

June 29, 2009

Ms. Maria Laaw
Director, Office of Administrative Services
Yap State

Dear Ms. Laaw:

In planning and performing our audit of the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Yap (the State) as of and for the year ended September 30, 2008 (on which we have issued our report dated June 29, 2009), 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, we considered the State's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting. However, in connection with our audit, we identified, and included in the attached Appendix I, deficiencies related to the State's internal control over financial reporting and other matters as of September 30, 2008 that we wish to bring to your attention.

We have also issued a separate report to the Honorable Sebastian Anafel, also dated June 29, 2009, on our consideration of the State's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.

The definition of a deficiency is also set forth in the attached Appendix I.

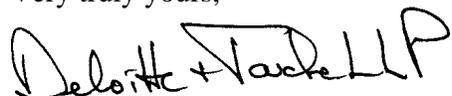
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with this report.

This report is intended solely for the information and use of the management of State of Yap and the Office of the National Public Auditor and is not intended to be and should not be used by anyone other than these specified parties. However, this report is also a matter of public record.

We will be pleased to discuss the attached comments with you and, if desired, to assist you in implementing any of the suggestions.

We wish to thank the staff and management of the State for their cooperation and assistance during the course of this engagement.

Very truly yours,



SECTION I – OTHER MATTERS

1. Travel Advances

Comment: One travel advance remains unliquidated 1 year after travel. It is a policy of Yap State to advance only 80% of per diem; however, for travel authorization number A2006529, the per diem and car rental was 100% advanced. Moreover, the employee still owes Yap State \$1,127 for this travel and no collection documentation was provided. This matter does not result in questioned costs as funding used for the advance originated from the general fund.

Recommendation: For travel related expenditures, Yap State should adhere to its policies.

2. Accounts Receivable Reconciliation

Comment: The general ledger balance of 01-1830 was not reconciled to the related receivable schedule provided. The effect is immaterial as the receivable is fully allowed for in the State's books.

Recommendation: Receivable ledgers should be reconciled in a timely manner.

3. Subsequent Collections

Comment: We were not provided a reconciliation of subsequent collections for Fund 21 to determine which direct deposits received related to September 30, 2008 receivables.

Recommendation: Receivable ledgers should be timely reconciled.

4. PO and Travel Advances

Comment: Advances that are over a year old have not been liquidated in a timely manner.

Recommendation: PO advances and travel advances should be reconciled and liquidated in a timely manner.

5. Missing Documents

Comment: Various purchase orders, invoices and checks could not be located. Such did not have a material impact on our audit but indicates that filing procedures need to be enhanced.

Recommendation: The State should periodically assess the state of its filing system.

6. Accounts Payable

Comment: The accounts payable subledger for the general fund has a debit balance of \$57,019 and there is no support for a \$13,418 balance in Fund 39.

Recommendation: The State should periodically reconcile its accounts payable subledgers with the general ledger balances.

APPENDIX I, CONTINUED

7. Annual Leave

Comment: Of four employees tested, the annual leave for one employee (Emp #78237) was accrued at 8 hours per pay period when it should have been at 4 hours per pay period based on the number of years of service indicated in the personnel action form.

Recommendation: Annual leave should be accrued at appropriate rates evidenced in personnel action forms.

8. Encumbrances

Comment: Various encumbrances that are over a year old have not been liquidated in a timely manner.

Recommendation: Encumbrances should be reconciled and liquidated in a timely manner.

9. Reconciliation of RSI – Budget to Actual – General Fund

Comment: The total amount allotted per the State's accounting system for the General fund is \$6,539,085, resulting in a variance of \$921,342 with the \$7,460,427 (which includes continuing appropriations from the prior year and current FY 08 appropriations per Yap State Public laws) presented in the RSI.

Recommendation: The State has not reconciled its budgetary financial statements and has not reconciled appropriations against allotments. The State should engage in such a reconciliation at least quarterly.

SECTION II – DEFINITIONS

The definition of a deficiency that is established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, is as follows:

A *deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, INTERNAL CONTROL OVER FINANCIAL REPORTING

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

Management's Responsibility

The State's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

Objectives of Internal Control over Financial Reporting

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

Inherent Limitations of Internal Control over Financial Reporting

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.