

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

**Financial Statements and
Independent Auditors' Report**

September 30, 2009 and 2008

Fortenberry & Ballard, PC
Certified Public Accountants

Yap State Public Service Corporation
TABLE OF CONTENTS

PAGE	#
FINANCIAL AUDIT REPORT	
Independent Auditor's Report on the Basic Financial Statements	3
Management's Discussion and Analysis	5
FINANCIAL STATEMENTS	
Exhibit A - Combined Statement of Net Assets	13
Exhibit B - Combined Statement of Revenues, Expenses, and Changes in Net Assets	14
Exhibit C - Combined Statement of Cash Flows	15
Notes to the Financial Statements	17
REPORTS REQUIRED BY GOVERNMENTAL AUDITING STANDARDS (GAS)	
Independent Auditor's 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"	29
Independent Auditor's Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with <i>OMB Circular A-133</i>	31
FINDINGS, CORRECTIVE ACTION PLAN AND AUDIT FOLLOW-UP	
Schedule of Findings and Questioned Costs	34
Auditee's Schedule of Prior Audit Findings	35

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, 2009 and 2008, 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 an opinion 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Yap State Public Service Corporation as of September 30, 2009 and 2008, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 6 - 11 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Yap State Public Service Corporation's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurements and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with Government Auditing Standards, we have also issued our report dated December 31, 2009, 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

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

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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 not a required part of the basic financial statements. 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.

FORTENBERRY & BALLARD, PC

December 31, 2009

MANAGEMENT'S DISCUSSION AND ANALYSIS

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
Years ended September 30, 2009 and 2008

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, 2009 and 2008. 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, 2009, 2008 and 2007. It should be read in conjunction with the financial statements that follow this section. The following table summarizes the financial condition and operations of YSPSC as of 2009, 2008 and 2007.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
ASSETS			
Plant in Service, net	\$ 8,447,107	\$ 9,085,334	\$ 8,846,342
Work in progress, net of current portion	660,035	176,003	823,692
Current and other assets	<u>2,206,865</u>	<u>2,500,958</u>	<u>2,590,027</u>
Total assets	<u><u>11,314,007</u></u>	<u><u>11,762,295</u></u>	<u><u>\$ 12,260,061</u></u>
NET ASSETS AND LIABILITIES			
Invested in capital assets, net of related debt	\$ 4,827,710	\$ 6,360,740	\$ 6,769,437
Restricted	-	-	108,127
Unrestricted	<u>1,004,286</u>	<u>(888,049)</u>	<u>2,213,619</u>
Total net assets	<u>5,831,996</u>	<u>5,472,691</u>	<u>9,091,183</u>
Notes payable, net of current portion	4,065,899	2,679,432	2,793,156
Current portion of notes payable	213,533	113,723	107,441
Other current liabilities	<u>1,202,579</u>	<u>3,496,449</u>	<u>268,281</u>
Total liabilities	5,482,011	6,289,604	3,168,878
Total net asset and liabilities	<u><u>\$ 11,314,007</u></u>	<u><u>\$ 11,762,295</u></u>	<u><u>\$ 12,260,061</u></u>
REVENUES, EXPENSES, AND NET ASSETS			
Operating revenues	5,053,044	1,023,556	\$ 5,020,612
Operating expenses	<u>6,044,668</u>	<u>6,702,017</u>	<u>5,015,866</u>
Income (Loss) from operations	(991,624)	(5,678,461)	4,746

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
Years ended September 30, 2009 and 2008

	<u>2008</u>	<u>2008</u>	<u>2007</u>
Grants	1,878,146	2,182,373	236,600
Interest expense	(27,070)	(13,034)	(16,599)
Interest income	4,901	16,623	13,120
Gain (loss) on disposal of utility plant	(283)	-	296
Other income/(expenses)	<u>(606,714)</u>	<u>(487,536)</u>	<u>(190,253)</u>
Net income (loss)	257,429	(3,980,035)	47,910
Capital contributions	<u>101,876</u>	<u>361,543</u>	<u>1,264,718</u>
Change in net assets	359,305	(3,618,492)	1,312,628
Net assets, beginning	<u>5,472,691</u>	<u>9,091,183</u>	<u>7,778,555</u>
Net assets, ending	<u>\$ 5,831,996</u>	<u>\$ 5,472,691</u>	<u>\$ 9,091,183</u>

FINANCIAL OPERATIONS OVERVIEW

When YSPSC ended fiscal year 2008 with a \$5.8 million operating loss and liabilities of approximately \$6.3 million, the future of the company seemed bleak. But the responsiveness of the board, the dedication and commitment of the management and staff, and the understanding and cooperation of its valued customers, in addition to the financial support of the state government has allowed the YSPSC to weather the challenges of the past twelve months and has emerged leaner and stronger at the end fiscal year 2009 as a result of the difficult times.

Results of Operations

Operating Loss – The YSPSC ended fiscal year 2009 with an operating loss of \$991,624. While the loss may seem huge, compared to the \$5.6 million loss for fiscal year 2008, it is actually an 83% improvement over the past year's results. In February of 2009, a new electric tariff was adopted resulting in a 22% increase in revenue over fiscal year 2008. Strict cost cutting measures implemented by management and lower fuel prices resulted in a 10% decrease in operating costs. These measures taken by YSPSC during 2009 allowed it to continue service delivery throughout 2009 without interruption.

Fuel prices: Compared to the volatile fluctuations in fuel prices for 2007 and 2008, fuel prices remained fairly constant in 2009. When the fiscal year began in October 2008, the YSPSC was paying \$4.19 for a gallon of fuel. In December 2008, the price dropped to \$3.72 per gallon and for the remaining months, per gallon fuel prices to YSPSC fluctuated between \$3.72 and \$3.59. At the end of September 2009, the price per gallon to YSPSC was still \$3.592. The relatively stable prices are seen as primarily the result of world-wide fuel economics. However, the formation of the FSM Petroleum Corporation (FSMPC) which currently supplies the YSPSC with diesel fuel has also benefited the YSPSC by the FSMPC's efforts to mitigate the effects of fuel price fluctuations on customers. These events are the reason for the 13% decrease of production fuel expense in 2009 as compared to 2008.

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
Years ended September 30, 2009 and 2008

New Electric Tariff: In March 2008 when the YSPSC was directed by legislative action to repeal the variable fuel charge it had adopted in March 2006, the YSPSC was only able to bill its customer a base rate without allowances for fuel purchases. Fortunately, the state government stepped in with fuel subsidies, allowing YSPSC to purchase fuel for its generators. In the mean time, the board worked to revise the electric tariff to build in the cost of fuel into the base rate, rather than to bill it to customers as a fuel charge. The new tariff which was adopted by the Board on December 5, 2008 went into effect in February 2009 and is the primary reason for the 22% increase in revenue in 2009 as compared to 2008.

KWH Billed – The increase in revenue collections for 2009 is in part attributable to a modest increase of 2% in consumers' electricity consumption as compared to 2008. Across customer classes, consumption by residential and commercial customers increased 7% and 2%, respectively, while government consumption remained steady at approximately 2.9 million kWh.

Water Revenue – Revenue from water sales decreased slightly to \$434,896 for 2009 compared to \$462,650 for fiscal year 2008, despite the second installment of the water tariff increase which became effective at the beginning of fiscal year 2008. Overall water usage declined by approximately 9.5% in 2008 as compared to 2007. Consumption in 2009 is up slightly, however, this has not flowed through to water collections. This inconsistency will be investigated and changes made to the current method of accounting for amounts due from customers for electric and water sales to avoid future misclassifications – a possible explanation for the discrepancy.

Other Operating Expenses – In order to survive the limited working capital during fiscal year 2009, all other operating expenses were significantly reduced. Accordingly, salaries and wages decreased by 6% from \$720,799 in 2008 to \$679,015 in 2009 and administrative expenses declined 33% from \$281,492 in fiscal year 2008 to \$187,533 in 2009. Other production costs which consist primarily of spare parts for machinery and equipment showed a 60% increase from \$200,672 in 2008 to \$320,221 in 2009 due to work done in 2009 to overhaul the two Deutz generators.

Significant Changes to Net Assets

Noncurrent Assets – The utility plant in service decreased by \$819,473 in 2009 as compared to 2008. The decrease is attributable to retirements after a physical inspection of plant assets conducted to identify out of service and irreparable assets. The cost of the retired assets almost all of which were fully depreciated was \$913,998. \$520,000 of the costs retired was attributable to two old broken Caterpillar engines. During the year, \$94,555 of previous work in progress for the Woleai Power System was also added to plant assets during 2009.

Cash – YSPSC ended fiscal year 2009 with 13% less cash in the bank than had existed a year earlier at September 30, 2008. Despite the \$1.6 million loan from the State government for 66% of fuel charge refunds, and the new electric tariff implemented in February 2009, working capital remained scarce. Despite the 22% increase in revenue over 2008, the fuel charge credits given to customers resulted in

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
Years ended September 30, 2009 and 2008

only a 12% increase in cash collected from customers in 2009 as compared to 2008. Increased efforts by the billing staff to collect from customers with past due accounts in excess of unpaid fuel charge refunds and more timely payments from government accounts allowed the Corporation to survive from month to month.

Current Assets – Overall current assets decreased 4% in 2009 as compared to 2008, with the inventory of spare parts and fuel showing the largest decrease – from \$903,516 in 2008 compared to \$695,567 in 2009. The decrease is due to the lower cost of fuel on hand at the end of the year plus a decrease in the supply of spare parts as a result of the required 48,000 hour maintenance on the Deutz generators which was completed in 2009. Customer receivables shows a slight increase of 6% over 2008 as a result of the YSPSC easing up slightly on service disconnection for delinquent customers who were still owed fuel charge refunds required by YSL 7-25.

Current Liabilities – In total, current liabilities decreased by 64% from \$3,610,172 in 2008 to \$1,416,112 in 2009. The refunds payable to customers decreased by \$2,276,761 in 2009 from the original \$3,121,297 at the end of fiscal year 2008 to \$844,535 at September 30, 2009. The decrease is attributable to the sixty-six percent of the refunds payable to residential and commercial customers that were processed during fiscal year 2009, in addition to adjustments made to the liability to reflect amounts forgiven by the State government. Accounts payable at September 30, 2009 showed a 170% increase over 2008 as a result of delayed invoices for the Duetz generators 48,000 hour maintenance overhaul.

Long-Term Debt - The increase in the long-term portion of notes payable of \$1,386,467 is primarily due to the \$1.6 million loan from the State government to fund 66% of fuel charge credits in 2009 for residential and commercial electric customers. The new Yap State loan will mature in October 2023 and brings the number of loans currently being serviced by the YSPSC to four – two from the State government and one each from the U.S. Rural Housing Service and the Asian Development Bank. The old Yap State loan and the loan from the U.S. Rural Housing Service will mature in 2017 and 2013, respectively, but the Asian Development Bank loan will not mature until February 2032.

Capital Projects – Due to its commitment to refund customers for the 2006 fuel charge, YSPSC did not undertake any capital projects in 2009 other than the ongoing renewable energy project funded by the European Union and the French Embassy. Accordingly, the capital contributions of \$101,876 reflected for 2009 is 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

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
Years ended September 30, 2009 and 2008

island utilities; specifically, Guam Power Authority, Palau Public Utility Corporation, Pohnpei Utilities Corporation and Yap Public Services Corporation. YSPSC received \$476,752 and \$532,437, respectively in fiscal years 2009 and 2008 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. The project proposal was approved in 2009 and implementation of the project was begun. A total of \$45,682 in cost reimbursement for the program was received by YSPSC in fiscal year 2009.

Strategic Plan and Rate Study – YSPSC was successful in obtaining a \$99,500 grant from U.S. DOI/OIA to contract with appropriate utility and financial experts to develop a strategic plan to allow YSPSC to weather its current financial crisis and set its course for the next ten years. The plan will include a utility rate study that will be used to help revise customer rates. Presentation and submission of the first draft of the strategic plan and rate study for Yap Proper was completed in June 2009. The outer island rate study still has yet to be finalized. A total of \$78,313 was expended in 2009 for the project.

Fuel Subsidy – In October and December of 2008, the state government deposited two grants aggregating \$911,204 directly with the FSM Petroleum Corporation to defray the cost of fuel purchases for the YSPSC.

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.

HIGHLIGHTS FOR FISCAL YEAR 2010

Having survived the financial challenges of 2009, YSPSC looks to the year 2010 with renewed vigor. The DOI funded Strategic Plan expected to be finalized 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 crises. In the short-term, the YSPSC will also be completing the following new and ongoing projects and activities:

Fuel Surcharge Refund to customers – In October 2008, the State of Yap appropriated \$1.6 million as a loan to YSPSC to provide the cash needed to settle the \$3.12 million owed to customers in fuel

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
Years ended September 30, 2009 and 2008

surcharge refunds. The loan was intended to fund only 66% of the total refunds owed to residential and commercial electric customers and such refunds were processed beginning November 2008 through February 2009. In October 2009, YSPSC credited the remaining 34% of fuel charge refunds worth \$310,033 to the accounts of residential customers, thereby fully satisfying its liability to this class of customers. The remaining \$534,503 representing 34% of refunds to commercial customers and 100% of refunds owed to the national government will be settled in 2010.

New Electric Tariff – Upon its finalization of the proposed new electric tariff included in the DOI strategic plan by the consultants and official endorsement by the YSPSC and the state leadership, the YSPSC will begin the process of implementing the new electric rate, including helping the public understand how the new rate is structured.

Renewable Energy – YSPSC has been awarded a \$50,000 grant from the French Embassy as part of its renewable energy program. This particular grant will be used to set up solar panels at the dispensary in Falalop, Ulithi.

DOI funded Training Programs – During fiscal year 2010, YSPSC will be administering three training programs for the utility companies in Micronesia – the ongoing Pacific Linemen Training program, the Water and Wastewater Management training program begun in 2008 and a recent grant of \$254,000 for Micronesian Heavy Equipment training program. The regional utility companies participating in the training program, in addition to the YSPSC, are the Guam Power Authority, the Pohnpei Public Utilities Corporation and the Palau Public Utilities Corporation.

New Grant Requests – A grant proposal for \$135,000 has been submitted to the U.S. Department of Agriculture (USDA) for a bucket truck to replace the existing bucket truck in service. Efforts are also underway to obtain a grant from DOI of \$50,000 to upgrade the billing software for YSPSC.

FINANCIAL STATEMENTS

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

Statements of Net Assets
Years Ended September 30, 2009 and 2008

<u>ASSETS</u>	<u>2009</u>	<u>2008</u>
Non-current assets:		
Utility plant:		
Plant in service	\$ 19,234,052	\$ 20,053,495
Work in progress	660,035	176,003
Less accumulated depreciation	<u>(10,786,945)</u>	<u>(10,968,161)</u>
Utility plant, net	<u>9,107,142</u>	<u>9,261,337</u>
Current assets:		
Cash and cash equivalents	612,649	706,850
Accounts receivable	827,876	767,466
Other receivables	27,036	8,253
Inventory	695,565	903,516
Prepaid expenses	<u>43,739</u>	<u>114,873</u>
Total current assets	<u>2,206,865</u>	<u>2,500,958</u>
Total assets	<u>\$ 11,314,007</u>	<u>\$ 11,762,295</u>
<u>NET ASSETS AND LIABILITIES</u>		
Net assets (deficit):		
Invested in capital assets, net of related debt	\$ 4,827,710	\$ 6,468,182
Restricted	-	-
Unrestricted	<u>1,004,286</u>	<u>(995,491)</u>
Total net assets	<u>5,831,996</u>	<u>5,472,691</u>
Contingencies		
Current liabilities:		
Current portion of notes payable	213,533	113,723
Refunds payable to customers	844,535	3,121,297
Accounts payable	167,299	61,900
Employees' annual leave and accrued payroll	57,744	46,167
Accrued taxes and other liabilities	18,897	42,898
Deferred revenue	41,554	134,816
Other payables and customer deposits	<u>72,550</u>	<u>89,371</u>
Total current liabilities	<u>1,416,112</u>	<u>3,610,172</u>
Notes payable, net of current portion	<u>4,065,899</u>	<u>2,679,432</u>
Total liabilities	<u>5,482,011</u>	<u>6,289,604</u>
Total net assets and liabilities	<u>\$ 11,314,007</u>	<u>\$ 11,762,295</u>

See accompanying notes to financial statements

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Operating revenues:		
Electricity sales	\$ 4,618,148	\$ 3,682,203
Water sales	434,896	462,650
Total operating revenues	<u>5,053,044</u>	<u>4,144,853</u>
Refunds to customers	-	(3,121,297)
Net operating revenues	<u>5,053,044</u>	<u>1,023,556</u>
Operating expenses:		
Production fuel	4,125,087	4,733,975
Depreciation	732,812	765,079
Salaries and wages and related expenses	679,015	720,799
Administrative and general	187,533	281,492
Other production costs	320,221	200,672
Total operating expenses	<u>6,044,668</u>	<u>6,702,017</u>
Operating (loss) income	(991,624)	(5,678,461)
Interest and other nonoperating income, net	4,901	16,623
Foreign exchange loss	(41)	(1,304)
Operating grants and subsidies	1,878,146	2,182,373
Interest expense	(27,070)	(13,034)
Training expense	(567,483)	(486,232)
Other income (expense)	(39,117)	-
Loss on disposal of utility plant	(283)	-
Net (loss) earnings before capital contributions	<u>257,429</u>	<u>(3,980,035)</u>
Capital contributions	<u>101,876</u>	<u>361,543</u>
Change in net assets	359,305	(3,618,492)
Net assets at beginning of year	5,472,691	9,091,183
Net assets at end of year	<u>\$ 5,831,996</u>	<u>\$ 5,472,691</u>

See accompanying notes to financial statements.

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

Statements of Cash Flows
Years Ended September 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Cash flows from operating activities:		
Cash received from customers	\$ 4,880,589	\$ 4,333,547
Cash refunds paid to customers	(2,276,762)	-
Cash paid to suppliers	(4,289,179)	(5,417,422)
Cash paid to employees	<u>(667,438)</u>	<u>(752,924)</u>
Net cash provided by (used in) operating activities	<u>(2,352,790)</u>	<u>(1,836,799)</u>
Cash flows from investing activities:		
Interest and other income	<u>4,901</u>	<u>15,319</u>
Net cash provided by investing activities:	<u>4,901</u>	<u>15,319</u>
Cash flows from noncapital financing activities:		
Proceeds from operating grants and subsidies	1,878,146	2,182,373
Other expense	<u>(606,671)</u>	<u>(486,232)</u>
Net cash provided by noncapital financing activities	<u>1,271,475</u>	<u>1,696,141</u>
Cash flows from capital and related financing activities:		
Capital contributions	101,876	361,543
Acquisition of utility plant	(578,870)	(356,382)
Interest paid	(27,070)	(13,034)
Proceeds from issuance of long-term debt	1,600,000	-
Repayment of notes payable	<u>(113,723)</u>	<u>(107,442)</u>
Net cash provided by (used in) capital and related financing activities	<u>982,213</u>	<u>(115,315)</u>
Net change in cash and cash equivalents	(94,201)	(240,654)
Cash and cash equivalents at beginning of year	706,850	947,504
Cash and cash equivalents at end of year	<u>\$ 612,649</u>	<u>\$ 706,850</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, 2009 and 2008

Reconciliation of operating (loss) income to net cash (used in) provided by operating activities:	<u>2009</u>	<u>2008</u>
Operating (loss) income	\$ (991,624)	\$ (5,678,461)
Adjustments to reconcile operating (loss) income to net cash (used in) provided by operating activities:		-
Depreciation	732,812	765,079
Decrease (increase) in assets:		
Receivables	(60,410)	101,184
Inventory	207,951	(157,692)
Prepaid expenses	71,134	(94,404)
Other receivables	(18,783)	(673)
Increase (decrease) in liabilities:		
Refunds payable to customers	(2,276,762)	3,121,297
Accounts payable	105,399	21,775
Employees' annual leave and accrued payroll	11,577	(32,124)
Accrued taxes and other withholdings	(24,001)	10,457
Deferred revenue	(93,262)	88,185
Other payables and customer deposits	(16,821)	18,578
Net Cash (used in) provided by operating activities	<u>\$ (2,352,790)</u>	<u>\$ (1,836,799)</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, 2009 and 2008

(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.

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.

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.

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

Notes to Financial Statements
September 30, 2009 and 2008

- **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. YSPSC has no nonexpendable restricted net assets at September 30, 2009 and 2008.

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, 2009 and 2008 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, 2009 and 2008, 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.

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.

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

Notes to Financial Statements
September 30, 2009 and 2008

Revenues

Sales of electricity and water are recorded as billed to customers on a monthly billing cycle basis. At September 30, 2009 and 2008, unbilled revenues of \$216,662 and \$128,994, 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 post employment 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 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

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

Notes to Financial Statements
September 30, 2009 and 2008

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

In July 2004, GASB issued 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 provisions of this statement are effective for YSPSC for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of YSPSC.

In December 2006, GASB issued 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 provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of YSPSC.

In June 2007, GASB issued 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 provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of YSPSC.

In June 2008, GASB issued 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 provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of YSPSC.

(3) Cash and Cash Equivalents

GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

Category 1 Deposits that are federally insured or collateralized with securities held by YSPC or its agent in YSPSC's name;

Category 2 Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in YSPSC's name; or

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

Notes to Financial Statements
September 30, 2009 and 2008

Category 3 Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in YSPSC's name and non-collateralized deposits.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, 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 YSPSC's name. YSPSC does not have a deposit policy for custodial credit risk.

As of September 30, 2009 and 2008, the carrying amount of YSPSC's total cash and time certificates of deposit was \$612,649 and \$706,850, respectively, and the corresponding bank balances were \$655,845 and \$750,310, respectively. All of the bank balances are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2009 and 2008, bank deposits of \$250,000 were FDIC insured. YSPSC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk. YSPSC has not experienced any losses in such accounts and management believes it is not exposed to any significant credit risk on its deposits.

(4) Utility Plant

A summary of changes in capital assets for the years ended September 30, 2009 and 2008 is as follows:

	<u>Beg. Balance Oct. 1, 2008</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>End. Balance Sept. 30, 2009</u>
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	<u>2,101,528</u>	<u> </u>	<u>5,360</u>	<u>2,096,198</u>
	20,053,495	94,555	914,028	19,234,052
Less accumulated depreciation	(10,968,161)	(732,812)	914,028	(10,786,945)
Non-depreciable plant:				
Work in progress	<u>176,003</u>	<u>484,032</u>	<u> </u>	<u>660,035</u>
	<u>\$ 9,261,337</u>	<u>\$(154,225)</u>	<u>\$1,828,056</u>	<u>\$9,107,142</u>

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

Notes to Financial Statements
September 30, 2009 and 2008

	<u>Beg. Balance Oct. 1, 2007</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>End. Balance Sept. 30, 2008</u>
Depreciable Plant:				
Production plant	\$ 9,759,000	\$34,521		\$9,793,521
Distribution plant	7,216,030	942,416		8,158,446
General plant	<u>2,074,394</u>	<u>27,134</u>		<u>2,101,528</u>
	19,049,424	1,004,071	-	20,053,495
Less accumulated depreciation	(10,203,082)	(765,079)		(10,968,161)
Non-depreciable plant:				
Work in progress	<u>823,692</u>	<u>269,298</u>	<u>(916,987)</u>	<u>176,003</u>
	<u>\$9,670,034</u>	<u>\$508,290</u>	<u>\$(916,987)</u>	<u>\$9,261,337</u>

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

	<u>2009</u>	<u>2008</u>
Electric plant	\$ 12,259,270	\$ 13,233,981
Water plant	<u>6,974,782</u>	<u>6,819,514</u>
	<u>\$ 19,234,052</u>	<u>\$ 20,053,495</u>

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

Notes to Financial Statements
September 30, 2009 and 2008

(5) Notes Payable

<u>2009</u>	<u>2008</u>	
		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.
\$ 2,157,295	\$ 2,202,712	
		Uncollateralized note of original principal of \$824,420 payable to Yap State in quarterly interest only payments through March 2003; monthly principal and interest payments 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.
481,611	539,163	
		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.
1,600,000	-	
		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.
<u>40,526</u>	<u>51,280</u>	
4,279,432	2,793,155	Total notes payable
<u>213,533</u>	<u>113,723</u>	Less current portion
<u>\$ 4,065,899</u>	<u>\$ 2,679,432</u>	

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

Notes to Financial Statements
September 30, 2009 and 2008

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

Year ending September 30,	Principal	Interest	Total
2010	\$ 213,557	\$ 26,158	\$ 126,127
2011	225,308	23,351	126,126
2012	228,137	20,513	126,126
2013	223,135	17,703	126,126
2014	220,359	15,290	118,342
2015 through 2019	1,165,556	43,514	589,341
2020 through 2024	1,095,159	10,120	605,630
2025 through 2029	605,632	-	605,630
2030 through 2034	302,589	-	423,727
	<u>\$ 4,279,432</u>	<u>\$ 156,649</u>	<u>\$ 2,847,175</u>

Changes in long-term liabilities for the years ended September 30, 2009 and 2008 are as follows:

	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>\$ 4,065,899</u>

	Outstanding September 30, 2007	Increases	Decreases	Outstanding September 30, 2008	Current	Noncurrent
ADB loan	\$ 2,248,129	\$ -	\$ 45,417	\$ 2,202,712	\$ 45,416	\$ 2,157,296
Yap State loan	590,919	-	51,756	539,163	57,553	481,610
USA loan	61,549	-	10,269	51,280	10,754	40,526
	<u>\$ 2,900,597</u>	<u>\$ -</u>	<u>\$ 107,442</u>	<u>\$ 2,793,155</u>	<u>\$ 113,723</u>	<u>\$ 2,679,432</u>

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

Notes to Financial Statements
September 30, 2009 and 2008

(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:

As discussed in Note 11, Yap State Law (YSL) No. 7-25 mandates that YSPSC credit back certain charges to prior customers. 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 for given this debt.

(7) Significant Revenue Sources

Power and water billings to Yap State Government agencies accounted for 25% and 22%, respectively, of operating revenues for the years ended September 30, 2009 and 2008.

(8) Restricted Net Assets

There were no restricted net assets at September 30, 2009 or 2008.

(9) Grants

YSPSC received the following grants and capital contributions during the years ended September 30, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
U.S. Federal Emergency Management Agency	\$ -	\$ 133,183
U.S. Department of the Interior	612,235	532,437
Yap State (including \$354,887 forgiveness)	1,265,911	1,649,936
European Union donated capital	95,427	169,935
French Embassy donated capital	6,449	-
Yap State donated capital	-	58,425
	<u>\$ 1,980,022</u>	<u>\$ 2,543,916</u>

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

Notes to Financial Statements
September 30, 2009 and 2008

(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) Variable Fuel Charge Refund

Prior to March 2006, YSPSC's electricity rate structure included a \$0.035 fuel surcharge per kWh used by consumers. Effective with the March 2006 meter readings, YSPSC implemented a new rate structure which included a variable fuel charge for electrical customers. With the new rate structure, electricity rates billed to customers increased or decreased in proportion to the fuel price changes of the fuel purchased by YSPSC.

In February 2008, the Yap State Legislature enacted Law No. 7-25 to amend Yap State Law No. 4-4, YSPSC's enabling legislation. 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, 2009, the total variable fuel charge refund payable to customers amounted \$844,536. At September 30, 2008 this payable was \$3,121,297. 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 #7-38 and discussed in Note 5.

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, 2009 and for the year then ended, and have issued our report thereon dated December 31, 2009. 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A *material weakness* is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be 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.

AICPA & MSCPA

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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 31, 2009

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 are applicable to each of its major federal programs for the year ended September 30, 2009. 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 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 are applicable to each of its major federal programs for the year ended September 30, 2009.

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, 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.

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A *control deficiency* in an entity's 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be 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, 2009, and have issued our report thereon dated December 31, 2009. 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 31, 2009

Certified Public Accountants

Yap State Public Service Corporaton
(A Component Unit of the State of Yap)
Schedule of Expenditures of Federal Awards
for the year ended September 30, 2009

<u>Grantor/Program</u>	<u>CFDA #</u>	<u>Total Authorized</u>	<u>Unearned Revenue Beginning of Year</u>	<u>Expenses</u>	<u>Cash Receipts</u>	<u>Unearned Revenue at End of Year</u>
Direct Grants:						
U.S. Department of the Interior:						
Office of Territorial and International Affairs: Economic, Social, and Political Development of the Territories/Operations and Maintenance Improvement Programs (OMIP)	15.875					
Pacific Lineman Training		\$ 753,500	\$ 74,751	\$ 476,752	\$ 417,730	\$ 15,729
Strategic Plan and Rate Study Program		99,500	-	78,313	99,500	21,187
OMIP Wasterwater Training Specialist		49,000	-	11,488	-	-
Micronesia Water/Wastewater Training Program		279,500	-	45,682	45,682	-
			\$ 74,751	\$ 612,235	\$ 562,912	\$ 36,916

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)**

Findings and Questioned Costs
Year Ended September 30, 2009

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? Yes.

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)
Auditee's Summary Schedule of Prior Audit Findings
September 30, 2009

As required by Section __.315(b) of OMB Circular A-133, Yap State Public Service Corporation has prepared and hereby submits the following summary schedule of prior audit findings as of September 30, 2009:

<u>Finding</u>	<u>Finding Status</u>
2008-1	Corrected.