

YAP STATE PUBLIC SERVICE CORPORATION

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

SEPTEMBER 30, 2004 AND 2003

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, 2004 and 2003, 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 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 Yap State Public Service Corporation as of September 30, 2004 and 2003, 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 1-4 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 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 May 22, 2005, 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 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.



May 22, 2005

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis Year Ended September 30, 2004

The following Management's 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, 2004. 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 YSPSC's annual report presents our discussion of YSPSC's performance for the years ended September 30, 2004 and 2003. It should be read in conjunction with financial statements that follow this section.

The following table summarizes the financial condition and operation of YSPSC as of 2004 and 2003.

ASSETS	<u>2004</u>	<u>2003</u>
Plant in service, net	\$ 9,935,836	\$ 9,564,720
Work in progress, capital projects	388,075	805,531
Current assets	<u>1,516,549</u>	<u>2,151,597</u>
Total assets	\$ <u>11,840,460</u>	\$ <u>12,521,848</u>
NET ASSETS AND LIABILITIES		
Invested in capital assets, net of related debt	\$ 7,205,204	\$ 7,190,925
Restricted	277,769	539,265
Unrestricted	<u>750,041</u>	<u>1,290,669</u>
Total net assets	8,233,014	9,020,859
Notes payable, net of current portion	3,056,635	3,118,708
Current portion of notes payable	62,072	60,618
Other current liabilities	<u>488,739</u>	<u>321,663</u>
Total liabilities	<u>3,607,446</u>	<u>3,500,989</u>
Total net assets and liabilities	\$ <u>11,840,460</u>	\$ <u>12,521,848</u>
REVENUES, EXPENSES, AND NET ASSETS		
Operating revenues	\$ 2,945,230	\$ 3,304,830
Operating expenses	<u>3,959,790</u>	<u>4,013,309</u>
Loss from operations	<u>(1,014,560)</u>	<u>(708,479)</u>
Grants	25,000	434,096
FEMA proceeds in excess of typhoon expenses	209,675	-
Interest expense	(20,092)	(20,608)
Interest income	6,503	22,216
Gain (loss) on disposal of utility plant	100	(12,480)
Other income/expense	<u>5,529</u>	<u>-</u>
Net loss	(787,845)	(285,255)
Net assets, beginning	<u>9,020,859</u>	<u>9,306,114</u>
Net assets, ending	\$ <u>8,233,014</u>	\$ <u>9,020,859</u>

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
Year Ended September 30, 2004

2004 FINANCIAL OPERATION HIGHLIGHTS

Fiscal year 2004 was an eventful year for YSPSC in several areas. YSPSC began the new year on a positive note by moving into its new facilities during October 2003. The new complex consists of three separate buildings. Building A is used for administration, Building B houses purchasing activities and has substantial space for spare parts storage and Building C is used by the Power Distribution and Engineering Departments. Otherwise, natural disasters in the form of Typhoons Sudal and Lupit had the single most significant effect on fiscal year 2004 operations.

Typhoon Sudal

Typhoon Sudal struck the island on April 8-9, 2004 with devastating effects. Wind speeds of approximately 135 MPH and sea surges of up to 11½ feet above normal caused widespread damage on Yap Proper and the Outer Islands. All areas of YSPSC operations were affected with the most significant damage sustained by the power distribution system. More than 80% of the total 76 miles of conductors were damaged and more than 90% of service drops for approximately 2,000 customers were damaged or destroyed. Numerous power poles and transformers were totally destroyed and many poles required realignment.

YSPSC staff worked closely with Federal Emergency Management Agency (FEMA) personnel for several months in order to assess the amount of damage to YSPSC equipment, structures and other property. FEMA ultimately obligated twenty-two separate projects for repair and improvement of YSPSC facilities and equipment. Total funding for the twenty-two projects is summarized by department as follows:

<u>Department</u>	<u>FEMA Project Type</u>			
	<u>Emergency</u>	<u>Permanent</u>	<u>Mitigation</u>	<u>Total</u>
Power Distribution	\$ 123,688	\$ 1,119,877	\$ 663,373	\$ 1,906,938
Power Generation	32,032	98,030	-	130,062
Water/Sewer	21,022	43,071	-	64,093
Outer Island Operations	3,853	39,292	-	43,145
Administration	<u>12,307</u>	<u>25,605</u>	<u>-</u>	<u>37,912</u>
Total Cost-All Projects	\$ <u>192,902</u>	\$ <u>1,325,875</u>	\$ <u>663,373</u>	\$ <u>2,182,150</u>

Total cost of the above projects is shared 90% by FEMA and 10% by YSPSC. The Yap State Government is paying 100% of YSPSC's 10% matching share. FEMA funding is made available first to the FSM National Government, which then transfers money to the Yap State Government for payment to YSPSC. As of September 30, 2004, the Yap State Government had paid YSPSC \$196,120 in FEMA reimbursement funds and another \$34,609, comprised of FEMA and YSPSC matching funding, was paid on November 23, 2004. It should be noted that FEMA funding is designated for, and must be used for specific projects and is not available for operations.

In addition to the above amounts, The Palau Public Utility Corporation donated a transformer to YSPSC due to the failure of one of the main YSPSC step-up transformers. The value of the donated transformer is estimated to be \$25,000. YSPSC paid the cost of transportation from Palau and installation at YSPSC, most of which is included in a FEMA project for reimbursement.

Typhoon Lupit

The effect of Typhoon Lupit in November 2003 was felt mainly on the island of Ulithi. YSPSC received FEMA funding of \$84,321 in June 2004 to pay for those storm related costs.

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis Year Ended September 30, 2004

Operations

Operating Revenue

Operating revenue for fiscal year 2004 of \$2,945,230 was 10.9% lower than the \$3,304,830 earned in fiscal year 2003. As compared to fiscal year 2003, total revenue from electric power sales declined by \$362,772 while water/sewer revenue increased by \$3,172 for a net decrease for the year of \$359,600. Management believes that Typhoon Sudal is primarily responsible for the decline in electric power revenue since numerous electric power customers were lost as a result of the typhoon and electric power demand was considerably less from April through September 2004 as compared to the same period in the prior year.

Operating Expense

Operating expense for fiscal year 2004 of \$3,959,790, after reduction for costs related to Typhoons Sudal and Lupit, was 1.33% less than the \$4,013,309 incurred in fiscal year 2003. The decrease in total operating expense for all departments was \$53,519. The decrease was largely due to typhoon related costs that were either capitalized as an asset on the balance sheet or disclosed separately as a component of Other Nonoperating Income in the income statement.

Fuel Cost

Total fuel cost was expected to increase during the year as a result of price increases in ten (10) of twelve months. However, the total diesel fuel cost for 2004 was relatively unchanged from 2003. Management believes the reason total fuel cost for 2004 did not increase despite the increased cost per gallon is the result of substantially reduced electric power demand after Typhoon Sudal from April through September 2004 as compared to the same period in fiscal year 2003.

However, YSPSC uses over one million gallons of diesel fuel annually and management expects that per gallon fuel cost increases occurring in fiscal years 2004 and 2005 will increase operating costs significantly during fiscal year 2005 provided prices remain at higher levels.

Operating Loss

The fiscal year 2004 operating loss was \$1,014,560 as compared to the 2003 loss of \$708,479. The \$306,081 increase is due to the decline in operating revenue of \$359,600 and the decrease in operating expense of \$53,519.

Cash

Cash collected from operations in 2004 was \$3,000,215 as compared to \$3,415,447 in 2003. However, YSPSC has been fortunate over the years in having a high collection rate. Despite the large decrease in electric power revenue and total cash collections, the Corporation continued to maintain a high collection rate on billings of approximately 100%.

Capital Projects

The primary capital project in process during fiscal year 2004 was the Woleai Relocation Project. Funded by an FSM grant, a new electric power generation plant at a new location was under construction on Falalop, Woleai. At year-end, \$281,888 had been expended on the project.

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis Year Ended September 30, 2004

Remedial Measures

In order to mitigate the effect of increasing fuel costs and the anticipated future loss of revenue, two important actions were initiated during the latter part fiscal year 2004.

First: Cost containment measures were implemented during July 2004 in order to eliminate all unnecessary expenditures including 1) placing a freeze on pay increases, 2) terminating paid time off cash outs, 3) suspension of all travel not 100% reimbursed and 4) elimination of all purchases not essential to maintenance of operations. Additionally, purchases to implement the larger FEMA projects for Typhoon Sudal were postponed until adequate financing could be obtained.

Second: The YSPSC Board of Directors began considering an electric power rate increase in early September 2004 and voted final approval on November 18, 2004 after public hearings on Yap, Ulithi and Woleai. The increase first took effect in February 2005. Increasing diesel fuel costs and the anticipated departure of both Kingtex (FSM) Inc. and Micronesian Knitting, Inc. were important considerations during analysis of the new rate structure by the Board.

Fiscal Year 2005

During the first half of fiscal year 2005, YSPSC lost two of its largest customers. The decrease in annual electric power and water revenue calculated using current electric rates and also the new electric rates effective in February 2005 is estimated to be as follows:

<u>Customer</u>	<u>Current Rates</u>	<u>New Rates</u>
Kingtex (FSM) Inc.	\$ 149,000	\$ 214,000
Micronesian Knitting, Inc.	<u>236,000</u>	<u>341,000</u>
Decrease in Annual Revenue	\$ <u>385,000</u>	\$ <u>555,000</u>

Summary

Fiscal year 2004 was another difficult year for YSPSC primarily because of the effects of Typhoon Sudal. Since its formation in 1996, YSPSC has lost important customers such as Ting Hong and has seen sizeable decreases in revenue from other large customers such as Yap Fresh Tuna, Inc and Yap Fisheries Association. The loss of two major customers early in fiscal year 2005 only makes matters more difficult. Additionally, YSPSC has a small customer base, which combined with lethargic economic development in the State will likely limit the Corporation's capacity to increase its customer base and revenue. However, YSPSC will continue to enforce cost containment actions and to search for innovative long-term solutions that will enable it to further contain costs and continue to provide high quality services to its customers.

YAP STATE PUBLIC SERVICE CORPORATION

Balance Sheets
September 30, 2004 and 2003

<u>ASSETS</u>	<u>2004</u>	<u>2003</u>
Utility plant:		
Plant in service	\$ 18,212,667	\$ 17,103,923
Work in progress	388,075	805,531
Less accumulated depreciation	<u>(8,276,831)</u>	<u>(7,539,203)</u>
Utility plant, net	<u>10,323,911</u>	<u>10,370,251</u>
Current assets:		
Cash	733,733	1,426,645
Accounts receivable, net of an allowance for doubtful accounts of \$209,707 in 2004 and \$206,265 in 2003	388,101	369,306
U.S. federal grants receivable	34,609	-
Inventory	<u>360,106</u>	<u>355,646</u>
Total current assets	<u>1,516,549</u>	<u>2,151,597</u>
	<u>\$ 11,840,460</u>	<u>\$ 12,521,848</u>
<u>NET ASSETS AND LIABILITIES</u>		
Net assets:		
Invested in capital assets, net of related debt	\$ 7,205,204	\$ 7,190,925
Restricted	277,769	539,265
Unrestricted	<u>750,041</u>	<u>1,290,669</u>
Total net assets	<u>8,233,014</u>	<u>9,020,859</u>
Current liabilities:		
Current portion of notes payable	62,072	60,618
Accounts payable	302,380	155,465
Employees' annual leave and accrued payroll	72,309	77,224
Accrued taxes and other withholdings	31,988	33,087
Contract retention payable	28,174	-
Other payables	<u>53,888</u>	<u>55,887</u>
Total current liabilities	550,811	382,281
Notes payable, net of current portion	<u>3,056,635</u>	<u>3,118,708</u>
Total liabilities	<u>3,607,446</u>	<u>3,500,989</u>
Contingency	<u>\$ 11,840,460</u>	<u>\$ 12,521,848</u>

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION

Statements of Operations and Net Assets
Years Ended September 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Operating revenues:		
Electricity sales	\$ 2,546,288	\$ 2,909,060
Water sales	<u>398,942</u>	<u>395,770</u>
Total operating revenues	<u>2,945,230</u>	<u>3,304,830</u>
Operating expenses:		
Production fuel	1,752,677	1,731,035
Salaries and wages and related	842,774	820,497
Depreciation	737,627	719,616
Other production costs	399,169	420,515
Administrative and general	<u>227,543</u>	<u>321,646</u>
Total operating expenses	<u>3,959,790</u>	<u>4,013,309</u>
Loss from operations	(1,014,560)	(708,479)
Interest and other nonoperating income	12,032	22,216
Grant income	25,000	14,096
FEMA proceeds in excess of typhoon expenses	209,675	-
Interest expense	(20,092)	(20,608)
Gain (loss) on disposal of utility plant	<u>100</u>	<u>(12,480)</u>
Net loss before capital contributions	(787,845)	(705,255)
Capital contributions	<u>-</u>	<u>420,000</u>
Net loss	(787,845)	(285,255)
Net assets at beginning of year	<u>9,020,859</u>	<u>9,306,114</u>
Net assets at end of year	<u>\$ 8,233,014</u>	<u>\$ 9,020,859</u>

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION

Statements of Cash Flows
Years Ended September 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Cash received from customers	\$ 2,926,436	\$ 3,380,882
Cash paid to suppliers	(2,205,231)	(2,402,550)
Cash paid to employees	<u>(848,788)</u>	<u>(837,602)</u>
Net cash (used in) provided by operating activities	<u>(127,583)</u>	<u>140,730</u>
Cash flows from investing activities:		
Redemption of time certificates of deposit	-	680,000
Interest income	<u>6,503</u>	<u>22,216</u>
Net cash provided by investing activities	<u>6,503</u>	<u>702,216</u>
Cash flows from noncapital financing activities:		
Grant proceeds received	280,441	54,139
Cost of typhoon repairs	<u>(105,375)</u>	<u>-</u>
Net cash provided by noncapital financing activities	<u>175,066</u>	<u>54,139</u>
Cash flows from capital and related financing activities:		
Capital contribution	-	420,000
Purchase of utility plant	(666,188)	(907,837)
Proceeds from loan	-	103,000
Interest paid	(20,092)	(20,608)
Repayment of loans	<u>(60,618)</u>	<u>(21,931)</u>
Net cash used in capital and related financing activities	<u>(746,898)</u>	<u>(427,376)</u>
Net (decrease) increase in cash	(692,912)	469,709
Cash at beginning of year	<u>1,426,645</u>	<u>956,936</u>
Cash at end of year	\$ <u><u>733,733</u></u>	\$ <u><u>1,426,645</u></u>
Reconciliation of loss from operations to net cash (used in) provided by operating activities:		
Loss from operations	\$ (1,014,560)	\$ (708,479)
Adjustments to reconcile loss from operations to net cash (used in) provided by operating activities:		
Depreciation	737,627	719,616
Decrease (increase) in assets:		
Receivables	(18,795)	74,142
Inventory	(4,460)	(61,704)
Other receivables	-	1,910
Increase (decrease) in liabilities:		
Accounts payable	152,444	137,635
Employees' annual leave and accrued payroll	(4,915)	8,321
Accrued taxes and other withholdings	(1,099)	(5,429)
Contract retention payable	28,174	-
Other payables	<u>(1,999)</u>	<u>(25,282)</u>
Net cash (used in) provided by operating activities	\$ <u><u>(127,583)</u></u>	\$ <u><u>140,730</u></u>

Supplemental schedule of noncash financing activity:

During the year ended September 30, 2004, YSPSC received a donated asset from another utility recorded at an estimated fair value of \$25,000.

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION

Notes to Financial Statements
September 30, 2004 and 2003

(1) Organization and Summary of Significant Accounting Policies

Organization

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

Basis of Accounting

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

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 the years ended September 30, 2004 and 2003 was approximately 4.0% and 4.2%, respectively, of the cost of depreciable properties.

Cash

For purposes of the balance sheets and statements of cash flows, cash includes cash on hand and in bank. At September 30, 2004 and 2003, \$100,000 of cash in bank are subject to Federal Deposit Insurance Corp. coverage, with the remaining balance exceeding insurable limits. Therefore, the amounts which exceed FDIC limits are characterized as uncollateralized.

Receivables

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

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, 2004 and 2003

(1) Organization and Summary of Significant Accounting Policies, Continued

Annual and Sick Leave

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

Revenues

Sales of electricity and water are recorded as billed to customers on a monthly billing cycle basis. At September 30, 2004 and 2003, unbilled revenues of \$59,605 and \$58,849, respectively, are estimated and accrued based on the most recent billing cycles.

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.

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 2003 financial statements have been reclassified to conform with the 2004 presentation.

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.

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:

YAP STATE PUBLIC SERVICE CORPORATION

Notes to Financial Statements
September 30, 2004 and 2003

(1) Organization and Summary of Significant Accounting Policies, Continued

Accounting Standards, Continued

- 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.

- 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, 2004 and 2003.

New Accounting Standards

For fiscal year 2005, YSPSC will be implementing GASB Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3)* and GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. As of September 30, 2004, YSPSC has not evaluated the financial statement impact of GASB Statement Nos. 40 and 42.

(2) Utility Plant

A summary of changes in capital assets for the years ended September 30, 2004 and 2003 is as follows:

	Beginning Balance <u>October 1, 2003</u>	Transfers and <u>Additions</u>	Transfers and <u>Deletions</u>	Ending Balance <u>September 30, 2004</u>
Production plant	\$ 9,372,736	\$ 3,595	\$ -	\$ 9,376,331
Distribution plant	6,900,601	131,686	-	7,032,287
General plant	830,586	973,463	-	1,804,049
Work in progress	<u>805,531</u>	<u>508,646</u>	<u>(926,102)</u>	<u>388,075</u>
	17,909,454	1,617,390	(926,102)	18,600,742
Less accumulated depreciation	<u>(7,539,203)</u>	<u>(737,628)</u>	<u>-</u>	<u>(8,276,831)</u>
	\$ <u>10,370,251</u>	\$ <u>879,762</u>	\$ <u>(926,102)</u>	\$ <u>10,323,911</u>

YAP STATE PUBLIC SERVICE CORPORATION

Notes to Financial Statements
September 30, 2004 and 2003

(2) Utility Plant, Continued

	<u>Beginning Balance</u> <u>October 1, 2002</u>	<u>Transfers and</u> <u>Additions</u>	<u>Transfers and</u> <u>Deletions</u>	<u>Ending Balance</u> <u>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>

Utility plant is comprised of the following components:

	<u>2004</u>	<u>2003</u>
Electric plant	\$ 11,689,182	\$ 10,584,033
Water plant	<u>6,523,485</u>	<u>6,519,890</u>
	<u>\$ 18,212,667</u>	<u>\$ 17,103,923</u>

(3) Notes Payable

Notes payable at September 30, 2004 and 2003 are as follows:

	<u>2004</u>	<u>2003</u>
Loan 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. \$ 2,270,837	\$ 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.	758,209	810,290
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>89,661</u>	<u>98,199</u>
Total notes payable	3,118,707	3,179,326
Less current portion	<u>62,072</u>	<u>60,618</u>
	<u>\$ 3,056,635</u>	<u>\$ 3,118,708</u>

YAP STATE PUBLIC SERVICE CORPORATION

Notes to Financial Statements
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(3) Notes Payable, Continued

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 62,072	\$ 18,638
2006	63,568	17,143
2007	87,812	15,606
2008	112,099	14,028
2009	113,723	12,404
2010 through 2014	573,270	36,736
2015 through 2019	592,302	4,881
2020 through 2024	605,630	-
2025 through 2029	605,630	-
2030 through 2032	<u>302,601</u>	<u>-</u>
	<u>\$ 3,118,707</u>	<u>\$ 119,436</u>

Changes in long-term liabilities for the years ended September 30, 2004 and 2003 are as follows:

	<u>Outstanding September 30, 2003</u>	<u>Increases</u>	<u>Decreases</u>	<u>Outstanding September 30, 2004</u>	<u>Current</u>	<u>Noncurrent</u>
ADB loan	\$ 2,270,837	\$ -	\$ -	\$ 2,270,837	\$ -	\$ 2,270,837
Yap State loan	810,290	-	52,081	758,209	53,131	705,078
USA loan	<u>98,199</u>	<u>-</u>	<u>8,538</u>	<u>89,661</u>	<u>8,941</u>	<u>80,720</u>
	<u>\$ 3,179,326</u>	<u>\$ -</u>	<u>\$ 60,619</u>	<u>\$ 3,118,707</u>	<u>\$ 62,072</u>	<u>\$ 3,056,635</u>
	<u>Outstanding September 30, 2002</u>	<u>Increases</u>	<u>Decreases</u>	<u>Outstanding September 30, 2003</u>	<u>Current</u>	<u>Noncurrent</u>
ADB loan	\$ 2,270,837	\$ -	\$ -	\$ 2,270,837	\$ -	\$ 2,270,837
Yap State loan	827,420	-	17,130	810,290	52,080	758,210
USA loan	<u>-</u>	<u>103,000</u>	<u>4,801</u>	<u>98,199</u>	<u>8,538</u>	<u>89,661</u>
	<u>\$ 3,098,257</u>	<u>\$ 103,000</u>	<u>\$ 21,931</u>	<u>\$ 3,179,326</u>	<u>\$ 60,618</u>	<u>\$ 3,118,708</u>

(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) Significant Revenue Sources

Power and water billings to Yap State Government agencies accounted for 23% and 21% of total operating revenues in 2004 and 2003, respectively.

YAP STATE PUBLIC SERVICE CORPORATION

Notes to Financial Statements
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(6) Restricted Net Assets

Restricted net assets at September 30, 2004 and 2003 consist of unexpended balances of the following grants:

	<u>2004</u>	<u>2003</u>
U.S. Department of the Interior	\$ 138,809	\$ 138,809
Yap State capital grant	<u>138,960</u>	<u>400,456</u>
	<u>\$ 277,769</u>	<u>\$ 539,265</u>

(7) Grants

YSPSC received the following grants during the years ended September 30, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
U.S. Federal Emergency Management Agency (FEMA) grants (netted with typhoon costs in 2004)	\$ 315,050	\$ 14,096
Donated asset from another utility	25,000	-
Yap State capital grant	<u>-</u>	<u>420,000</u>
	<u>\$ 340,050</u>	<u>\$ 434,096</u>

(8) 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.

(9) Typhoon Damages

YSPSC is self-insured for typhoon risks. In November 2003 and April 2004, the islands of Yap were struck by typhoons causing significant damage to YSPSC's plant. Damages are estimated at \$2.2 to \$2.3 million. YSPSC has sought assistance from FEMA in funding the cost of repairs. At September 30, 2004, no significant damages have been accrued because most of the repair costs are anticipated to be recovered from FEMA assistance and some of the costs incurred will be capitalized. Typhoon damages and the related FEMA recoveries are estimated amounts and actual amounts may vary significantly from these estimates.

A summary of typhoon damages and related recoveries for the year ended September 30, 2004 is as follows:

Typhoon costs	\$ (269,356)
Less capitalized items	<u>163,981</u>
	(105,375)
FEMA recoveries	<u>315,050</u>
	<u>\$ 209,675</u>

YAP STATE PUBLIC SERVICE CORPORATION

Notes to Financial Statements
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(10) Subsequent Event

On November 18, 2004, the Board of Directors approved an increase in utility rates which took effect in February 2005.