

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

Financial Statements and
Independent Auditors' Report
September 30, 2011, and 2010

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 Yap State Public Service Corporation, a component unit of Yap State Government, as of September 30, 2011 and 2010, and the related statements of activities 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, 2011 and 2010, 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.

The accompanying financial statements have been prepared assuming that Yap State Public Service Corporation will continue as a going concern. As discussed in Note 11 to the financial statements, Yap State Public Service Corporation expended operating capital and is experiencing difficulty generating sufficient cash flow to meet debt and other obligations. These conditions raise substantial doubt about its ability to continue as a going concern without rate increases. Management's plan in regard to these matters is also discussed in Note 11. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 2, 2011, 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 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 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 2, 2011

Certified Public Accountants

MANAGEMENT'S DISCUSSION AND ANALYSIS

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis Years ended September 30, 2011 and 2010

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, 2011 and 2010. 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, 2011, 2010 and 2009. 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 2011, 2010 and 2009.

ASSETS	<u>2011</u>	<u>2010</u>	<u>2009</u>
Plant in service, net	\$ 7,880,872	\$ 8,231,830	\$ 8,447,107
Work in progress, net of current portion	485,383	255,864	660,035
Current and other assets	<u>3,174,010</u>	<u>2,118,800</u>	<u>2,206,865</u>
Total assets	<u>\$ 11,540,265</u>	<u>\$ 10,606,494</u>	<u>\$ 11,314,007</u>
NET ASSETS AND LIABILITIES			
Invested in capital assets, net of related debt	\$ 4,469,404	\$ 4,421,815	\$ 4,827,710
Restricted	1,168,832	-	-
Unrestricted	20,958	1,444,680	1,004,286
Total net assets	5,659,194	5,866,495	5,831,996
Notes payable, net of current portion	3,612,430	3,840,571	4,065,899
Current portion of notes payable	284,421	225,308	213,533
Other current liabilities	1,984,220	674,120	1,202,579
Total liabilities	<u>5,881,071</u>	<u>4,739,999</u>	<u>5,482,011</u>
Total net assets and liabilities	<u>\$ 11,540,265</u>	<u>\$ 10,606,494</u>	<u>\$ 11,314,007</u>
REVENUES, EXPENSES AND NET ASSETS			
Operating revenues	5,682,964	5,634,641	5,053,044
Operating expenses	<u>6,172,497</u>	<u>5,670,790</u>	<u>6,044,668</u>
Income (loss) from operations	<u>\$ (489,533)</u>	<u>\$ (36,149)</u>	<u>\$ (991,624)</u>

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
Years ended September 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Grants	\$ 709,686	\$ 703,485	\$ 1,878,146
Interest expense	(16,109)	(26,148)	(27,070)
Interest income	1,322	2,630	4,901
Training expense	(384,713)	(749,440)	-
Gain (loss) on disposals	-	-	(283)
Other income (expenses)	(27,954)	105,483	(606,641)
Net income (loss)	(207,301)	(139)	257,429
Capital contributions	-	34,638	101,876
Change in net assets	(207,301)	34,499	359,305
Net assets, beginning	5,866,495	5,831,996	5,472,691
Net assets, ending	\$ <u>5,659,194</u>	\$ <u>5,866,495</u>	\$ <u>5,831,996</u>

FINANCIAL OPERATIONS OVERVIEW

The Yap State Public Services Corporation completed fiscal year 2011 with just enough cash in its bank accounts to cover only eight days worth of diesel fuel to power its generators on Yap Proper. The depletion of its operating capital was brought on by fuel prices exceeding the fuel cost component of the existing electric tariff of \$3.77 per gallon which was set back in 2009. Fuel prices which had remained fairly constant during fiscal years 2009 and 2010 began to rise in October 2010 – peaking at \$5.08 in April 2011. By the end of September, prices had decreased slightly to \$4.854.

Ideally, YSPSC should have immediately raised rates to ensure that sufficient cash was available to mitigate the risks of interruptions to utility services to customers. But, mindful of public reactions to past tariff increases, management decided to take a more conservative approach in tackling the 2011 fuel price hikes. In May 2011, the \$0.035 fuel surcharge allowed by law was assessed to customers. Then management and staff formulated short-term and long-term proposals for future electric tariffs and ventured to share these plans with key government officials in an attempt to secure support for the tariff amendments that needed to be implemented by the YSPSC. Even though the collaboration with the State leadership important and necessary, the time involved did not allow the YSPSC to adopt a new tariff before the end of September. Notice for proposed amendments to the electric tariff was finally posted to the public in November 2011. Revenue for the proposed rate amendments, if adopted, would not be realized by the Corporation until March 2012. Because of the severe cash shortages currently being experienced by the Corporation, the 2011 audit report expressed substantial doubt about the YSPSC's ability to continue as a going concern if the electric tariff was not amended to cover the increase in fuel costs.

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
Years ended September 30, 2011 and 2010

Results of Operations

Operating Loss – The disparity between fuel costs billed to customers and the actual paid by the YSPSC to its supplier contributed to the operating loss of \$489,533 for fiscal year 2011. The loss for 2010 was \$36,149, an increase of 1,254%.

Electric Revenue: Electric revenue for 2011 of \$5,123,712 was down 1% when compared with 2010. This is despite the additional \$0.035 fuel surcharge assessed to customers beginning in May 2011. The surcharge was expected to generate approximately \$168,000 from May to September 2011, but a decline in overall electricity consumption caused the 2011 electric sales to fall below the 2010 electric sales of \$5,164,759.

Kilowatt Hours Billed: Consistent with the prior years, the electricity customer base continued to contract. The rate of decrease was 2% from 10.5 million kilowatt hours billed in 2010 to 10.3 million in 2011. In fiscal year 2011, the residential class reflected a 5% decrease, while the government class contracted by 2%. Monthly electricity consumption averaged 932,745 kilowatt hours in 2010, and in the months prior to the assessment of the \$0.035 fuel surcharge in fiscal year 2011, consumption averaged 926,801 kilowatt hours per month, but fell to 883,001 kilowatt hours after the adoption of the fuel surcharge in May 2011.

Water Revenue: Total number of gallons billed to customers contracted slightly from 92.9 million gallons in 2010 to 89.2 million gallons for 2011. Consistent with fiscal year 2010, the lower usage was reflected in the consumption for the residential class. Despite the decrease in consumption, water sales showed a modest increase of 12% over 2010, from \$469,882 to \$559,252 in 2011.

Production Fuel: The YSPSC expended \$467,199 more for fuel in 2011 than in 2010. The 12% increase in production fuel costs is due to the higher average fuel prices paid in 2011 compared to 2010. The average monthly fuel price paid by the YSPSC in 2010 was \$3.77 compared to \$4.468 in 2011, an increase of 69 cents. The increase in production fuel costs was the primary contributing factor to the 9% increase in the fiscal year 2011 operating expense. Production fuel expense at \$4,267,911 comprises 69% of total operating expenses of \$6,172,497 for 2011.

Other Operating Expenses – Due to the shortage of working capital brought about by higher fuel prices, all other operating expenses, with the exception of salaries and wages, decreased as compared to fiscal year 2010. The increase in salaries and wages of 27% is attributable to one new position in Administration and wage increases for linemen who had attained certification in the Pacific Linemen Training Program. The YSPSC also had to absorb the cost of part of the salary and recruitment and repatriation costs of the Heavy Equipment Trainer when DOI funding for the Heavy Equipment Training Program failed to materialize for its second year.

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
Years ended September 30, 2011 and 2010

Significant Changes to Net Assets

Cash – Cash received from customers of \$5,623,148 in 2011 is basically at the same level as 2010 of \$5,602,208. However, cash on hand decreased 69% to \$119,834 from \$383,939 at the end of fiscal year 2010, primarily due to the higher cost of fuel. Management is hopeful that the new tariff which was publicized in November 2011 would be in place by January or February 2012 to alleviate the YSPSC's current cash flow problems.

Receivables – Customer receivables increased 7% to \$949,549 from \$889,919 in 2010. The increase is attributable to revisions to YSPSC's disconnection policy which came about after it was brought to management's attention that customers could be legally disconnected only after 90 days of delinquency, instead of the 60 days that had been the practice. This change in policy has caused some customers to delay payment of their accounts until after 60 days.

Long-term Debt – A total of \$169,028 was paid on the principal for long-term debts in 2011 as compared to \$213,553 in 2010. These represent 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 6 to the financial statements.

Current Liabilities – Current liabilities increased 152% in 2011 as compared to 2010. The major part of this increase is due to \$1.1 million in deferred revenue for the European Union grant for neighboring islands solar projects that was received but not used in fiscal year 2011. The solar projects are slated to be implemented in fiscal year 2012. Accounts payable increased by \$202,797 over fiscal year 2010 to \$232,757, an increase of 677%! The lack of working capital in 2011 necessitated that only the most pressing bills were paid each month.

Capital Projects – Due to its commitment to refund customers for the 2006 fuel charge and the current higher fuel prices, YSPSC did not undertake any capital projects in 2011 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 for 2010 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. Six linemen from Power Distribution Division successfully completed the Linemen Training Program and were

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certified in 2011. YSPSC received \$317,652 and \$403,208, respectively, in fiscal years 2011 and 2010 in cost reimbursements for the training program.

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 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 \$32,108 and \$206,725 in cost reimbursement for the program was received by YSPSC in fiscal years 2011 and 2010, 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. The program was designed as a two-year program, but DOI provided funding for only fiscal year 2010. Due to the lack of funding, the program was discontinued in fiscal year 2011. A total of \$33,112 and \$91,388 was received in fiscal years 2011 and 2010 for program cost-reimbursements.

USDA Bucket Truck – In fiscal year 2010, a grant of \$135,000 was received (including \$35,000 matching from YSPSC) from the US Department of Agriculture to replace an old bucket truck which was in use by Power Distribution personnel. In 2011, a Utility Fleet Versalift bucket truck was purchased for \$113,911.

CRISP Monitoring and Evaluation – Due to its good track record in administering the various training programs funded by the U.S. Department of Interior (DOI), DOI awarded YSPSC \$199,942 in 2011 to monitor and evaluate the Chuck Public Utilities Corporation's (CPUC) Capitalization, Recovery and Institutional Strengthening Project (CRISP). YSPSC received \$49,080 in 2011 for cost reimbursements for this program.

Renewable Energy program – As part of its ongoing renewable energy program, in 2011, YSPSC received \$33,562 from the French Embassy for solar systems training and \$1,168,832 from the European Union (without the 25% match by the Yap State Government) for the installation of solar systems in the neighboring islands. The European Union Energy Facility II grant is designed to provide solar electricity to ten islands and atolls in the State of Yap, 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.

ADB Loan for Small Generator and Yap Proper Renewable Energy Projects – Throughout fiscal year 2011, YSPSC worked with various ADB consultants to finalize an \$8 million loan package for renewable energy projects on Yap Proper.

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Management's Discussion and Analysis
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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 2012

In the short-term the following projects will be the primary focus of activities for the Yap State Public Services Corporation:

New Electric Tariffs – Work was begun in 2010 to identify sections of the YSPSC enabling legislation that would require amendments in order to accommodate the new tariff proposed by the rate study funded by DOI in fiscal year 2008. However, before the YSPSC could seek the amendments to its enabling legislation, fuel prices rose sharply in the middle of 2011. Consequently, the YSPSC had to formulate a short-term rate to be adopted in the interim while the process of implementing a long-term rate was ongoing. The short-term rate, which was publicized in November 2011 is a fixed rate, much like the rate adopted in 2009. The long-term rate is envisioned to be one that includes a fuel cost component which would fluctuate with the rise and fall of fuel prices as recommended by the DOI tariff study. It is hoped that the amendments to YSPSC's enabling legislation that are necessary to accommodate the long-term rate would be enacted sometime during fiscal year 2012 in order to avoid the future cash flow problems as is currently being experienced by the YSPSC.

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 joined the rest of the Micronesian utility companies as a participant in the Pacific Linemen Training Program in 2011.

European Union Energy Facility Grant – \$1,168,832 was received from the European Commission for a budget of EUR2.5 million to fund solar photovoltaic systems for 10 targeted outer islands of Yap State. The grant required a match of 25% or approximately USD\$843,700 which was appropriated by YSL 8-3 and 8-9. Purchase of the solar systems is expected to be tendered in early 2012 with installations to follow soon after the systems are received in Yap. It is estimated that by 2015, with the completion of EFII and similar projects, 100% of the Outer-islands' population of Yap State will be electrified with 100% renewable energy systems (14 islands with an approximate total population of 2,600 islanders.)

ADB Loan for Yap Energy Projects – Efforts are underway to finalize the package for an \$9 million ADB loan for the purchase of a smaller generator for the Yap Power Plant and the installation of wind turbines and photovoltaic systems on Yap Proper. This is part of the YSPSC's efforts to reduce its dependence on fossil fuel – the small generator is envisioned to effect a 4% reduction in diesel fuel

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
Years ended September 30, 2011 and 2010

while the renewable energy projects is hoped to result in a 28% reduction in diesel fuel consumption by the Yap Power Plant. The successful attainment of the loan largely depends on the availability of cofinanciers and also on whether the FSM National Government and/or the State of Yap will guarantee the debt as required by ADB loan policies.

Utility STAR upgrade – Management will continue to seek funding to allow the YSPSC to upgrade its utility software to accommodate the integration of customers billing and payments with the general ledger in order to facilitate the maintenance, reporting and collection of customer accounts. The version of the Able Software currently in use does not allow integration with the general ledger, therefore, reconciliation with the general ledger is being done manually.

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)

Statement of Net Assets
As of September 30, 2011 and 2010

<u>ASSETS</u>	<u>2011</u>	<u>2010</u>
Non-current assets:		
Utility plant:		
Plant in service	20,087,596	\$ 19,716,251
Work in progress	485,383	255,864
Less accumulated depreciation	(12,206,724)	(11,484,421)
Utility plant, net	<u>8,366,255</u>	<u>8,487,694</u>
Current assets:		
Cash and cash equivalents	119,834	383,939
Restricted cash	1,168,832	-
Accounts receivable and unbilled accrued revenue, net of allowance for doubtful accounts	949,549	889,919
Other receivables	13,587	13,401
Inventory	871,204	793,694
Prepaid expenses	51,004	37,847
Total current assets	<u>3,174,010</u>	<u>2,118,800</u>
Total assets	<u>\$ 11,540,265</u>	<u>\$ 10,606,494</u>
<u>NET ASSETS AND LIABILITIES</u>		
Net assets (deficit):		
Invested in capital assets, net of related debt	\$ 4,469,404	\$ 4,421,815
Restricted	1,168,832	-
Unrestricted	20,958	1,444,680
Total net assets	<u>5,659,194</u>	<u>5,866,495</u>
Contingencies		
Current liabilities:		
Current portion of notes payable	284,421	225,308
Refunds payable to customers	181,368	326,646
Accounts payable	232,757	29,960
Employees' annual leave and accrued payroll	86,335	86,753
Accrued taxes and other liabilities	-	11,150
Deferred revenue	1,318,332	57,529
Customer deposits	165,428	162,082
Total current liabilities	<u>2,268,641</u>	<u>899,428</u>
Notes payable, net of current portion	<u>3,612,430</u>	<u>3,840,571</u>
Total liabilities	<u>5,881,071</u>	<u>4,739,999</u>
Total net assets and liabilities	<u>\$ 11,540,265</u>	<u>\$ 10,606,494</u>

See accompanying notes to financial statements

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)
Statement of Activities
For the Years Ended September 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating revenues:		
Electricity sales	\$ 5,123,712	\$ 5,164,759
Water sales and waste water services	559,252	469,882
Net operating revenues	<u>5,682,964</u>	<u>5,634,641</u>
Operating expenses:		
Production fuel	4,267,911	3,800,712
Depreciation	722,303	697,476
Salaries and wages and related expenses	853,239	674,475
Administrative and general	161,980	181,218
Other production costs	167,064	316,909
Total operating expenses	<u>6,172,497</u>	<u>5,670,790</u>
Operating (loss) income	(489,533)	(36,149)
Interest income	1,322	2,630
Foreign exchange loss	(3,627)	(3,996)
Operating grants and subsidies	709,686	703,485
Interest expense	(16,109)	(26,148)
Training expense	(384,713)	(749,440)
Other income (expense)	(24,326)	109,479
Total other income/expense	<u>282,232</u>	<u>36,010</u>
Net (loss) earnings before capital contributions	(207,301)	(139)
Capital contributions	<u>-</u>	<u>34,638</u>
Change in net assets	(207,301)	34,499
Net assets at beginning of year	5,866,495	5,831,996
Net assets at end of year	<u>\$ 5,659,194</u>	<u>\$ 5,866,495</u>

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)
 Statements of Cash Flows
 For the Years Ended September 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Cash received from customers	5,623,148	\$ 5,602,208
Cash refunds paid to customers	(141,932)	(517,889)
Cash paid to suppliers	(4,484,825)	(4,446,631)
Cash paid to employees	(864,807)	(645,466)
Net cash provided by (used in) operating activities	<u>131,584</u>	<u>(7,778)</u>
Cash flows from investing activities:		
Interest and other income	1,322	2,630
Net cash provided by investing activities:	<u>1,322</u>	<u>2,630</u>
Cash flows from noncapital financing activities:		
Proceeds from operating grants and subsidies	801,657	703,485
Other expense	(412,667)	(643,956)
Net cash provided by noncapital financing activities	<u>388,990</u>	<u>59,529</u>
Cash flows from capital and related financing activities:		
Capital contributions	-	34,638
Acquisition of utility plant	(600,864)	(78,028)
Interest paid	(16,109)	(26,148)
Repayment of notes payable	(169,028)	(213,553)
Net cash provided by (used in) capital and related financing activities	<u>(786,001)</u>	<u>(283,091)</u>
Net change in cash and cash equivalents	(264,105)	(228,710)
Cash and cash equivalents at beginning of year	383,939	612,649
Cash and cash equivalents at end of year	<u>\$ 119,834</u>	<u>\$ 383,939</u>

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YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)
 Statements of Cash Flows
 For the Years Ended September 30, 2011 and 2010

Continued from previous page.

Reconciliation of operating (loss) income to net cash (used in) provided by operating activities:

Operating (loss) income	\$ (489,533)	\$ (36,149)
Adjustments to reconcile operating (loss) income to net cash (used in) provided by operating activities:		
Depreciation	722,303	697,476
Decrease (increase) in assets:		
Receivables	(59,630)	(62,043)
Inventory	(77,510)	(98,129)
Prepaid expenses	(13,157)	5,892
Other receivables	(186)	13,635
Increase (decrease) in liabilities:		
Refunds payable to customers	(145,278)	(517,889)
Accounts payable	202,797	(137,339)
Employees' annual leave and accrued payroll	(418)	29,009
Accrued taxes and other withholdings	(11,150)	(7,747)
Deferred revenue	-	15,975
Other payables and customer deposits	3,346	89,531
Net Cash (used in) provided by operating activities	<u>\$ 131,584</u>	<u>\$ (7,778)</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, 2011 and 2010

(1) Organization

Yap State Public Service Corporation (YSPSC) is a legally separate component unit of the Government of Yap State. 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.

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, 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 had no nonexpendable restricted net assets at September 30, 2011 and 2010.

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September 30, 2011 and 2010

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. See Note 3 for more details.

• **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.

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).

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, 2011 and 2010, 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 estimated 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.

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.

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

Notes to Financial Statements
September 30, 2011 and 2010

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, 2011 and 2010, unbilled revenues of \$224,374 and \$230,725, 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 been 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. The most significant estimates are depreciation and allowance for doubtful accounts. Actual results could differ from those estimates.

New Accounting Standards

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.

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(A COMPONENT UNIT OF THE STATE OF YAP)**

Notes to Financial Statements
September 30, 2011 and 2010

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.

During the year ended September 30, 2011, YSPSC implemented 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 implementation of this statement did not have a material effect on the financial statements of YSPSC.

(3) Cash and Cash Equivalents

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 policy for custodial credit risk.

As of September 30, 2011, the carrying amount of the YSPSC's total cash and cash equivalents was \$1,342,332, which includes restricted cash of \$1,168,832, and the corresponding bank balance was \$1,291,108, which is maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. At September 30, 2011, bank deposits in the amount of \$250,000 were FDIC insured. Collateralization of deposits is not required; therefore \$1,041,108 is uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

The amount of cash restricted, \$1,168,832, is from a grant from the European Union, which was not expended during fiscal year 2011. This amount is also shown on the Statement of Net Assets as restricted net assets. The purpose of this grant is to increase access to modern, affordable, and sustainable electricity services for the remote islands of Yap.

(4) Accounts Receivable and Accrued Unbilled Revenue

YSPSC's accounts receivable, less allowance for doubtful accounts, and accrued unbilled revenue at September 31, 2011 and 2010 were as follows:

**YAP STATE PUBLIC SERVICE CORPORATION
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September 30, 2011 and 2010

	2011	2010
Gross accounts receivable	\$ 868,845	\$ 802,864
Less allowance for doubtful accounts	(143,670)	(143,670)
Net accounts receivable	725,175	659,194
Accrued unbilled revenue	224,374	230,725
Net accounts receivable and accrued unbilled revenue	\$ 949,549	\$ 889,919

(5) Utility Plant

A summary of changes in capital assets for the years ended September 30, 2011 and 2010 is as follows:

	Beginning Balance October 1, 2010	Transfers and Additions	Transfers and Deletions	Ending Balance September 30, 2011
Depreciable Plant:				
Production plant	9,709,703	\$ 82,580	\$ -	\$ 9,792,283
Distribution plant	7,871,829	288,765	633,861	8,794,455
General plant	2,134,719	-	(633,861)	1,500,858
	19,716,251	371,345	-	20,087,596
Less accumulated depreciation	(11,484,421)	(722,303)	-	(12,206,724)
Non-depreciable plant:				
Work in progress	255,864	229,519	-	485,383
	\$ 8,487,694	\$ (121,439)	\$ -	\$ 8,366,255
	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	2,096,198	38,521	-	2,134,719
	19,234,052	482,199	-	19,716,251
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
	\$ 9,107,142	\$ (198,599)	\$ (420,849)	\$ 8,487,694

**YAP STATE PUBLIC SERVICE CORPORATION
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Notes to Financial Statements
September 30, 2011 and 2010

(6) Notes Payable

<u>2011</u>	<u>2010</u>	
\$ 2,066,461	\$ 2,111,878	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.
383,006	422,877	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.
1,429,915	1,501,861	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.
17,469	29,263	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.
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3,896,851	4,065,879	Total notes payable
284,421	225,308	Less current portion
<u>\$ 3,612,430</u>	<u>\$ 3,840,571</u>	

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

Notes to Financial Statements
September 30, 2011 and 2010

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

Year ending September 30,	Principal	Interest	Total
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	225,170	12,096	237,266
2017 through 2021	1,197,318	27,551	1,224,869
2022 through 2026	857,734	2,700	860,434
2027 through 2031	661,916	-	661,916
2032	60,336	-	60,336
	<u>\$ 3,896,851</u>	<u>\$ 108,756</u>	<u>\$4,005,607</u>

Changes in long-term liabilities for the years ended September 30, 2011 and 2010 are as follows:

	Outstanding September 30, 2010	Increases	Decreases	Outstanding September 30, 2011	Current	Noncurrent
ADB loan	\$2,111,878	\$ -	\$ 45,417	\$ 2,066,461	\$ 45,417	\$2,021,044
Yap State loan	422,877	-	39,871	383,006	81,343	301,663
YSL 7-38 loan	1,501,861	-	71,946	1,429,915	145,319	1,284,596
USA loan	29,263	-	11,794	17,469	12,342	5,127
	<u>\$ 4,065,879</u>	<u>\$ -</u>	<u>\$ 169,028</u>	<u>\$ 3,896,851</u>	<u>\$284,421</u>	<u>3,612,430</u>

	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>

**YAP STATE PUBLIC SERVICE CORPORATION
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Notes to Financial Statements
September 30, 2011 and 2010

(7) 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, 2011, the total variable fuel charge refund has been repaid to residential and commercial customers. 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 \$181,368, 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.

(8) Grants

YSPSC received the following grants and capital contributions as reported in the Statement of Activities during the years ended September 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
U.S. Department of the Interior	\$ 510,426	\$ 631,363
Yap State	165,697	72,122
European Union	-	34,638
	<u>\$ 676,123</u>	<u>\$ 738,123</u>

The European Union also granted YSPSC \$1,168,832, but this amount was not expended during fiscal year 2011. Therefore, this amount is shown as deferred revenue and restricted cash.

(9) Subsequent Events

The YSPSC is applying for a \$9,000,000 loan from the Asian Development Bank. The potential elements of this loan include: loan guarantees by the FSM National Government, loan participation by the State of Yap, and co-financing by the YSPSC in the amount of \$3,000,000. The loan, if received, will be expended for renewable energy in Yap proper, using a wind

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Notes to Financial Statements
September 30, 2011 and 2010

generator, a 300 kilowatt grid connected solar panel, and a more efficient 1.8 megawatt diesel generator.

(10) 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.

(11) Going Concern

During the year 2008 there was a going concern precipitated by a legislative decision mandating YSPSC repay customers a portion of their utility bill. YSPSC subsequently increased billing by legal utility rate increases and repaid customers a substantial amount of the liability; therefore, there was no longer a going concern issue during the 2010 fiscal year. However, in the 2011 fiscal year, because of rising fuel costs, YSPSC depleted operating cash and was past due on several invoices, including debt service to Yap State, vendors, and a liability estimating \$150,000, at September 30, 2011. A public hearing on rate increase proposals has been scheduled to occur before the end of calendar year 2011. Management believes these rate increases will be sufficient to alleviate the uncertainty regarding the going concern.

REPORTS REQUIRED BY *GOVERNMENT AUDITING STANDARDS*

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, 2011 and for the year then ended, and have issued our report thereon dated December 2, 2011. 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 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 2, 2011

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, 2011. 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, 2011.

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

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, 2011, and have issued our report thereon dated December 2, 2011. 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 2, 2011

Certified Public Accountants

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)
Schedule of Expenditures of Federal Awards
For the Year Ended September 30, 2011

Direct grants:			Beginning			Ending
US Department of Agriculture/ Rural Housing Service: Communities Facilities Loan and Grant Program	10.766	<u>Authorized</u> \$ 100,000	<u>Unearned</u> Revenue \$ -	<u>Expenses</u> \$ 78,474	<u>Cash</u> Receipts \$ 78,474	<u>Unearned</u> Revenue \$ -
US Department of Interior/ Office of Territorial and International Affairs: Economic, Social, and Political Development of the Territories/ Operations and Maintenance Improvement Programs (OMIP)						
Pacific Lineman Training	15.875	305,000	54,247	317,652	408,469	145,064
OMIP Capitalization and Recovery and Institution	15.875	199,942	-	49,080	49,986	905
Heavy Equipment Mechanics Training	15.875	124,500	-	33,112	33,112	-
Micronesia Water/Wastewater Training Program	15.875	279,500	2,291	32,108	33,348	3,531
Total US Department of Interior			<u>56,538</u>	<u>431,952</u>	<u>524,915</u>	<u>149,500</u>
All Federal Funding			<u>\$ 56,538</u>	<u>\$ 510,426</u>	<u>\$ 603,389</u>	<u>\$ 149,500</u>

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

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(A COMPONENT UNIT OF THE STATE OF YAP)**

Schedule of Findings and Questioned Costs
Year Ended September 31, 2011

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 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? Yes.
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.