

YAP STATE PUBLIC SERVICE CORPORATION

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

SEPTEMBER 30, 2002 AND 2001

Deloitte & Touche LLP
361 South Marine Drive
Tamuning, Guam
96913-3911

Tel: (671)646-3884
Fax: (671)649-4932
www.dttguam.com



INDEPENDENT AUDITORS' REPORT

The Board of Directors
Yap State Public Service Corporation:

We have audited the accompanying balance sheets of the Yap State Public Service Corporation, a component unit of the Yap State Government, as of September 30, 2002 and 2001, and the related statements of operations and net assets and 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 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 opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of Yap State Public Service Corporation as of September 30, 2002 and 2001, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 1 to the financial statements, Yap State Public Service Corporation changed its method of accounting for nonexchange transactions to conform with Government Accounting Standards Board Statement No. 33 and has restated the 2001 financial statements to reflect the change.

Our audit of the financial statements for the year ended September 30, 2002, was made for the purpose of expressing our opinion on the financial statements taken as a whole. The accompanying Schedule of Expenditures on Asia Development Bank Financed Projects on page 8 is presented for purposes of additional analysis. This additional information 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 financial statements and in our opinion, is fairly stated in all material respects, in relation to the financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 26, 2002, on our consideration of the Yap State Public Service Corporation's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. 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.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, flowing style.

November 26, 2002

YAP STATE PUBLIC SERVICE CORPORATION

Balance Sheets
September 30, 2002 and 2001

<u>ASSETS</u>	<u>2002</u>	<u>2001</u> As restated (note 1)
Utility plant (note 2):		
Plant in service	\$ 16,732,977	\$ 13,442,039
Work in progress	340,450	2,769,776
Less accumulated depreciation	<u>(6,878,917)</u>	<u>(6,252,463)</u>
Utility plant, net	<u>10,194,510</u>	<u>9,959,352</u>
Current assets:		
Cash	956,936	1,068,853
Time certificates of deposit	680,000	-
Accounts receivable, net of an allowance for doubtful accounts of \$209,815 in 2002 and 2001	443,448	492,509
Other receivables	41,953	68,034
Inventory	293,942	286,788
Prepaid expense	<u>-</u>	<u>1,625</u>
Total current assets	<u>2,416,279</u>	<u>1,917,809</u>
	<u>\$ 12,610,789</u>	<u>\$ 11,877,161</u>
<u>RETAINED EARNINGS AND LIABILITIES</u>		
Retained earnings	\$ <u>9,167,305</u>	\$ <u>9,352,706</u>
Current liabilities:		
Current portion of notes payable (note 7)	17,130	-
Accounts payable	17,830	1,197
Accrued taxes and other withholdings	38,516	37,954
Employees' annual leave and accrued payroll	68,903	60,420
Other payables	81,169	129,111
Deferred revenue	<u>138,809</u>	<u>138,809</u>
Total current liabilities	362,357	367,491
Notes payable (note 7)	3,081,127	1,776,338
Construction payables	<u>-</u>	<u>380,626</u>
	<u>3,443,484</u>	<u>2,524,455</u>
Contingency (note 4)	<u>\$ 12,610,789</u>	<u>\$ 11,877,161</u>

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION

Statements of Operations and Net Assets
Years Ended September 30, 2002 and 2001

	<u>2002</u>	<u>2001</u> As restated (note 1)
Operating revenues (note 6):		
Electricity sales	\$ 2,857,146	\$ 2,862,098
Water sales	<u>444,821</u>	<u>429,772</u>
Total operating revenues	<u>3,301,967</u>	<u>3,291,870</u>
Operating expenses:		
Production fuel	1,588,889	1,736,711
Salaries and wages and related	711,669	695,734
Depreciation	667,613	701,023
Other production costs	613,405	633,014
Administrative and general	<u>327,235</u>	<u>252,697</u>
Total operating expenses	<u>3,908,811</u>	<u>4,019,179</u>
Loss from operations	(606,844)	(727,309)
Other nonoperating income (note 5)	425,580	414,402
Interest expense	<u>(4,137)</u>	<u>-</u>
Loss before extraordinary item	(185,401)	(312,907)
Extraordinary item - fire loss (note 8)	<u>-</u>	<u>(504,313)</u>
Net loss	(185,401)	(817,220)
Retained earnings at beginning of year	<u>9,352,706</u>	<u>10,169,926</u>
Retained earnings at end of year	\$ <u><u>9,167,305</u></u>	\$ <u><u>9,352,706</u></u>

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION

Statements of Cash Flows
Years Ended September 30, 2002 and 2001

	<u>2002</u>	<u>2001</u> As restated (note 1)
Cash flows from operating activities:		
Loss from operations	\$ (606,844)	\$ (727,309)
Other income	4,182	3,364
Adjustments to reconcile loss from operations to net cash provided by (used for) operating activities:		
Depreciation	667,613	701,023
(Increase) decrease in assets:		
Receivables	49,061	(109,486)
Inventory	(7,154)	(22,165)
Other receivables	(1,297)	9,290
Prepaid expenses	1,625	28,262
Increase (decrease) in liabilities:		
Accounts payable	16,633	(28,381)
Accrued taxes and other liabilities	9,045	(3,043)
Other payables	(47,942)	(154,475)
Net cash provided by (used for) operating activities	<u>84,922</u>	<u>(302,920)</u>
Cash flows from investing activities:		
Purchases of time certificates of deposit	(680,000)	-
Proceeds from time certificates of deposit	-	848,543
Interest income	22,401	53,244
Net cash (used for) provided by investing activities	<u>(657,599)</u>	<u>901,787</u>
Cash flows from noncapital financing activities:		
Contributed capital and other grants received in cash	<u>426,375</u>	<u>392,956</u>
Cash flows from capital and related financing activities:		
Purchase of utility plant	(1,283,397)	(1,998,905)
Proceeds from loan	1,321,919	766,609
Interest paid	(4,137)	-
Contract retention	-	227,112
Net cash provided by (used for) capital and related financing activities	<u>34,385</u>	<u>(1,005,184)</u>
Net change in cash	(111,917)	(13,361)
Cash at beginning of year	<u>1,068,853</u>	<u>1,082,214</u>
Cash at end of year	\$ <u><u>956,936</u></u>	\$ <u><u>1,068,853</u></u>

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION

Notes to Financial Statements
September 30, 2002 and 2001

(1) Summary of Significant Accounting Policies

The accounting policies of Yap State Public Service Corporation (YSPSC) conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds.

Basis of Accounting: 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 on the balance sheet.

The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses recorded at the time liabilities are incurred.

General: YSPSC is a component unit of the Government 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.

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: 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 the years ended September 30, 2002 and 2001 was approximately 4.0% and 5.2% of the cost of depreciable properties, respectively.

Annual and Sick Leave: Earned but unused 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, 2002 and 2001, unbilled revenues are estimated and accrued based on the most recent billing cycles.

Accounting Standards: 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.

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 determined using the first in-first out method.

YAP STATE PUBLIC SERVICE CORPORATION

Notes to Financial Statements
September 30, 2002 and 2001

(1) Summary of Significant Accounting Policies, Continued

Cash: For purposes of the balance sheets and statements of cash flows, cash includes cash on hand, cash in bank checking and savings accounts and time certificates of deposit with initial maturities of three months or less. Time certificates of deposit with initial maturities in excess of three months are separately categorized. At September 30, 2002 and 2001, \$100,000 and \$200,000, respectively, of cash and certificate of deposit balances are subject to Federal Deposit Insurance Corp. (FDIC) coverage, with the remaining balance exceeding insurable limits. Therefore, the amounts which exceed FDIC limits are characterized as uncollateralized.

Management Estimates: The preparation of financial statements in conformity with generally accepted accounting principles 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.

Receivables: All of YSPSC's accounts receivable are with customers and government agencies based in the State of Yap.

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.

Reclassifications: Certain items in the 2001 financial statements have been reclassified to conform with the 2002 presentation.

Adoption of New Accounting Principle: Effective October 1, 2001, YSPSC adopted GASB Statement No. 33, "Accounting and Financial Reporting for Nonexchange Transactions." GASB No. 33 establishes uniform revenue recognition criteria and financial reporting standards regarding the timing of recognition of the results of nonexchange transactions involving cash and other financial and capital resources. The provisions of GASB No. 33 are to be applied to all periods presented and, accordingly, the statement of operations for 2001 has been restated to reflect additional grant income of \$219,474.

(2) Utility Plant

Utility plant consists of the following at September 30, 2002 and 2001:

	<u>Estimated Useful Lives</u>	<u>2002</u>	<u>2001</u>
Production plant	5 - 40 years	\$ 9,105,270	\$ 8,869,782
Distribution plant	5 - 40 years	6,913,101	3,874,139
General plant	3 - 20 years	<u>714,606</u>	<u>698,118</u>
Utility plant in service		16,732,977	13,442,039
Work in progress		<u>340,450</u>	<u>2,769,776</u>
		17,073,427	16,211,815
Less accumulated depreciation		<u>(6,878,917)</u>	<u>(6,252,463)</u>
		<u>\$ 10,194,510</u>	<u>\$ 9,959,352</u>

YAP STATE PUBLIC SERVICE CORPORATION

Notes to Financial Statements
September 30, 2002 and 2001

(2) Utility Plant, Continued

Utility plant is comprised of the following components:

Electric plant	\$ 10,299,358	\$ 9,647,519
Water plant	<u>6,433,619</u>	<u>3,794,520</u>
	\$ <u>16,732,977</u>	\$ <u>13,442,039</u>

(3) Related Party Transactions

In the ordinary course of business, YSPSC enters into transactions with the State of Yap and private businesses in which certain of 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.

(4) Contingency

Real Property Title

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.

(5) Other Income

In 2002 and 2001, YSPSC included the following operating and capital grants within other nonoperating income:

	<u>2002</u>	<u>2001</u>
U.S. Department of the Interior OMIP grants	\$ 257,579	\$ 100,915
Australian Disaster Relief grant	15,000	40,000
Other U.S. Department of the Interior grants	-	130,877
U.S. Federal Emergency Management Agency grants	104,824	-
Yap State Capital grants	<u>21,594</u>	<u>86,000</u>
	\$ <u>398,997</u>	\$ <u>357,792</u>

(6) Significant Revenue Sources

Power and water billings to Yap State Government agencies accounted for 21% and 24% of total operating revenues in 2002 and 2001, respectively.

YAP STATE PUBLIC SERVICE CORPORATION

Notes to Financial Statements
September 30, 2002 and 2001

(7) Notes Payable

Notes payable at September 30, 2002 and 2001 are as follows:

	<u>2002</u>	<u>2001</u>
Loan payable to the Asia Development Bank 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 August 2036 and the loan is collateralized by the guarantee of the FSM National Government.	\$ 2,270,837	\$ 1,776,338
Uncollateralized note 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.	<u>827,420</u>	<u>-</u>
Total notes payable	3,098,257	1,776,338
Less current portion	<u>17,130</u>	<u>-</u>
	<u>\$ 3,081,127</u>	<u>\$ 1,776,338</u>

The scheduled maturities of these notes payable are as follows:

Year ending <u>September 30,</u>	
2003	\$ 17,130
2004	52,080
2005	53,131
2006	54,204
2007	78,006
Thereafter	<u>2,843,706</u>
	<u>\$ 3,098,257</u>

(8) Extraordinary Item

In March 2001, YSPSC's administrative office and a warehouse were destroyed by fire resulting in an extraordinary loss of \$504,313.

YAP STATE PUBLIC SERVICE CORPORATION

Schedule of Expenditures on Asian Development Bank Financed Projects
September 30, 2002

<u>Project</u>	<u>Paid by Yap State and YSPSC</u>	<u>Paid from Asian Development Loan Proceeds</u>	<u>Total</u>
Eye well drilling	\$ 24,455	\$ 220,105	\$ 244,560
Water Distribution Pipeline	178,630	1,607,668	1,786,298
Eye well field design	46,350	417,147	463,497
Well field generator	<u>-</u>	<u>25,917</u>	<u>25,917</u>
	\$ <u>249,435</u>	\$ <u>2,270,837</u>	\$ <u>2,520,272</u>

See Accompanying Independent Auditors' Report.