

YAP STATE PUBLIC SERVICE CORPORATION

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

SEPTEMBER 30, 2003 AND 2002

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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 Yap State Government, as of September 30, 2003 and 2002, 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, 2003 and 2002, 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 adopted the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and GASB Statement No. 38, *Certain Financial Statements Note Disclosures*, as of October 1, 2002. The accompanying 2002 financial statements have been restated to reflect the changes required by GASB 34.

The Management Discussion and Analysis on pages 1-3 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. 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 November 26, 2003, 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 cursive script that reads "Deloitte + Touche LLP".

November 26, 2003

YAP STATE PUBLIC SERVICE CORPORATION

Management Discussion and Analysis Year Ending September 30, 2003

The following Management Discussion and Analysis of the Yap State Public Service Corporation's (YSPSC) activities and financial performance provides the reader with an introduction and overview to the financial statements for the fiscal year ended September 30, 2003. 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. Government Accounting Standards Boards requires that published financial statements must contain a management discussion and analysis. This section of the Yap State Public Service Corporation's, (YSPSC), annual report presents our discussion of YSPSC's performance for the years ended September 30, 2003 and 2002. It should be read in conjunction with financial statements that follow this section.

The following table summarizes the financial condition and operation of YSPSC 2003 and 2002.

ASSETS	<u>2003</u>	<u>2002</u>
Plant in service, net	\$ 9,564,720	\$ 9,854,060
Work in progress, capital projects	805,531	340,450
Current assets	<u>2,151,597</u>	<u>2,416,279</u>
Total assets	\$ <u>12,521,848</u>	\$ <u>12,610,789</u>
NET ASSETS AND LIABILITIES		
Invested in capital assets, net of related debt	\$ 7,190,925	\$ 7,096,253
Restricted	539,265	138,809
Unrestricted	<u>1,290,669</u>	<u>2,071,052</u>
Total net assets	9,020,859	9,306,114
Long-term debt	3,118,708	3,081,127
Current portion long-term debt	60,618	17,130
Other current liabilities	<u>321,663</u>	<u>206,418</u>
Total liabilities	<u>3,500,989</u>	<u>3,304,675</u>
Total net assets and liabilities	\$ <u>12,521,848</u>	\$ <u>12,610,789</u>
REVENUES, EXPENSES, AND NET ASSETS		
Operating revenues	\$ 3,304,830	\$ 3,306,149
Operating expenses	<u>4,013,309</u>	<u>3,908,811</u>
Loss from operations	<u>(708,479)</u>	<u>(602,662)</u>
Capital Grants	434,096	398,997
Interest Income	22,216	22,401
Interest Expense	(20,608)	(4,137)
Loss on disposal of utility plant	(12,480)	-
Other Income/Expense	<u>22,768</u>	<u>417,261</u>
Net loss	<u>(262,487)</u>	<u>(185,401)</u>
Net assets, beginning	<u>9,306,114</u>	<u>9,491,515</u>
Net assets, ending	\$ <u>9,043,627</u>	\$ <u>9,306,114</u>

YAP STATE PUBLIC SERVICE CORPORATION

Management Discussion and Analysis
September 30, 2003 and 2002

2003 FINANCIAL OPERATION HIGHLIGHTS

Overall economic conditions in Yap during fiscal year 2003 were depressed. Consequently, YSPSC was not able to continue additional growth in annual revenues. Electrical service billings at 15.06 million kwh were below the 15.44 attained in fiscal year 2002. Electrical work order services for the year were sufficient to provide a small increase the total electric sales. Overall water service revenues were down FY-2003 due to less work order and dockside water sales. This resulted in \$160,000 less cash collected in FY-2003 than the all time high of \$3.38 million in FY2002. Despite the decline in service demand, the Corporation was able to maintain its monthly cash collection at approximately 100% of billings. Services were also provided without any operating subsidies.

Operating expenses incurred of \$4.013 million were 2.67% above FY-2002. Additional expenses in generation plant repairs and maintenance and personnel expense areas partly attributed to the increase. Changes in foreign exchange rates for the Australian dollar were the major cause of the increased repair and maintenance cost. Increases over budgeted amounts in personnel cost were experienced due to unexpected repatriation expenses for the General Manager and Controller. Relocation costs for a new Water/Sewer Division manager and a Chief Electrical Engineer, also, contributed to the increased personnel costs. Fuel costs for FY-2003 at \$1.731 million were the single biggest contributor to the increased operating expenses. Per gallon fuel costs averaged \$1.30 per gallon; up \$0.13 over the FY-2002 per gallon average. YSPSC sustained an operating loss of \$708,000 compared to \$602,662 in FY-2002.

During the first quarter, the Water Division received a \$14,095 FEMA grant to repair the Colonia sewer outflow caused by tropical storm Mitag. In the fourth quarter, the Electric Power Division received a \$420,000 grant from the FSM National Government to move and recondition the electric power generation plant in Falalop, Woleai. At year end, only a small portion of that grant (\$19,544) had been expended for the beginning mobilization of the project. Net loss for the year was \$262,487.

Much time, effort, and revenue was expended in FY-2003 on the completion of the new office and operating facilities. YSPSC was able to acquire additional long term financing of \$103,000 at 4.625% annual interest for 10 years from the U.S. Rural Development Program. This financing was used to augment the Yap State Government loan acquired in FY-2002 for the completion of the new facilities. Other capital expenditures of \$186,000 were paid from operating revenues and capital grants received in the previous year.

Stagnant service demand, increased operating expenses, and capital expenditures in FY-2003 all played a part in heavy drains on uncommitted operating cash reserves. YSPSC has reached a major crossroad in its continuing operations. In FY-2004, the Corporation is faced with potential cash shortfalls that will only be remedied by increased revenue generation and carefully managed expenditures.

2002 FINANCIAL OPERATION HIGHLIGHTS

YSPSC had its highest level of sales in both its electric and water operations in FY-2002, consolidating the trend first noted in the prior fiscal year. Electricity sales of 15.44 million kilowatt hours and water sales of 134 million gallons compared with FY-2001 sales of 15.2 million kilowatt hours and 123.6 million were the best that has been experience in YSPSC history. As a result, total collection climbed to \$3.38 million versus \$3.2 million in FY-2001. These revenue collections exceeded YSPSC's revenue budget by \$66,000.

YAP STATE PUBLIC SERVICE CORPORATION

Management Discussion and Analysis September 30, 2003 and 2002

The fiscal year collections reflect a 47% increase from the \$2.3 million collected in FY-1997; YSPSC's first year of fiscal autonomy; giving an annual growth rate of 8%. Contributing to YSPSC's historically strong financial conditions is its ability to collect 100% of its accounts receivable and provide its services without any operating subsidies.

In spite of its record revenue, YSPSC incurred an operating loss of \$602,662 and a net loss of \$185,000. This loss is primarily the result of high diesel fuel costs used to generate the electric power. In FY-2002, the cost of fuel averaged \$1.17 per gallon. YSPSC's rates were revised in 1997 to break-even at diesel fuel cost of \$0.95 per gallon. This is the third year that fuel costs have exceeded the breakeven rate. Fully 50% of YSPSC outlays for operations and maintenance are for diesel fuel. Another factor contributing to YSPSC's losses are its operations in the neighboring islands of Yap State. Because of the high fixed costs and small customer base, the neighboring islands contributed approximately \$220,000 of the FY-2002 operating losses.

The FY-2002 operating results reflect the effect of a new ruling from the U.S. Government Accounting Standards Board (GASB). GASB 33 requires that all grants be recorded as other revenue. Before this year, those grants that were for capital projects were recorded as contributed capital. The effect of this ruling for YSPSC was to add \$399,000 to YSPSC's bottom line in FY-2002, thereby mitigating most of the operating losses for the year. Regardless of the accounting effect of grants from outside sources, they provide an important part of YSPSC revenue sources.

The completion of the Asian Development Bank funded water supply project in FY-2002 resulted in a final ADB long term debt of \$2.27 million. Repayment of the loan will not begin until 2007 on a repayment schedule of 25 years. YSPSC, also received a long-term loan of \$827,420 from the Yap State Government for the purpose of re-building the office and warehouse/distribution facilities that burned down in FY-2001. This loan is repayable over 15 years beginning in fiscal 2003. The ADB loan is essentially interest free to YSPSC and the State Government loan is at a below market level of 2%. Management feels that YSPSC will be able to meet its future debt obligations as they become due.

As YSPSC enters fiscal year 2003, it confronts a number of fiscal challenges. Diesel fuel prices skyrocketed to \$1.31 per gallon in October 2002, as talk of war shook world oil markets. YSPSC's auditors have stated for three consecutive years that YSPSC may have to consider enacting a fuel adjustment charge to deal with its rising fuel costs. YSPSC may have no choice but to address this issue in the coming fiscal year. The uncertainty of the regional economic picture also suggests that the electric demand may not be sustainable at the level of the prior two years. The YSPSC Board of Directors and management will need to closely monitor the financial effect of these challenges.

YAP STATE PUBLIC SERVICE CORPORATION

Balance Sheets
September 30, 2003 and 2002

<u>ASSETS</u>	<u>2003</u>	<u>2002</u> As restated (note 1)
Utility plant (notes 2 and 7):		
Plant in service	\$ 17,103,923	\$ 16,732,977
Work in progress	805,531	340,450
Less accumulated depreciation	<u>(7,539,203)</u>	<u>(6,878,917)</u>
Utility plant, net	<u>10,370,251</u>	<u>10,194,510</u>
Current assets:		
Cash	1,426,645	956,936
Time certificates of deposit	-	680,000
Accounts receivable, net of an allowance for doubtful accounts of \$206,265 in 2003 and \$209,815 in 2002	369,306	443,448
Other receivables	-	41,953
Inventory	<u>355,646</u>	<u>293,942</u>
Total current assets	<u>2,151,597</u>	<u>2,416,279</u>
	<u>\$ 12,521,848</u>	<u>\$ 12,610,789</u>
<u>NET ASSETS AND LIABILITIES</u>		
Net assets:		
Invested in capital assets, net of related debt	\$ 7,190,925	\$ 7,096,253
Restricted	539,265	138,809
Unrestricted	<u>1,290,669</u>	<u>2,071,052</u>
Total net assets	<u>9,020,859</u>	<u>9,306,114</u>
Current liabilities:		
Current portion of notes payable (note 7)	60,618	17,130
Accounts payable	12,843	17,830
Accrued taxes and other withholdings	33,087	38,516
Employees' annual leave and accrued payroll	57,227	68,903
Other payables	<u>218,506</u>	<u>81,169</u>
Total current liabilities	382,281	223,548
Notes payable (note 7)	<u>3,118,708</u>	<u>3,081,127</u>
Total liabilities	<u>3,500,989</u>	<u>3,304,675</u>
Contingency (note 4)	<u>\$ 12,521,848</u>	<u>\$ 12,610,789</u>

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION

Statements of Operations and Net Assets
Years Ended September 30, 2003 and 2002

	<u>2003</u>	<u>2002</u> As restated (note 1)
Operating revenues (note 6):		
Electricity sales	\$ 2,909,060	\$ 2,861,328
Water sales	<u>395,770</u>	<u>444,821</u>
Total operating revenues	<u>3,304,830</u>	<u>3,306,149</u>
Operating expenses:		
Production fuel	1,731,035	1,588,889
Salaries and wages and related	820,497	711,669
Depreciation	719,616	667,613
Other production costs	420,515	613,405
Administrative and general	<u>321,646</u>	<u>327,235</u>
Total operating expenses	<u>4,013,309</u>	<u>3,908,811</u>
Loss from operations	(708,479)	(602,662)
Other nonoperating income (note 5)	456,312	421,398
Interest expense	(20,608)	(4,137)
Loss on disposal of utility plant	<u>(12,480)</u>	<u>-</u>
Net loss	(285,255)	(185,401)
Net assets at beginning of year	<u>9,306,114</u>	<u>9,491,515</u>
Net assets at end of year	<u>\$ 9,020,859</u>	<u>\$ 9,306,114</u>

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION

Statements of Cash Flows
Years Ended September 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Cash flows from operating activities:		
Cash received from customers	\$ 3,380,882	\$ 3,353,913
Cash paid to suppliers and employees	<u>(3,240,152)</u>	<u>(3,268,991)</u>
Net cash provided by operating activities	<u>140,730</u>	<u>84,922</u>
Cash flows from investing activities:		
Redemption of time certificates of deposit	680,000	-
Purchases of time certificates of deposit	-	(680,000)
Interest income	<u>22,216</u>	<u>22,401</u>
Net cash provided by (used for) investing activities	<u>702,216</u>	<u>(657,599)</u>
Cash flows from noncapital financing activities:		
Grant proceeds received	<u>474,139</u>	<u>426,375</u>
Cash flows from capital and related financing activities:		
Purchase of utility plant	(907,837)	(1,283,397)
Proceeds from loan	103,000	1,321,919
Interest paid	(20,608)	(4,137)
Repayment of loans	<u>(21,931)</u>	<u>-</u>
Net cash (used for) provided by capital and related financing activities	<u>(847,376)</u>	<u>34,385</u>
Net change in cash	469,709	(111,917)
Cash at beginning of year	<u>956,936</u>	<u>1,068,853</u>
Cash at end of year	\$ <u><u>1,426,645</u></u>	\$ <u><u>956,936</u></u>
Reconciliation of loss from operations to net cash provided by operating activities:		
Loss from operations	\$ (708,479)	\$ (602,662)
Adjustments to reconcile loss from operations to net cash provided by (used for) operating activities:		
Depreciation	719,616	667,613
(Increase) decrease in assets:		
Receivables	74,142	49,061
Inventory	(61,704)	(7,154)
Other receivables	1,910	(1,297)
Prepaid expenses	-	1,625
Increase (decrease) in liabilities:		
Accounts payable	(4,987)	16,633
Accrued taxes and other liabilities	(17,105)	9,045
Other payables	<u>137,337</u>	<u>(47,942)</u>
Net cash provided by operating activities	\$ <u><u>140,730</u></u>	\$ <u><u>84,922</u></u>

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION

Notes to Financial Statements
September 30, 2003 and 2002

(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, 2003 and 2002 was approximately 4.2% and 4.0% 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, 2003 and 2002, 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

Management Discussion and Analysis September 30, 2003 and 2002

(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, 2003 and 2002, \$100,000 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 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.

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 2002 financial statements have been reclassified to conform with the 2003 presentation.

Adoption of New Accounting Principle: For the year ended September 30, 2003, YSPSC 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 No. 37 and applied those standards on a retroactive basis. 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:

Capital assets, net of accumulated depreciation and 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

Management Discussion and Analysis September 30, 2003 and 2002

(1) Summary of Significant Accounting Policies, Continued

Adoption of New Accounting Principle, Continued:

- 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.

The provisions of GASB Statement No. 34 have been applied to the years presented.

GASB 34 and GASB 33 require that recipients of grants and other government mandated non-exchange transactions with restrictions on use of the grant proceeds recognize revenue from the grant when grant resources are received rather than when use restrictions are met. Grant proceeds are recorded as restricted net assets until the use restrictions are met. The adoption of these accounting principles resulted in the following restatement of the September 30, 2002 financial statements:

	<u>As previously presented</u>	<u>As currently presented</u>	<u>Difference</u>
Deferred revenue	\$ 138,809	\$ -	\$ (138,809)
Restricted net assets	-	138,809	138,809

(2) Utility Plant

A summary of changes in capital assets for the years ended September 30, 2003 and 2002 is as follows:

	<u>Beginning Balance October 1, 2002</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Ending Balance September 30, 2003</u>
Production plant	\$ 9,105,270	\$ 267,466	\$ -	\$ 9,372,736
Distribution plant	6,913,101	-	(12,500)	6,900,601
General plant	714,606	175,290	(59,310)	830,586
Work in progress	<u>340,450</u>	<u>613,997</u>	<u>(148,916)</u>	<u>805,531</u>
	17,073,427	1,056,753	(220,726)	17,909,454
Less accumulated depreciation	<u>(6,878,917)</u>	<u>(719,616)</u>	<u>59,330</u>	<u>(7,539,203)</u>
	<u>\$ 10,194,510</u>	<u>\$ 337,137</u>	<u>\$ (161,396)</u>	<u>\$ 10,370,251</u>
	<u>Beginning Balance October 1, 2001</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Ending Balance September 30, 2002</u>
Production plant	\$ 8,869,782	\$ 246,380	\$ (10,892)	\$ 9,105,270
Distribution plant	3,874,139	3,038,962	-	6,913,101
General plant	698,118	46,755	(30,267)	714,606
Work in progress	<u>2,769,776</u>	<u>786,069</u>	<u>(3,215,395)</u>	<u>340,450</u>
	16,211,815	4,118,166	(3,256,554)	17,073,427
Less accumulated depreciation	<u>(6,252,463)</u>	<u>(667,613)</u>	<u>41,159</u>	<u>(6,878,917)</u>
	<u>\$ 9,959,352</u>	<u>\$ 3,450,553</u>	<u>\$ (3,215,395)</u>	<u>\$ 10,194,510</u>

YAP STATE PUBLIC SERVICE CORPORATION

Management Discussion and Analysis September 30, 2003 and 2002

(2) Utility Plant, Continued

Utility plant is comprised of the following components:

	<u>2003</u>	<u>2002</u>
Electric plant	\$ 10,584,033	\$ 10,299,358
Water plant	<u>6,519,890</u>	<u>6,433,619</u>
	\$ <u>17,103,923</u>	\$ <u>16,732,977</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

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 2003 and 2002, YSPSC included the following operating and capital grants within other nonoperating income:

	<u>2003</u>	<u>2002</u>
U.S. Department of the Interior OMIP grants	\$ -	\$ 257,579
Australian Disaster Relief grant	-	15,000
U.S. Federal Emergency Management Agency grants	14,096	104,824
Yap State Capital grants	<u>420,000</u>	<u>21,594</u>
	\$ <u>434,096</u>	\$ <u>398,997</u>

(6) Significant Revenue Sources

Power and water billings to Yap State Government agencies accounted for 23% and 21% of total operating revenues in 2003 and 2002, respectively.

YAP STATE PUBLIC SERVICE CORPORATION

Management Discussion and Analysis September 30, 2003 and 2002

(7) Notes Payable

Notes payable at September 30, 2003 and 2002 are as follows:

	<u>2003</u>	<u>2002</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	\$ 2,270,837
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.	810,290	827,420
Note 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 \$1,075 including interest at 4.625% starting March 26, 2003 and maturing in September 2013. The note is collateralized by all the Corporation's equipment, furniture and fixtures located at YSPSC's office.	<u>98,199</u>	<u>-</u>
Total notes payable	3,179,326	3,098,257
Less current portion	<u>60,618</u>	<u>17,130</u>
	<u>\$ 3,118,708</u>	<u>\$ 3,081,127</u>

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>
2004	\$ 60,618	\$ 20,092
2005	62,072	18,638
2006	63,568	17,143
2007	87,812	15,606
2008	112,099	14,028
2009 through 2013	577,977	44,929
2014 through 2018	580,192	9,091
2019 through 2023	605,630	-
2024 through 2028	605,630	-
2029 through 2032	<u>423,728</u>	<u>-</u>
	<u>\$ 3,179,326</u>	<u>\$ 139,527</u>

YAP STATE PUBLIC SERVICE CORPORATION

Management Discussion and Analysis
September 30, 2003 and 2002

(8) Subsequent Event

In November 2003, Yap was struck by a typhoon. Damages have been preliminarily estimated at \$81,000. Actual damages may ultimately be different than estimated. YSPSC has a \$100,000 deductible on its typhoon insurance coverage.