

**Yap State Public Service Corporation
(A Component Unit of Yap State Government)**

**Financial Statements and
Independent Auditors' Report**

September 30, 2010 and 2009

Fortenberry & Ballard, PC
Certified Public Accountants

Yap State Public Service Corporation
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FORTENBERRY & BALLARD, PC
Certified Public Accountants

Independent Auditors' Report

The Board of Directors
Yap State Public Service Corporation

We have audited the accompanying statements of net assets of the Yap State Public Service Corporation, a component unit of Yap State Government, as of September 30, 2010 and 2009, and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the Yap State Public Service Corporation's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Yap State Public Service Corporation as of September 30, 2010 and 2009, and the changes in financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 30, 2010, on our consideration of the Yap State Public Service Corporation'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 purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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 considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 5 through 11 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's

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responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide an assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements of Yap State Public Service Corporation taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Fortenberry & Ballard, PC

Fortenberry & Ballard, PC
December 30, 2010

Certified Public Accountants

MANAGEMENT'S DISCUSSION AND ANALYSIS

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
Years ended September 30, 2010 and 2009

The following Management's Discussion and Analysis is required by GASB Statement No. 34 issued by the U.S. Governmental Accounting Standards Board. Its objective is to provide the reader with an introduction and overview of the financial statements of the Yap State Public Service Corporation (YSPSC) for the years ended September 30, 2010 and 2009. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto which follow this section.

GASB 34 of the U.S. Governmental Accounting Standards Board requires that published financial statements must contain a management discussion and analysis. This section of the YSPSC's annual report presents our discussion of YSPSC's performance for the years ended September 30, 2010, 2009 and 2008. It should be read in conjunction with financial statements that follow this section.

The following table summarizes the financial condition and operations of YSPSC as of 2010, 2009 and 2008.

	<u>2010</u>	<u>2009</u>	<u>2008</u>
ASSETS			
Plant in Service, net	\$ 8,231,830	\$ 8,447,107	\$ 9,085,334
Work in progress, net of current portion	255,864	660,035	176,003
Current and other assets	2,118,800	2,206,865	2,500,958
Total assets	10,606,494	\$ 11,314,007	\$ 11,762,295
NET ASSETS AND LIABILITIES			
Invested in capital assets, net of related debt	\$ 4,421,815	\$ 4,827,710	\$ 6,468,182
Restricted	-	-	-
Unrestricted	1,444,680	1,004,286	(995,491)
Total net assets	5,866,495	5,831,996	5,472,691
Notes payable, net of current portion	3,840,571	4,065,899	2,679,432
Current portion of notes payable	225,308	213,533	113,723
Other current liabilities	674,120	1,202,579	3,496,449
Total liabilities	4,739,999	5,482,011	6,289,604
Total net asset and liabilities	\$ 10,606,494	\$ 11,314,007	\$ 11,762,295
REVENUES, EXPENSES, AND NET ASSETS			
Operating revenues	5,634,641	\$ 5,053,044	\$ 1,023,556
Operating expenses	5,670,790	6,044,668	6,702,017
Income (Loss) from operations	(36,149)	(991,624)	(5,678,461)

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
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	<u>2010</u>	<u>2009</u>	<u>2008</u>
Grants	703,485	1,878,146	2,182,373
Interest expense	(26,148)	(27,070)	(13,034)
Interest income	2,630	4,901	16,623
Training expense	(749,440)		
Gain (loss) on disposal of utility plant	-	(283)	-
Other income/(expenses)	105,483	(606,641)	(487,536)
Net income (loss)	(139)	257,429	(3,980,035)
Capital contributions	34,638	101,876	361,543
Change in net assets	34,499	359,305	(3,618,492)
Net assets, beginning	5,831,996	5,472,691	9,091,183
Net assets, ending	\$ 5,866,495	\$ 5,831,996	\$ 5,472,691

FINANCIAL OPERATIONS OVERVIEW

Fiscal year 2010 marks the 15th anniversary of the Yap State Public Services Corporation which was created by Yap State Law No. 4-4 on March 9, 1995. Throughout its fifteen year history, the Corporation has stubbornly survived several natural and economic disasters which threatened its continued existence – a fire which destroyed its office building and warehouse in 2001, Typhoons Mitag in 2002 and Sudal and Lupit in 2004 which ravaged the Corporation's power distribution system and the fuel price hikes of 2006 and 2007. Despite the many financial setbacks, the Corporation, through providence and the hard work and commitment of management and staff, has been able to quickly and appropriately respond to each challenge with minimal disruption to its delivery of electricity, water and wastewater services to the people of Yap State.

Results of Operations

Operating Loss – The financial operating results of fiscal year 2010 is testimony to the YSPSC's resilience in the face of financial challenges – it ended the fiscal year only slightly short of breakeven – an operating loss of \$36,149, compared to the losses of \$991,624 in 2009 and \$5.7 million in 2008. The decrease in the operating deficit for 2010 is the result of a 12% increase in net operating revenues and 6% decrease in operating expenses as compared to fiscal year 2009.

Electric Revenue: Fiscal year 2010 is the first full year implementation of the tariff adopted in February 2009. Therefore, expectedly the electric revenue increased in fiscal year 2010 to \$5,164,719 from \$4,618,148 in 2009. In addition, in October 2009 and April 2010, the YSPSC fully satisfied its obligation under YSL 7-25 to repay variable fuel charge credits to the residential and commercial classes of customers, respectively. As a result, many delinquent customers resumed monthly payments after the

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
Years ended September 30, 2010 and 2009

remaining 34% of fuel charge refunds were credited to their accounts. These factors contributed to the 12% increase in electric revenue in 2010 over 2009.

Kilowatt Hours Billed: Despite the 12% increase in electric revenue, a comparison of the kilowatt hours billed to customers showed that electric consumption actually contracted by 2% from 10.8 million kilowatt hours in 2009 down to 10.5 million in 2010. The overall decrease is mainly attributable to conservation efforts by the government class which consumption declined by more than 6% in 2010.

Water Revenue: Total number of gallons billed to customers contracted slightly from 95.9 million gallons in 2009 to 92.9 million gallons for 2010. The residential customers showed the decline in water usage in 2010 probably as a result of water conservation efforts promoted by the Corporation at the height of the 2010 dry season. Despite the decrease in consumption, water sales showed a modest increase of 8% over 2009 from \$434,896 to \$469,882 in 2010.

Production Fuel: The YSPSC expended \$324,375 less for fuel in 2010 than in 2009. The 8% decrease in production fuel costs is due to the slightly lower average fuel prices paid in 2010 compared to 2009. The average monthly fuel price paid by the YSPSC in 2010 was \$3.77 compared to \$3.96 in 2009. The decrease in production fuel costs was the primary contributing factor to the 6% decrease in the fiscal year 2010 operating expense. Production fuel expense at \$3,800,712 comprises 67% of total operating expenses of \$5,670,790 for 2010, a percentage which is consistent with 2009.

Other Operating Expenses – To accommodate customer refunds for fuel charge credits processed in 2010, all other operating expenses were maintained at the same level as 2009. Even so, salaries and wages, administrative expenses and other production costs declined from one to three percent in 2010 as compared to 2009.

Significant Changes to Net Assets

Cash – Cash received from customers grew 15% from \$4,880,589 in fiscal year 2009 to \$5,602,209 in fiscal year 2010. However, despite the increase in receipts from customers, available cash at September 30, 2010 had declined 37% from 2009. In fact, the cash balance of \$383,939 at the end of the 2010 is the lowest in YSPSC's fifteen year history. The declining cash position is a result of the continuing cash payouts to customers required by YSL 7-25.

Receivables – Customer receivables increased 9% to \$889,919 due to separate classification of \$71,000 worth of accounts with credit balances to the liability entitled "Customer deposits and other payables" at September 30, 2010. Had the 2009 presentation been used, the receivables at 2010 would have been \$818,919 which is only \$3,000 more than the balance of \$815,719 at September 30, 2009.

Long-term Debt – The decrease of \$327,137 in long-term debt represent the 2010 payments on the four loans currently being serviced by the YSPSC. Additional information on long-term debts for the Corporation can be found in Note 5 to the financial statements.

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
Years ended September 30, 2010 and 2009

Current Liabilities – While receivables remained at the same levels for 2010 and 2009, current liabilities decreased 33% from \$1,316,302 in fiscal year 2009 to \$899,428 in 2010. The primary cause of the decrease is the payment of \$517,890 in fuel surcharge refunds to electric customers required by Yap State Law No. 7-25. At September 30, 2010, \$326,646 remained to be refunded to the FSM National Government offices and agencies located in Yap State.

Capital Projects – Due to its commitment to refund customers for the 2006 fuel charge, YSPSC did not undertake any capital projects in 2009 and 2010 other than the ongoing renewable energy project funded by the European Union and the French Embassy. Accordingly, the capital contributions of \$34,638 and \$101,876 for 2010 and 2009, respectively, are related to the solar-powered photovoltaic systems in Ulithi.

U.S. Federal, Local and Other Grants

Pacific Linemen Training Program – YSPSC took over administration of the training program from the American Samoa Power Authority (ASPA) with the revision of the program in 2007 to segregate training for Micronesian linemen from those of American Samoa. Funded by the U.S. Dept. of Interior Office of Insular Affairs Operations and Maintenance Improvement Program (OMIP) funds, with matching share by participating utilities, the continuing program aims to train professional linemen for the Micronesian island utilities; specifically, Guam Power Authority, Palau Public Utility Corporation, Pohnpei Utilities Corporation, Commonwealth Utilities Corporation, and Yap Public Services Corporation. YSPSC received \$403,208 and \$476,752, respectively in fiscal years 2010 and 2009 in cost reimbursements for the training program.

Renewable Energy program – In light of the high cost of fossil fuel, YSPSC is continuing to explore alternative sources of energy and seek grants from outside sources to implement renewable energy projects that may help lower the cost of power generation. One such project is the electrification of Asor and Fadrai in Ulithi Atoll using mini grids powered by solar panels. The project was authorized a budget of EU719,062 in 2007 and is funded by the 9th European Development Fund. US\$230,000 was received in fiscal year 2008 for site preparation, the building of the mini grids and power houses for batteries banks and electronics. The project continued in fiscal year 2009 with \$95,427 expended for the European Union Grant and \$6,449 from the French Embassy. Another \$34,638 was expended in FY10 from the European Grant to complete the project. Project close-out is pending project completion certification by the FSM National Government.

In 2009, YSPSC was awarded \$50,000 from the French Embassy as part of the renewable energy program. This particular grant will be used to set up solar panels at the dispensary in Falalop, Ulithi.

Micronesian Water and Wastewater Training Program – Patterned after the successful Pacific Linemen Training Program, the YSPSC submitted a grant proposal to U.S. DOI/OIA in September 2008 for basic courses and skills training for water and wastewater division personnel for the Micronesian utility companies, e.g, Pohnpei Utilities Corporation, Palau Public Utility Corporation, Kosrae Utilities

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Corporation, Chuuk Utilities Corporation, and Yap State Public Utilities Corporation. The project proposal was approved in 2009 and implementation of the project was begun. A total of \$206,968 and \$45,682 in cost reimbursement for the program was received by YSPSC in fiscal years 2010 and 2009, respectively.

Heavy Equipment Mechanics Training Program – The third U.S. DOI training program for Micronesian Utility companies, this program began in fiscal year 2010 with participation by the FSM utility companies. A total of \$91,388 was received in fiscal year for program cost-reimbursements.

Keeping the Lights on Workshop – In April 2010, the U.S. Department of Interior funded travel and accommodation costs for the general manager, the comptroller and the Chairman of the Board to attend a workshop in Honolulu, Hawaii to discuss problems and brainstorm solutions in light of the struggles being faced by Pacific islands utility companies to survive amid the rising costs of production fuel. The Yap State Governor and the Speaker of the Yap State Legislature were also in attendance at the workshop.

HIGHLIGHTS FOR FISCAL YEAR 2011

In the short-term the following projects will be the primary focus of activities for the foreseeable future.

New Electric Tariff – Work was begun in 2010 to identify sections of the YSPSC enabling legislation that would require amendment in order to accommodate the new tariff proposed by the rate study funded by DOI in fiscal year 2008. In 2011, the YSPSC will begin the process of implementing the new rate including helping the public understand how the new rate is structured.

USDA Bucket Truck – A grant of \$135,000 was received (including \$33,000 matching from YSPSC) from the US Department of Agriculture in fiscal year 2010 to replace the existing bucket truck which is used by Power Distribution personnel. Bid proposals have been solicited from qualified companies and the truck will be purchased upon final selection of the contractor.

DOI Funded Training Programs – The highly successful training programs to equip utility personnel with the basic skills necessary to ensure safety and successful operation and delivery of utility services will continue with the Pacific Linemen Training, Water and Wastewater training and Heavy Equipment Mechanics Training. The Majuro Electric Company, the Marshall Islands utility company will be joining the rest of the Micronesian utility companies as a participant in the Pacific Linemen Training Program in 2011.

European Union Energy Facility Grant – Preliminary approval has been received from the European Commission for a budget of \$3.3 million to fund solar photovoltaic systems for 10 targeted outer islands of Yap State, namely Ngulu, Falalus, Siliap, Tagailap and Wottegai in Woleai atoll, Eauripik, the two islands in the atoll of Faraulep (Falalop and Pigue) and finally Elato and Lamotrek. The grant requires a

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Management's Discussion and Analysis
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match of 25% which the YSPSC is currently hoping to obtain from the State Legislature and/or the CFSM Congress.

ADB Loan for Yap Wind Turbine Generators Project – Efforts are underway to successfully obtain a \$8 million ADB loan to install wind turbine generators in Yap State. The first phase of the project will involve the installation and operation of two turbines with an additional three turbines to be added in the second phase of the project. The actual implementation of the project is contingent on the approval of the ADB loan and the availability of the required 23% local match in the form of grants, loans and/or in-kind contributions and is slated for the year 2012. The aim of the project is to provide 24% of the electricity needs of Yap Proper upon successful completion of the two phases of the project.

Now at the end of its fifteenth year, YSPSC looks back to its past to learn from its experiences and begin long-term planning for a much more successful future. The Strategic Plan completed in 2010 will provide the framework for the years ahead as management begins to implement its recommendations, among which were lessening the State's dependence on fossil fuel through an energy conservation program, and adopting a new electric tariff structure that would allow the establishment of cash reserves to be established for funding future fuel crisis.

The management and staff of YSPSC will be pleased to answer any questions that may arise in relation to matters discussed in this report. Kindly refer your comments or questions to YSPSC at telephone no. (691) 350-4427, Colonia, Yap FM 96943.

FINANCIAL STATEMENTS

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)

Statements of Net Assets
Years Ended September 30, 2010 and 2009

<u>ASSETS</u>	<u>2010</u>	<u>2009</u>
Non-current assets:		
Utility plant:		
Plant in service	\$ 19,716,251	\$ 19,234,022
Work in progress	255,864	660,035
Less accumulated depreciation	<u>(11,484,421)</u>	<u>(10,786,945)</u>
Utility plant, net	<u>8,487,694</u>	<u>9,107,112</u>
Current assets:		
Cash and cash equivalents	383,939	612,649
Accounts receivable	889,919	827,876
Other receivables	13,401	27,036
Inventory	793,694	695,565
Prepaid expenses	<u>37,847</u>	<u>43,739</u>
Total current assets	<u>2,118,800</u>	<u>2,206,865</u>
Total assets	<u>\$ 10,606,494</u>	<u>\$ 11,313,977</u>
<u>NET ASSETS AND LIABILITIES</u>		
Net assets (deficit):		
Invested in capital assets, net of related debt	\$ 4,421,815	\$ 4,827,680
Unrestricted	<u>1,444,680</u>	<u>1,004,286</u>
Total net assets	<u>5,866,495</u>	<u>5,831,966</u>
Current liabilities:		
Current portion of notes payable	225,308	213,533
Refunds payable to customers	326,646	844,535
Accounts payable	29,960	167,299
Employees' annual leave and accrued payroll	86,753	57,744
Accrued taxes and other liabilities	11,150	18,897
Deferred revenue	57,529	41,554
Other payables and customer deposits	<u>162,082</u>	<u>72,550</u>
Total current liabilities	899,428	1,416,112
Notes payable, net of current portion	<u>3,840,571</u>	<u>4,065,899</u>
Total liabilities	<u>4,739,999</u>	<u>5,482,011</u>
Total net assets and liabilities	<u>\$ 10,606,494</u>	<u>\$ 11,313,977</u>

See accompanying notes to financial statements

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)

Statements of Activities
Years Ended September 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Operating revenues:		
Electricity sales	\$ 5,164,759	\$ 4,618,148
Water sales and wastewater services	<u>469,882</u>	<u>434,896</u>
Total operating revenues	5,634,641	5,053,044
Operating expenses:		
Production fuel	3,800,712	4,125,087
Depreciation	697,476	732,812
Salaries and wages and related expenses	674,475	679,015
Administrative and general	181,218	187,533
Other production costs	<u>316,909</u>	<u>320,221</u>
Total operating expenses	<u>5,670,790</u>	<u>6,044,668</u>
Operating (loss) income	(36,149)	(991,624)
Interest and other non-operating income, net	2,630	4,901
Foreign exchange loss	(3,996)	(41)
Operating grants and subsidies	703,485	1,878,146
Interest expense	(26,148)	(27,070)
Training expense	(749,440)	(567,483)
Other income (expense)	109,479	(39,117)
Loss on disposal of utility plant	<u>-</u>	<u>(283)</u>
Total other income/expense	<u>36,010</u>	<u>1,249,053</u>
Net (loss) earnings before capital contributions	(139)	257,429
Capital contributions	<u>34,638</u>	<u>101,876</u>
Change in net assets	34,499	359,305
Net assets at beginning of year	5,831,996	5,472,691
Net assets at end of year	<u>\$ 5,866,495</u>	<u>\$ 5,831,996</u>

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)

Statements of Cash Flows
September 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Cash flows from operating activities:		
Cash received from customers	\$ 5,602,208	\$ 4,880,589
Cash refunds paid to customers	(517,889)	(2,276,762)
Cash paid to suppliers	(4,446,631)	(4,289,179)
Cash paid to employees	<u>(645,466)</u>	<u>(667,438)</u>
Net cash provided by (used in) operating activities	<u>(7,778)</u>	<u>(2,352,790)</u>
Cash flows from investing activities:		
Interest and other income	<u>2,630</u>	<u>4,901</u>
Net cash provided by investing activities:	<u>2,630</u>	<u>4,901</u>
Cash flows from noncapital financing activities:		
Proceeds from operating grants and subsidies	703,485	1,878,146
Other expense	<u>(643,957)</u>	<u>(606,671)</u>
Net cash provided by noncapital financing activities	<u>59,528</u>	<u>1,271,475</u>
Cash flows from capital and related financing activities:		
Capital contributions	34,638	101,876
Acquisition of utility plant	(78,028)	(578,870)
Interest paid	(26,148)	(27,070)
Proceeds from issuance of long-term debt	-	1,600,000
Repayment of notes payable	<u>(213,553)</u>	<u>(113,723)</u>
Net cash provided by (used in) capital and related financing activities	<u>(283,091)</u>	<u>982,213</u>
Net change in cash and cash equivalents	(228,710)	(94,201)
Cash and cash equivalents at beginning of year	612,649	706,850
Cash and cash equivalents at end of year	<u><u>\$ 383,939</u></u>	<u><u>\$ 612,649</u></u>

(Continued on next page)

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)

Statements of Cash Flows (continued)

September 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Reconciliation of operating (loss) income to net cash (used in) provided by operating activities:		
Operating (loss) income	\$ (36,149)	\$ (991,624)
Adjustments to reconcile operating (loss) income to net cash (used in) provided by operating activities:		
Depreciation	697,476	732,812
Decrease (increase) in assets:		
Receivables	(62,043)	(60,410)
Inventory	(98,129)	207,951
Prepaid expenses	5,892	71,134
Other receivables	13,635	(18,783)
Increase (decrease) in liabilities:		
Refunds payable to customers	(517,889)	(2,276,762)
Accounts payable	(137,339)	105,399
Employees' annual leave and accrued payroll	29,009	11,577
Accrued taxes and other withholdings	(7,747)	(24,001)
Deferred revenue	15,975	(93,262)
Other payables and customer deposits	<u>89,531</u>	<u>(16,821)</u>
Net cash used in operating activities	<u>\$ (7,778)</u>	<u>\$ (2,352,790)</u>

See accompanying notes to financial statements

NOTES TO THE FINANCIAL STATEMENTS

**YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)**

Notes to Financial Statements
September 30, 2010 and 2009

(1) Organization

Yap State Public Service Corporation (YSPSC) is a legally separate component unit of the Government of Yap Sate. YSPSC provides electrical, water and sewer services in the State of Yap. YSPSC commenced operations on April 1, 1996, with the assets and liabilities of the Division of Public Utilities of the Yap State Department of Public Utilities and Contracts transferred as of that date. YSPSC is governed by a seven member Board of Directors who are nominated by the Governor with the advice and consent of the Legislature of the State of Yap.

(2) Summary of Significant Accounting Policies

The accounting policies of YSPSC conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. All proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with operations are included in the statements of net assets. The accrual basis of accounting is utilized by proprietary funds. Under this method of accounting, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

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

YSPSC has adopted GASB Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments" (GASB 34) as amended by GASB Statement Nos. 37 and 38. GASB 34 establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following net asset categories:

- Invested in capital assets, net of related debt:
Net assets invested in capital assets include restricted and unrestricted net assets, net of accumulated depreciation and reduced by outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- Restricted:
Nonexpendable – Net assets subject to externally imposed stipulations that require YSPSC to maintain them permanently. YSPSC has no nonexpendable restricted net assets at September 30, 2010 and 2009.

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Notes to Financial Statements
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Expendable – Net assets whose use by YSPSC is subject to externally imposed stipulations that can be fulfilled by actions of YSPSC pursuant to those stipulations or that expire by the passage of time.

- **Unrestricted:**

Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action by management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Utility Plant

Utility plant assets were transferred from Division of Public Utilities to YSPSC as of April 1, 1996 at the estimated net book value in the absence of documents to support cost. The net book value of the utility plant assets transferred was \$6,805,075 as of April 1, 1996. Depreciation is computed using the straight-line method over the estimated useful lives of the assets (3 - 40 years for plant assets). Depreciation expense for each of the years ended September 30, 2010 and 2009 was approximately four percent of the cost of depreciable properties. YSPSC currently capitalizes all plant assets that have a useful life of more than one year.

Cash and Cash Equivalents

For purposes of the statements of net assets and the statements of cash flows, cash and cash equivalents are defined as cash on hand, cash in bank and time certificates of deposit with original maturities of three months or less. Time certificates of deposit with original maturities in excess of three months are classified separately.

At September 30, 2010 and 2009, cash and cash equivalent balances of \$250,000 are insured by the Federal Deposit Insurance Corporation (FDIC). The remaining balances consist of uninsured and uncollateralized cash and time certificates of deposit. YSPSC has not experienced any credit losses in such accounts.

Receivables

All receivables are due from government agencies, businesses and individuals located within the State of Yap and are interest free and uncollateralized. The allowance for uncollectible accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectability of these accounts and prior collection experience. The allowance is established through a provision for bad debts charged to expense.

**YAP STATE PUBLIC SERVICE CORPORATION
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September 30, 2010 and 2009

Inventory

Supply inventories are carried at specific identification cost or at estimated values when contributed by the State of Yap. Fuel inventories are carried at cost and are determined using the first in-first out method.

Annual and Sick Leave

Earned but unused annual leave is paid to employees upon termination of their employment. Accordingly, YSPSC accrues these benefits in the period earned.

Revenues

Sales of electricity and water are recorded as billed to customers on a monthly billing cycle basis. At September 30, 2010 and 2009, unbilled revenues of \$230,725 and \$216,662, respectively, are estimated and accrued based on the most recent billing cycles.

Operating and Non-operating Revenues and Expenses

YSPSC considers revenues and expenses directly related to utility operations to be operating revenues and expenses. Revenues and expenses related to investing, financing and capital activities and revenues and expenses related to natural disasters are reflected as non-operating.

Risk Management

YSPSC is exposed to various risks of loss from torts, theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; and natural disasters. Commercial insurance coverage has been obtained for claims arising from most of these matters. YSPSC is self-insured for typhoon risks. Management is of the opinion that no material losses have sustained as a result of this practice during the past three years.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America require 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.

New Accounting Standards

During the year ended September 30, 2009, YSPSC implemented GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments. The implementation of this statement did not have a material effect on the financial statements of YSPSC.

During the year ended September 30, 2008, YSPSC implemented GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future*

**YAP STATE PUBLIC SERVICE CORPORATION
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Notes to Financial Statements
September 30, 2010 and 2009

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 implementation of this statement did not have a material effect on the financial statements of YSPSC.

During the year ended September 30, 2008, YSPSC implemented GASB Statement No. 50, *Pension Disclosures an Amendment of GASB Statements No. 25 and 27*. GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits. The implementation of this statement did not have a material effect on the financial statements of YSPSC

During the year ended September 2009, YSPSC implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other postemployment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The implementation of this statement did not have a material effect on the financial statements of YSPSC.

During the year ended September 30, 2010, YSPSC implemented GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. The implementation of this statement did not have a material effect on the financial statements of YSPSC.

During the year ended September 30, 2010, YSPSC implemented GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The implementation of this statement did not have a material effect on the financial statements of YSPSC.

During the year ended September 30, 2010, YSPSC implemented GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB Statement No. 53 is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. The implementation of this statement did not have a material effect on the financial statements of YSPSC.

In February 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. The objective of GASB Statement No. 54 is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. Elimination of the reserved component of fund balance in favor of a restricted classification will enhance the consistency between information reported in the government-wide statements and

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Notes to Financial Statements
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information in the governmental fund financial statements and avoid confusion about the relationship between reserved fund balance and restricted net assets. The provisions of this statement are effective for periods beginning after June 15, 2010. The implementation of this Standard will change the way fund balance is presented in the following ways:

- Non-spendable: Amounts that cannot be spent; such as inventories,
- Restricted: Amounts that can only be spent only for specific purposes stipulated by constitution, external resource providers, or through enabling legislation,
- Committed: Amounts that can be used only for the specific purposes determined by formal action of the government's highest level of decision-making authority,
- Assigned: Amounts intended to be used by the government for specific purposes, but do not meet the criteria to be classified as restricted or committed. In governmental funds other than the General Fund, assigned fund balance represents the remaining amount that is not restricted or committed,
- Unassigned: Amounts not contained in the other classifications.

During the year ended September 30, 2010, YSPSC implemented GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans* and Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*. These statements are intended to improve consistency in the measurement and financial reporting of other post-employment benefits (OPEB) such as retiree health insurance, and the effects of municipal bankruptcy. The provisions related to the frequency and timing of measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. Statement 58 is effective for periods beginning after June 15, 2009, but both are encouraged to be retroactively implemented. The implementation of these statements did not have a material effect on the financial statements of YSPSC.

In June 2010, GASB issued Statement No. 59, *Financial Instruments Omnibus*. The Statement updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. The Statement is effective for periods beginning after June 15, 2010. Management does not believe the implementation of this statement will have a material effect on the financial statements of YSPSC.

(3) Cash and Cash Equivalents

YSPSC has cash equivalents in one bank account to facilitate the management of cash. Unless otherwise required by law, interest income received accrues to the General Fund. Cash and cash equivalents applicable to a particular fund are readily identifiable. These deposits are stated at cost, which approximates market.

Custodial Credit Risk—Deposits: Custodial credit risk is the risk that in the event of a bank failure, the YSPSC's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution, but not in the depositor's name. YSPSC does not have a deposit

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policy for custodial credit risk.

As of September 30, 2010, the carrying amount of the YSPSC's total cash and cash equivalents was \$383,939, and the corresponding bank balance was \$385,684, which is maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. At September 30, 2010, bank deposits in the amount of \$250,000 were FDIC insured. Collateralization of deposits is not required; therefore \$133,939 is uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

(4) Utility Plant

A summary of changes in capital assets for the years ended September 30, 2010 and 2009 is as follows:

	Beginning Balance October 1, 2009	Transfers and Additions	Transfers and Deletions	Ending Balance September 30, 2010
Depreciable Plant:				
Production plant	\$ 9,283,626	\$ 426,077	\$ -	\$ 9,709,703
Distribution plant	7,854,228	17,601	-	7,871,829
General plant	2,096,168	38,521	-	2,134,719
	<u>19,234,022</u>	<u>482,199</u>	<u>-</u>	<u>19,716,251</u>
Less accumulated depreciation	(10,786,945)	(697,476)		(11,484,421)
Non-depreciable plant:				
Work in progress	660,035	16,678	420,849	255,864
	<u>\$ 9,107,112</u>	<u>\$ (204,985)</u>	<u>\$ 420,849</u>	<u>\$ 8,487,694</u>
	Beginning Balance October 1, 2008	Transfers and Additions	Transfers and Deletions	Ending Balance September 30, 2009
Depreciable Plant:				
Production plant	\$ 9,793,521	\$ 30,250	\$ 540,145	\$ 9,283,626
Distribution plant	8,158,446	64,305	368,523	7,854,228
General plant	2,101,528		5,360	2,096,168
	<u>20,053,495</u>	<u>94,555</u>	<u>914,028</u>	<u>19,234,022</u>
Less accumulated depreciation	(10,968,161)	(732,812)	914,028	(10,786,945)
Non-depreciable plant:				
Work in progress	176,003	484,032		660,035
	<u>\$ 9,261,337</u>	<u>\$ (154,225)</u>	<u>\$ 1,828,056</u>	<u>\$ 9,107,112</u>

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September 30, 2010 and 2009

Utility plant at cost, is comprised of the following components:

	<u>2010</u>	<u>2009</u>
Electric plant	\$12,512,674	\$ 12,259,270
Water plant	<u>7,203,577</u>	<u>6,974,752</u>
	<u>\$19,716,251</u>	<u>\$ 19,234,022</u>

(5) Notes Payable

<u>2010</u>	<u>2009</u>	
\$ 2,111,878	\$ 2,157,295	Loan of original principal of \$2,270,837 payable to the Asia Development Bank (ADB) borrowed through the Federated States of Micronesia (FSM) and Yap State for construction of certain water projects. YSPSC was to be liable to Yap State for interest at 6.82% on the outstanding balance; however, Yap state has waived the interest payment requirement. The loan is repayable in Special Drawing Rights commencing August 2007 with the final payment due in February 2032. The loan is collateralized by the guarantee of the FSM National Government.
422,877	481,611	Uncollateralized note of original principal of \$824,420 payable to Yap State in quarterly interest only payments through March 2003; monthly principal and interest payment of \$5,651 starting June 1, 2003; interest at 2%, maturing in May 2017. The proceeds of the note were used for the construction of the warehouse facility and main office.
1,501,861	1,600,000	Uncollateralized note of original principal of \$1,600,000 payable to Yap State in monthly principal and interest payments of \$10,202 starting November 1, 2009; interest at 1%, maturing in October 2023. The proceeds of the note were used for the repayment to prior non-government utility customers pursuant to YSL Bill # 7-38 & 7-79.
<u>29,263</u>	<u>40,526</u>	Note of original principal of \$103,000 payable to United States of America, acting through the Rural Housing Service, for the construction of the warehouse facility and main office. The note is payable in monthly installments of \$1075 including interest at 4.625% starting March 26, 2003 and maturing in September 2013. The note is collateralized by equipment, furniture, and fixtures located at YSPSC's office.
4,065,879	4,279,432	Total notes payable
<u>225,308</u>	<u>213,533</u>	Less current portion
<u>\$ 3,840,571</u>	<u>\$ 4,065,899</u>	

**YAP STATE PUBLIC SERVICE CORPORATION
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Notes to Financial Statements
September 30, 2010 and 2009

The scheduled debt service of these notes payable is as follows:

Year ending September 30,	Principal	Interest	Total
2011	225,308	23,351	248,659
2012	228,137	20,513	248,650
2013	223,135	17,703	240,838
2014	220,359	15,290	235,649
2015	222,746	12,903	235,649
2016 through 2020	1,182,067	34,905	1,216,972
2021 through 2025	977,032	5,825	982,857
2026 through 2030	605,632	-	605,632
2031 through 2032	181,463	-	181,463
	<u>\$ 4,065,879</u>	<u>\$ 130,490</u>	<u>\$ 4,196,369</u>

Changes in long-term liabilities for the years ended September 30, 2010 and 2009 are as follows:

	Outstanding September 30, 2009	Increases	Decreases	Outstanding September 30, 2010	Current	Noncurrent
ADB loan	\$ 2,157,295	\$ -	\$ 45,417	\$ 2,111,878	\$ 45,417	\$ 2,066,461
Yap State loan	481,611	-	58,734	422,877	59,999	362,878
YSL 7-38 loan	1,600,000	-	98,139	1,501,861	108,097	1,393,764
USA loan	40,526	-	11,263	29,263	11,795	17,468
	<u>\$ 4,279,432</u>	<u>\$ -</u>	<u>\$ 213,553</u>	<u>\$ 4,065,879</u>	<u>\$ 225,308</u>	<u>\$ 3,840,571</u>

	Outstanding September 30, 2008	Increases	Decreases	Outstanding September 30, 2009	Current	Noncurrent
ADB loan	\$ 2,202,712	\$ -	\$ 45,417	2,157,295	\$ 45,417	\$ 2,111,878
Yap State loan	539,163	-	57,552	481,611	58,714	422,897
YSL 7-38 loan	-	1,600,000	-	1,600,000	98,139	1,501,861
USA loan	51,280	-	10,754	40,526	11,263	29,263
	<u>\$ 2,793,155</u>	<u>\$ 1,600,000</u>	<u>\$ 113,723</u>	<u>\$ 4,279,432</u>	<u>\$ 213,533</u>	<u>\$ 4,065,989</u>

**YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)**

Notes to Financial Statements
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(6) Contingencies

Title to Real Estate:

YSPSC does not currently hold title to real property underlying its operating sites. Such property substantially is held in the name of the State of Yap. YSPSC is not charged for use of this property.

Payable to Federated States of Micronesia:

In February 2008, the Yap State Legislature enacted Law (YSL) No. 7-25 to amend No. 4-4, YSPSC's enabling legislation, mandating that YSPSC credit back certain charges to prior customers. Yap State Law No. 7-25 directed YSPSC to repeal all fuel surcharges and fees in excess of \$0.035 per kWh and to refund to customers all fuel surcharges and fees collected in excess of \$0.035 per kWh from March 2006 to February 2008. At September 30, 2010, the total variable fuel charge refund payable to customers amounted \$326,646. The repayment of those costs over the legislated \$0.035 was facilitated by a loan from the State of Yap for \$1,600,000 authorized by YSL No. 7-38.

YSL No. 39 then authorized the Governor to forgive any refund that may be owed by YSPSC to Yap State Government agencies for these declared excessive surcharges. The refund owed FSM National Government as a prior customer remains outstanding at \$321,000 and is included as a current liability in the Statement of Net Assets. Although FSM National Government has not asserted a claim to this liability neither has it forgiven this debt.

(7) Significant Revenue Sources

Power and water billings to Yap State Government agencies accounted for 21% and 25%, respectively, of operating revenues for the years ended September 30, 2010 and 2009.

(8) Grants

YSPSC received the following grants and capital contributions during the years ended September 30, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
U.S. Department of the Interior	\$ 631,363	\$ 612,235
Yap State	72,122	1,265,911
European Union	34,638	95,427
French Embassy	-	6,449
	<u>\$ 738,123</u>	<u>\$ 1,980,022</u>

**YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)**

Notes to Financial Statements
September 30, 2010 and 2009

(9) Related Party Transactions

In the ordinary course of business, YSPSC enters into transactions with the State of Yap and private businesses in which certain YSPSC's board members hold positions of influence. Several board members hold management positions with the State of Yap, of which YSPSC is a component unit. Several board members hold management positions with private companies with which YSPSC, from time to time, engages in business transactions. YSPSC management is of the opinion that its transactions with related parties are executed under the same laws and conditions as are entered into with unrelated entities.

REPORTS REQUIRED BY *GOVERNMENT AUDITING STANDARDS* AND BY OFFICE
OF MANAGEMENT AND BUDGET (*OMB*) *CIRCULAR A-133*

FORTENBERRY & BALLARD, PC
Certified Public Accountants

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

The Board of Directors
Yap State Public Service Corporation

We have audited the accompanying statement of net assets of the Yap State Public Service Corporation, a component unit of Yap State Government, as of September 30, 2010 and for the year then ended, and have issued our report thereon dated December 30, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Yap State Public Service Corporation's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Yap State Public Service Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the entity's internal control over financial reporting.

A deficiency in internal control 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 material misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Yap State Public Service Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an

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opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended for the information of the Board of Directors and management, federal awarding agencies, pass-through entities and the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties.

Fortenberry & Ballard, PC

Fortenberry & Ballard, PC
December 30, 2010

Certified Public Accountants

FORTENBERRY & BALLARD, PC
Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR FEDERAL PROGRAM AND INTERNAL CONTROL
OVER COMPLIANCE WITH *OMB CIRCULAR A-133*

The Board of Directors
Yap State Public Service Corporation

Compliance

We have audited the compliance of the Yap State Public Service Corporation with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2010. Yap State Public Service Corporation's major federal programs are identified in the summary of the auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contract and grants applicable to each of its major federal programs is the responsibility of the Yap State Public Service Corporation's management. Our responsibility is to express an opinion on the Yap State Public Service Corporation's compliance based on our audit.

We conducted our audit of compliance 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, and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Yap State Public Service Corporation's compliance with those requirements referred to above and performing such other procedures as we considered necessary in the circumstances. We believe our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Yap State Public Service Corporation's compliance with those requirements.

In our opinion, Yap State Public Service Corporation complied, in all material respects, with the requirements referred to above that have could have a direct and material effect on each of its major federal programs for the year ended September 30, 2010.

Internal Control Over Compliance

The management of the Yap State Public Service Corporation is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Yap State Public Service Corporation's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and

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to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Yap State Public Service Corporation's internal control over compliance.

A deficiency in internal control over compliance 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, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in the internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of the Yap State Public Service Corporation, as of and for the year ended September 30, 2010, and have issued our report thereon dated December 30, 2010. Our audit was performed for the purpose of forming an opinion on basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of Yap State Public Service Corporation's management. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information of the Board of Directors and management, federal awarding agencies, pass-through entities and the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties.

FORTENBERRY & BALLARD, PC

Fortenberry & Ballard, PC
December 30, 2010

Certified Public Accountants

**YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)**

Schedule of Expenditures of Federal Awards

Year Ended September 30, 2010

Direct grants:

US Dept of Interior/

Office of Territorial and International Affairs:

Economic, Social, and Political Development

of the Territories/ Operations and Maintenance

Improvement Programs (OMIP)

			Beginning Unearned Revenue	Expenses	Cash Receipts	Ending Unearned Revenue
	Authorized		<u>Revenue</u>	<u>Expenses</u>	<u>Receipts</u>	<u>Revenue</u>
Pacific Lineman Training	15.875	\$484,000	\$ 15,729	\$ 403,208	\$ 441,726	\$ 54,247
Strategic Plan and Rate Study Program	15.875	99,500	21,187	21,187	-	-
OMIP Wastewater Training Specialist	15.875	49,000	-	18,631	19,622	991
Micronesia Water/Wastewater Training Program	15.875	279,500	-	206,725	246,153	39,428
			<u>\$ 36,916</u>	<u>\$ 649,751</u>	<u>\$ 687,879</u>	<u>\$ 94,666</u>

Note 1: The Schedule of Expenditures of Federal Awards is prepared on the accrual basis of accounting.

**YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

Section 1: Summary of Auditor's Results

Financial Statements:

1. Type of auditor's report issued on the financial statements: Unqualified.
2. Material noncompliance relating to the financial statements? No.
3. Internal control over financial reporting:
 - a. Material weakness(es) identified? No.
 - b. Significant deficiency(ies) identified that are not considered to be material weaknesses? No.
4. Type of auditor's report issued on compliance for major federal programs: Unqualified.
5. Internal control over major programs:
 - a. Material weakness(es) identified? No.
 - b. Significant deficiency(ies) identified that are not considered to be material weaknesses? No.
6. Any audit findings reported as required by Section____.510(a) of OMB Circular A-133? No.
7. Federal programs identified as major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
15.875	Department of the Interior: Economic, Social, and Political Development of the Territories

8. The dollar threshold used to distinguish between Type A and Type B programs (as terms are defined in OMB Circular A-133) was \$300,000.
9. Auditee qualified as a low-risk auditee as the term is defined in OMB Circular A-133? No.
10. Prior fiscal year audit findings and questioned cost relative to federal awards which would require the auditee to prepare a summary schedule of prior audit findings as discussed in Section____.315(b) of OMB Circular A-133? No.