YAP FISHING AUTHORITY

Financial Statements and Independent Auditor's Report Fiscal Years Ended September 30, 2006 and 2005

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EXECUTIVE SUMMARY

Financial Audit of the
Yap Fishing Authority
for the Years ended September 30, 2006 and 2005

The Office of the Yap State Public Auditor was engaged to audit the Yap Fishing Authority for the years ended September 30, 2006 and 2005 and has issued its report dated February 5, 2008. Due to scope limitations presented by inadequate accounting records and other factors explained in the Independent Auditor's Report on page 1, I was unable to determine whether the financial position of YFA as of September 30, 2006 and 2005 nor the results of its operations and cash flows for the years then ended were fairly presented. Fiscal year 2006 is the fourth 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, 2006 and 2005, YFA incurred $18,258 and $1,328, respectively, in expenses related to public assistance projects for Typhoon Sudal.

The report on internal control over financial reporting and compliance and other matters required *by Government Auditing Standards* on page 14 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 16. Of the 17 findings, Findings No. 5 and No. 7 are considered to be material weaknesses. Most of the seventeen findings are related to inadequate controls over financial reporting, nine of which are repeat findings from the prior years.

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

Findings Nos. 1 thru 4 discusses missing or inadequate policies relating to:

- YFA's right to lease property and assess fees on the buildings and other facilities adjacent to the its complex,
- Consistent withholding of taxes from permanent and temporary employees
- Criteria for contractor selection
- Vehicle policy

Findings Nos. 5 thru 17 relates to internal control deficiencies, most of which are repeat findings from the prior years. Unless the Board requires management to correct the deficiencies cited in controls over financial reporting, YFA would remain inauditable for the coming years.

Subsequent to the date of this report, initial procedures for the audit of YFA for the year ended September 30, 2007 found a further deterioration in YFA's accounting records with a consequential loss of cash collections in excess of $4,000. This matter was brought to the attention of the Board in a letter dated April 2, 2008. We commend the Board of YFA for taking swift action to investigate the situation, make management changes, and ensure that FY07 accounting records were reconciled to allow the fiscal year 2007 audit to continue.

We thank the Board of Directors, the management and staff of YFA for their assistance and support during the course of this audit.

Gertrude Gootinan

Gertrude Gootinan
Yap State Public Auditor
May 26, 2008

YAP FISHING AUTHORITY
Years ended September 30, 2006 and 2005

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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, 2006 and 2005 and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the YFA management. My responsibility is to express an opinion on these financial statements based on my audits.

I was unable to obtain a properly reconciled trial balance for fiscal year 2005. Moreover, documentation to support the carrying value of property and equipment were also unavailable. In addition, because of inadequate accounting records, I was unable to satisfy myself that revenues and expenses in fiscal year 2005 were consistently recorded between 2005 and 2004.

In fiscal year 2006, documentation was not available to substantiate the carrying value of YFA's fishing dock of $1,538,661 and $1,604,405 representing 73% and 84% of property and equipment as of September 30, 2006 and 2005, respectively.

As discussed in Note 2, the YFA reports the investment in Yap Fresh Tuna, a 50% owned subsidiary in which YFA is deemed to have controlling interest, on the equity method which carrying value at September 30, 2006 and 2005 is $398,016. In my opinion, the financial statements of YFA should be consolidated with the financial statements of YFTI to be in conformity with accounting principles generally accepted in the United States of America. Audited financial information for YFTI is unavailable since 1999, therefore, the impact of consolidation on YFA's assets and liabilities as of September 30, 2006 and 2005 is indeterminable.

YFTI ceased operations in FY03, but has not been officially dissolved to allow a decision to be made by the joint venture partners, Yap Fishing Authority and the National Fisheries Corporation, relating to the transfers or disposals of YFTI's assets and liabilities which carrying value at September 30, 2006 is $4,216,222 and $4,868,608, respectively, and $4,216,671 and $4,869,057 at September 30, 2005. Accordingly, the outcome of any potential dissolution of YFTI on the financial statements of YFA cannot be presently determined.

Since YFA did not provide documentation to support the carrying value of its dock, I was unable to form an opinion as to the fair presentation of property and equipment as of September 30, 2006 and 2005. Because of the this scope limitation and the significance of the uncertainties described in the preceding paragraphs, I am unable to express, and I do not express an opinion on the Yap Fishing Authority's financial position as of September 30, 2006 and 2005 and the results of its operations and cash flows for the years then ended.

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.

The accompanying Schedule of Expenditures of Federal Awards (page 6) is presented for the purpose of additional analysis and is not a required part of the financial statements. This schedule is the responsibility of YVB'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 February 5, 2008 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

Gertrude Gootinan
Yap State Public Auditor

February 5, 2008, except for Note 12 which date is April 2, 2008.

YAP FISHING AUTHORITY

Balance Sheets
September 30, 2006 and 2005

ASSETS		2006		2005
Current Assets				
Cash	$	5,513	$	45,048
Investments in unconsolidated subsidiary		398,016		398,016
Trade receivables, net		20,038		21,760
Prepaid expense		2,798		11,833
Employee receivables, net		629		1,358
Travel advance		1,216		--
Due from grantor		1,754		--
Total current assets		429,964		478,015
Property and equipment, net		2,115,100		1,861,959
TOTAL ASSETS	$	2,545,064	$	2,339,974
LIABILITIES AND NET ASSETS				
Current liabilities				
Accounts payable	$	13,462	$	14,016
Accrued payroll and others		4,303		2,630
Due to affiliate		41,945		41,945
Due to the State Government		35,325		35,325
Total current liabilities		95,035		93,916
Contingencies				
Net Assets				
Invested in capital assets		2,115,100		1,861,959
Unrestricted		334,929		384,099
Total net assets		2,450,029		2,246,058
TOTAL LIABILITIES AND NET ASSETS	$	2,545,064	$	2,339,974

See accompanying notes to financial statements

YAP FISHING AUTHORITY

Statements of Revenues, Expenses and Changes in Net Assets
Years ended September 30, 2006 and 2005

	2006	2005
Operating revenues		
Fish and ice sales	$ 63,951	$ 49,037
Charter and rental income	50,799	38,898
Other income	15,863	21,094
Other sales	3,382	4,320
Fishing rights and dockage fees	2,470	625
Total operating revenues	136,465	113,974
Operating expenses		
Depreciation	180,928	183,184
Utilities	62,685	52,785
Payroll, taxes and benefits	51,979	37,452
Other	49,387	69,432
Bad debt expense	32,313	9,092
Contractual services	3,408	14,287
Travel	--	2,681
Total operating expenses	380,700	368,913
Loss from operations	(244,235)	(254,939)
Nonoperating revenues/(expenses)		
Intergovernmental contribution	458,112	1,328
Loss on disposal of assets	(11,641)	(3,000)
Other income	1,735	1,782
Gain on investment in unconsolidated subsidiary	--	2,742
Total nonoperating revenues	448,206	2,852
Changes in net assets	203,971	(252,087)
Net assets at beginning of year	2,246,058	2,498,145
Net assets at end of year	$ 2,450,029	$ 2,246,058

See accompanying notes to financial statements

YAP FISHING AUTHORITY

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

	2006	2005
Cash flows from operating activities		
Receipts from customers	$ 118,942	$ 70,872
Receipts from other operating activities	16,275	39,272
Cash payments for goods and services	(123,480)	(98,751)
Cash payments to employees	(49,577)	(38,015)
Net cash used for operating activities	(37,840)	(26,622)
Cash flows from noncapital financing activities		
Other receipts/(expenses)	1,735	(1,218)
FEMA grant receipts	18,258	1,328
Net cash provided by (used for) noncapital financing activities	19,993	110
Cash flows used for investing activities		
Acquisition of fixed assets	(21,688)	(6,000)
Net cash used for investing activities	(21,688)	(6,000)
Net increase (decrease) in cash	(39,535)	(32,512)
Cash, beginning of year	45,048	77,560
Cash, end of year	$ 5,513	$ 45,048
Reconciliation of operating loss to net cash used for operating activities:		
Loss from operations	$ (244,235)	$ (254,939)
Adjustments to reconcile loss from operations to net cash used for operating activities		
Depreciation	180,928	183,184
Donated spare parts	13,334	--
(Increase)/decrease in assets		
Due from grantor	(1,754)	10,278
Trade receivables	1,722	(15,890)
Employee receivables	729	(1,358)
Travel advance	(1,216)	--
Prepaid expense	11,533	57,387
Increase/(decrease) in liabilities		
Accounts payable	(554)	(6,079)
Accrued payroll and other	1,673	795
Net cash used for operating activities	$ (37,840)	$ (26,622)
Supplemental disclosures of noncash transactions		
Intergovernmental contributions which increased property, plant & equipment	$ 444,725	$ 23,074
Loss on disposal of assets which decreased property, plant & equipment	$ 11,641	$ --

See accompanying notes to financial statements

YAP FISHING AUTHORITY

Schedules of Expenditures of Federal Awards
Years ended September 30, 2006 and 2005

Grantor/CFDA #/Grantor's Program Title	CFDA #	FY06 Expenditures	FY05 Expenditures
Federal Emergency Management Agency Grant FEMA-FM-DR1511 Typhoon Sudal Public Assistance Grant – Yap Fishing Authority (Note 1)	83.516	$18,258	$1,328
TOTAL FEDERAL AWARDS EXPENDED		$18,258	$1,328

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.

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.

Accounting Standards - Government Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting" requires that proprietary activities apply all Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. YFA implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

YFA has adopted GASB Statement No. 34 *(Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments)* which 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 nonexpendable restricted net assets as at September 30, 2006 and 2005.

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

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

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

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

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

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

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

In July 2004, GASB issued Statement No. 45, "*Accounting and Financial Reporting by Employers for post employment Benefits Other than Pensions*". GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other post employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of Statement No. 45 will have a material effect on the financial statements of YFA.

In September 30, 2006, GASB issued Statement No. 48, "*Sales and Pledges of Receivables and Future Revenue and Intra-Entity Transfer of Assets and Future Revenues*". GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. The Statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. The provisions of this Statement are effective for periods beginning after December 15, 2006. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of YFA.

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, 2006 and 2005 are fully collateralized as such are subject to Federal Deposit Insurance Corporation (FDIC) coverage.

Depreciation – 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 2005 balances in order to conform to the 2006 presentation.

2. INVESTMENT IN UNCONSOLIDATED SUBSIDIARY

At September 30, 2006 and 2005 YFA holds an investment in an unconsolidated joint venture with the National Fisheries Corporation (NFC). YFA has a 50% interest in Yap Fresh Tuna Inc. with a carrying value of $398,016 at September 30, 2006 and 2005.

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 and the State of Yap, through YFA, became the controlling partner. In 2003, YFTI unofficially ceased operations. YFA continued to record incidental rental income and expenses for YFTI facilities, but does not record depreciation and interest expense. Accordingly, no adjustment has been made to the carrying value of the investment in YFTI as of September 30, 2006.

YAP FISHING AUTHORITY

Notes to Financial Statements
September 30, 2006 and 2005

3. TRADE RECEIVABLE

A summary of trade receivables at September 30, 2006 and 2005 is presented below:

	2006	2005
Regular trade customers	$ 449,145	$ 458,887
Affiliates of YFA	114,273	107,160
Yap State departments and agencies	30,324	24,782
Officers and employees	50,462	19,437
	644,204	610,266
Less: allowance for doubtful accounts	(624,166)	(588,506)
Trade receivables, net	$ 20,038	$ 21,760

4. EMPLOYEES RECEIVABLE

A summary of employees' receivable is presented below:

	2006	2005
Employees receivable	$ 36,718	$ 25,395
Less: Allowance for doubtful accounts	(36,089)	(25,395)
	$ 629	$ --

5. PROPERTY AND EQUIPMENT

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

	Beginning Balance October 1, 2005	Prior Period Adjust-ments	Transfers and Additions	Transfers and Disposals	Ending Balance September 30, 2006
Buildings	$ 1,600,000	$	$ 13,132	$	$ 1,613,132
Dock	2,629,778				2,629,778
Fishing fleet			414,080		414,080
Refrigeration & cold storage equipments	269,986	589		(19,086)	251,489
Motor vehicles	128,799	32,873		(25,868)	135,804

Other equipment	122,404	8,483	18,369	(58,630)	90,626
Other capital asset	1,159		--	--	1,159
Total cost	4,752,126	41,945	445,581	(103,584)	5,136,068
Less: accumulated depreciation	(2,890,167)	(41,815)	(180,928}	91,942	(3,020,968)
	$ 1,861,959	$ 130	$ 264,653	$ (11,642)	$ 2,115,100

	Beginning Balance October 1, 2004	Transfers and Additions	Transfers and Disposal	Ending Balance September 30, 2005
Buildings	$ 1,600,000	$	$	$ 1,600,000
Dock	2,629,778			2,629,778
Fishing fleet				
Refrigeration & cold storage equipments	269,986			269,986
Motor vehicles	122,799	6,000		128,799
Other equipment	122,404			122,404
Other capital asset	1,159			1,159
Total cost	4,746,126	6,000		4,752,126
(Less) accumulated depreciation	(2,706,983)	(183,184)		(2,890,167)
	$ 2,039,143	$ (177,184)	$	$ 1,861,959

Depreciation expense recognized for the year ended September 30, 2006 and 2005 is $180,928 and $183,184, respectively.

6. DUE TO AFFILIATE

In fiscal year 2000, YFA added a donated used tuna long-liner, the *FV Marwel*, to its fishing fleet. YFA commissioned the Yap Fresh Tuna, Inc. (YFTI), a 50% owned subsidiary, to outfit, staff, and manage the *FV Marwel* for commercial fishing. YFTI intermittently billed YFA for expenses incurred in operating the boat which aggregated $41,945 as of September 30, 2002. YFTI ceased operations in fiscal year 2003. However, it has not been formally dissolved to allow YFA to settle its inter-company receivables and payables. Management intends to work with its joint venture partner, the National

Fisheries Corporation (NFC) to reach an agreement on the disposal of YFTI's assets and liabilities in order to formally dissolve the Yap Fresh Tuna, Inc. Accordingly, the $41,945 due to YFTI is still shown as a liability as of September 30, 2006 and 2005.

7. DUE TO YAP STATE GOVERNMENT

This has been a long-standing payable on YFA's books for which original records have been lost. Attempts to confirm the $35,325 balance at September 30, 2006 and 2005 with the State Finance has failed to produce information that would allow management to settle the account. Management intends to further investigate the balance with State officials and pursue forgiveness of the debt should the State Finance fail to produce reliable records to confirm the debt.

8. CONTINGENT LIABILITIES

Pending Dissolution of YFTI – In March 2006, the President of NFC made a verbal offer to Yap State officials for NFC to relinquish its interest in YFTI. In response, the YFA Board of Directors resolved on May 26, 2006 to take the necessary steps to ultimately dissolve YFTI. At September 30, 2006, official action had not been taken to dissolve YFTI. Accordingly, due to uncertainties relating to the ultimate disposal or transfers of its assets and liabilities which carrying value is $4,216,222 and $4,868,608 respectively at September 30, 2006 and $4,216,671 and $4,869,057 respectively at September 30, 2005, it is expected that the eventual dissolution of YFTI could potentially alter the financial statements of YFA as presented for the years ended September 30, 2006 and 2005.

Disputed payables – As of September 30, 2006, $4,246 worth of unpaid invoices in the name of YFA exits with two local vendors. Management is of the opinion that the invoices were not for official expenses and should be billed to the employees who obtained the goods on credit. Should management be unsuccessful in clearing YFA's name from the invoices, the Authority may be required to use its funds to settle the liability.

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. INTERGOVERNMENTAL CONTRIBUTIONS

Monetary and donated goods and services during the year ended September 30, 2006 and 2005 comprised the following:

	2006	2005
Overseas Fishery Cooperation Foundation	$ 439,854	$ --
FEMA Grant	18,258	--
	$ 458,112	$ --

Under the terms of a Memorandum of Agreement between the Government of the Federated States of Micronesia and the Overseas Fishery Cooperation Foundation (OFCF), OFCF would provide technical assistance to Yap Fishing Authority to contribute to the development of the local fishery. OFCF is a foundation operating under the Fishery Division of the Government of Japan to administer and implement fishery assistance grants from the Government of Japan to coastal countries throughout the world.

Goods and equipment received under the project during fiscal year 2006 include equipment and spare parts worth $25,774 and a tuna long-liner, the *FV Mathawalyap*, valued at $414,080. The value of the donated goods is recorded as nonoperating revenue in the accompanying financial statements.

During the year ended September 30, 2006, YFA completed the rebuilding and repairs of certain buildings damaged in April 2004 by Typhoon Sudal. Total FEMA Public Assistance Grant funding expended for the projects in fiscal year 2006 totaled $18,258.

11. OTHER EXPENSES

Provided below is the breakdown of Other Expenses for the years ended September 30, 2006 and 2005:

	2006	2005
Gagil-Maap Grassroots project	$ 3,530	43,127
Workshop expense	7,579	8,543
Communication	3,570	5,165
General administrative expenses	8,967	--
Miscellaneous	4,085	5,255
Cold storage repairs & maintenance	14,496	3,256
Office supplies	1,305	2,878
Representation and entertainment	4,547	1,208
Fleet expenses	1,308	--
	$ 49,387	$ 69,432

12. SUBSEQUENT EVENT:

April 2, 2008 – In response to certain matters brought to the attention of the Board relating to the audit of the financial statements of YFA for the year ended September 30, 2007, the Board has assigned one of its members to oversee the daily affairs of the Yap Fishing Authority until the recruitment of a general manager.

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

To the Board of Directors of
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, 2006, and have issued my report thereon dated February 5, 2008, which report was a disclaimer due to scope limitations presented by the lack of underlying documentation to support the cost of property and equipment and audited financial information for its unconsolidated subsidiary Yap Fresh Tuna, Inc. and uncertainties relating to the potential transfer and disposal of assets and liabilities associated with the potential dissolution of the fifty percent owned unconsolidated subsidiary, Yap Fresh Tuna, Inc. 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. My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Of the matters reported to management in the Schedule of Findings, I consider Findings Nos. 5 and 11 to be material weaknesses.

Compliance

As part of obtaining reasonable assurance about whether the YFA's financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit and accordingly, I do not express such an opinion. The results of my tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards* which are presented as Findings Nos. 1 through 4 in the accompanying Schedule of Findings.

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.

Gertrude Gootinan

Gertrude Gootinan
Yap State Public Auditor

February 5, 2008

YAP FISHING AUTHORITY

Schedule of Findings
September 30, 2006

FINDING NO. 1 – RIGHTS TO LEASE PROPERTY AND ASSESS FEES

Criteria: Yap Fishing Authority's rights to its buildings and other facilities and the land and water adjacent to its locale which are owned by the State Government should be documented in writing to allow management the discretion and the flexibility to charge rental and other fees as a means of generating income.

Condition: Our review of services and rental income for the year ended September 30, 2006 found that YFA was not billing and receiving lease payments from all tenants of the old Ting Hong cold storage facility. For example, the Department of Education and a local exporter/retailer are tenants of the building. The Department of Education has been using the facility rent free since fiscal year 2003 whereas the other tenant continues to pay rent to YFA for its use of the same facility.

The State Government owns the former Ting Hong facility, but YFA believed that it received in writing authorization from a former Governor to manage the Ting Hong facility soon after the departure of the Ting Hong Fishing Company. Despite assistance of the Attorney General's Office, a copy of the letter has not been located. Consequently, the Governor's Standing Lease Committee by virtue of the facility being State property is also laying claim to the rights to lease the facility.

In fact, in August 2003 in response to YFA's attempt to collect on back rent from the Department of Education, intervention by the Standing Lease Committee in favor of the Department of Education prevented YFA from collecting on the back rent and resulted in the Department of Education continuing to use the facility without paying rent to YFA. That was when the question of YFA's rights to manage the property arose, but the issue could not be settled due to the lack of documentation from YFA to show that it had been given specific rights to manage the facility.

Moreover, since the demise of the Yap Fresh Tuna Inc. (YFTI), the Standing Lease Committee has also begun negotiating leases for the YFTI cold storage facility and the dock area. Here again, YFA management believe that YFA, and not the Standing Lease Committee, should have exclusive rights to lease the facility since YFTI is a subsidiary of YFA.

Cause: Even though YFA management believed that YFA should have exclusive rights to manage the properties above, no formal attempts were made to negotiate the rights with the Governor and the Standing Lease Committee.

Effect: The lack of exclusive rights to lease the above properties results in loss of potential rental income for YFA.

Recommendation: We recommend that the Board of Directors work with the Standing Lease Committee and the Governor's Office to clarify YFA's rights, if any, to the YFTI cold storage facility, dock area, and koyeng and the former Ting Hong cold storage building.

Auditee response: The YFA Board and its legal counsel will work with the Governor to formalize and document the necessary understanding on the matter. Preliminary discussion with the Governor has already been initiated.

FINDING NO. 2 – NONCOMPLIANCE WITH TAX LAWS

Criteria: FSM tax laws require employers to withhold and remit on a quarterly basis the applicable Social Security and Income taxes from the salaries and wages of all its employees.

Condition: Contractual services for the year ended September 30, 2006 was $27,824 comprising $24,416 in salaries and wages for permanent YFA employees and approximately $3,804 for salaries and wages for temporary work crew. YFA did not withhold taxes from one of its permanent employees whose annual income was approximately $4,000. Moreover, review found that some checks charged to contractual services for wages of the temporary crew were made payable to cash. There was no evidence that the applicable taxes were withheld from wages paid to temporary crew members. We also found one instance where certain YFA permanent employees who were involved in the off-loading of a fishing vessel were paid cash without deductions for social security and withholding taxes.

Cause: Employees in charge of preparing payroll are able to change payment methods and avoid deductions for taxes when they see fit because management has not adopted policies prohibiting checks payable to cash nor has management ensured that salaries and wages for permanent and temporary employees are prepared and recorded consistently with tax laws.

Effect: YFA paid $9,071 in the combined salaries and wages for one permanent employee, the temporary work crew, and the permanent employees who helped off-loaded the fishing vessel, translating to an underpayment of social security and income taxes of $1,088 for the year ended September 30, 2006. By not ensuring proper deductions of taxes from the salaries and wages of its employees, YFA is rendering itself susceptible to interest and penalties for underpayment of taxes.

Recommendation: We recommend that the Board of Directors prohibit the issuance of checks made payable to cash. Moreover, the Board should ensure the General Manager instruct the accounting staff to follow the same procedures for calculating payroll and applicable withholdings for any and all types of salaries and wages paid to permanent and temporary employees.

Local Questioned Costs – The estimated $1,088 which was not withheld from employees for remittance to the tax authorities is hereby raised as local questioned costs.

Auditee Response: The board has directed management to stop this practice immediately and comply with the tax laws. Management is instructed by the board to consider the option of retaining the services of an independent contractor whose services will be utilized and paid for on a need basis thereby eliminate [sic] the need for YFA to intermittently do direct hiring of temporary labor as per its need from time to time.

FINDING NO. 3 – INELIGIBLE CONTRACTORS

Criteria: According to the State Contracts Act, construction contracts should be let by "free and open" competition. After submission and review of bids, the contract should only be awarded to the lowest responsive bidder who has been determined by the contracting officer to be "responsible". A criterion for establishing the responsibility of the contractor should be a lack of conflicts of interest on the part of the contractor and the contractor's demonstrated ability to finance the project without requiring advance payments from the Authority.

Condition: During fiscal year 2006, the YFA let for bid several projects for the construction and repairs of its building and other structures damaged by Typhoon Sudal. Funding for the projects was derived from the Public Assistance Grants awarded by FEMA to Yap State for Typhoon Sudal. The two largest projects were awarded by YFA to a construction company owned by a former project inspector of the Public Assistance Office. At the time that damage assessment surveys were conducted by FEMA, the owner of the construction company was a key member of the Public Assistance office and therefore had unfair advantage over other competitors due to his prior employment with the Public Assistance office. Due to obvious conflicts of interest, this construction company should have been disqualified from the list of responsible bidders.

One of the two projects awarded to the same company was not competitively procured. Instead, YFA sought and obtained a waiver of the bidding requirement from the Governor, even though there was no actual emergency to warrant a waiver. This allowed YFA to award to contract to the construction company above. This construction company only came into being in the aftermath of Typhoon Sudal and did not have an established track record. Moreover, it had no means of financing the construction of the project to allow YFA to make scheduled progress payments based on the completion stages of the project.

Cause: YFA did not follow the State Bidding Laws which required evaluation of the qualifications of the contractors before award of the contract. Instead it followed the common misguided practice of awarding the contract to the person who had the most obvious conflict of interest in participating in the contract.

Effect: By awarding the project to a contractor who was once employed by the Public Assistance Office which is tasked with inspection and acceptance of the final project, YFA opened itself to the risk that the Public Assistance Office inspectors may not be as forthcoming about problems in the quality of the construction work. Moreover, because the contractor had no prior track record, YFA could not be assured that the quality of the construction work would be up to standards. In addition, by selecting a newly-formed construction company which did not have the financial means to finance the project on its own, YFA had to agree to advance payments to the contractor, thereby, handing over to the contractor its only bargaining chip and placing the Authority at the mercy of the contractor. As of September 30, 2006, $56,250 had been advanced to the contractor for the larger of the two projects.

Recommendation: We recommend that the Board of Directors formulate policies and procedures for the procurement and management of construction contracts for the Authority consistent with the intent of the State Contracts Act and bidding laws.

Auditee Response: The board has directed management to comply with the Yap State Contracts Act.

FINDING NO. 4 – LACK OF A VEHICLE POLICY

Criteria: YFA must have a vehicle policy consistent with the Government Vehicle Act to prevent misuse of the Authority's vehicles and to curb vehicle-related expenses such as fuel and the cost of repair and maintenance.

Condition: YFA had three vehicles: a 4x4 pick-up truck driven by the cold storage supervisor, a small pick-up truck for the Grassroots Fishery Recovery Project (GGP) which is exclusively driven by the general manager and a Jeep for general use. Even though only the cold storage section may have had valid reasons to take vehicles home overnight, other employees were allowed to drive the Authority's vehicle for their personal commute.

Our review of fuel expense showed that YFA expended $5,000 to fuel its vehicles in fiscal year 2006 compared to $3,560 for fuel, oil and lubricants for the same number of vehicles and heavy equipment in fiscal year 2005. The fiscal year 2006 fuel expense translates to $19 worth of fuel per working day for the entire year, an amount that we consider to be excessive considering the low level of ongoing activity throughout the year. In comparison, the average daily fuel expense in FY05 was $12 per working day which is also considered excessive. The 37% increase in daily fuel expense over FY05 is unreasonable.

Cause: The fiscal year 2005 audit contained a finding with recommendation for management to adopt a vehicle policy consistent with the Government Vehicle Act to ensure that vehicles are used only for official purposes. The Board and Management did not act on our audit recommendation therefore similar practices continued into FY06 contributing to higher fuel expenses.

Effect: Besides the higher fuel expense and the cost of wear and tear on the vehicles, the general disregard for preventing the abuse of Authority vehicles contributes to a lack of accountability in the government.

Recommendation: We recommend that the Board of Directors formulate and adopt vehicle policies and procedures for the Authority consistent with those of the Government Vehicle Act.

Prior Year Status: A similar finding was issued for the audit for the year ended September 30, 2005.

Auditee Response: The board has directed management to follow/comply with the State Government Vehicle Policy.

FINDING NO. 5 – RECONCILIATION OF THE GENERAL LEDGER

Criteria: To facilitate the annual audit, management should ensure that accounting records are periodically reconciled in a manner consistent with accounting principles generally accepted in the United States of America.

FINDING NO. 5 – RECONCILIATION OF THE GENERAL LEDGER (cont.)

Condition: We noted the following deficiencies in the maintenance of the general ledger which prevented a timely audit of YFA for fiscal year 2006:

1. Balance sheet accounts were not reconciled on a timely basis to eliminate prior year errors and ensure the balances carried forward into fiscal year 2006 were accurate.

2. Prior year audit adjustments were not posted properly in the general ledger.

3. Supporting schedules for balance sheet accounts that were reconciled to the general ledger were unavailable. Schedules that were provided to us had to be revised several times before we could use them for the audit.

4. Classification of similar income and expense transactions were not consistently recorded in the general ledger resulting in too many income and expense accounts with insignificant amounts.

Cause: Management did not ensure that the right people were hired to handle the accounting work.

Effect: Management hired a comptroller who obviously could not work with the automated general ledger and an accountant who missed work excessively. Accordingly, year-round tasks were neglected resulting in a general ledger that was fraught with errors at the end of the year. Fortunately, in the middle of our fieldwork, the accountant was replaced. The current accountant has been instrumental in reconciling many of the schedules required for the audit. The comptroller remains on payroll although we do not understand what his duties entail.

Recommendation: With the current accountant on board, we recommend that the acting manager require her to prepare periodic reconciliation schedules for the various accounts of the general ledger to ensure that at the end of the year, accounts are free of errors.

Prior Year Status: A similar finding was issued for the years ended September 30, 2000 through 2005.

Auditee response: The board has directed management to reconcile monthly.

FINDING NO. 6 – MISSING YFTI COLLECTIONS

Criteria: Collections should be banked on a timely basis to prevent misappropriation of cash.

Condition: Since discontinuation of the Yap Fresh Tuna Inc., (YFTI) operation, income from the rental of the YFTI koyeng continue to be received by YFA's accounting section which had performed the accounting services for both YFTI and YFA in the past under the combined management of both entities. Our review of unpaid invoices as of September 30, 2006 discovered undeposited YFTI cash collections on hand at YFA. Handwritten notes and unpaid invoices on file indicated that the YFTI collections were being used by YFA. Discussions with the acting manager showed that YFA from time to time borrowed from the YFTI collections to augment its petty cash transactions.

Cause: We had previously discussed with the Board of Directors the need for better accountability over the YFTI bank account, but no action was taken by the Board to remedy the concerns we raised.

Effect: Our review of cash receipts and cash on hand found that as of the date of our review, YFA owed $235 to the YFTI undeposited collections. Moreover, based on the records of deposits and cash receipts issued, we determined approximately $710 in cash was missing from the fund.

Recommendation: We strongly recommend that the Board of Directors require the acting manager to take action to recover the missing cash and prevent the same from recurring. It is apparent that despite the prior year findings relating to missing cash which resulted in the resignation and departure of certain YFA employees, management had not adequately rectified the problem.

Local Questioned Costs: Total questioned costs raised as a result of this finding is **$710**.

Prior Year Status: A special engagement which report was dated October 12, 2005 cited YFA for approximately $10,988 in missing cash collections.

Auditee response: Employees who were handling the transaction are not YFA employees anymore. The board has directed management to cease the use of that collection for any other uses that's [sic] not related to YFTI.

FINDING NO. 7 – UNTIMELY BANKING OF COLLECTIONS

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

Condition: The audit for the year ended September 30, 2004 found that by delaying banking of collections, employees were able to borrow from the collections. The amount of money borrowed eventually rose beyond the employees' ability to pay which resulted in missing cash of over $10,000. Since then, YFA had taken steps to improve the timeliness of banking. However, our review of the general ledger details of fiscal year ended September 30, 2006 found that cash collected from sales were not immediately deposited to the YFA bank account. The standard test of controls for sales and cash receipts found several instances of delayed deposit of cash collections of up to eight days after the sales date. The amount of the deposits was small, but if the problem is not rectified early, the risk of misappropriation of cash will increase.

Cause: Our discussions with employees found that due to the problems of missing cash in the past, only certain employees were allowed access to the safe where collections were stored overnight. But when the employee responsible for banking collections did not report to work for extended periods of time, banking of collections could not be made.

Effect: Because management did not take employee's excessive absences into consideration in its procedures to safeguard cash, the control of segregation of duties did not work as intended by management.

Recommendation: We recommend that the Board require the general manager to take action to curtail excessive absences which affect key controls such as segregation of duties of employees. Moreover, compensating control procedures should be instituted to allow timely banking of collections without comprising the integrity of cash collections.

Auditee response: The board has directed management to deposit collection the very next day.

FINDING NO. 8 – OUTSTANDING RECEIVABLES

Criteria: The Board of Directors is responsible for adopting policies to effect the collection of balances due to YFA, especially accounts outstanding over 365 days.

Condition: YFA had been carrying a significant amount of trade account receivables on its books. As of September 30, 2006, the amount was $644,204 of which $610,323 or 95% consists of outstanding trade receivables over 365 days. A large number of these accounts are over ten years old with very little supporting documentation still available at YFA to effect collection. The remaining $33,881 or 5% are for trade receivables related to FY05. The majority of these receivables had been reserved as doubtful for many years now and the Board had not taken any decisive action to try to collect them or write them off the books. In the meantime, management continues to allow credit sales every year, even despite the Authority's dismal collection record.

Cause: An indeterminable percentage of the trade and customer receivables represent prior year balances that could no longer be substantiated by YFA invoices. Accordingly, YFA has nothing to back up its collection claims except for a prior year balance that was brought forward in the accounting records. Moreover, at one point in the past, YFA hired a debt collector to collect on its trade receivables. An indeterminable amount of trade receivables are disputed by customers who claim that they have settled their accounts with YFA through payment to the collector.

Effect: Over half of a million dollars in customer receivables, including balances owed by former and current employees of YFA is reserved as uncollectible and the amount continues to increase each year. Some of these accounts are for people who are currently employed, either by the Government or by the private sector.

Recommendation: The Board should require management to review the current listing of customer and employee receivables classifying each customer's balance into two portions – the balance that could not be substantiated by invoices or are disputed and balances that could be substantiated by invoices and therefore likely to be collectible. YFA should then present the information to the Board of Directors for potential write-offs and renewed collection efforts.

Prior Year Status: YFA's inability to collect on past due accounts has been a finding in its audit reports since fiscal year 2000.

Auditee Response: The Authority is in the process of attempting to collect on the accounts receivables. Board anticipates legal difficulties with some accounts being older than six years due to the statute of limitations.

FINDING NO. 9 – RECEIVABLE FROM BOARD MEMBER

Criteria: The Board of Directors has the responsibility to establish policies to safeguard the financial interests of the entity it governs. Such policies should be applied even to board members in order for financial transactions to be conducted at arms-length.

Condition: During the year ended September 30, 2005, YFA provided equipment rental to one board member for a personal business venture. The total amount owed by the board member to YFA for the equipment rental is $26,750, $17,750 of which was related to fiscal year 2006. The $26,750 was still outstanding as of September 2006 and there was no payment arrangement between the individual and YFA to ensure that the receivable was settled in a timely manner.

Cause: Management allowed the Board member equipment rental to use for his personal business on credit without a formal agreement to ensure prompt payment. The individual's position on the board may have influenced management to allow the equipment rental even though his ability to pay for the equipment was not assured. To allow YFA assets to be used in furtherance of a board member's financial interests without consideration of his ability to pay for the services constitutes abuse of power.

Effect: YFA provided $26,750 worth of equipment rental services of which $9,000 was related to fiscal year 2005. Without a written promissory note from the board member, there is a high risk YFA may not be able to collect the balance owed on the equipment rental services. In short, a board member benefited personally from his position on the board by acquiring the use of YFA equipment rental services free of charge.

YFA's inability to collect on past due trade accounts has been a finding in each of the Authority's past audit reports. Despite the recommendations in the past to disallow credit sales, YFA continued the same practice with the effect that the very stewards of YFA assets were the same individuals who were contributing to its financial hardships.

Recommendation: We, again, strongly recommend to the Board of Directors that sales on account for YFA goods and services be disallowed immediately. This policy should apply to YFA employees and board members, as well as third parties.

Prior Year Status: The above recommendation was issued to the Authority for the years 2000, 2001, 2002, 2003, 2004 and 2005.

Auditee response: The board has directed management to stop giving credit to customers, except preferred customers with a proven tract [sic] record. A credit limit of $100 to be paid within two weeks of each occurrence is stipulated by the board. The board recognizes the importance of "control credit" as a proven means to more the Authority's fish catches [sic].

FINDING NO. 10 – FORGIVEN DEBT

Criteria: The Board of Directors must act in the best interest of YFA.

Condition: In our attempt to confirm outstanding balances of some trade receivables, we learned that balance owed by the Office of Planning and Budget of $8,065 was forgiven by the Board in response to a waiver request initiated by the Director of OPB. The waiver essentially requested YFA to forgive OPB's debt on the basis that both entities belong to the same government therefore it was deemed unnecessary to transfer funds from one governmental entity to the other. The Office of Planning & Budget is one of many departments that owe money to YFA

Cause: The Board of Directors decided to forgive OPB's debt on the basis that the transaction was unnecessary between governmental entities and component units, without regards to the primary objectives of setting up YFA as an enterprise fund to generate revenue through sales to the public and other governmental entities.

Effect: The Board's decision to forgive OPB's debt might set precedence for other departments and agencies to contest paying their debt.

Recommendation: We recommend to the Board to seriously consider the basis and implications of debt forgiveness before taking any such action. Moreover, we recommend that the Board require OPB to repay all balances due to YFA since by not requiring OPB to pay for the goods and services it received from YFA, YFA would in essence be footing part of the cost of the operations of the Office of Planning and Budget.

Prior Year Status: The above finding was issued to YFA for the year ended September 30, 2006.

Auditee Response: The board has initiated dialogue with the new director of OPB on the matter.

FINDING NO. 11 – LACK OF A FIXED ASSET REGISTER

Criteria: Management is responsible to ensure that schedules are available to support general ledger balances.

Condition: A fixed asset register was not readily available to support the general ledger balances for fixed assets for the year ended September 30, 2006 soon after the close of the fiscal year. The register that was submitted for our review was not inaccurately prepared. Prior year adjustments had not been posted and newly acquired assets and disposals were also not reflected in the register. Moreover beginning balances were not reconciled to the prior periods and depreciation expense was inaccurately calculated.

Cause: Management did not set a timeline for accounting staff to complete supporting schedules for general ledger balances soon after the completion of each fiscal year.

Effect: General ledger balances for fixed assets were incorrect as of September 30, 2006. Only after the accountant was replaced was the new accountant able to prepare a fixed asset register that we could use for our audit several months after the end of the fiscal year.

Recommendation: We recommend that the acting manager require employees to perform their assigned tasks. The new accountant contracted by the Board needs to start updating the fixed asset register for FY07 as soon as possible. The register should be maintained regularly to keep it manageable and not become an overwhelming task at the end of the year.

Prior Year Status:
A similar finding was also offered in the audit reports for the years ended September 30, 2005, 2004, 2003, 2002, 2001 and 2000.

Auditee response: Register system now in place and updated regularly.

FINDING NO. 12 – MISSING ASSETS

Criteria: Controls should be in place to safeguard Company assets.

Condition: During the year ended September 30, 2006, the Government of Japan contributed under the Overseas Fisheries Cooperative Foundation's Fisheries Development Association of the Pacific Islands Nations (FDAPIN) program, $25,774 worth of spare parts and tools and equipment for the YFA cold storage and workshop. Our physical observation of fixed assets as of October 2006 found three missing items – a portable drill and two electric work testers. The missing assets are valued at $334.

Cause: Management did not ensure proper accountability and physical control over donated assets.

Effect: Assets that were intended for Company use may have been taken by employees for personal use.

Recommendation: We recommend that management institute controls to safeguard assets, especially those that can be easily removed from the premises. Moreover, management must communicate in writing its policy to employees to ensure that everyone understands that Company assets should not be removed from the premises without written documentation.

Auditee Response: The board has directed management to maintain a control log accounting for every asset and to track the use of such especially if they are to be used outside to [sic] the premises. Management is directed to communicate the directive in writing to the Authority's employees.

FINDING NO. 13 – CHARGE ACCOUNTS

Criteria: The Financial Management Act – Section 503 (3) prohibit government entities and departments from acquiring goods and services without first securing certification of the availability of funds.

Condition: Our review of YFA's payables found many transactions processed through open charge accounts with local vendors, despite a prior year recommendation to cease the practice. Our review of YFA liabilities with local vendors found with one vendor a total of $6,943 in unpaid invoices most of which were related to prior years. The invoices were signed by YFA personnel as having received the goods, but YFA was disputing $3,838 of the charges claiming that the goods obtained were never received on behalf of YFA. Another charge account with yet another local vendor showed a total of $976 in unpaid invoices of which $408 was disputed by YFA. This account showed that approximately $2,000 worth of transactions was processed through the charge account in fiscal year 2006.

Cause: Management has not adopted procedures to prevent employees from obtaining goods from local vendors in the name of YFA without funds certification and written approval from management.

Effect: The lack of proper controls over purchases increases the risk that YFA may be paying for goods that were obtained without proper approval. Moreover, the existing disputed invoices may eventually have to be paid by YFA, unless management could take action to require the employees who signed received the goods to be responsible to settle the disputed invoices.

Recommendation: We strongly recommend that the Board of Directors instruct employees to immediately adopt the use of a purchase order system for all purchases in excess of $50. The petty cash should be used for purchases of less than $50 but purchases over $50 must be initiated with the preparation of a purchase order form indicating the Acting Manager's approval and certification of funds availability by the accounting office. The State purchase requisition form should be adapted by YFA for its use. After the funds certification and the manager's approval have been obtained, the purchase order/requisition could then be presented to the vendor to obtain goods and the final invoice. Check payments to vendors and suppliers should be prepared only upon receipt of the final invoice.

Moreover, the Board of Directors should direct the acting manager to investigate all disputed invoices with the two local vendors and seek the help of the Attorney General's office in requiring the employees who obtained the goods in question to pay for the invoices themselves. To discourage future charges on account, vendors and employees should be placed on notice that purchases of goods without a duly approved purchase order would not be honored by YFA.

Prior Year Status: A similar finding was issued in the audit report for the Yap Fishing Authority for the year ended September 30, 2005.

Auditee Response: Petty cash purchase is authorized for up to $50.00. Anything beyond that or for non-emergency purchase, the use of purchase order shall be complied with. Additionally, any purchase of $1,000 or more, except for payroll, requires approval of the board.

FINDING NO. 14 – PAYABLE DUE TO STATE GOVERNMENT

Criteria: YFA should be able to explain amounts on its general ledger.

Condition: As of September 30, 2006, YFA had on its general ledger $35,325 due to the State Government. As in the previous years, the accounting staff is unable to provide an explanation for the amount nor were they able to provide supporting documentation for the account. Our attempts to confirm the balance with the State Finance found that they had no records of the amount owed by YFA.

Cause: An inadequate filing system, plus turnover of staff members, in addition to damages to records from natural disasters has resulted in no one left at YFA who could explain the balance recorded on the general ledger. Moreover, no attempts had been made by management or the accounting staff to determine whether YFA still owed the balance to the State Government.

Effect: The $35,325 has remained unchanged on the books of the Authority for more than ten years. Unless management takes action to determine whether a liability to the State Government actually exists, the Authority would continue to carry the amount on its books.

Recommendation: We recommend that the acting general manager investigate the nature of the balance due to the State Government and initiate discussion of the balance with the State Government and with the assistance of the Board of Directors agree with the Governor and the Director of OAS on the proper disposition of the balance.

Auditee Response: The board has initiated dialogue with the Director of OAS to properly dispose of this matter one way or another.

FINDING NO. 15 – LACK OF CUSTOMER BILLING RECORDS

Criteria: Records of amounts billed should be available to substantiate amounts due from customers.

Condition: Our review of the accounting for operating revenue found that while billing records for cold storage sales for fish and ice were adequate, records of billings for other sales and incidental receipts were inadequately documented. Other sales generally comprise equipment rental, slipway rental and intermittent fishing supplies sales.

Cause: There were no systematic policies and procedures in place for other sales to ensure that invoices and/or sales receipts issued to customers were adequate to show the total billed and amount collected.

Effect: Our tests of customer receipts found seven transactions where we could not determine whether each payment represented the full amount billed or whether it was a partial payment. The seven transactions aggregated $582, or an average of $83 per receipt. Although, the amount is immaterial, the inability to distinguish between full and partial payments increases the risk of errors in customer receivable records.

Recommendation: We recommend the acting general manager to work with the accounting staff to strengthen billing records for other sales to ensure that adequate records are maintained to show amounts billed to customers and records of payments made.

Auditee Response: New accountant is in place and is keeping good records.

FINDING NO. 16 – ANNUAL LEAVE BALANCES

Criteria: YFA should have a leave policy in place to govern its employee benefits such as vacation and sick leave 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 unpaid leave balances as of September 30, 2006 comprising $554 of the $2,248 balance per the general ledger. We also found instances of leave advances made without proper authorization. YFA staff members told us that management intended to offset unpaid leave balances with outstanding receivable balances for some employees but had not done so. Moreover, records of leave balances were not consistently maintained to ensure accurate leave balances.

Cause: Despite recommendations made in the prior year, YFA has not revised and updated its personnel policy manual for use. In FY2005, a copy of the manual was finally found among some old records after having been lost for several years. Even now that the manual has been found, it still needs to be updated and adopted for official use.

Effect: YFA employees were uncertain about leave policies before the manual was found. Uncertainties relating to personnel matters increase the risks of abuse and errors.

Recommendation: We recommend that the Board of Directors review and revise as appropriate the old personnel manual in order to strengthen controls over payroll transactions and to ensure consistency with personnel and other policies of the Yap State Government and formally adopt it for the Authority.

Prior Year Status:
Related finding was also offered in the audit report for the years ended September 30, 2005 and 2004.

Auditee Response: Management and support staff will correct the annual leave balances necessary [sic] the current personnel manual.

FINDING NO. 17 – EXPIRED EMPLOYMENT CONTRACTS

Criteria: Payroll should only be processed for employees with valid employment records with the Authority.

Condition: Our review of payroll transactions found that two employees were paid for nine pay periods (four and a half months) without valid employment contracts. Both employees were initially contracted to work for the six months ended July 22, 2006. After their contracts expired, they were paid for an additional nine pay periods before new contracts were executed and back-dated to cover the previous nine pay periods.

Cause: The manager was unable to prepare the contracts for the Board's review in a timely fashion. In addition, the Board was unable to meet to make a decision relating to the continued employment of the two employees soon after their contracts expired.

Effect: Continuing to pay employees after expiration of their employment contracts increases the risk of unauthorized payroll.

Recommendation: We recommend that management take steps to ensure that employment records for staff members are kept current to prevent employees from receiving pay checks with out valid contracts with YFA.

Auditee Response: Currently all contract employees have valid contracts. Both board and management are cognizant of the need to renew contracts as necessary and on time, and management is tasked to track the status of all contracts.