

Because of the scope limitations described in the preceding paragraphs, I was unable to audit the financial statements supporting the financial activities of the Yap Fishing Authority, nor was I able to form an opinion on those financial activities by other auditing procedures. Since I did not audit the accompanying balance sheets of the Yap Fishing Authority as of September 30, 2004 and 2003 and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended, the scope of my work was not sufficient to enable me to express, and I do not express, an opinion on these financial statements.

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 YFA's management.

In accordance with *Government Auditing Standards*, I have also issued a report dated November 16, 2005 on my consideration of the Yap Fishing Authority's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, and contracts. The purpose of that report is to describe the scope of my testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of my audits.



Gertrude Gootinan
Yap State Public Auditor

November 16, 2005, except for
Note 18 which date is March 24, 2006

YAP FISHING AUTHORITY

Balance Sheets
September 30, 2004 and 2003

| ASSETS | <u>2004</u> | <u>2003</u> |
|---|----------------------------|----------------------------|
| Current Assets: | | |
| Cash | \$ 77,560 | \$ 2,232 |
| Investments in unconsolidated subsidiary (note 2) | 395,274 | 397,732 |
| Investment in Palau Micronesia Air (note 15) | -- | 2,000 |
| Prepaid expense | 69,220 | -- |
| Due from Grantor | 10,278 | 33,330 |
| Trade receivables, net (note 4) | 5,870 | 15,010 |
| Employee receivables, net (note 5) | -- | 633 |
| Fishing supplies inventory | -- | 7,972 |
| | <hr/> | <hr/> |
| Total current assets | 558,202 | 458,909 |
| | | |
| Property and equipment, net (note 6) | <u>2,039,143</u> | <u>2,221,347</u> |
| | | |
| TOTAL ASSETS | \$ <u>2,597,345</u> | \$ <u>2,680,256</u> |
| | | |
| LIABILITIES AND NET ASSETS | | |
| Current liabilities: | | |
| Accounts payable | \$ 20,095 | \$ 18,450 |
| Accrued payroll and others | 1,835 | 2,448 |
| Due to affiliate (note 7) | 41,945 | 41,945 |
| Due to the State Government | 35,325 | 35,325 |
| | <hr/> | <hr/> |
| Total current liabilities | 99,200 | 98,168 |
| | | |
| Contingencies | | |
| | | |
| Net Assets: | | |
| Invested in capital assets | 2,039,143 | 2,221,347 |
| Unrestricted | 459,002 | 360,741 |
| | <hr/> | <hr/> |
| Total net assets | 2,498,145 | 2,582,088 |
| | | |
| TOTAL LIABILITIES AND NET ASSETS | \$ <u>2,597,345</u> | \$ <u>2,680,256</u> |

See accompanying notes to financial statements

YAP FISHING AUTHORITY

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2004 and 2003

| | <u>2004</u> | <u>2003</u> |
|---|---------------------|---------------------|
| Operating revenues: | | |
| Fish & ice sales | \$ 74,782 | \$ 95,638 |
| Charter & rental income | 58,106 | 73,118 |
| Other income | 12,230 | 23,548 |
| Other sales | 14,811 | - |
| Dockage fees | <u>50</u> | <u>5,888</u> |
| Total operating revenues | 159,979 | 198,192 |
| Operating expenses: | | |
| Depreciation | 182,184 | 284,030 |
| Other | 62,296 | 33,391 |
| Payroll, taxes and benefits | 38,275 | 38,834 |
| Utilities | 32,478 | 34,675 |
| Contractual services | 18,626 | 11,525 |
| Bad debt expense | 18,970 | 44,949 |
| Non-YFA expense | 19,955 | - |
| Fleet expenses | 9,069 | 85,471 |
| Travel | <u>2,373</u> | <u>6,876</u> |
| Total operating expenses | 384,226 | 539,751 |
| Loss from operations | (224,247) | (341,559) |
| Nonoperating revenues/(expenses) | | |
| Donations and other contributions (note 11) | 189,767 | - |
| Operating subsidy (note 12) | 81,000 | - |
| Intergovernmental contribution (note 3) | 10,278 | 103,028 |
| Loss on disposal of assets (note 13) | - | (280,852) |
| Typhoon loss (note 14) | (128,311) | - |
| Inventory loss (note 13) | (7,972) | (27,659) |
| Loss on investment in unconsolidated subsidiary (note 16) | (2,458) | (143,452) |
| Impairment loss in PMAir (note 15) | <u>(2,000)</u> | <u>-</u> |
| Total nonoperating revenues/(expenses) | 140,304 | (348,935) |
| Net loss | (83,943) | (690,494) |
| Net assets at beginning of year | 2,582,088 | 3,272,582 |
| Net assets at end of year | <u>\$ 2,498,145</u> | <u>\$ 2,582,088</u> |

See accompanying notes to financial statements

YAP FISHING AUTHORITY

Statements of Cash Flows
Years Ended September 30, 2004 and 2003

| | <u>2004</u> | <u>2003</u> |
|---|---------------------|---------------------|
| Cash flows from operating activities | | |
| Receipts from customers | \$ 142,078 | \$ 196,948 |
| Receipts from other operating activities | 27,041 | 23,548 |
| Cash payments for goods and services | (231,342) | (209,255) |
| Cash payments to employees | (38,254) | (36,162) |
| Net cash used for operating activities | <u>(100,477)</u> | <u>(24,921)</u> |
| Cash flows from noncapital financing activities | | |
| Operating subsidy from Yap State Government | 81,000 | -- |
| FEMA grant | 33,330 | 69,698 |
| FESAP grant | 69,220 | -- |
| Net cash provided by noncapital financing activities | <u>183,550</u> | <u>69,698</u> |
| Cash flows used for investing activities | | |
| Acquisition of fixed assets | <u>(7,745)</u> | <u>(59,912)</u> |
| Net cash used for investing activities | <u>(7,745)</u> | <u>(59,912)</u> |
| Net increase (decrease) in cash | 75,328 | (15,135) |
| Cash, beginning of year | <u>2,232</u> | <u>17,367</u> |
| Cash, end of year | \$ <u>77,560</u> | \$ <u>2,232</u> |
| Reconciliation of operating loss to net cash used for operating activities: | | |
| Loss from operations | \$ (224,247) | (341,559) |
| Adjustments to reconcile loss from operations to net cash used for operating activities | | |
| Depreciation | 182,184 | 284,030 |
| (Increase)/decrease in assets | | |
| Due from grantor | 0 | -- |
| Trade receivables | 9,140 | 22,304 |
| Employee receivables | 633 | 2,232 |
| Prepaid expense | (69,220) | -- |
| Increase/(decrease) in liabilities | | |
| Accounts payable | 1,645 | 7,632 |
| Accrued payroll and other | (612) | 440 |
| Net cash used for operating activities | \$ <u>(100,477)</u> | \$ <u>(24,921)</u> |
| Supplemental disclosures of noncash transactions: | | |
| Loss on disposal of assets which decreased property & equipment | \$ <u>--</u> | \$ <u>(280,852)</u> |
| Typhoon loss | <u>(128,311)</u> | <u>--</u> |
| Bad debt expense which decreased trade and other receivables | \$ <u>18,970</u> | \$ <u>(44,949)</u> |
| Inventory loss which decreased spare parts and fishing supplies inventory | \$ <u>(7,972)</u> | \$ <u>(27,659)</u> |
| Net loss in equity investment which decreased investment in unconsolidated subsidiary | \$ <u>(2,458)</u> | \$ <u>(143,452)</u> |
| Impairment loss in PMAir | \$ <u>(2,000)</u> | \$ <u>--</u> |

See accompanying notes to financial statements

YAP FISHING AUTHORITY

Schedule of Expenditures of Federal Awards
Year ended September 30, 2004 and 2003

| Grantor/CFDA Grantor's Program Title | Federal CDFA No. | FY04 Expenditures | FY03 Expenditures |
|--|---------------------------------|------------------------------|------------------------------|
| Federal Emergency Management Agency Grant DMR-FM-1417 Typhoon Mitag Public Assistance Grant – Yap Fishing Authority Note (1) | 83.516 | -- | \$103,028 |
| Federal Emergency Management Agency Grant FEMA-FM-DR1511 Typhoon Sudal Public Assistance Grant – Yap Fishing Authority (Note 2) | 83.516 | \$10,278 | -- |
| TOTAL FEDERAL AWARDS EXPENDED | | \$10,278 | \$103,028 |

Note (1) :

The FEMA Grant is passed through the FSM National Government to the State of Yap. The amount received by YFA was the result of reimbursement claims submitted to the Division of Yap State Finance.

Note (2):

These are expenses incurred in fiscal year 2004 and were recorded as a receivable from the Yap State Government. FEMA Grant is passed through the FSM National Government to the State of Yap in fiscal year 2005.

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Notes to Financial Statements
September 30, 2004 and 2003

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity: The Yap Fishing Authority (YFA), an enterprise fund of the State of Yap, was created in 1979 pursuant to Yap State Law (YSL) No. 6-13. The primary objective of YFA is to promote, develop, and support commercial utilization of living marine resources within the State of Yap.

YFA is governed by a five-member Board of Directors appointed by the Governor with the advice and consent of the State Legislature.

Basis of Accounting – YFA 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.

Adoption of New Accounting Pronouncements – During the years ended September 30, 2004 and 2003, the YFA adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34 (*Basic Financial Statements – and Management’s Discussion and analysis – for State and Local Government*) and applied those standards on a retroactive basis. GASB Statement No. 34 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 YFA to maintain them permanently.
- c) **Expendable** – Net assets whose use by the YFA is subject to externally imposed stipulations that can be fulfilled by actions of the Authority pursuant to those stipulations or that expire by the passage of time.
- d) **Unrestricted** – Net assets that are not subject to externally imposed stipulations. Unrestricted Net Assets may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

The YFA does not have restricted net assets as at September 30, 2004 and 2003.

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

Concurrent with the implementation of GASB No. 34, YFA also adopted GASB Statement No. 33 (Accounting and Financial Reporting for Non-exchange Transactions) and Statement No. 36 (Recipient Reporting for Certain Shared Non-exchange Revenues). Statement No. 33 defines and classifies non-exchange transactions into four categories and establishes the timing of recording of each category of transactions in the financial statements. Statement No. 36 further defines revenue recognition of non-exchange transactions that were first

YAP FISHING AUTHORITY

Notes to Financial Statements
September 30, 2004 and 2003

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

presented in Statement No. 33. Hence, operating grants received by YFA from the State of Yap are classified as voluntary non-exchange transactions as defined by GASB Statement No. 33. Thus, the grants are reported on the accompanying Statements of Revenues, Expenses and Changes in Fund Equity as non-operating revenue, regardless whether such grants are used to acquire capital assets. Before the adoption of these accounting pronouncements, YFA recorded as an addition to contributed capital, the portion of operating grants used to acquire capital assets.

GASB Statement No. 38 requires certain disclosures to be made in the notes to the financial statements concurrent with the implementation of Statement No. 34. While this statement did not affect amounts reported in the financial statements of the YFA, certain note disclosures have been added or amended.

Cash – For purposes of the balance sheet and statement of cash flows, cash represents cash on hand and cash on deposit in a bank account. All of the balances at September 30, 2004 and 2003 are fully collateralized as such are subject to Federal Deposit Insurance Corporation (FDIC) coverage.

Inventory – Inventory is stated at specific identification cost.

Depreciation – YFA capitalizes fixed assets with costs in excess of \$100. 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 using the straight-line method over the estimated useful lives of the assets as follows:

| | |
|---|------------|
| Buildings | 3-20 years |
| Dock | 40 years |
| Fishing fleet | 10 years |
| Refrigeration & cold storage equipment | 5-10 years |
| Motor vehicles | 5-20 years |
| Other equipment | 2-10 years |
| Other capital assets | 2-10 years |

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

Reclassifications – Certain reclassifications have been made to the fiscal year 2003 balances and amounts in order to conform to the fiscal year 2004 presentation.

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Notes to Financial Statements
September 30, 2004 and 2003

2. INVESTMENT IN UNCONSOLIDATED SUBSIDIARY

At September 30, 2004 and 2003 YFA holds an investment in an unconsolidated joint venture with the National Fisheries Corporation. YFA has a 50% interest in Yap Fresh Tuna Inc. with a carrying value of \$395,274 and \$397,732 at September 30, 2004 and 2003, respectively.

In the prior years, by virtue of its management agreement with Yap State, NFC was considered to be the controlling partner; hence, YFTI was consolidated with NFC's financial statements and was carried on the equity method in YFA's financial statements.

In fiscal year 1999, NFC's management of YFTI was discontinued. Therefore, the State of Yap, through YFA, now appears to be the controlling partner. Audits of YFTI for the years ended September 30, 2004 and 2003 have not been finalized to allow for consolidation. Adjustments to the investment account for fiscal years 2004 and 2003 are based on unaudited results of YFTI's operation. (See Note 16)

3. DUE FROM GRANTOR

Early in fiscal year 2003, YFA was a recipient of a \$103,028 grant from the U.S. Federal Emergency Management Agency for the repair of *F/V Fasiran* damaged during Typhoon Mitag in March 2002. The grant with CFDA #83.66 was received through the Yap State Government under FEMA DMR 1417 Typhoon Mitag Public Assistance Grants. The receivable due to YFA from the FEMA Grant was \$33,330 at September 30, 2003.

In fiscal year 2004, as a result of Typhoon Sudal, YFA suffered major damages to its buildings and equipments and lost 100% of its fleet of fishing vessels. YFA sought assistance from the U.S. Federal Emergency Management Agency under FEMA DMR 1511 for the repair of the buildings and replacement of the fishing vessels. In addition, YFA was tasked under project worksheet (PW #381) to assist the U.S. Army divers to remove and dispose of YFA's sunken fishing vessels at the harbor area. Total reimburseable expenses incurred by YFA under PW #381 at September 30, 2004 totaled \$10,278. The amount is recorded as a receivable due from grantor and intergovernmental contribution on the accompanying financial statements.

4. TRADE RECEIVABLE

A summary of trade receivables at September 30, 2004 and 2003 is presented below:

| | <u>2004</u> | <u>2003</u> |
|---|------------------|------------------|
| Regular trade customers | \$ 444,271 | \$ 430,004 |
| Affiliates of YFA | 108,684 | 109,963 |
| Yap State departments and agencies | 11,298 | 7,343 |
| Officers and employees | 36,774 | 35,789 |
| | <u>601,028</u> | <u>583,099</u> |
| (Less): allowance for doubtful accounts | <u>(595,158)</u> | <u>(568,089)</u> |
| Trade receivables, net | <u>\$ 5,870</u> | <u>\$ 15,010</u> |

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Notes to Financial Statements
September 30, 2004 and 2003

5. EMPLOYEES RECEIVABLE

A summary of employees' receivable is presented below:

| | <u>2004</u> | <u>2003</u> |
|---------------------------------------|------------------|-----------------|
| Employees receivable | \$ 25,395 | \$ 35,577 |
| Less: allowance for doubtful accounts | <u>(25,395)</u> | <u>(34,399)</u> |
| | <u>\$ --</u> | <u>\$ 633</u> |

6. PROPERTY AND EQUIPMENT

A summary of property and equipment as of September 30, 2004 and 2003 is as follows:

| | <u>Beginning Balance October 1, 2003</u> | <u>Transfers and Additions</u> | <u>Transfers and Disposals</u> | <u>Ending Balance September 30, 2004</u> |
|---|--|--|--|--|
| Buildings | \$ 1,651,117 | \$ | \$ (51,117) | \$ 1,600,000 |
| Dock | 2,629,778 | | | 2,629,778 |
| Fishing fleet | 1,261,019 | | (1,261,017) | -0- |
| Refrigeration & cold storage equipments | 286,352 | 14,017 | (30,383) | 269,986 |
| Motor vehicles | 180,360 | | (57,561) | 122,799 |
| Other equipment | 58,249 | 114,865 | (50,709) | 122,404 |
| Other capital asset | <u>52,842</u> | | <u>(51,684)</u> | <u>1,159</u> |
| | <u>6,119,717</u> | <u>128,882</u> | <u>(1,502,471)</u> | <u>4,746,126</u> |
| (Less): Accumulated depreciation | <u>(3,898,370)</u> | <u>(182,184)</u> | <u>1,373,569</u> | <u>(2,706,983)</u> |
| | <u>\$ 2,221,347</u> | <u>\$ (53,302)</u> | <u>\$ (128,902)</u> | <u>\$ 2,039,143</u> |

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Notes to Financial Statements
September 30, 2004 and 2003

6. PROPERTY AND EQUIPMENT (cont.)

| | <u>Beginning Balance October 1, 2002</u> | <u>Transfer and Additions</u> | <u>Transfer and Disposal</u> | <u>Ending Balance September 30, 2003</u> |
|---|--|---------------------------------------|--------------------------------------|--|
| Buildings | \$ 1,651,117 | \$ | \$ | \$ 1,651,117 |
| Dock | 2,629,778 | | | 2,629,778 |
| Fishing fleet | 1,676,004 | 59,693 | (474,680) | 1,261,017 |
| Refrigeration & cold storage equipments | 286,352 | | | 286,352 |
| Motor vehicles | 180,360 | | | 180,360 |
| Other equipment | 122,313 | 219 | (64,283) | 58,249 |
| Other capital asset | 55,411 | | (2,569) | 52,842 |
| | <u>6,601,335</u> | <u>59,912</u> | <u>(541,532)</u> | <u>6,119,715</u> |
| (Less): Accumulated depreciation | <u>(3,875,018)</u> | <u>(284,030)</u> | <u>260,680</u> | <u>(3,898,368)</u> |
| | <u>\$ 2,726,317</u> | <u>\$ (224,118)</u> | <u>\$ (280,852)</u> | <u>\$ 2,221,347</u> |

Depreciation expense recognized for the fiscal year ended September 30, 2004 and 2003 is \$182,184 and \$284,030, respectively.

7. DUE TO AFFILIATE

During fiscal year 2000, YFA added a donated used tuna longliner to its fleet of fishing vessels. In February 2000, YFA commissioned the Yap Fresh Tuna Inc. (YFTI), a 50% owned subsidiary, to outfit, staff, and manage the fishing vessel for commercial fishing. YFTI intermittently bills YFA for expenses incurred in operating the boat. In fiscal year 2003, the fishing vessel was no longer in operation and therefore, no transaction was ever recorded in fiscal year 2004. As of September 30, 2004, the inter-company payable to YFTI for expenses incurred and revenues earned in the operation of the boat during fiscal 2002 and 2003 is \$41,945.

8. CONTINGENT LIABILITIES

As of September 30, 2004 and 2003, YFA possessed a majority interest in the company of Yap Fresh Tuna, Incorporated. The minority shareholder in that company is the National Fisheries Corporation. YFTI has at all times maintained its own Board of Directors. YFTI, in turn, entered into a partnership agreement with Micronesia Petroleum Company (of Kosrae) in 1998. The venture, named MPC-Yap, continues to date. The MPC-Yap partnership has maintained its own Board of Directors at all times. In 2002, disagreements arose between MPC-Kosrae directors and Yap directors and operators of MPC-Yap. The

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Notes to Financial Statements
September 30, 2004 and 2003

CONTINGENT LIABILITIES (CONT.)

disagreements were negotiated over time and a Memorandum of Understanding was signed on or about September 12, 2003, under which MPC-Yap would be dissolved or transformed. Litigation was threatened by MPC-Kosrae before the agreement and has been threatened if the terms of the agreement are not met.

The agreement was reaffirmed on or about September 8, 2005, with payment terms from YFTI included for YFTI to buy out MPC-Kosrae's 55% interest in partnership for a total of \$200,000, spread out over less than one year. If such information is correct, YFA's ownership interest may be estimated at about 27%. YFA's potential liability in YFTI is limited to the capital already contributed, as it was legally incorporated and no specific allegation has yet been made to pierce the corporate veil. Therefore, no claim described herein has been asserted directly against YFA. The financial information provided by MPC-Yap could not be relied on and therefore, YFA's investment in MPC-Yap could not be determined.

During fiscal year 2003, YFA received \$103,028 in U.S. Federal Emergency Management Agency Public Assistance Grants (CFDA No. 83.516) for Typhoon Mitag under FEMA 1417 DMR-FM. The FEMA programs are subject to financial and compliance audits to ascertain if U.S. Federal laws and guidelines have been followed. \$87,471 of the FEMA expenditures during fiscal year 2003 was raised as questioned costs. If these costs are ultimately disallowed by FEMA, the State of Yap and/or YFA may be charged for the reimbursement to the grantor agency. No provision for any liabilities that may result upon the ultimate outcome of these matters has been made in the accompanying financial statements.

9. RISK MANAGEMENT

YFA 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 YFA.

10. RELATED PARTY TRANSACTIONS

In the ordinary course of business, YFA enters into transactions with private businesses and State departments and agencies in which certain of YFA's board members hold positions of influence.

In November 2000, the Board of Directors appointed the general manager of YFTI, a 50% owned subsidiary of YFA, to act as interim manager for YFA. During fiscal year 2003, YFTI ceased operations and its employees were transferred to the YFA payroll.

11. DONATIONS AND OTHER CONTRIBUTIONS

YFA was the recipient of the 2003/2004 Goods and Services Foreign Aid Assistance Package from the Government of Japan to the Federated States of Micronesia. Accordingly, donated equipments and tools worth \$120,547 received by YFA in November 2003 and February 2004 are included in property and equipment in the accompanying financial statements for the year ended September 30, 2004.

YAP FISHING AUTHORITY

Notes to Financial Statements
September 30, 2004 and 2003

11. DONATIONS AND OTHER CONTRIBUTIONS (CONT.)

In August 2004, YFA received \$69,220 from the Fisheries Extension Service Assistance Project funded by the Japan Overseas Fisheries Cooperation Foundation for the implementation of Fishing Recovery Project in Yap. The funds were intended for the purchase of a vehicle, outboard motor boats and fishing gears to be rented by YFA to community fishermen to allow them to fish and sell their catch back to YFA for an income. YFA advanced the total amount of \$69,220 to two local vendors for the purchase of the required assets. At September 30, 2004, vendors had not fulfilled YFA's purchase order, therefore, the cash on deposit with the vendors are presented as prepaid expenses on the accompanying balance sheet as of September 30, 2004.

12. OPERATING SUBSIDY

In September 2004, Yap State Legislature appropriated \$81,000 from the General Fund of Yap State under YSL 6-32 to subsidize the operation of YFA.

13. ASSET DISPOSAL AND INVENTORY LOSS

In fiscal year 2004 and 2003, the value of fishing gear inventory was written off resulting in a loss of \$7,972 and \$27,659 respectively. In February 2002, F/V Marwel sustained irreparable damage to its refrigeration system and the inability to replace or repair the refrigeration system in fiscal year 2003 undermined the utility of the vessel. Therefore, the value of the fishing vessel was written off resulting in a loss of \$280,852 for the year ended September 30, 2003.

14. TYPHOON LOSS

In fiscal year 2004, through the effects of Typhoon Sudal, YFA suffered major damages to its buildings and equipments and lost 100% of its fleet of fishing vessels, as well as its spare parts inventory. Management prepared and submitted applications for FEMA Public Assistance Funding through the Yap State Government to which U.S. FEMA approved grant authorizations for eight YFA projects worth \$339,093. Included in the amount is \$150,000 for the *F/V Mailap* approved with the condition that YFA must first obtain and submit to FEMA proof of insurance coverage for the vessel. Project worksheets for the remaining two vessels with a combined total of \$198,000 are still pending approval upon submission of YFA's proof of insurance coverage to FEMA. During the year ended September 30, 2004, an adjustment to write off the value of spare parts inventory damaged by the storm. In addition, a loss of \$128,311 was recognized for the net book value of the fishing vessels and other assets damaged by Typhoon Sudal.

15. IMPAIRMENT LOSS IN PMAIR

At September 30, 2003, YFA holds 20 shares of the common stock of Palau Micronesia Airlines (also known as Palau Rock Island Air). The shares have no stated par value. The investment of \$2,000 is carried by the cost method on the balance sheet as of September 30, 2003. In December 23, 2004, the Airline suddenly suspended its operations to reorganize and reevaluate its business strategy. It is not known when or if the airline will resume operation, therefore, YFA recorded the impairment loss of \$2,000 at September 30, 2004.

YAP FISHING AUTHORITY

Notes to Financial Statements
September 30, 2004 and 2003

16. LOSS ON INVESTMENT IN UNCONSOLIDATED SUBSIDIARY

YFA holds 50% of the shares of Yap Fresh Tuna, Inc. (See Note 2). Condensed unaudited financial information for YFTI for the years ended September 30, 2004 and 2003 are as follows:

| Balance sheet: | <u>2004</u> | <u>2003</u> |
|---------------------------------|---------------------|---------------------|
| Current assets | \$ 104,080 | \$ 115,846 |
| Property, plant and equipment | <u>4,105,747</u> | <u>4,098,947</u> |
| | <u>\$ 4,209,827</u> | <u>\$ 4,214,793</u> |
| Current liabilities | \$ 1,159,057 | \$ 1,160,533 |
| Long-term debt | 3,708,641 | 3,708,642 |
| Stockholder's equity | <u>(657,871)</u> | <u>(654,382)</u> |
| | <u>\$ 4,209,827</u> | <u>\$ 4,214,793</u> |
| Statement of revenue & expenses | | |
| Sales | \$ 28,078 | \$ 87,033 |
| Cost of sales | -0- | (747) |
| Operating expenses | <u>(32,994)</u> | <u>(373,189)</u> |
| Net loss | <u>\$ (4,916)</u> | <u>\$ (286,903)</u> |

During the year ended September 30, 2003 operations at YFTI ceased and its employees were transferred to YFA.

17. SUBSEQUENT EVENTS

As of February 2005, FEMA had approved grant authorization for eight YFA projects worth \$339,093 under FEMA FM-DR-1511. Included in the amount is \$150,000 for the F/V Mailap, approved with the condition that YFA must first obtain and submit to FEMA proof of insurance coverage for the vessel. Project worksheets for the remaining two vessels with a combined total of \$198,000 are still pending approval upon submission of YFA's proof of insurance coverage to FEMA. Management is of the opinion that YFA cannot afford insurance coverage for the vessels. The State of Yap is currently negotiating with FEMA to waive the insurance requirement. If the State of Yap is not able to successfully negotiate a waiver from FEMA, YFA or the State of Yap may have to fund the replacement cost of the three fishing vessels worth \$348,000.

In October 2005, the Japan Government through Fisheries Development Association of the Pacific Island Nations (FDAPIN) donated equipments and spare parts worth \$25,774 to replace YFA cold storage and shop equipments damaged by Typhoon Sudal.

YAP FISHING AUTHORITY

Notes to Financial Statements
September 30, 2004 and 2003

18. MARCH 24, 2006

In a March 2006 visit to Yap, the President/CEO of the National Fisheries Corporation (NFC), proposed to YFA (and its sole owner, the State of Yap) that NFC pull out of YFTI in its entire ownership and freely transfer all its rights and obligations in YFTI to YFA. The Office of the Governor plans to hold a series of meetings with interested parties in Yap to consider the appropriate State of Yap response to the NFC's proposal.



**OFFICE OF THE PUBLIC AUDITOR
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**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**

To the Board of Directors of
Yap Fishing Authority:

I was engaged to audit the financial statements of the Yap Fishing Authority (YFA), as of and for the year ended September 30, 2004, and have issued our report thereon dated November 16, 2005, which report was a disclaimer due to scope limitations presented by inadequate accounting records and lack of concrete action taken by management to address findings and recommendations of an agreed-upon-procedures engagement dated October 12, 2005, the unavailability of audited financial data for the Yap Fresh Tuna, Inc. (YFTI), a 50% owned subsidiary, and management's discussion and analysis which, although not a required part of the basic financial statements, is supplementary information required by the Government Accounting Standards Board. I conducted the audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered the YFA'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. However, I noted matters involving the internal control over financial reporting and its operation that I consider to be reportable condition. Reportable conditions involve matters coming to my attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in my judgment, could adversely affect YFA's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and as Findings No. 1 thru 14, 16, 18, and 19.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. My consideration on the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described in the Schedule of Findings, I consider Findings No. 3, 4, 6 and 7 to be material weaknesses.

Compliance

Compliance with laws, regulations, contracts, and grants applicable to YFA is the responsibility of the YFA's management. As part of obtaining reasonable assurance about whether the YFA's financial statements are free of material misstatement. I performed tests of the YFA'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 audit, and accordingly, I do not express such an opinion.

The results of my tests disclosed instances of noncompliance that I have reported to management as Findings No. 15 and 17.

This report is intended for the information of the management and Board of Directors of the Yap Fishing Authority and is not intended to be and should not be used 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

November 16, 2005

YAP FISHING AUTHORITY

Schedule of Findings
September 30, 2004

FINDING NO. 1 – BOARD MEETING MINUTES

Criteria: The elected Secretary of the Board of Directors should keep minutes for YFA Board meetings and should also be responsible for maintaining a file for the minutes.

Condition: Our review of the Board meeting minutes found that only two (2) minutes were available on file at YFA for meetings held after March 3, 2005 to the present. These meetings took place on March 7 and July 25, 2005. The minutes on file at YFA were still in draft form and were not signed by the elected secretary of the Board of Directors. Our audit for fiscal year 2003 also found that the secretary only attended one meeting, therefore, the minutes for the rest of the meetings were taken either by one of the Board members or the YFA office manager. We were aware of several meetings held by the Board in fiscal year 2005 for which minutes were not available.

Cause: YFA Board of Directors held several meetings to discuss matters involving employees at YFA. Due to conflicts of interest, the YFA office manager was not invited to attend such meetings and therefore, minutes were not taken.

Effect: When meetings are not properly documented, there is a greater risk that YFA will not conduct its operation in accordance with the authority of the Board.

Recommendation: I strongly recommend that the Board of Directors ensure that the secretary keeps minutes of all meetings, signs the minutes after adoption, and ensures that copies are kept on file at YFA.

FINDING NO. 2 – ACCOUNTABILITY OF GRANT RECEIPT

Criteria: Funds should only be expended upon receiving a valid invoice from vendors.

Condition: On August 26, 2004, YFA received \$69,220 from the Japan Embassy for the implementation of the Fishing Village Recovery Project also known as the Grassroots Project. On August 31, 2004, YFA paid two local vendors the amounts of \$57,710 and \$11,510 for a combined sum of \$69,220. The two payments were made based on quotations submitted by the two vendors. YFA immediately recorded the payments as expenses. Goods were not received from the vendors until November 2004 (FY05). Because YFA cancelled the purchase of some items on the original quotations, the two vendors were left with a combined balance of \$13,677 which has yet to be reimbursed to YFA.

Included in the \$13,677 was a certain amount quoted for fuel. Since the vendor who was advanced the funds for fuel was not in the business of selling fuel, YFA requested the vendor to return \$1,000 back to YFA in order to purchase fuel from MPC. We found no written agreements between the two vendors and YFA requiring the vendors to ensure that equipments and supplies quoted by the vendors be available when needed. Neither was there formal agreements requiring the vendors to return the unused portion of the purchase advances to YFA.

YAP FISHING AUTHORITY

Schedule of Findings
September 30, 2004

FINDING NO. 2 – ACCOUNTIBILITY OF GRANT RECEIPT (CONT.)

Cause: The above condition occurred because YFA did not follow proper procurement procedures requiring receipt of goods and final invoices before disbursement of funds.

Effect: YFA gave up custody of grant funds by advancing funds on purchase requisitions before goods were received. Because the two vendors were given full custody of the grant funds with minimum restrictions, YFA had very little control over the remaining funds.

Recommendation: YFA Management and its Board of Directors should establish policies and procedures over disbursements to ensure proper control over grants received. Moreover, YFA should require the vendors to return the unused portion of the purchase advances to YFA for deposit into YFA's bank account.

FINDING NO. 3 – UNALLOWABLE EXPENSES

Criteria: YFA should ONLY pay for expenses related to its operation.

Condition: Our review of expenses found that check #1797 for \$700 was paid to a local vendor for space rental of the "Blelach" fish market. The supporting invoice was billed to "Blelach" fish market. Further review found another two additional rental payments for the fish market, checks #1879 and #2028 for \$350 and \$525 respectively, bringing the total to \$1,575. We obtained a copy of the business license for the fish market and found that the former general manager of YFA was named as the owner of the fish market.

We also found that YFA incurred expenses totaling \$12,927 for the accommodations of Koyo Maru #78 crew and expenses relating to a crew member's remains. According to the office manager, such expenses were paid by YFA on a reimbursement basis as per verbal agreement between YFA former general manager and the Captain of Koyo Maru. Despite this verbal understanding, YFA expensed the amount and made no effort to bill Koyo Maru in fiscal year 2004.

Other non-YFA expenses incurred were for a Japanese group for \$2,254, travel fund used by employees for personal use for \$317, YFTI payroll expenses for \$1,000, repair services for a privately owned boat for \$720, equipments purchased for employees for \$1,996 and \$40 for leis and boat rental at Pathways.

Cause: It had been a common practice at YFA that payments were prepared immediately upon verbal instruction from the General Manager without questioning the validity of the expenses or requiring proper documentation of the expenses paid.

Effect: No documentary evidence was found to indicate that YFA would be reimbursed for expenses paid on behalf of the above parties. As a result, YFA paid a total of \$19,955 in fiscal year 2004 for expenses that were not related its operation.

YAP FISHING AUTHORITY

Schedule of Findings
September 30, 2004

FINDING NO. 3 – UNALLOWABLE EXPENSES (cont.)

Recommendation: I recommend that YFA Board of Directors require that payments are reviewed and approved by a member of the Board of Directors and management to ensure that expenses to be paid are related to the operation of YFA.

FINDING NO. 4 – INVENTORY OF FIXED ASSETS

Criteria: A periodic inventory of fixed asset should be conducted to verify the existence of assets and to identify obsolete, broken or missing assets.

Condition: Our review of fixed assets records for fiscal year ended September 30, 2004 found that YFA did not verify the existence of fixed assets and adjust the fixed asset register accordingly.

Additions to fixed assets in FY2004 of \$56,753 were not recorded to the general ledger and \$80,502 in disposals was not removed from the general ledger balance as of September 30, 2004. In addition, \$166,345 in depreciation expense was not recorded to the general ledger

Cause: YFA management did not require periodic physical inventory of fixed assets and updating of the fixed asset register. And the office staff was not capable of recording the necessary year-end transactions to reflect the value of fixed assets.

Effect: Because of the above condition, material adjustment was required to be made to the general ledger for proper disclosure in the financial statement. Furthermore, proper accountability over assets cannot be realized without an updated listing of assets owned by the Authority and therefore, there will be great risk in misstatement of fixed assets.

Recommendation: As recommended in FY00, YFA should conduct a physical inventory of its fixed assets to ensure that the assets listed on the fixed asset register are still in good working condition. Obsolete, damaged or missing assets should be removed from the listing. After the listing has been updated, it should then be reconciled to the general ledger.

Prior Year Status: The above recommendation was also offered in the audit reports for the years ended September 30, 2003, 2002, 2001 and 2000.

FINDING NO. 5 – UNNECESSARY PURCHASE OF FIXED ASSET

Criteria: YFA should only purchase equipments that are necessary for its operation.

Condition: Our review of fixed assets found that on May 28, 2004, YFA paid \$590 for a 20' chest type freezer that was recorded as an addition to equipment for cold storage section. A staff member from cold storage section informed us that that the freezer was kept at YFA per the instruction of the Interim General Manager. We were also told that the freezer was damaged during Typhoon Sudal in April 2004.

YAP FISHING AUTHORITY

Schedule of Findings
September 30, 2004

FINDING NO. 5 – UNNECESSARY PURCHASE OF FIXED ASSET (cont.)

Cause: YFA's management did not think it's important to limit expenditure of funds to YFA related activities.

Effect: Because YFA owns a freezer unit, a blast freezer, refrigeration and chiller unit worth \$100,000, we saw no need for YFA to purchase a chest type freezer, especially one that had been damaged by the typhoon. Such practice of unnecessary purchases increases the risk of purchases for personal use.

Recommendation: I strongly recommend that YFA Board of Directors ensure that policies and procedures are in place to mitigate the risk of abuse of YFA funds.

FINDING NO. 6 – UNTIMELY RECORDING OF SALES TRANSACTIONS

Criteria: Accounting principles require that sales transactions should be recorded to the general ledger in a timely manner to ensure completeness and accuracy of financial information.

Condition: During our audit for fiscal year 2004, we found that sales from August 14 through September 30, 2004 aggregating \$6,301 were not recorded to the general ledger. We asked YFA to record such sales before providing to us the final trial balance for the year ended September 30, 2004. When we reviewed the final general ledger details, we found that cash sales were not recorded to the general ledger for periods ranging from 11 to 58 days after the initial sales date.

Cause: A special engagement was performed on cold storage sales for the period of October 1, 2004 to May 12, 2005, which found that cash sales were not recorded to the general ledger on a timely basis. Further investigation found \$10,992 in cash sales was not recorded because cash had gone missing. In fiscal year 2004, the accounting clerk would verify daily sales report, recount cash collected and vouch it to the daily sales report. An official cash receipt would then be issued and recorded to the general ledger. So the delay in recording sales transactions was due to the unavailability of cash. Money collected from cash sales could be pilfered because access to YFA's safe was not restricted. Three employees had access to the safe.

Effect: Given the above conditions, we could not verify the completeness, validity and accuracy of the sales recorded in the general ledger. Accordingly, we were not able to form an opinion that revenue was fairly stated in the financial statements, resulting in a disclaimer of opinion.

Recommendation: The YFA Board of Directors should immediately take action on the recommendations given in the "Agreed Upon Procedures" engagement report. Furthermore, policies and procedures should be promptly in place to prevent the employees from manipulating sales records and receipts.

YAP FISHING AUTHORITY

Schedule of Findings
September 30, 2004

FINDING NO. 6 – UNTIMELY RECORDING OF SALES TRANSACTIONS (cont)

Prior Year Status: A similar finding was cited in the audit report for the year ended September 30, 2003.

FINDING NO. 7 – UNTIMELY DEPOSITS

Criteria: Cash collected should be banked immediately on the next business day after the sales date.

Condition: Our review of the general ledger details of fiscal year ending September 30, 2004 found that cash collected from sales were not immediately deposited to YFA bank account. In fiscal year 2003, the time gap between sales date and banking of cash collected ranged from 2 to 14 days. In 2004, the time lag had increased to 60 days.

Cause: Due to circumvention of internal control procedures, employees were able to borrow cash collected and delayed banking of cash and recording of cash sales transactions (see Finding #6). Deposits were made when cash was available or when cash subsequently collected was sufficient to cover what had been borrowed.

Effect: YFA employees had the opportunity to delay banking of cash collected and falsify sales information. Therefore, we could not rely on the validity and accuracy of sales amounts presented in the financial statements. Accordingly, we could not form an opinion that sales and revenue were fairly stated.

Recommendation: Same recommendation as Finding no. 6.

Prior Year Status: A similar finding was also cited in the audit report for the year ended September 30, 2003.

FINDING NO. 8 – EMPLOYEE RECEIVABLES

Criteria: Proper accounting controls require that receivables owed by employees should be immediately settled either by full payment or through biweekly payroll deductions.

Condition: At September 30, 2004, \$26,672 in employee receivables remained outstanding. Of the total, \$11,602 represented accounts with current activities. We reviewed activities up to August 31, 2005 and found very little payroll deductions credited against the account balances. Our estimate of the percentage of doubtful receivables increased from 98% in fiscal year 2003 to 100% in fiscal year 2004.

In addition we also found that fish and ice sales on account were recorded as employee receivables. Those sales on account increased receivable account balances for employees to \$25,395. Interestingly, our special engagement conducted on cold storage sales for the period of October 1, 2004 to May 12, 2005, found that \$10,990 in cash collected from cold storage sales was missing.

YAP FISHING AUTHORITY

Schedule of Findings
September 30, 2004

FINDING NO. 8 – EMPLOYEE RECEIVABLES (cont.)

Cause: Our audits for fiscal years 2001, 2002 and 2003 contained recommendations to minimize employee receivables to amounts that could be collected in a timely manner. YFA management did not implement the recommendations set forth in our audit findings for the past years with the result that employees continued to increase their receivables.

We explained to the accounting clerk during our audits for the above fiscal years that sales on account for employees should be recorded as trade receivables. Employee receivables would be cash advances and other receivables owed by employees. However, because of the lack of supervision and secondary review, the accounting clerk had sole discretion over the classification of transactions.

Effect: The lack of action taken on audit recommendations allowed employees the opportunity to continue to increase their receivables knowing that management would not require repayment of the balances.

Due to inadequate records, we could not determine whether increases to employee receivables were merely errors or whether such represented actual sales that would be reclassified to A/R trade at a later time. Accordingly, we found no assurance that employee receivable transactions were valid and accurate.

Recommendation: Recommendations that were made in the previous years were not implemented and therefore, we strongly recommend that YFA Management and its Board of Directors should discontinue sales on credit, cash advances and any form of receivables to YFA employees.

Prior Year Status: Similar findings were reported for the years ended September 30, 2001, 2002 and 2003.

FINDING NO. 9 - TRADE RECEIVABLES

Criteria: Proper accounting of receivables requires effective control over collection.

Condition: At September 30, 2004, a total of \$601,028 in trade receivables was still outstanding of which \$595,158 was fully reserved as uncollectible. The results of our review also showed that 95% of current receivables were not subsequently collected.

Cause: As mentioned in the other finding, YFA management did not implement the audit recommendations to cease allowing sales on credit. This gave employees the opportunity to continue increasing receivables.

Effect: The inability of YFA to manage its receivables results in a lack of working capital. For the year ended September 30, 2004, YFA requested \$81,000 from the State Legislature to fund its operations.

YAP FISHING AUTHORITY

Schedule of Findings
September 30, 2004

FINDING NO. 9 - TRADE RECEIVABLES (cont.)

Recommendation: We strongly recommend that the new YFA Board of Directors limit sales on credit to government agencies with valid purchase orders and well-established private businesses that have good credit history. The Board should require the YFA management and staff to begin an aggressive campaign to collect on trade receivable accounts.

Prior Year Status: This finding was cited for the YFA for the years ended September 30, 2003, 2002, 2001, 2000, and 1999.

FINDING NO. 10 – PETTY CASH FUND

Criteria: The petty cash fund is intended for immediate cash needs of the Authority and should be restricted for official use only.

Condition: The YFA staff had been using petty cash fund over the past years as a personal loan fund for their personal expenses. Amounts borrowed were added to employee receivables. During a surprise count of the petty cash, we found handwritten notes among the petty cash receipts with employee names and amounts borrowed without the evidence of the manager's approval.

Cause: YFA employees have been obtaining cash advances from the petty cash for personal expenses believing that it was allowable as long as they repaid the amounts borrowed.

Effect: Advancing from the petty cash fund have become a common practice among the staff members. When official purchases were necessary and the petty cash fund had been depleted, another replenishment of petty cash was prepared and amounts owed by employees were charged to their receivables accounts. Borrowing from the petty cash fund in addition to credit sales have increased employee receivables and as a result 100% of employee receivables was fully reserved as uncollectible in fiscal year 2004.

Recommendation: We recommend that YFA staff refrain using the petty cash fund for personal obligations and that management ensures that all cash out from the petty cash funds are for official purposes only.

Prior Year Status: Similar findings were also reported to YFA for the years ended September 30, 2001, 2002 and 2003.

FINDING NO. 11 - IMPROPER CLASSIFICATION OF EXPENSES

Criteria: Proper accounting principles require expenses to be properly classified in the general ledgers.

Condition: Our review of expenses for fiscal year 2004 found that of the 16 transactions tested, 8 transactions were posted to the wrong accounts. Shown below are the following transactions:

YAP FISHING AUTHORITY

Schedule of Findings
September 30, 2004

FINDING NO. 11 - IMPROPER CLASSIFICATION OF EXPENSES (cont.)

| Chk.# | Description | Amount | Account |
|--------------|--------------------------------------|------------------|-----------------------|
| 1634 | Repair for Catamaran | 720.00 | A/R Collection Agen. |
| 1797 | Space rental for Blelach fish market | 700.00 | Cold storage expense |
| 1800 | Office equips & supplies | 3,000.00 | Office supplies |
| 1837 | 20' chest freezer | 590.00 | Cold storage equip. |
| 1892 | Room charges for Japanese | 2,254.25 | Other income – admin. |
| 1916 | Piloting charges for Koyo Maru #78 | 875.00 | Other income – admin. |
| 1969 | To cover YFTI payroll | 1,000.00 | A/R trade |
| 2013 | Per-diem & o/supplies | 969.00 | Per-diem - admin |
| | Total | 10,108.25 | |

Our review of contractual services also found three (3) transactions aggregating \$4,695 erroneously recorded as contractual services. The actual transactions were fish & bait purchases of \$3,895 and \$800 in repair & maintenance of *F/V Fasiran*.

Cause: The office manager did not ensure that the general ledger accounts were reviewed and reconciled on a timely basis. Furthermore, YFA did not feel the necessity to ensure the accuracy of recorded transactions.

Effect: Because material error was found during our tests of review, the risk of misstatement of expenses to the financial statements was high.

Recommendation: I recommend that YFA Management and its Board of Directors that policies and procedures are in place to require secondary review and reconciliation of the general ledger accounts.

FINDING NO. 12 – MISSING SUPPORTING DOCUMENTATION

Criteria: Underlying supporting documentation should be available to substantiate transactions recorded in the general ledger.

Condition: Of the sixteen (16) expense transactions reviewed aggregating \$23,584, four (4) transactions worth \$3,608 were not supported by underlying documentation. Such transactions were – refund on charter, payment to YFTI to cover payroll expenses and travel advances.

Cause: The General Manager did not require the accounting staff to ensure sufficient documentation is maintained on file for transactions posted to the general ledger.

YAP FISHING AUTHORITY

Schedule of Findings
September 30, 2004

FINDING NO. 12 – MISSING SUPPORTING DOCUMENTATION (cont.)

Effect: Although the above amount was immaterial, preparing checks without adequate supporting documentation had become common practice at YFA. Because of inadequate segregation of duties, such practice increases the risk of unauthorized payments and even fraud.

Recommendation: We recommend that the General Manager require vendor invoices or other underlying supporting documentation to be obtained or prepared to support amounts disbursed. Moreover, YFA's management should ensure that staff members responsible for filing documents be more responsible and attentive in maintaining files in an orderly manner and secured from natural catastrophes.

Prior Year Status: A similar finding was also issued for the year ended September 30, 2003.

FINDING NO. 13 - LACK OF SEGREGATION OF DUTIES

Criteria: A good internal control system provides for adequate segregation of duties among staff members.

Condition: Our tests of controls over sales for fiscal year 2004, found that one person was responsible for receiving cash generated from sales, recording it in the general ledger and preparing deposit slips for banking. There was no indication of a second party verifying such transactions. The same person signed disbursement checks and used a signature stamp for the required second signature on checks.

Cause: Due to the small size of the entity and the small number of employees in the office inadequate segregation of duties was expected, however, management had not taken steps to ensure that appropriate secondary review procedures were instituted and implemented.

Effect: We found a greater risk of mishandling of cash as well as abuse due to the lack of secondary review of cash transactions.

Recommendation: We recommend that management delegate responsibility to another staff to verify or take on either the receiving of cash or the preparing of deposit to prevent abuse or mishandling of YFA funds.

Prior Year Status: A similar finding was also cited in the audit report for the year ended September 30, 2003.

YAP FISHING AUTHORITY

Schedule of Findings

September 30, 2004

FINDING NO. 14 – ANNUAL LEAVE BALANCE

Criteria: YFA should have a leave policy in place or at least follow the Yap State Government policy on annual leave accruals.

Condition: Our review of annual leave payable found that employees who were no longer employed at YFA still had leave balances worth \$785 at September 30, 2004. A former employee who had a receivable balance of \$9,077 claimed that until YFA deducted from his outstanding balances what was owed to him for earned but unused annual leave hours and overtime claimed, he would not repay his receivables.

Cause: YFA's personnel manual could not be located and the office staff could not recall whether employees were entitled to the cash equivalent of their unused annual leave balance after their employment at YFA was terminated.

Effect: Without written policies and procedures in place, YFA was not protected against such claims. No action was made toward the claim; neither was there an attempt to collect the receivable.

Recommendation: The Board of Directors should require management to ensure that personnel and other policies and procedures of the Yap State Government be followed at YFA until such time when YFA could come up with its own personnel policies and procedures.

FINDING NO. 15 – TRAVEL EXPENSES

Criteria: An entity that has not formalized its own policies and procedures should follow established policies and procedures and the attendant forms of the State Government.

Condition: Our review of expenses for the Yap Fishing Authority for the year ended September 30, 2004, found travel related transactions, check #s 2012 and 2013 in the amount of \$964 and \$969, respectively. The checks payable to employees of YFA were supposedly for per diem, car rental and office supplies. No underlying documentation was found to support each of the two payments that were immediately recorded to expense accounts. The combined checks aggregating \$1,933 was charged to expense accounts as follows: \$300 - office supplies, \$295 - transportation expense and \$1,338 - travel expenses.

Cause: Travel authorization forms and travel vouchers that would specify the types and amounts of expenses authorized for trips were not required and therefore, travel related transactions were recorded as expenses.

Effect: Travel expense for the year was not material to the financial statements, however, the absence of the proper forms to authorize, process, and record travel-related costs increased the risk of abuse and fraud.

Recommendation: We recommend that the manager and Board of Directors ensure that YFA adopts the State travel forms and ensure that travel costs are authorized and recorded consistently with State policies on travel.

YAP FISHING AUTHORITY

Schedule of Findings
September 30, 2004

FINDING NO. 15 – TRAVEL EXPENSES (cont.)

Status: This finding was also cited in the audit report for YFA for the year ended September 30, 2003.

FINDING NO. 16 – PAYROLL DEDUCTIONS PAYABLE

Criteria: Proper accounting controls require periodic reconciliation of the general ledger.

Condition: The trial balance at September 30, 2004 included minor accounts with obviously incorrect balances, i.e. payroll liability accounts with debit balances. Our review of such balances found that most of the September 30, 2004 balances were results of unadjusted errors in the beginning balances.

This was repeat finding from fiscal year 2003 which had not been resolved by YFA Management and staff. Before we began our fieldwork we asked YFA to review the accounts and make the necessary adjustments. But when we received the final trial balance in September 2005, only a few payable accounts had been adjusted and the rest remained the same. According to the accounting clerk, she didn't know the reason why the beginning balances were incorrect and therefore, she did not want to make adjustments to correct them.

Cause: The accounting clerk and the office manager, both responsible for maintaining the general ledger did not make the effort to correct the errors identified.

Effect: Although amounts involved are not material to the financial statements, YFA is responsible for providing financial information that is complete and accurate and recorded in accordance with generally accepted accounting principles.

Recommendation: We recommend that manager and Board of Directors ensure that the accounting clerk be held responsible for the accuracy of the financial records. We also recommend that the office manager and accounting clerk be required to establish and maintain a periodic schedule for reconciling the general ledger to ensure the availability of an auditable trial balance within a reasonable timeframe after year end.

Status: This finding was also cited in the audit report for YFA for the year ended September 30, 2003 .

FINDING NO. 17 - COSTS CHARGED TO FEDERAL GRANTS

Criteria: OMB Circular A-87 requires that costs charged to federal grants should be adequately documented. We expected that valid claims of expenses whether by general ledger expense accounts or by reference to checks and invoices would be consistent with the general ledger details of the same period or at least be consistent with YFA's controlling records.

YAP FISHING AUTHORITY

Schedule of Findings
September 30, 2004

FINDING NO. 17 - COSTS CHARGED TO FEDERAL GRANTS (cont.)

Condition: Our review of YFA Harbor Clean-up project funded by FEMA and Yap State Government under Disaster Declaration FEMA-1511 – DR – FM for Typhoon Sudal found that YFA received through Yap State Government \$873.75 for the use of its boat for the total of 26 hours. PW#381 stated that YFA was eligible for funding for the use of its boat for a total of 56 hours. As per discussion with YFA office staff, YFA provided boat for use for the Army divers from June 14 – 16, 2005 but the length of time of the boat usage was never documented.

YFA used a Contractor to be responsible in the Harbor Clean-up Project and as per Agreement, “YFA may retain so much of the Contractor’s compensation as may be necessary to cover the costs of any YFA resources that Contractor may have used”. Our review also found that YFA claimed to the Contractor costs for the use of boat and forklift for 37 and 13 hours respectively. The log for boat and forklift usage showed that the boat was used for 22 hours and 7 hours for the forklift usage. No documentary evidence was found to substantiate those hours differences (15 and 6 hours) between YFA’s claim and its log sheets for boat and forklift usage. We accepted the variances as FEMA did not strictly stated the number of hours for equipment usage by the Contractor, however, YFA should substantiate those costs of its resources that the Contractor had used.

Cause: Under the Project Worksheet (PW) for Harbor clean-up, YFA agreed to a force account for equipment which stated that YFA would provide boat for 56 hours for the use of its boat. The completed phase of the clean-up in which YFA provided boat for 26 hours to the Army Divers was certified by the FEMA inspectors and therefore, FEMA approved that YFA be reimbursed for boat usage for 26 hours @ \$33.00 per hour, which totaled to \$873.75.

The second condition happened because the Contractor was an employee of YFA, and was also being compensated by YFA at the time of the Contract. Contractor did not question the difference in hours charged to him as YFA provided all the resources, i.e. labor, equipments, boats and even fuel.

Effect: Because the State Government was not appropriately screening reimbursement claims for FEMA projects, \$1,718.75 in unsubstantiated costs were paid to YFA.

Recommendation: We recommend that the General Manager formally adopt a policy requiring future reimbursement requests to the State Government to be based on and supported by general ledger account details and/or copies of YFA checks and vendor invoices.

Status: A similar finding was issued for the YFA audit report for the year ended September 30, 2003.

YAP FISHING AUTHORITY

Schedule of Findings
September 30, 2004

FINDING NO. 18 – DOUBLE COMPENSATION FOR THE SAME HOURS

Criteria: An employee should not be compensated by two entities for the same hours worked.

Condition: Our audit procedures for fiscal year 2004 found that an employee who was compensated at YFA for a total of \$4,160 from October 1, 2003 to September 30, 2004 was also being compensated at YFTI for \$3,500 during the same period. It seemed that such employee getting compensated for the same hours worked from both entities. No documentary evidence was found to substantiate or show that such employee was eligible to be compensated from both entities.

Cause: The above employee is responsible in maintaining financial records for both YFA and YFTI. Secondary review on financial transactions for both entities was never done. In addition, the same personnel were responsible in the preparation and authorization of transactions for both entities.

Effect: With the above cause, there is great risk of fraud, waste and abuse.

Recommendation: We strongly recommend that the YFA Board of Directors require that employees of YFA maintain YFA financial records and YFTI financial records should be given to a different person.

FINDING NO. 19 – SEGREGATION OF YFA AND YFTI ACTIVITIES

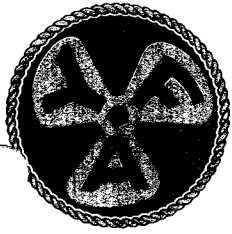
Criteria: YFA and YFTI are two different entities and therefore activities of one entity should be segregated from the other.

Condition: During our review of YFA projects that were to be funded by FEMA and the State Government under FEMA-FM – DR1511 Typhoon Sudal found that costs totaling \$5,125 was claimed to be reimbursed to YFA whereas, such costs were recorded by YFTI as its liability as of September 30, 2004. In another PW, YFA listed 6 units UPS backups that needed to be replaced. In May 2004, 5 units UPS backups were purchased in Guam using YFTI checks for use at the YFA office.

Cause: The Interim General of YFA who was also the General Manager of YFTI felt that it is his responsibility to manage the two entities and therefore did not see the necessity of segregating financial activities of one entity from the other.

Effect: Although the above condition did not have a material impact on YFA financial statements, these two entities have different sets of books with different activities. Until the leaders of Yap State decided to merge these two entities under one, activities of one should be segregated from the other.

Recommendation: I strongly recommend that the YFA Board of Directors consider this situation and require that persons independent of YFTI be the General Manager of YFA and accounting clerk of YFA.



YAP FISHING AUTHORITY

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January 11, 2006

Office of the Public Auditor
Yap State Government
Colonia, Yap State FM 96943

RE: YFA 09/30/04 Audit

Dear Public Auditor

The Board and Management of the Yap Fishing Authority have reviewed the September 30, 2004 YFA audit and following are our responses to the findings noted in the audit.

Sincerely;



Joe Giliko
YFA Board

Cc: YFA
Board members:
George Garangmaw
Jesse Faimau
Marcellino Jibemai

Schedule of Findings (YFA Audit - Sept. 20, 2004)

Finding No. 1 - Board Meeting Minutes.

The current board of directors of YFA was recently organized in or around 2005 but after the audit period. The YFA Board does recognize the importance of meeting minutes and have recommended that the Chairman appoint a staff of the Department of R&D along with the YFA secretary to take minutes of all forthcoming YFA Board meetings. The minute taking responsibilities will be shared by both and as convenient to their own time and the meeting purpose, place and time.

Finding No. 2 - Accountability of Grant Receipt.

The Board/Management has reviewed this finding and concurs that any funds allocated to the Authority should be accounted for and administered per fund guidelines by the Authority. Yap Fishing Authority is requesting the two vendors to return the balance of the funds to YFA, and to be administered/dispensed per YFA/Japan Embassy agreement

Finding No. 3 - Unallowable Expense.

The board has reviewed this finding and has decided to review the existing signatories to the YFA bank account. The Board is recommending 2 board members and 2 YFA staffs, preferably management staffs, to be the authorized signatories to the YFA account. Any two of the above can incur valid expenses against the YFA account. All expenses greater than \$100.00 requires one of the two board members signatures.

Finding No. 4 - Inventory of Fixed Assets.

The Board has assigned management to conduct a physical inventory of all fixed assets including condition of assets for the board's review. The Board/Management are targeting February 09, 2006 (30-days) to complete the listing. Moreover, annual inventory count will be conducted each and every year for review.

Finding No. 5 - Unnecessary Purchase of Fixed Assets.

The Board have reviewed this finding and concurs that board oversight needs to be in place over all purchase. The board further feels its recommendations to change account

signatories (ref. Finding No. 3) should control managements discretion over future purchases.

Finding No. 6 - Untimely Recording of Sales Transactions.

The board concurs with this finding and have adopted the "Agreed Upon Procedures" to be implemented by YFA Management. Furthermore, an ongoing internal investigation into the problems has been initiated for further corrective actions, including collections of YFA funds.

Finding No. 7 - Untimely Deposits.

This finding is related to finding No. 6. (Refer to above for corrective actions).

Finding No. 8 - Employee Receivables.

The board concurs with this finding to control employee receivables. Specifically, the board has agreed to review the listing of employee receivables and 1) pursue collections from all employees thru salary deductions and from former employees with the Attorney Generals Office assistance. 2) Limit the petty cash fund to only \$50.00 for small cash purchases only. 3) Ban employee "borrowing" from the cash funds or any YFA accounts.

Finding No. 9 - Trade Receivables.

Similar to finding No. 8, the board is requesting YFA management to provide a detailed listing of all trade receivables. Upon a status review of each account, pursue collections of all due trade receivables with the Attorney General's Office assistance.

Finding No. 10 - Petty Cash Fund.

The Board agrees that the Petty Cash Fund should be used for official purposes only. Because of the smaller operations comparatively to previous years, the Board has reduced the Petty Cash Fund to only \$50.00 and only for official purpose.

Finding No. 11 - Improper Classification of Expenses.

The board agrees with the finding and has further agreed to hire a qualified "controller" for the Authority. Furthermore, trainings in basic accounting/bookkeeping will be targeted for all key management staffs.

Finding No. 12 - Missing Supporting Documentation.

The board concurs and feels that a qualified "controller" along with the management can ensure all transactions are recorded properly including documentation of transactions.

Finding No. 13 - Lack of Segregation of Duties.

The board has reviewed this finding and has decided that upon obtaining key management staff along with the implementation of the "agreed upon procedures" will alleviate this concern.

Finding No. 14 - Annual Leave Balance.

The board has decided that such issues are usually addressed in "employee or operations manuals", which is not in existence for the Yap Fishing Authority. Consequently, the Board has agreed to develop a new manual for the authority and to adopt related government policies for the time being, until such manual is drafted and promulgated for the Authority.

Finding No. 15 - Travel Expenses.

Similar to finding No. 14, the board agreed the new "Manual" should also address travel expenses for the Authority.

Finding No. 16 - Payroll Deductions Payable.

The board concurs with this finding and has decided that the anticipated controller for the authority should be controlling these issues with the Manager. Furthermore, the envisioned "manual" will provide general guidelines for Management to work within.

Finding No. 17 - Costs Charged to Federal Grants.

The board could not determine the reasons for an YFA employee to independently contract for an YFA project. The board however, agrees with the finding and will work with management to ensure all future reimbursements be supported with proper documentations.

Finding No. 18 - Double Compensation for the Same Hours.

The board have reviewed this finding and based on preliminary discussions with the Public Auditor, agrees that the YFTI financial records be given to a third party (Division of Finance) to handle.

Finding No. 19 - Segregation of YFA and YFTI activities.

As finding No. 18, the board agrees that the removal of the YFTI account to an independent entity (Yap Finance Division) will resolve YFA and YFTI financial transactions to each respective entity.