

YAP STATE PUBLIC SERVICE CORPORATION

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

SEPTEMBER 30, 2005 AND 2004

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, 2005 and 2004, and the related statements of revenues, expenses and changes in 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, 2005 and 2004, 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 November 21, 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.



November 21, 2005

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis Year Ended September 30, 2005

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, 2005. 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, 2005 and 2004. 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 2005 and 2004.

ASSETS	<u>2005</u>	<u>2004</u>
Plant in service, net	\$ 9,563,555	\$ 9,935,836
Work in progress, capital projects	133,905	388,075
Current and other assets	<u>1,581,330</u>	<u>1,516,549</u>
Total assets	<u>\$ 11,278,790</u>	<u>\$ 11,840,460</u>
NET ASSETS AND LIABILITIES		
Invested in capital assets, net of related debt	\$ 6,640,825	\$ 7,205,204
Restricted	121,443	277,769
Unrestricted	<u>1,114,334</u>	<u>750,041</u>
Total net assets	<u>7,876,602</u>	<u>8,233,014</u>
Notes payable, net of current portion	2,993,067	3,056,635
Current portion of notes payable	63,568	62,072
Other current liabilities	<u>345,553</u>	<u>488,739</u>
Total liabilities	<u>3,402,188</u>	<u>3,607,446</u>
Total net assets and liabilities	<u>\$ 11,278,790</u>	<u>\$ 11,840,460</u>
REVENUES, EXPENSES, AND NET ASSETS		
Operating revenues	\$ 3,549,637	\$ 2,945,230
Operating expenses	<u>4,273,002</u>	<u>3,959,790</u>
Loss from operations	<u>(723,365)</u>	<u>(1,014,560)</u>
Grants	-	25,000
FEMA proceeds in excess of typhoon expenses	150,423	209,675
Interest expense	(18,638)	(20,092)
Interest income	3,475	6,503
Gain on disposal of utility plant	79	100
Other income/expense	<u>(2,568)</u>	<u>5,529</u>
Net loss before cumulative effect of a change in accounting principles	(590,594)	(787,845)
Cumulative effect of a change in accounting principle	<u>234,182</u>	<u>-</u>
Net loss	(356,412)	(787,845)
Net assets, beginning	<u>8,233,014</u>	<u>9,020,859</u>
Net assets, ending	<u>\$ 7,876,602</u>	<u>\$ 8,233,014</u>

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
Year Ended September 30, 2005

2005 FINANCIAL OPERATION HIGHLIGHTS

The most notable financial event occurring during fiscal year 2005 was the implementation of a new electric power rate badly needed to offset ever increasing diesel fuel costs. The new rate did increase cash flow and allowed the Corporation to continue operations uninterrupted but the full benefit was less than needed due to the departure of two of the Corporation's largest customers during the first half of the fiscal year.

Typhoon Sudal

Of the twenty-two separate projects obligated by FEMA for Typhoon Sudal repairs, total project cost and funding received through September 30, 2005 is as follows:

<u>Department</u>	<u>Total Project Cost</u>	<u>Reimbursement: Total Through September 30, 2005</u>
Power Distribution	\$1,906,938	\$123,688
Power Generation	130,062	130,062
Water/Sewer	64,093	64,093
Outer Island	43,145	43,145
Administration	37,912	37,912
Total Cost-All Projects	<u>\$2,182,150</u>	<u>\$398,900</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.

Operations

Operating Revenue:

Operating revenue for fiscal year 2005 of \$3,549,637 was 20% higher than the \$2,945,230 earned in fiscal year 2004. As compared to fiscal year 2004, total revenue from electric power sales increased by \$637,231 while water/sewer revenue decreased by \$32,824 for a net increase for the year of \$604,407. Management believes that the increase in electric power revenue is the result of 1) increased electric power demand as more customers were added after Typhoon Sudal and 2) the new electric power rate that was implemented during February 2005. The decrease in water revenue was caused by the loss of two major customers during the first half of fiscal year 2005.

Operating Expense:

Operating expense for fiscal year 2005 of \$4,273,002, after reduction for costs related to Typhoon Sudal and the initial capitalization of Power Plant spare parts inventory, was 8% more than the \$3,959,790 incurred in fiscal year 2004. The increase in total operating expense for all departments was \$313,212. The net increase was largely due to increased diesel fuel costs and decreases in other operating costs resulting from cost containment measures implemented during fiscal year 2004 and continued throughout fiscal year 2005.

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis Year Ended September 30, 2005

Diesel Fuel Cost:

The single most significant increase in operating cost over the past two fiscal years has been the increase in cost of diesel fuel. Diesel fuel cost per gallon increased 79% from October 1, 2003 through September 30, 2005.

As mentioned in the fiscal year 2004 discussion, the total diesel fuel cost for 2004 was relatively unchanged from 2003 despite substantial per gallon increases and management believes that was the result of substantially reduced electric power demand after Typhoon Sudal.

However, the combination of increased electric power demand during fiscal year 2005 and additional increases in diesel cost per gallon resulted in a total increase in fiscal year 2005 fuel cost of \$423,447.

The Corporation's budget for fiscal year 2006 includes \$2,706,500 for the purchase of 1,118,900 gallons of diesel and lube oils for Yap and Outer Island operations. The budgeted cost represents an estimated annual increase of \$530,376 for fiscal year 2006.

Management believes that diesel fuel prices will remain at higher levels for the foreseeable future and that annual fuel cost at the end of fiscal year 2006 will have increased approximately one million dollars per year as compared to total fuel cost at the end of fiscal year 2004.

Operating Loss:

The fiscal year 2005 operating loss was \$723,365 as compared to the 2004 loss of \$1,014,560. The \$291,195 decrease is due an increase in total operating revenue of \$604,407 and the increase in operating expense of \$313,212.

Cash:

Cash collected from operations in 2005 was \$3,550,376 as compared to \$3,000,215 in 2004. YSPSC was again fortunate in having a high collection rate for fiscal year 2005 which is again approximately 100% of billings. The increase of \$500,161 as compared to fiscal year 2004 is attributed to increased electric power demand after Typhoon Sudal and the new electric power rate that went into effect during February 2005.

Capital Projects

The only capital project completed during fiscal year 2005 was the Woleai Relocation Project. Funded by an FSM grant, a new electric power generation plant at a new location was placed in service during January 2005 on Falalop, Woleai at a cost of, \$298,557. The only capital project in process at September 30, 2005 was related to Typhoon Sudal and will be reimbursed by FEMA:

<u>Department</u>	<u>Project Name</u>	<u>Total Cost</u>	<u>Incurred at 9-30-05</u>	<u>FEMA Reimbursements</u>
Power Distribution	Permanent Repairs	\$1,783,250	\$133,905	None

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
Year Ended September 30, 2005

Remedial Measures

In order to relieve the effect of increasing fuel costs, the following actions have been taken:

First: During the last week in September 2005, the YSPSC Board of Directors began considering both a change in the current electric power rate structure to include a variable fuel charge that will increase or decrease depending on current diesel fuel prices and an increase in water rates. The proposed rate increases have been approved in principal by the board but are subject to public hearings before final ratification. It is hoped that the new rates will first become effective in early 2006.

Second: Cost containment measures described in the fiscal year 2004 discussion will continue in effect until the new revenue raising measures described above receive final ratification.

Summary

Fiscal year 2005 was another difficult year mainly because of rapidly increasing diesel fuel costs but that increase was partially offset by the new electric power rate that went into effect during February 2005. The new electric rates increased revenue sufficiently for the Corporation to maintain current operations. However, unless additional revenue is generated, cost containment measures in effect for over a year will ultimately have a negative effect on operations due to reduced spending on maintenance. Corporation management is continuing to research alternatives that will lower all operating costs effectively including the cost of power generation.

YAP STATE PUBLIC SERVICE CORPORATION

Statements of Net Assets
September 30, 2005 and 2004

ASSETS	2005	2004
Non-current assets:		
Utility plant:		
Plant in service	\$ 18,550,240	\$ 18,212,667
Work in progress	133,905	388,075
Less accumulated depreciation	(8,986,685)	(8,276,831)
Utility plant, net	9,697,460	10,323,911
Deposits	47,676	-
Total non-current assets	9,745,136	10,323,911
Current assets:		
Cash	497,723	733,733
Accounts receivable, net of an allowance for doubtful accounts of \$248,204 in 2005 and \$209,707 in 2004	430,408	388,101
U.S. federal grants receivable	-	34,609
Inventory	605,523	360,106
Total current assets	1,533,654	1,516,549
	\$ 11,278,790	\$ 11,840,460
NET ASSETS AND LIABILITIES		
Net assets:		
Invested in capital assets, net of related debt	\$ 6,640,825	\$ 7,205,204
Restricted	121,443	277,769
Unrestricted	1,114,334	750,041
Total net assets	7,876,602	8,233,014
Current liabilities:		
Current portion of notes payable	63,568	62,072
Accounts payable	174,012	302,380
Employees' annual leave and accrued payroll	78,937	72,309
Accrued taxes and other withholdings	30,494	31,988
Contract retention payable	-	28,174
Other payables	62,110	53,888
Total current liabilities	409,121	550,811
Notes payable, net of current portion	2,993,067	3,056,635
Total liabilities	3,402,188	3,607,446
Contingency	\$ 11,278,790	\$ 11,840,460

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating revenues:		
Electricity sales	\$ 3,183,519	\$ 2,546,288
Water sales	<u>366,118</u>	<u>398,942</u>
Total operating revenues	<u>3,549,637</u>	<u>2,945,230</u>
Operating expenses:		
Production fuel	2,176,124	1,752,677
Salaries and wages and related	813,323	842,774
Depreciation	740,209	737,627
Other production costs	272,742	399,169
Administrative and general	<u>270,604</u>	<u>227,543</u>
Total operating expenses	<u>4,273,002</u>	<u>3,959,790</u>
Loss from operations	(723,365)	(1,014,560)
Interest and other nonoperating income, net	907	12,032
Grant income	-	25,000
FEMA proceeds in excess of typhoon expenses	150,423	209,675
Interest expense	(18,638)	(20,092)
Gain on disposal of utility plant	<u>79</u>	<u>100</u>
Net loss before cumulative effect of a change in accounting principle	(590,594)	(787,845)
Cumulative effect of a change in accounting principle	<u>234,182</u>	<u>-</u>
Net loss	(356,412)	(787,845)
Net assets at beginning of year	<u>8,233,014</u>	<u>9,020,859</u>
Net assets at end of year	<u>\$ 7,876,602</u>	<u>\$ 8,233,014</u>

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION

Statements of Cash Flows
Years Ended September 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Cash received from customers	\$ 3,494,263	\$ 2,926,436
Cash paid to suppliers	(2,881,593)	(2,205,231)
Cash paid to employees	<u>(808,189)</u>	<u>(848,788)</u>
Net cash used in operating activities	<u>(195,519)</u>	<u>(127,583)</u>
Cash flows from investing activities:		
Interest income	<u>3,475</u>	<u>6,503</u>
Net cash provided by investing activities	<u>3,475</u>	<u>6,503</u>
Cash flows from noncapital financing activities:		
Grant proceeds received	168,170	280,441
Cost of typhoon repairs	<u>(17,747)</u>	<u>(105,375)</u>
Net cash provided by noncapital financing activities	<u>150,423</u>	<u>175,066</u>
Cash flows from capital and related financing activities:		
Purchase of utility plant	(113,679)	(666,188)
Interest paid	(18,638)	(20,092)
Repayment of loans	<u>(62,072)</u>	<u>(60,618)</u>
Net cash used in capital and related financing activities	<u>(194,389)</u>	<u>(746,898)</u>
Net decrease in cash	(236,010)	(692,912)
Cash at beginning of year	<u>733,733</u>	<u>1,426,645</u>
Cash at end of year	\$ <u><u>497,723</u></u>	\$ <u><u>733,733</u></u>
Reconciliation of loss from operations to net cash used in operating activities:		
Loss from operations	\$ (723,365)	\$ (1,014,560)
Adjustments to reconcile loss from operations to net cash used in operating activities:		
Depreciation	740,209	737,627
Decrease (increase) in assets:		
Receivables	(42,307)	(18,795)
Inventory	(11,235)	(4,460)
U.S. federal grants receivable	34,609	-
Prepayment	(47,676)	-
Increase (decrease) in liabilities:		
Accounts payable	(130,936)	152,444
Employees' annual leave and accrued payroll	(1,494)	(4,915)
Accrued taxes and other withholdings	6,628	(1,099)
Contract retention payable	(28,174)	28,174
Other payables	<u>8,222</u>	<u>(1,999)</u>
Net cash used in operating activities	\$ <u><u>(195,519)</u></u>	\$ <u><u>(127,583)</u></u>

Supplemental schedule of noncash financing activity:

During the year ended September 30, 2005, YSPSC changed its method of accounting for certain inventory items which resulted in an increase in inventory of \$234,182.

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, 2005 and 2004

(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 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.

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 in the statements of net assets. 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 each of the years ended September 30, 2005 and 2004 was approximately 4.0% of the cost of depreciable properties.

Cash

For purposes of the statements of net assets and the statements of cash flows, cash includes cash on hand and in bank. At September 30, 2005 and 2004, \$100,000 of cash in bank 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.

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 collectibility 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 determined using the first in-first out method.

YAP STATE PUBLIC SERVICE CORPORATION

Notes to Financial Statements
September 30, 2005 and 2004

(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, 2005 and 2004, unbilled revenues of \$50,307 and \$59,605, 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.

Change in Accounting Principle

In prior years, YSPSC has expensed generation inventories as they were acquired. In fiscal year 2005, YSPSC decided to perform a physical inventory of the generation spare parts and record the inventory in the financial statements. The effect of this accounting change is reflected in the financial statements as the cumulative effect of a change in accounting principles.

Operating and Non-operating Revenues and Expenses

YSPSC considers revenues and expense 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.

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.

YAP STATE PUBLIC SERVICE CORPORATION

Notes to Financial Statements
September 30, 2005 and 2004

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

Accounting Standards, Continued

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:

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, 2005 and 2004.

New Accounting Standards

For fiscal year 2005, YSPSC implemented 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*. The impact of GASB Statement Nos. 40 and 42 was not significant to the financial statements.

For fiscal year 2006, YSPSC will be implementing GASB Statement No. 46, *Net Assets Restricted by Legislation*. Management does not anticipate that implementation of GASB Statement No. 46 will have a material financial statement impact.

YAP STATE PUBLIC SERVICE CORPORATION

Notes to Financial Statements
September 30, 2005 and 2004

(2) Utility Plant

A summary of changes in capital assets for the years ended September 30, 2005 and 2004 is as follows:

	<u>Beginning Balance</u> <u>October 1, 2004</u>	<u>Transfers and</u> <u>Additions</u>	<u>Transfers and</u> <u>Deletions</u>	<u>Ending Balance</u> <u>September 30, 2005</u>
Production plant	\$ 9,376,331	\$ 313,557	\$ (15,995)	\$ 9,673,893
Distribution plant	7,032,287	26,256	(14,188)	7,044,355
General plant	1,804,049	28,329	(386)	1,831,992
Work in progress	<u>388,075</u>	<u>44,387</u>	<u>(298,557)</u>	<u>133,905</u>
	18,600,742	412,529	(329,126)	18,684,145
Less accumulated depreciation	<u>(8,276,831)</u>	<u>(740,209)</u>	<u>30,355</u>	<u>(8,986,685)</u>
	<u>\$ 10,323,911</u>	<u>\$ (327,680)</u>	<u>\$ (298,771)</u>	<u>\$ 9,697,460</u>
	<u>Beginning Balance</u> <u>October 1, 2003</u>	<u>Transfers and</u> <u>Additions</u>	<u>Transfers and</u> <u>Deletions</u>	<u>Ending Balance</u> <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>

Utility plant is comprised of the following components:

	<u>2005</u>	<u>2004</u>
Electric plant	\$ 12,005,248	\$ 11,689,182
Water plant	<u>6,544,992</u>	<u>6,523,485</u>
	<u>\$ 18,550,240</u>	<u>\$ 18,212,667</u>

(3) Notes Payable

Notes payable at September 30, 2005 and 2004 are as follows:

	<u>2005</u>	<u>2004</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

YAP STATE PUBLIC SERVICE CORPORATION

Notes to Financial Statements
September 30, 2005 and 2004

(3) Notes Payable, Continued

	<u>2005</u>	<u>2004</u>
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.	705,078	758,209
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 equipment, furniture and fixtures located at YSPSC's office.	<u>80,720</u>	<u>89,661</u>
Total notes payable	3,056,635	3,118,707
Less current portion	<u>63,568</u>	<u>62,072</u>
	\$ <u>2,993,067</u>	\$ <u>3,056,635</u>

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 63,568	\$ 17,143	\$ 80,711
2007	87,812	15,606	103,418
2008	112,099	14,028	126,127
2009	113,723	12,404	126,127
2010	114,232	11,896	126,128
2011 through 2015	504,454	24,840	529,294
2016 through 2020	668,012	4,881	672,893
2021 through 2025	605,630	-	605,630
2026 through 2030	605,630	-	605,630
2031 through 2032	<u>181,475</u>	<u>-</u>	<u>181,475</u>
	\$ <u>3,056,635</u>	\$ <u>100,798</u>	\$ <u>3,157,433</u>

Changes in long-term liabilities for the years ended September 30, 2005 and 2004 are as follows:

	<u>Outstanding September 30, 2004</u>	<u>Increases</u>	<u>Decreases</u>	<u>Outstanding September 30, 2005</u>	<u>Current</u>	<u>Noncurrent</u>
ADB loan	\$ 2,270,837	\$ -	\$ -	\$ 2,270,837	\$ -	\$ 2,270,837
Yap State loan	758,209	-	53,131	705,078	54,204	650,874
USA loan	<u>89,661</u>	<u>-</u>	<u>8,941</u>	<u>80,720</u>	<u>9,364</u>	<u>71,356</u>
	\$ <u>3,118,707</u>	\$ <u>-</u>	\$ <u>62,072</u>	\$ <u>3,056,635</u>	\$ <u>63,568</u>	\$ <u>2,993,067</u>

YAP STATE PUBLIC SERVICE CORPORATION

Notes to Financial Statements
September 30, 2005 and 2004

(3) Notes Payable, Continued

	Outstanding September 30, 2003	Increases	Decreases	Outstanding September 30, 2004	Current	Noncurrent
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>

(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% of total operating revenues in each of the years ended September 30, 2005 and 2004.

(6) Restricted Net Assets

Restricted net assets at September 30, 2005 and 2004 consist of unexpended balances of the following grants:

	<u>2005</u>	<u>2004</u>
U.S. Department of the Interior	\$ -	\$ 138,809
Yap State capital grant	<u>121,443</u>	<u>138,960</u>
	<u>\$ 121,443</u>	<u>\$ 277,769</u>

(7) Grants

YSPSC received the following grants during the years ended September 30, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
U.S. Federal Emergency Management Agency (FEMA) grants (netted with typhoon costs)	\$ 168,170	\$ 315,050
Donated asset from another utility	<u>-</u>	<u>25,000</u>
	<u>\$ 168,170</u>	<u>\$ 340,050</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.

YAP STATE PUBLIC SERVICE CORPORATION

Notes to Financial Statements
September 30, 2005 and 2004

(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. Remaining damages are estimated at \$1.6 to \$1.7 million. YSPSC has sought assistance from FEMA in funding the cost of repairs. At September 30, 2005 and 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 years ended September 30, 2005 and 2004 are as follows:

	<u>2005</u>	<u>2004</u>
Typhoon costs	\$ (17,747)	\$ (269,356)
Less capitalized items	<u>-</u>	<u>163,981</u>
	\$ (17,747)	(105,375)
FEMA recoveries	<u>168,170</u>	<u>315,050</u>
	\$ <u>150,423</u>	\$ <u>209,675</u>

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Board of Directors
Yap State Public Service Corporation:

We have audited the financial statements of the Yap State Public Service Corporation (YSPSC), as of and for the year ended September 30, 2005, and have issued our report thereon dated November 21, 2005. 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 YSPSC's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

However, we noted other matters involving the internal control over financial reporting that we have reported to management of YSPSC in a separate letter dated November 21, 2005.

Compliance

As part of obtaining reasonable assurance about whether YSPSC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 that are required to be reported under *Government Auditing Standards*.

This report is intended for the information of the Board of Directors and management of YSPSC and the cognizant audit and other federal agencies and is not intended to be, and should not be, used by anyone other than those specified parties.



November 21, 2005