

STATE OF YAP
FEDERATED STATES OF MICRONESIA

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEAR ENDED SEPTEMBER 30, 2006

STATE OF YAP
FEDERATED STATES OF MICRONESIA

FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2006

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INDEPENDENT AUDITORS' REPORT

Honorable Sebastian Anafel
Governor, State of Yap
Federated States of Micronesia:

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Yap (the State), as of and for the year ended September 30, 2006, which collectively comprise the State's basic financial statements as set forth in Section II of the foregoing table of contents. These financial statements are the responsibility of the management of the State. Our responsibility is to express an opinion on the respective financial statements based on our audit. We did not audit the financial statements of the Public Transportation System, which represents the State's business-type activities or the Yap Visitor's Bureau, which represent 1%, 2%, and 3%, respectively, of the assets, net assets, and revenues of the State's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the Public Transportation System, and the Yap Visitor's Bureau are based solely on the reports of the other auditors.

Except as discussed in the following paragraphs, 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective 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 State'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 respective 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 audit and the reports of other auditors provide a reasonable basis for our opinion.

The financial statements of Yap Fishing Authority have not been audited, and we were not engaged to audit these financial statements as part of our audit of the State's basic financial statements. The financial activities of Yap Fishing Authority are included in the State's basic financial statements as a discretely presented component unit and represent 14%, 18%, and 5%, respectively, of the assets, net assets, and revenues of the State's aggregate discretely presented component units.

Because of inadequacies in the accounting records and the internal control over financial reporting, the audited financial statements of Yap Fresh Tuna, Inc., a 50%-owned subsidiary in which Yap Fishing Authority is deemed to have a controlling interest, were not available to be consolidated with the financial statements of Yap Fishing Authority. Consolidation of Yap Fresh Tuna, Inc. financial statements with the financial statements of Yap Fishing Authority is required to conform to accounting principles generally accepted in the United States of America.

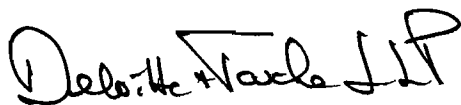
In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Yap as of September 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In addition, in our opinion, based on our audit and the reports of other auditors, because of the effects of the matters discussed in the third and fourth paragraphs above, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the aggregate discretely presented component units of the State of Yap as of September 30, 2006, and the changes in financial position thereof for the year then ended.

The Management's Discussion and Analysis, on pages 3 through 9, as well as the Schedule of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual - General Fund and notes thereto, on pages 45 and 46, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the management of the State. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Our audit was conducted for the purpose of forming an opinion on the State's respective financial statements that collectively comprise the State's basic financial statements. The combining and individual fund financial statements, as set forth in Section IV of the foregoing table of contents, which are also the responsibility of the management of the State, are presented for purposes of additional analysis and are not a required part of the basic financial statements of the State. Such additional information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 25, 2007, on our consideration of the State's (Primary Government only) internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



June 25, 2007

YAP STATE GOVERNMENT

Management's Discussion and Analysis Year Ending September 30, 2006

This analysis, prepared by the Office of Administrative Services, offers readers of the Yap State Government's (Yap State) financial statements a narrative overview of the activities of the government for the fiscal year ended September 30, 2006. We encourage readers to consider this information in conjunction with Yap State's financial statements, which follow. Fiscal year 2005 comparative information has been included, where appropriate. This analysis is required by the Governmental Accounting Standards Board, (GASB) which provides guidelines on what must be included and excluded from this analysis.

FINANCIAL HIGHLIGHTS

- For the fiscal year ended September 30, 2006, Yap State's total net assets increased by approximately \$0.14 million (or 0.14%) from \$98.85 million in the prior year to \$98.99 million.
- During fiscal year 2006, Yap State's revenues of \$24.78 million exceeded total expenses and special items (\$24.64 million) by \$0.14 million. Revenues decreased from fiscal year 2005, by \$4.65 million (or 15%) and expenses decreased \$0.87 million (or 4%). The decrease in revenues is primarily due to reduced investment income and uncollectible grants while the decrease in expenditures is primarily attributable to grants receivable potentially uncollectible.
- Yap State budgetary position remained stable without the significant positive variances compared to the previous year. In fiscal year 2006: revenues available for appropriation were \$1.82 million more than budgeted for the general fund although actual expenditures, special items and transfers were in excess of the budget by \$0.69 million. However, the overall excess of revenues over expenditures reflected a \$1.14 positive change in the general fund balance.
- The unreserved surplus of the General Fund increased by \$2.26 million (up 7.93%); increase from \$29.61 million in the prior year to \$31.87 million in fiscal year 2006. The rise is attributable to the hold on budget stability in the general fund and the gains made on Yap State's investment portfolio. Investment income realized on Yap State's investments totaled \$4.54 million in fiscal year 2006, a decrease of \$3.01 million (or 39.86%) from the \$7.55 million earned in fiscal year 2005.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to Yap State's basic financial statements. Yap State's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains additional required supplementary information in the form of budgetary schedules, which are prepared on the budgetary basis of accounting, and other optional supplementary information, in addition to the basic financial statements themselves, which includes combining statements for governmental funds component units.

YAP STATE GOVERNMENT

Management's Discussion and Analysis Year Ending September 30, 2006

Government-Wide Financial Statements

The government-wide statements report information about Yap State as a whole using accounting methods similar to those used by private-sector companies. It provides both long-term and short-term information about the State's financial status.

The statement of net assets includes all the government's assets and liabilities. The difference in the two is called net assets. Over time, increases or decreases in the State's net assets serve as indicator to measure the State's financial position.

The statement of activities on the other hand, account for the State's current year's revenues and expenses regardless of when cash is received or paid.

The government-wide financial statements of Yap State are divided into three categories:

- Governmental activities – Most of Yap State's basic services are included here, such as education, health, special appropriations, finance, judiciary, and general administration. Federal grants finance most of these activities.
- Business-type activities – Yap State reports the operations of its Public Transportation System, which charges tariffs to help cover the costs of the transportation services it provides.
- Component Units – Yap State includes the operating results of the Yap Visitor's Bureau, the Yap State Public Service Corporation, the Yap Fishing Authority, and The Diving Seagull, Inc in its report. Although legally separate, these "component units" are important because Yap State is financially accountable for them.

Fund Financial Statements

The fund financial statements provide more detailed information about Yap State's significant funds. Funds are accounting devices that Yap State uses to keep track of specific sources of funding and spending for particular services. The State uses fund accounting to comply with financial and related legal requirements

Yap State has two types of funds:

- Governmental funds. Most of Yap State's basic services are included in governmental funds, which focus on (1) how cash and other financial assets that can be readily be converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance Yap State programs. Because this information does not encompass the additional long-term focus of the government-wide statements, we provide additional information at the bottom of the governmental

YAP STATE GOVERNMENT

Management's Discussion and Analysis Year Ending September 30, 2006

funds statement, or on the subsequent page, that explains and reconciles the relationship (or differences) between them.

- Proprietary funds. Services for which Yap State charges customers a fee are generally reported in proprietary funds. Proprietary funds, like the government-wide statements, provide both long- and short-term financial information.

FINANCIAL ANALYSIS OF YAP STATE AS A WHOLE

Net assets may serve over time as a useful indicator of a government's financial position. At the end of fiscal year 2006, Yap State's assets exceeded liabilities by \$98.99 million. Of its total net assets, \$26.01 million (26.16%) are restricted as to the purposes they can be used for. Another \$37.62 million (37.88%) can be used for or are invested in capital assets (buildings, roads, etc.). Yap State uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although Yap State's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. The following schedule summarizes Yap State's net assets as of September 30, 2006:

	2006	2005
Current and other non-capital assets	\$ 71,880,529	\$ 66,833,527
Capital assets	37,619,801	38,777,134
Total Assets	<u>109,500,330</u>	<u>105,610,661</u>
Other liabilities	5,936,917	3,060,815
Long-term liabilities	4,577,176	4,166,635
Total Liabilities	<u>10,514,093</u>	<u>7,225,450</u>
Net Assets		
Invested in capital assets, net of related debt	37,619,801	38,777,134
Restricted	26,020,531	25,643,619
Unrestricted	35,345,905	33,962,458
Total Net Assets	<u>\$ 98,986,237</u>	<u>\$ 98,383,211</u>

At the end of fiscal year 2006, Yap State's unrestricted assets show a surplus of \$35.35 million (35.64% of total net assets). These funds are included in Yap State's investment portfolio and are available for discretionary purposes subject to appropriation by the Yap State Legislature. Yap State's net assets increased \$0.14 million (up 0.14%) from fiscal year 2005. Key elements of the increase and the differences from the prior year are shown in the following schedule:

YAP STATE GOVERNMENT

Management's Discussion and Analysis Year Ending September 30, 2006

	2006	2005
Revenues:		
Program Revenues:		
Charges for services	\$ 1,269,093	\$ 1,012,971
Operating grants and contributions	13,863,198	16,351,067
Capital grants and contributions	186,020	244,710
General Revenues:		
Taxes	3,960,193	3,962,751
Unrestricted investment earnings	4,935,835	7,374,241
Other	564,608	483,811
Total revenues	24,778,947	29,429,551
Expenses:		
General government	7,736,926	6,893,979
Health Services	3,393,744	2,869,352
Education	5,337,633	4,891,778
Economic development	1,032,690	2,183,014
Public Safety	270,178	621,907
Public works and transportation	3,791,605	4,062,339
Community affairs	735,920	655,298
Boards and commissions	48,957	455,651
Payments to components	530,999	1,237,827
Judiciary	-	213,160
Public auditor	11,087	156,436
Public transportation system	347,072	320,040
Other	908,648	775,009
Total expenses	24,145,459	25,015,750
Special item	(500,000)	-
Change in net assets	133,488	4,413,801
Net assets at the beginning of the year, as restated	98,852,749	93,969,410
Net assets at the end of the year	\$98,986,237	\$98,383,211

Total revenues in FY-06 of \$24.78 million decreased from the prior year's \$29.42 million (down 15.80%) primarily due to decreases in investment earnings.

Total expenses in FY-06 of \$24.15 million slightly decreased over fiscal year 2005's \$25.01 million (down 4%).

YAP STATE GOVERNMENT

Management's Discussion and Analysis Year Ending September 30, 2006

FINANCIAL ANALYSIS OF YAP STATE'S FUNDS

As noted earlier, Yap State uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. As of the end of fiscal year 2006, Yap State's governmental funds reported a combined fund balance of \$65.96 million, which represents an increase of \$2.17 million (or 3.54%) in comparison with fiscal year 2005. This increase is primarily attributable to increases in encumbrances and reserves for continuing appropriations for compact capital projects. Of the total fund balance, \$20.82 million is reserved to indicate that it is not available for new spending because it has already been committed: 1) to generate income for future operations (\$12.05 million); 2) to liquidate contracts and purchase orders of the prior period (\$6.26 million); and 3) to fund continuing appropriations for both operating and capital purposes (\$2.51 million). The unreserved combined fund balance is \$45.13 million, a decrease of approximately \$1.0 million (or 2.16%) from fiscal year 2005. The decrease is mainly due to increases in fund balance reserves that exceed increases in unreserved balances.

GENERAL FUND BUDGETARY HIGHLIGHTS

During fiscal year 2006, Yap State revised general fund revenue and expenditure budgets to meet new program requirements in line with additional revenue resources. Yap State was able to maintain its budgetary stability throughout fiscal year 2006, resulting in a \$1.14 million positive variance in the excess of revenues over expenditures. Moreover, the unreserved general fund surplus increased by \$2.27 million (up 7.93%) in fiscal year 2006; from \$29.60 million in fiscal year 2005 to \$31.87 million. This increase was due to the \$4.54 million in investment income earned in fiscal year 2006.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Yap State's investment in depreciable capital assets for the primary government as of September 30, 2006, amounted to \$105.46 million, net of accumulated depreciation of \$67.84 million, leaving a net book value for depreciable capital assets of \$37.62 million. This represents a net decrease of \$1.63 million (or 4.15%) from fiscal year 2005. The table below summarizes Yap State's capital assets:

	Yap State's Capital Assets	
	September 30, 2006	
	2006	2005
Land	\$ 3,120,610	\$ 3,120,610
Construction in progress	299,425	-
Buildings	7,150,570	7,148,498
Equipment	727,057	194,690
Vehicles	548,417	408,507
Boats	85,787	45,209
Infrastructure	25,594,134	27,734,267
Public transportation	93,801	125,353
	<u>\$37,619,801</u>	<u>\$39,246,672</u>

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Management's Discussion and Analysis Year Ending September 30, 2006

Additional information on Yap State's capital assets can be found in note 5 to the financial statements.

Long-Term Debt

Long-term debt obligations of the Yap State primary government total \$4.57 million at September 30, 2006. This debt is comprised of the non-current portion of the ADB Early Retirement Program Loan (\$3.89 million), liability for compensated absences (\$0.51 million) and long-term payments due under land purchase agreements (\$.25 million). Principal payments on the outstanding ADB loan will not begin until 2008 and will be partially covered by \$2.45 million deposited in a restricted investment account jointly held with the FSM National Government.

Additional information on Yap State's long-term debt obligations can be found in note 7 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

Yap State ended fiscal year 2006 with a solid financial position as generally reflected in its increased unreserved general fund surplus. Total governmental operational results were skewed by disproportionately higher FEMA and National Emergency Grant revenues and expenditures, which in turn had a positive impact on local employment and the economy. Although recovery projects related to typhoon Sudal continued into fiscal year 2006, the funding levels significantly tapered off and a consequent leveling or drop in economic conditions resulted. Insofar as other economic factors in the local economy remain relatively stagnant, no material growth in local taxes or fees are expected.

Yap State management also maintains a cautious approach with respect to funding from Compact sector grants, currently comprising 34% of Yap State's revenues. The allotment of some of Yap's leftover prior year sector grant funds to other FSM government entities, the delayed implementation of the public infrastructure grants, and the uncertainties concerning decisions made by the U.S. Department of Interior in its interpretation of the *Fiscal Procedures Agreement* --- continues to inform Yap State's prudent choices and conservative projections with respect to Compact sector funding in fiscal year 2007 and beyond.

Yap State's investments continue to enjoy a favorable climate in the U.S. financial markets. Both fiscal year 2006 and 2007 have resulted in unrealized portfolio gains, some of which will undoubtedly be realized in fiscal year 2007 as investment income. Yap State's general fund surpluses roughly parallel the earnings realized on its investments, if the State continue to hold on fiscal discipline, management expects continued sound operating results and improved financial position to occur during fiscal year 2007.

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Management's Discussion and Analysis
Year Ending September 30, 2006

CONTACTING YAP STATE'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors, a general overview of Yap State's finances to demonstrate its accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Director, Office of Administrative Services, P.O Box 610, Yap, FM 96943.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Net Assets
September 30, 2006

	Primary Government			Component Units
	Governmental Activities	Business-Type Activities	Total	
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 1,761,790	\$ 42,933	\$ 1,804,723	\$ 2,424,248
Time certificates of deposit	-	-	-	1,566,000
Investments	52,739,012	-	52,739,012	398,016
Receivables, net of allowance for uncollectibles	4,031,538	2,149	4,033,687	724,291
Advances	462,982	-	462,982	-
Inventories	-	-	-	705,808
Other current assets	1,790,481	32,625	1,823,106	518,501
Total current assets	<u>60,785,803</u>	<u>77,707</u>	<u>60,863,510</u>	<u>6,336,864</u>
Noncurrent assets:				
Restricted assets:				
Investments	8,421,405	-	8,421,405	-
Investments	2,000,000	-	2,000,000	-
Loans	595,614	-	595,614	-
Capital assets, net of accumulated depreciation	37,526,000	93,801	37,619,801	12,379,467
Total noncurrent assets	<u>48,543,019</u>	<u>93,801</u>	<u>48,636,820</u>	<u>12,379,467</u>
Total assets	<u>\$ 109,328,822</u>	<u>\$ 171,508</u>	<u>\$ 109,500,330</u>	<u>\$ 18,716,331</u>
LIABILITIES				
Current liabilities:				
Current portion of long-term obligations	\$ -	\$ -	\$ -	\$ 247,671
Bank overdraft	812,553	-	812,553	-
Accounts payable	1,017,352	570	1,017,922	592,302
Compensated absences payable, net of current portion	85,655	-	85,655	-
Other liabilities and accruals	153,553	3,542	157,095	754,209
Deferred revenue	3,863,449	243	3,863,692	-
Total current liabilities	<u>5,932,562</u>	<u>4,355</u>	<u>5,936,917</u>	<u>1,594,182</u>
Noncurrent liabilities:				
Noncurrent portion of long-term obligations	3,897,015	-	3,897,015	3,538,770
Compensated absences payable	430,554	-	430,554	-
Other noncurrent liabilities	249,607	-	249,607	-
Total noncurrent liabilities	<u>4,577,176</u>	<u>-</u>	<u>4,577,176</u>	<u>3,538,770</u>
Total liabilities	<u>10,509,738</u>	<u>4,355</u>	<u>10,514,093</u>	<u>5,132,952</u>
Contingencies				
NET ASSETS				
Invested in capital assets, net of related debt	37,526,000	93,801	37,619,801	9,386,400
Restricted for:				
Nonexpendable:				
Future operations	5,961,900	-	5,961,900	-
Expendable:				
Compact related	19,482,610	-	19,482,610	-
Other purposes	576,021	-	576,021	121,443
Unrestricted	<u>35,272,553</u>	<u>73,352</u>	<u>35,345,905</u>	<u>4,075,536</u>
Total net assets	<u>98,819,084</u>	<u>167,153</u>	<u>98,986,237</u>	<u>13,583,379</u>
Total liabilities and net assets	<u>\$ 109,328,822</u>	<u>\$ 171,508</u>	<u>\$ 109,500,330</u>	<u>\$ 18,716,331</u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Activities
Year Ended September 30, 2006

Functions/Programs	Program Revenues				Net (Expenses) Revenues and Changes in Net Assets			
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government			Component Units
					Governmental Activities	Business-type Activities	Total	
Primary government:								
Governmental activities:								
Councils of traditional leaders	\$ 219,035	\$ -	\$ 218,036	\$ -	\$ (999)	\$ -	\$ (999)	\$ -
Public auditor	11,087	-	8,940	-	(2,147)	-	(2,147)	-
General government	7,736,926	169,383	-	171,020	(7,396,523)	-	(7,396,523)	-
Economic development	1,032,690	-	1,125,396	-	92,706	-	92,706	-
Public safety	270,178	-	269,547	-	(631)	-	(631)	-
Community affairs	735,920	-	453,026	-	(282,894)	-	(282,894)	-
Education	5,337,633	5,112	5,671,181	-	338,660	-	338,660	-
Public works and transportation	3,791,605	410,933	1,492,728	15,000	(1,872,944)	-	(1,872,944)	-
Health services	3,393,744	522,517	3,162,460	-	291,233	-	291,233	-
Boards and commissions	48,957	9,224	48,911	-	9,178	-	9,178	-
Payments to components	530,999	-	459,107	-	(71,892)	-	(71,892)	-
Other	289,764	-	-	-	(289,764)	-	(289,764)	-
Future operations	-	-	389,329	-	389,329	-	389,329	-
Other appropriations	399,849	-	399,849	-	-	-	-	-
Total governmental activities	23,798,387	1,117,169	13,698,510	186,020	(8,796,688)	-	(8,796,688)	-
Business-type activities:								
Public Transportation System	347,072	151,924	164,688	-	-	(30,460)	(30,460)	-
Total primary government	\$ 24,145,459	\$ 1,269,093	\$ 13,863,198	\$ 186,020	(8,796,688)	(30,460)	(8,827,148)	-
Component units:								
Yap Visitor's Bureau	\$ 378,899	\$ 5,198	\$ -	\$ -	-	-	-	(373,701)
Yap State Public Service Corporation	4,631,024	4,492,869	-	-	-	-	-	(138,155)
Yap Fishing Authority	357,685	135,219	-	-	-	-	-	(222,466)
The Diving Seagull, Inc.	5,327,085	5,299,294	-	-	-	-	-	(27,791)
Total component units	\$ 10,694,693	\$ 9,932,580	\$ -	\$ -	-	-	-	(762,113)
General revenues:								
Taxes:								
Revenue sharing					2,432,156	-	2,432,156	-
Excise taxes					1,528,037	-	1,528,037	-
Unrestricted investment earnings					4,935,835	-	4,935,835	120,393
Contributions from primary government					-	-	-	822,912
Other					564,608	-	564,608	-
Special items:								
Impairment loss on investment in stock					(500,000)	-	(500,000)	-
Total general revenues and special items					8,960,636	-	8,960,636	943,305
Change in net assets					163,948	(30,460)	133,488	181,192
Net assets at the beginning of the year, as restated					98,655,136	197,613	98,852,749	13,402,187
Net assets at the end of the year	\$ 98,819,084	\$ 167,153	\$ 98,986,237	\$ 13,583,379				

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Balance Sheet
Governmental Funds
September 30, 2006

	General	Special Revenue			Capital Projects	Permanent	Other Governmental Funds	Total
		U.S Federal Grants	Other U.S. Grants	Compact Sector Grants	Compact Capital Projects	Compact Trust		
ASSETS								
Cash and cash equivalents	\$ 1,532,861	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 228,929	\$ 1,761,790
Equity interest in internal investment pool	45,242,787	-	-	-	4,270,133	-	3,226,092	52,739,012
Investments	2,000,000	-	-	-	-	-	-	2,000,000
Receivables, net:								
Loans	650,913	-	-	-	-	-	-	650,913
Federal agencies	-	165,493	-	-	-	-	-	165,493
FSM National Government	401,266	194,413	1,403,343	1,659,294	-	-	50,810	3,709,126
Other	101,620	-	-	-	-	-	-	101,620
Due from other funds	1,988,466	4,518	916,436	777,367	13,322,189	-	427,778	17,436,754
Advances	462,982	-	-	-	-	-	-	462,982
Prepaid items	1,790,481	-	-	-	-	-	-	1,790,481
Restricted assets:								
Pooled investments	2,459,505	-	-	-	-	-	-	2,459,505
Investments	-	-	-	-	-	5,961,900	-	5,961,900
Total assets	\$ 56,630,881	\$ 364,424	\$ 2,319,779	\$ 2,436,661	\$ 17,592,322	\$ 5,961,900	\$ 3,933,609	\$ 89,239,576
LIABILITIES AND FUND BALANCES								
Liabilities:								
Bank overdraft	\$ 812,553	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 812,553
Accounts payable	388,247	211,291	33,858	293,560	-	-	90,396	1,017,352
Other liabilities and accruals	133,904	184	314	-	249	-	18,902	153,553
Deferred revenue	-	-	2,279,763	1,562,686	-	-	21,000	3,863,449
Due to other funds	15,448,288	-	-	467,860	-	-	1,520,606	17,436,754
Total liabilities	16,782,992	211,475	2,313,935	2,324,106	249	-	1,650,904	23,283,661
Fund balances (deficits):								
Reserved for:								
Related assets	6,095,614	-	-	-	-	5,961,900	-	12,057,514
Encumbrances	1,252,525	357,522	1,673,386	2,174,431	498,097	-	308,216	6,264,177
Continuing appropriations	627,490	-	-	-	1,729,460	-	150,000	2,506,950
Unreserved:								
General fund	31,872,260	-	-	-	-	-	-	31,872,260
Special revenue funds	-	(204,573)	(1,667,542)	(2,061,876)	-	-	1,919,346	(2,014,645)
Capital projects funds	-	-	-	-	15,364,516	-	(94,857)	15,269,659
Total fund balances	39,847,889	152,949	5,844	112,555	17,592,073	5,961,900	2,282,705	65,955,915
Total liabilities and fund balances	\$ 56,630,881	\$ 364,424	\$ 2,319,779	\$ 2,436,661	\$ 17,592,322	\$ 5,961,900	\$ 3,933,609	

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds

37,526,000

Long-term liabilities, including loans payable, are not due and payable in the current period and, therefore, are not reported in the funds. The liabilities include:

Long-term debt payable

(3,897,015)

Compensated absences payable

(516,209)

Land acquisition claims payable

(249,607)

(4,662,831)

Net assets of governmental activities

\$ 98,819,084

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds
Year Ended September 30, 2006

	Special Revenue			Capital Projects	Permanent	Other Governmental Funds	Total
	General	U.S Federal Grants	Other U.S. Grants	Compact Sector Grants	Compact Capital Projects	Compact Trust	
Revenues:							
Compact funding	\$ -	\$ -	\$ -	\$ 9,958,898	\$ -	\$ -	\$ 9,958,898
Net increase in the fair value of investments	4,546,506	-	-	-	-	389,329	4,935,835
Federal contributions and other grants	-	2,117,099	1,085,846	-	-	-	3,634,101
Revenue sharing	2,432,156	-	-	-	-	-	2,432,156
Excise taxes	1,349,732	-	-	-	-	178,305	1,528,037
CFSM grants	-	-	-	-	-	291,531	291,531
Fees and charges	368,337	-	-	483,899	-	-	930,408
Departmental charges	186,761	-	-	-	-	-	186,761
Other	564,608	-	-	-	-	-	564,608
Total revenues	9,448,100	2,117,099	1,085,846	10,442,797	-	389,329	24,462,335
Expenditures:							
Current:							
Councils of traditional leaders	218,036	-	-	-	-	-	218,036
Public auditor	8,940	-	-	-	-	-	8,940
General government	1,590,622	1,600,359	1,829,326	1,664,218	25,196	-	7,259,201
Economic development	58,978	-	-	659,695	11,605	-	1,024,736
Public safety	222,006	-	-	-	-	47,854	269,860
Community affairs	343,232	109,794	-	-	-	-	453,026
Education	53,764	818,087	-	4,746,472	-	-	5,676,293
Public works and transportation	1,903,661	-	-	-	50	-	1,918,711
Health services	36,143	544,004	-	3,080,888	-	-	3,684,977
Boards and commissions	58,135	-	-	-	-	-	58,135
Bad debts	289,764	-	-	-	-	-	289,764
Payments to component units	151,105	-	71,892	308,002	-	-	530,999
Other appropriations	364,328	-	-	35,521	-	-	399,849
Total expenditures	5,298,714	3,072,244	1,901,218	10,494,796	36,851	-	21,792,527
Excess (deficiency) of revenues over (under) expenditures	4,149,386	(955,145)	(815,372)	(51,999)	(36,851)	389,329	(9,540)
Other financing sources (uses):							
Operating transfers in	-	955,145	815,372	164,490	-	-	2,039,600
Operating transfers out	(1,865,824)	-	-	-	(173,776)	-	(2,039,600)
Total other financing sources (uses), net	(1,865,824)	955,145	815,372	164,490	(173,776)	-	104,593
Special items:							
Impairment loss on investment in stock	(500,000)	-	-	-	-	-	(500,000)
Net change in fund balances	1,783,562	-	-	112,491	(210,627)	389,329	95,053
Fund balances at the beginning of the year	38,064,327	152,949	5,844	64	17,802,700	5,572,571	2,187,652
Fund balances at the end of the year	\$ 39,847,889	\$ 152,949	\$ 5,844	\$ 112,555	\$ 17,592,073	\$ 5,961,900	\$ 2,282,705
							\$ 65,955,915

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Reconciliation of the Statement of Revenues, Expenditures,
and Changes in Fund Balances of Governmental Funds
to the Statement of Activities
Year Ended September 30, 2006

Amounts reported for governmental activities in the statement of activities on page 11 are different because:

Net change in fund balances - total governmental funds from page 13	\$ 2,169,808
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded or are less than depreciation in the current period, including increases to construction in progress	(1,595,319)
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore, are not reported as expenditures in governmental funds. These expenses include accrued annual leave and land claims payable that are reported in the statement of activities, but not in funds	(13,526)
The issuance of long-term debt (e.g. bonds, leases) provides current financial resources to governmental funds, while the repayment of principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction has any effect on net assets. This amount is the net effect of these differences in the treatment of long - term debt and related items	<u>(397,015)</u>
Change in net assets of governmental activities as presented on page 11.	\$ <u>163,948</u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Net Assets
Proprietary Funds
September 30, 2006

	<u>Public Transportation System</u>
<u>ASSETS</u>	
Current assets:	
Cash and cash equivalents	\$ 42,933
Receivables, net of allowance for uncollectibles	2,149
Other current assets	<u>32,625</u>
Total current assets	<u>77,707</u>
Noncurrent assets:	
Capital assets, net of accumulated depreciation	<u>93,801</u>
Total assets	<u><u>\$ 171,508</u></u>
<u>LIABILITIES</u>	
Current liabilities:	
Accounts payable	\$ 570
Other liabilities and accruals	3,542
Deferred revenue	<u>243</u>
Total liabilities	<u>4,355</u>
<u>NET ASSETS</u>	
Invested in capital assets	93,801
Unrestricted	<u>73,352</u>
Total net assets	<u>167,153</u>
	<u><u>\$ 171,508</u></u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenses, and Changes in Net Assets
Proprietary Funds
Year Ended September 30, 2006

	<u>Public Transportation System</u>
Operating revenues:	
Charges for services	\$ 144,831
Sales	8,366
Total operating revenues	<u>153,197</u>
Operating expenses:	
Cost of services	37,170
Administration costs	259,785
Depreciation and amortization	50,117
Total operating expenses	<u>347,072</u>
Operating loss	<u>(193,875)</u>
Nonoperating revenues:	
Other	<u>(1,273)</u>
Total nonoperating expenses	<u>(1,273)</u>
Loss before operating transfers	(195,148)
Operating transfers in	<u>164,688</u>
Change in net assets	(30,460)
Net assets at the beginning of the year	<u>197,613</u>
Net assets at the end of the year	<u>\$ 167,153</u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Cash Flows
Proprietary Funds
Year Ended September 30, 2006

	<u>Public Transportation System</u>
Cash flows from operating activities:	
Cash received from customers	\$ 151,766
Cash payments to employees	(124,365)
Cash payments to suppliers	<u>(175,792)</u>
Net cash used in operating activities	<u>(148,391)</u>
Cash flows from noncapital financing activities:	
Contributions from the primary government	<u>166,071</u>
Net cash provided by noncapital financing activities	<u>166,071</u>
Cash flows from capital and related financing activities:	
Purchases of capital assets	<u>(19,236)</u>
Net cash used in capital and related financing activities	<u>(19,236)</u>
Net change in cash and cash equivalents	(1,556)
Cash and cash equivalents at the beginning of the year	<u>44,489</u>
Cash and cash equivalents at the end of the year	<u>\$ 42,933</u>
Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	\$ (193,875)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation expense	50,117
Bad debts expense	(602)
Changes in assets and liabilities:	
Receivables, net	586
Other current assets	8,365
Accounts payable	(11,033)
Deferred revenue	<u>(1,949)</u>
Net cash used in operating activities	<u>\$ (148,391)</u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Combining Statement of Net Assets
Component Units
September 30, 2006

	Yap Visitor's Bureau	Yap State Public Service Corporation	Yap Fishing Authority	The Diving Seagull, Inc.	Total
<u>ASSETS</u>					
Current assets:					
Cash and cash equivalents	\$ 171,483	\$ 727,343	\$ 5,513	\$ 1,519,909	\$ 2,424,248
Time certificate of deposit	-	-	-	1,566,000	1,566,000
Investments	-	-	398,016	-	398,016
Receivables, net:					
General	-	591,748	20,038	-	611,786
Other	60,694	9,017	2,383	40,411	112,505
Inventories	-	705,808	-	-	705,808
Other current assets	326	20,385	1,516	496,274	518,501
Total current assets	<u>232,503</u>	<u>2,054,301</u>	<u>427,466</u>	<u>3,622,594</u>	<u>6,336,864</u>
Noncurrent assets:					
Capital assets, net of accumulated depreciation	21,486	9,288,010	2,158,583	911,388	12,379,467
Total noncurrent assets	<u>21,486</u>	<u>9,288,010</u>	<u>2,158,583</u>	<u>911,388</u>	<u>12,379,467</u>
Total assets	<u>\$ 253,989</u>	<u>\$ 11,342,311</u>	<u>\$ 2,586,049</u>	<u>\$ 4,533,982</u>	<u>\$ 18,716,331</u>
<u>LIABILITIES</u>					
Current liabilities:					
Current portion of long-term debt	\$ -	\$ 87,812	\$ -	\$ 159,859	\$ 247,671
Accounts payable	17,629	218,809	13,462	342,402	592,302
Other liabilities and accruals	1,183	351,880	78,363	322,783	754,209
Total current liabilities	<u>18,812</u>	<u>658,501</u>	<u>91,825</u>	<u>825,044</u>	<u>1,594,182</u>
Noncurrent liabilities:					
Noncurrent portion of long-term debt	-	2,905,255	-	633,515	3,538,770
Total liabilities	<u>18,812</u>	<u>3,563,756</u>	<u>91,825</u>	<u>1,458,559</u>	<u>5,132,952</u>
<u>NET ASSETS</u>					
Invested in capital assets, net of related debt	21,486	6,294,943	2,158,583	911,388	9,386,400
Restricted	-	121,443	-	-	121,443
Unrestricted	213,691	1,362,169	335,641	2,164,035	4,075,536
Total net assets	<u>235,177</u>	<u>7,778,555</u>	<u>2,494,224</u>	<u>3,075,423</u>	<u>13,583,379</u>
	<u>\$ 253,989</u>	<u>\$ 11,342,311</u>	<u>\$ 2,586,049</u>	<u>\$ 4,533,982</u>	<u>\$ 18,716,331</u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Combining Statement of Revenues, Expenses, and Changes in Net Assets
Component Units
Year Ended September 30, 2006

	Yap Visitor's Bureau	Yap State Public Service Corporation	Yap Fishing Authority	The Diving Seagull, Inc.	Total
Operating revenues:					
Charges for services	\$ 4,540	\$ 4,186,531	\$ -	\$ 5,299,294	\$ 9,490,365
Sales	658	306,338	135,219	-	442,215
Total operating revenues	<u>5,198</u>	<u>4,492,869</u>	<u>135,219</u>	<u>5,299,294</u>	<u>9,932,580</u>
Operating expenses:					
Cost of services	-	3,668,785	185,617	5,010,798	8,865,200
Administration costs	368,805	260,874	-	244,070	873,749
Depreciation and amortization	10,700	763,582	173,831	9,211	957,324
Total operating expenses	<u>379,505</u>	<u>4,693,241</u>	<u>359,448</u>	<u>5,264,079</u>	<u>10,696,273</u>
Operating income (loss)	<u>(374,307)</u>	<u>(200,372)</u>	<u>(224,229)</u>	<u>35,215</u>	<u>(763,693)</u>
Nonoperating revenues (expenses):					
Contributions from the primary government	369,871	-	453,041	-	822,912
Interest income	-	40,108	-	80,285	120,393
Interest expense	-	(17,143)	-	(63,006)	(80,149)
Other	606	79,360	1,763	-	81,729
Total nonoperating revenues (expenses), net	<u>370,477</u>	<u>102,325</u>	<u>454,804</u>	<u>17,279</u>	<u>944,885</u>
Change in net assets	<u>(3,830)</u>	<u>(98,047)</u>	<u>230,575</u>	<u>52,494</u>	<u>181,192</u>
Net assets at the beginning of the year	<u>239,007</u>	<u>7,876,602</u>	<u>2,263,649</u>	<u>3,022,929</u>	<u>13,402,187</u>
Net assets at the end of the year	<u>\$ 235,177</u>	<u>\$ 7,778,555</u>	<u>\$ 2,494,224</u>	<u>\$ 3,075,423</u>	<u>\$ 13,583,379</u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies

The accompanying financial statements of the State of Yap (the State) have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the State's accounting policies are described below.

A. Reporting Entity

The State is one of the four states that make up the Federated States of Micronesia (FSM), along with the states of Chuuk, Kosrae and Pohnpei. The State is a constitutional government comprised of three branches: the Legislative Branch, consisting of 10 members elected for a term of four years by qualified voters of their respective election districts; the Executive Branch, headed by the Governor and Lt. Governor who are primarily responsible for executing the laws and administering state government services; and the Judiciary Branch made up of the State Supreme Court, which consists of a Chief Justice and two Associate Justices, and other courts that may be created by law. The State also has traditional leaders that serve in the Council of Pilung and the Council of Tamol that advise the State on matters concerning customary law and traditional practice.

For financial reporting purposes, the State has included all funds, organizations, agencies, boards, commissions and institutions. The State has also considered all potential component units for which it is financially accountable as well as other entities for which the nature and significance of their relationship with the State are such that exclusion would cause the State's financial statements to be misleading or incomplete. The criteria to be considered in determining financial accountability include whether the State, as the primary government, has appointed a voting majority of an organization's governing body and either has the ability to impose its will on that organization or there is potential for the organization to provide specific financial benefits to or impose specific financial burdens on the State. Financial accountability also exists if an organization is determined to be fiscally dependent on the primary government, although the primary government does not appoint a voting majority of the organization's governing board.

Each blended and discretely presented component unit of the State has a September 30 year-end.

Once financial accountability has been determined for a potential component unit, that component unit is either blended into the primary government or discretely presented from the primary government. Potential component units that do not meet the financial accountability criteria, but where a voting majority of the governing board is appointed by the State, are deemed to be related organizations. The nature and relationship of the State's component units and related organizations are disclosed in the following section.

Blended component units are entities that are legally separate from the State, but are so related to the State that they are, in substance, the same as the State or entities providing services entirely or almost entirely to the State. The net assets and results of operations of the following legally separate entities are presented as part of the State's operations:

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

i. Blended Component Units

The following Component Unit is blended within the Primary Government:

Public Transportation System (PTS), a Proprietary Fund Type - Enterprise Fund. This fund was created by Yap State Law (YSL) No. 1-170 and is responsible for the provision of reliable and inexpensive transportation for those people living outside of the Colonia area. PTS is governed by a five-member Board of Directors appointed by the Governor subject to the advice and consent of the Legislature.

ii. Discretely Presented Component Units

Discretely presented component units are entities which are legally separate from the State, but are financially accountable to the State, or whose relationships with the State are such that exclusion would cause the State's basic financial statements to be misleading or incomplete. The component units' column of the basic financial statements includes the financial data of the following major component units:

Yap Visitor's Bureau (YVB): YVB was created by YSL No. 4-25 and is responsible for the promotion of Yap as a tourist destination. YVB is governed by a seven-member Board of Directors, of which five members are appointed by the Governor subject to the advice and consent of the Legislature, one member is appointed by the Speaker of the Legislature, and one member is elected by the six appointed members.

Yap State Public Service Corporation (YSPSC): YSPSC was created by YSL No. 4-4 and is responsible for the delivery of electricity, water and sewer in the State. YSPSC is governed by a seven-member Board of Directors appointed by the Governor subject to the advice and consent of the Legislature.

Yap Fishing Authority (YFA): YFA was created by Yap District Law (YDL) No. 6-13 and is responsible for the promotion, development, and supporting of commercial utilization of living marine resources within the State. YFA is governed by a five-member Board of Directors appointed by the Governor subject to the advice and consent of the Legislature.

The Diving Seagull, Inc. (DSI): DSI was incorporated in the State on March 17, 1997 and was organized primarily to pursue fishing and other fishing related activities by operating fishing vessels, marketing and selling fish, and developing cold storage and/or transshipment facilities. DSI is governed by a seven-member Board of Directors.

The State's component units, departments, and funds that are separately audited issue their own financial statements. These statements may be obtained by directly contacting the various entities or obtaining them directly from the Office of the Public Auditor at the following address:

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

ii. Discretely Presented Component Units, Continued

P.O. Box 927
Colonia, Yap, FSM 96943

iii. Omitted Component Units

The following component units have been omitted from the basic financial statements due to the lack of available financial information:

Gagil-Tomil Water Authority (GTWA): GTWA was created by YSL No. 1-183 and is responsible for the provision of services in the operation and maintenance of the Gagil-Tomil Water System. GTWA is governed by a nine-member Board of Directors, four of which are appointed by the Gagil member of the Council of Pilung, four appointed by the Tomil member of the Council of Pilung, and one appointed by the Governor. The financial activities of this omitted component unit are not considered material to the basic financial statements.

Southern Yap Water Authority (SYWA): SYWA was created by YSL No. 1-221 and is responsible for the operation and maintenance of the Southern Yap Water System. SYWA is governed by a six-member Board of Directors, of which one is appointed by the Governor, two members who are appointed by the Municipal Chief of Rull on the Council of Pilung, one of whom shall be from either Lamer or Luwech Villages, and three members who are appointed by the municipal chiefs of Gilman, Kanifay, and Dalipebinaw on the Council of Pilung. The financial activities of this omitted component unit are not considered material to the basic financial statements.

Yap Sports Council (YSC): YSC was created by YSL No. 4-65 and is responsible for promoting and encouraging sports participation at all levels of society. YSC is governed by an eleven-member Board of Directors, of which three members are appointed by the Governor subject to the advice and consent of the Legislature, two members are appointed by the Speaker of the Legislature, two members are appointed by the Council of Pilung, two members are appointed by the Council of Tamol, and two members are appointed by the Congress of the FSM National Government. The financial activities of this omitted component unit are not considered material to the basic financial statements.

B. Government-Wide Financial Statements

The Statement of Net Assets and the Statement of Activities report financial information on all of the non-fiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been eliminated from these statements except for other charges between the primary government and the discretely presented component units. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

Primary government activities are defined as either governmental or business-type activities. Governmental activities, which normally are supported by taxes, intergovernmental revenues and other non-exchange revenues, are reported separately from business-type activities, which rely to a significant extent on fees charged to external parties for goods or services. As such, business-type activities account for operations similarly to a for-profit business. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable. Discretely presented component unit activities are presented with their business-type focus.

The Statement of Net Assets presents all of the reporting entity's non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets.
- Restricted net assets - nonexpendable consists of permanent funds in which donors or other outside sources have stipulated that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to the principal.
- Restricted net assets - expendable consists of resources in which the State is legally or contractually obligated to spend resources in accordance with restrictions either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.
- Unrestricted net assets consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated (for example, internally restricted), to indicate that management does not consider them to be available for general operations.

The government-wide Statement of Net Assets reports \$26,020,531 of restricted net assets, of which \$576,021 is restricted by enabling legislation.

The Statement of Activities demonstrates the degree to which the direct expenses of given functions or segments are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function or segment. Program revenues include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not meeting the definition of program revenues are, instead, reported as general revenue.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

C. Fund Financial Statements

The fund financial statements present a balance sheet and a statement of revenues, expenditures, and changes in fund balances for its major and aggregated non-major funds.

Major individual governmental funds are reported as separate columns in the fund financial statements pursuant to GASB reporting standards, with nonmajor governmental funds being combined into a single column.

The State reports its financial position and results of operations in funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures/expenses. Transactions between funds within a fund type, if any, have not been eliminated.

D. Measurement Focus and Basis of Accounting

The government-wide financial statements are reported using the economic resources management focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements account for the general governmental activities of the State and are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become susceptible to accrual; generally when they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the State considers revenues to be available if they are collected within sixty days of the end of the current fiscal period.

Significant revenues susceptible to accrual include income and gross revenue taxes, federal grants, federal reimbursements and other reimbursements for use of materials and services. Miscellaneous revenues from other financing sources are recognized when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned, since they are both measurable and available. Investments and related investment earnings are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Expenditures generally are recorded in the period in which the related fund liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Amounts reported as program revenue include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources are reported as general revenues rather than as program revenues. General revenue is derived from taxation, investment income and other fees that are not allocated to specific programs.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All other revenues are reported as nonoperating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

The State reports the following fund types:

1. Governmental Funds

i. General Fund

This fund is the primary operating fund of the State. It is used to account for all governmental transactions, except those required to be accounted for in another fund.

ii. Special Revenue Funds

These funds account for specific revenue sources that have been aggregated according to enabling legislation to support specific governmental activities.

iii. Capital Projects Funds

These funds account for the acquisition or construction of major State capital facilities financed primarily from loans and federal reimbursements.

iv. Permanent Fund

This fund accounts for resources that are legally restricted to the extent that only earnings, and not principal, may be used to support programs for the benefit of the government.

2. Proprietary Funds

i. Enterprise Fund

This fund accounts for activities similar to those found in the private sector, where the determination of net income is necessary or useful to sound financial administration.

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 - Omnibus*, sets forth minimum criteria (percentage of the assets, liabilities, revenues or expenditures/expenses for either fund category or the governmental and enterprise combined) for the determination of major funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The nonmajor funds are combined in a column in the fund financial statements and detailed in the combining statements. The State reports the following major funds:

STATE OF YAP
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Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

U.S. Federal Grants Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for all financial transactions formally related to the Trust Territory of the Pacific Islands (TTPI) United States federally assisted funds, which are subgranted to the State, as well as other direct federal grants that the State received from the United States government once the State's subgrantee status with the TTPI ceased.

Other U.S. Grants Fund, a Governmental Fund Type – Special Revenue Fund. This fund accounts for all FEMA public assistance grants received from the U.S. Department of Homeland Security.

Compact Sector Grants Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for United States Congress appropriations under United States Public Law 99-239, as amended, Title II, Article I, Section 211(a) and approved by the FSM Congress to promote economic advancement and budgetary self-reliance. These appropriations are to be used for assistance in education, health care, the environment, public sector capacity building, and private sector development, or for other areas as mutually agreed, with priorities in the education and health care sectors.

Compact Capital Projects Fund, a Governmental Fund Type - Capital Projects Fund. This fund is used to account for financial transactions related to Compact Capital Account funds as provided under Section 211(a) of the Compact of Free Association.

Compact Trust Fund, a Governmental Fund Type - Permanent Fund. This fund accounts for United States Congress appropriations under United States Public Law 99-239, as amended, Title II, Article I, Section 215 and approved by the FSM Congress to provide for an additional source of revenue for the government budget that will be needed to substitute for the absence of Compact of Free Association funding. Earnings from funds invested would not be available for distribution until October 2023.

E. Reporting Standards

As allowed by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the State's proprietary funds follow all GASB pronouncements and those Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

F. Cash and Cash Equivalents and Time Certificates of Deposit

Cash and cash equivalents include cash held in demand accounts as well as short-term investments with a maturity date within three months of the date acquired by the State. Deposits maintained in time certificates of deposit with original maturity dates greater than three months are separately classified on the statement of net assets/balance sheet.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

G. Investments

Investments are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. When market prices of equity investments in companies are not readily determinable, the investments are carried at cost if less than twenty percent of the companies' total equity is owned, on the equity method if greater than twenty percent and less than fifty percent is owned, and on a consolidated basis if greater than fifty percent is owned.

H. Receivables

In general, tax revenue is recognized on the government-wide statements, when assessed or levied and on the governmental fund financial statements to the extent that it is both measurable and available. Receivables are stated net of estimated allowances for uncollectible accounts. Reimbursements due to the State for expenditures on federally funded reimbursement and grant programs are reported as "receivables from federal agencies".

Receivables of the primary government are primarily due from businesses and individuals residing in the State. The State establishes an allowance for doubtful accounts receivable based on the credit risk of specific customers, historical trends and other information.

I. Prepaid Items and Inventories

Certain payments made to vendors or persons for services reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

Inventories of the Component Units are determined by physical count and are valued at the lower of cost or market by the first-in first-out method (FIFO). During the year ended September 30, 2006, due to the inability of the related balance, the Primary Government ceased accountability for inventories.

J. Interfund Receivables/Payables

During the course of its operations, the State records transactions between individual funds for goods provided or services rendered. Receivables and payables resulting from transactions between funds are classified as "due from other funds" or "due to other funds" on the governmental fund balance sheet.

These balances result from the time lag between the dates that 1) interfund goods and services are provided or reimbursable expenditures occur, 2) transactions are recorded in the accounting system, and 3) payments between funds are made, and are scheduled to be collected in the subsequent year.

STATE OF YAP
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Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

K. Restricted Assets

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through loan agreements or enabling legislation. Specifically, the State has collateralized pooled investments from Asian Development Bank loan proceeds and earnings in the amount of \$2,459,505 for the Yap State Early Retirement Scheme. Furthermore, investments in the amount of \$5,961,900 are restricted under the Compact of Free Association in that they are not available for distribution until October 2023.

L. Capital Assets

Capital assets, which include property, plant, equipment and infrastructure assets (e.g. roads, bridges, docks, water and sewer lines, water catchments, and other similar items), are reported in the governmental activity column of the government-wide financial statements. Such assets, whether purchased or constructed, are recorded at historical cost or estimated historical cost. Donated capital assets are recorded at estimated fair market value at the date of donation.

Machinery and equipment, other than vehicles and boats, are capitalized when the cost of individual items exceed \$50,000. Vehicles and boats, along with significant repair and maintenance qualifying as a betterment of such, are capitalized regardless of cost and depreciated. Buildings and infrastructure projects, along with significant improvements or reconstruction qualifying as a betterment of such, are capitalized when the cost of individual items or projects exceed \$100,000. The costs of normal maintenance and repairs that do not add to the value of the capital asset or materially extend capital asset lives are not capitalized.

Capital assets of the primary government and the component units are depreciated using the straight-line method over their estimated useful lives, with a full year's depreciation charged in the year of acquisition and disposal, regardless of date. Estimated useful lives are as follows:

Buildings	40 - 50 years
Infrastructure	25 - 50 years
Facilities	3 - 40 years
Machinery and equipment	3 - 25 years
Furniture and fixtures	3 - 10 years

M. Interfund/Intrafund Transactions

As a general rule, the effect of interfund activity has been eliminated in the government-wide financial statements. Exceptions to this rule are: 1) activities between funds reported as governmental activities and funds reported as business-type activities and, 2) activities between funds that are reported in different functional categories in either the governmental or business-type activities column. Elimination of these activities would distort the direct costs and program revenues for the functions concerned.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

N. Deferred Revenue

In the government-wide financial statements, deferred revenue is recognized when cash, receivables or other assets are recorded prior to being earned. In the governmental fund financial statements deferred revenue represents monies received or revenues accrued which have not been earned or do not meet the "available" criterion for revenue recognition under the modified accrual basis of accounting. The deferred revenue in the governmental fund types has primarily resulted as federal funds are received in advance of eligible expenditures.

O. Compensated Absences

It is the government's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since the government does not have a policy to pay any amounts when employees separate from service with the government. All vacation pay is accrued when incurred in the government-wide financial statements. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements. Annual leave accumulates at the rate of one working day per bi-weekly pay period.

P. Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

The unreserved fund balances for the governmental funds represent the amount available for budgeting future operations. The reserve for related assets as of September 30, 2006, is represented by the following assets:

	<u>General</u>	U.S. Federal <u>Grants</u>	U.S. Federal <u>Grants</u>	Compact Capital <u>Projects</u>	Compact <u>Trust</u>	Other Governmental <u>Funds</u>	<u>Totals</u>
Equity interest in internal investment pool	\$ 1,040,495	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,040,495
Investments	2,000,000	-	-	-	-	-	2,000,000
Receivables:							
Loans	595,614	-	-	-	-	-	595,614
Restricted assets:							
Pooled investments	2,459,505	-	-	-	-	-	2,459,505
Investments	-	-	-	-	5,961,900	-	5,961,900
	<u>\$ 6,095,614</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,961,900</u>	<u>\$ -</u>	<u>\$ 12,057,514</u>

The reserve for related assets within the General Fund includes the amount of \$3,500,000 set aside for future repayment of the Early Retirement Program Loan.

STATE OF YAP
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Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

Q. Risk Financing

The State is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. It is the policy of the primary government not to purchase commercial insurance for the risks of loss to which it is exposed. Instead, State management believes it is more economical to manage its risks internally. In the event of claim settlements and judgments, the State reports all of its risk management activities in its General Fund. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. However, no material losses have been incurred as a result of this policy in the last three years.

R. Estimates

The preparation of financial statements in conformity with GAAP requires 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, expenditures and expenses during the reporting period. Actual results could differ from those estimates.

S. New Accounting Standards

During fiscal year 2006, the State implemented the following pronouncements:

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes standards for impairment of capital assets when its service utility has declined significantly and unexpectedly.
- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation (an amendment to GASB Statement No. 34)*, which requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets.
- GASB Statement No. 47, *Accounting for Termination Benefits*, which establishes guidance for state and local governmental employers on accounting and financial reporting for termination of benefits.
- GASB Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefit Expenditures/Expense and Liabilities by Cost-Sharing Employers*, which clarifies the requirements of GASB Statement Nos. 27 and 45 for recognition of pension and other postemployment benefit expenditures/expense and liabilities by cost-sharing employers.

The implementation of these pronouncements did not have a material impact on the accompanying 2006 financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies, Continued

S. New Accounting Standards, Continued

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments. The provisions of this Statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of the State.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other post employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of the State.

In September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*. GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. The Statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. The provisions of this Statement are effective for periods beginning after December 15, 2006. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of the State.

T. Restatement of Primary Government Governmental Activities Net Assets

Net assets, as previously reported at September 30, 2005,	\$ 98,185,598
Understatement of capital assets, net of accumulated depreciation, previously reported for governmental activities	<u>469,538</u>
Net assets, as restated, at September 30, 2005	\$ <u>98,655,136</u>

(2) Deposits and Investments

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

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2005

(2) Deposits and Investments, Continued

The State pools cash resources of its various funds in order to facilitate the management of cash. Unless otherwise required by law, interest income received on pooled cash accrues to the General Fund. Cash and cash equivalents applicable to a particular fund are readily identifiable. The State has invested the majority of its excess Compact Funds in a pooled investment fund which is managed under the control of the Federated Development Authority, an entity comprised of the FSM National Government and its four component states. Investment income originating from the pool accrues to the General Fund.

The deposit and investment policies of the State are governed by Title 13 of the Yap State Code. The Treasurer is responsible for ensuring that deposits of the General Fund are maintained in commercial checking or savings accounts of any financial institution whose assets are at least \$1 billion and whose deposits are subject to Federal Deposit Insurance Corporation (FDIC) insurance. The Governor is responsible for the investment of any monies of the State that are deemed not necessary for immediate use.

The Federated Development Authority has selected investment managers who are given authority to buy and sell securities. These investment managers may invest in stocks, bonds and cash equivalents, for which minimum standards of quality of such investments at the time of purchase shall be as follows:

- i. Cash equivalents - The investment manager may engage in all normally accepted short-term investment practices including, but not limited to U.S. Treasury and government agency securities, bankers acceptances, certificates of deposit, commercial paper and repurchase agreements using any of the foregoing as collateral. The following restrictions apply: (1) Commercial paper must be rated A-1/P-1 or higher by Standard & Poors Corporation and Moody's Investor Services; and (2) Certificates of deposit must be from FDIC insured banks or FSLIC insured savings and loan associations, both of which must have assets in excess of \$2 billion. Deposits in smaller institutions are acceptable, but must not exceed the amount of the insurance, unless collateralized by U.S. Treasury obligations at 102%.
- ii. Stocks - A "B" rating by a national rating service is required. Non-rated stocks, such as banks or insurance companies, must be equal in quality or higher.
- iii. Bonds – Investments in bonds are confined to issues rated "A" or higher by a national rating service, except in the case of U.S. Treasury or government agency obligations which are not rated.

The equity portfolio shall be diversified among issues and industry classifications. No more than 25% of the equity portfolio may be invested in any single classification, as described by the Standard and Poors 500 Index, unless prior approval is received from the Secretary of Finance.

No investment may be made in a single corporate entity which exceeds 5% of the total assets of the fund at the time of purchase without prior approval of the Secretary of Finance.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(2) Deposits and Investments, Continued

A. Deposits

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

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

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

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

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the State's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. The State does not have a deposit policy for custodial credit risk.

As of September 30, 2006, the carrying amount of the primary government's total cash and cash equivalents was \$1,804,723 and the corresponding bank balance was \$1,785,492, which is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2006, bank deposits in the amount of \$242,933 were FDIC insured. The State does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

B. Investments

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

Category 1 Investments that are insured or registered, or securities held by the State or its agent in the State's name;

Category 2 Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the State's name; or

Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the State's name.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(2) Deposits and Investments, Continued

B. Investments, Continued

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for investments falling into categories 1 and 2, and provided for disclosure requirements addressing other common risks of investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. GASB Statement No. 40 did retain and expand the element of custodial credit risk in GASB Statement No. 3.

As of September 30, 2006, the State's investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ <u>18,567,110</u>
Other investments:	
Domestic equities	35,417,754
Money market funds	354,169
Cash management account	<u>6,821,384</u>
	<u>42,593,307</u>
	\$ <u>61,160,417</u>

As of September 30, 2006, the State's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

	Credit Ratings	Investment Maturities (In Years)				Fair Value
		Less Than 1	1 to 5	6 to 10	Greater Than 10	
Corporate notes and bonds	A1	\$ -	\$ -	\$ 11,630	\$ 304,028	\$ 315,658
Corporate notes and bonds	A2	-	18,243	38,989	348,996	406,228
Corporate notes and bonds	A3	-	16,876	-	230,489	247,365
Corporate notes and bonds	Aa1	-	19,455	11,565	150,750	181,770
Corporate notes and bonds	Aa2	-	-	3,738	355,463	359,201
Corporate notes and bonds	Aa3	-	23,304	23,739	594,817	641,860
Corporate notes and bonds	Aaa	-	429,342	-	844,235	1,273,577
Corporate notes and bonds	Baa1	-	404,526	18,360	-	422,886
Corporate notes and bonds	Baa2	-	-	3,501	-	3,501
Corporate notes and bonds	Baa3	-	-	-	7,343	7,343
Corporate notes and bonds	Not rated	11,904	9,578	11,810	202,073	235,365
U.S. government obligations	Aaa	27,950	1,474,479	209,566	5,581,892	7,293,887
U.S. government agency obligations	Aaa	<u>1,691,442</u>	<u>2,339,916</u>	<u>1,196,501</u>	<u>1,950,610</u>	<u>7,178,469</u>
		<u>\$1,731,296</u>	<u>\$4,735,719</u>	<u>\$1,529,399</u>	<u>\$10,570,696</u>	<u>\$18,567,110</u>

As of September 30, 2006, the General Fund holds 10.7% of the shares of the Bank of the Federated States of Micronesia in the amount of \$1,000,000, 24.5% of the shares of the Pacific Islands Development Bank in the amount of \$1,000,000, and an uncertain percentage of the shares of Palau Micronesia Air (PMA) in the amount of \$500,000. As the fair market value of these investments, except for PMA, is not readily available, such have been recorded at cost. The shares in Palau Micronesia Air have been fully reserved for through an impairment loss in 2006.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(2) Deposits and Investments, Continued

B. Investments, Continued

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. With the exception of investments in U.S. government securities, which are explicitly or implicitly guaranteed by the United States government, all other investments must be rated in accordance with the State's investment policy.

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the State will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The State's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the State's name by the State's custodial financial institutions at September 30, 2006.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the State. As of September 30, 2006, the State's investment in agency obligations of the Federal National Mortgage Association constituted 11.5% of its total investments.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. The State does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Discretely Presented Component Units

The Yap Fishing Authority (YFA) investment represents a 50% interest in Yap Fresh Tuna, Inc., an unconsolidated entity that should be consolidated into YFA in accordance with accounting principles generally accepted in the United States of America.

(3) Receivables

Receivables as of September 30, 2006, for the primary government's individual major funds and nonmajor funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	General	U.S. Federal Grants	Other U.S. Grants	Compact Sector Grants	Compact Capital Projects	Compact Trust	Public Transportation System	Nonmajor And Other Funds	Totals
Receivables:									
Loans	\$ 8,050,913	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 2,000,000	\$10,050,913
Federal agencies	-	348,681	1,403,343	-	-	-	-	-	348,681
FSM National Government	401,266	1,721,280	-	1,823,784	1,969,268	-	-	2,476,548	9,795,489
Taxes	190,196	-	-	-	-	-	-	-	190,196
Accrued interest	-	-	-	-	-	-	-	-	-
Other	442,534	-	-	-	-	-	80,786	20,000	543,320
	9,084,909	2,069,961	1,403,343	1,823,784	1,969,268	-	80,786	4,496,548	20,928,599
Less: allowance for uncollectible accounts	(7,931,110)	(1,710,055)	-	(164,490)	(565,925)	-	(78,637)	(4,445,738)	(14,895,955)
Net receivables	\$ 1,153,799	\$ 359,906	\$ 1,403,343	\$ 1,659,294	\$ 1,403,343	\$ -	\$ 2,149	\$ 50,810	\$ 6,032,644

STATE OF YAP
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Notes to Financial Statements
September 30, 2006

(3) Receivables, Continued

Loans receivable of the primary government as of September 30, 2006 are as follows:

Major Governmental Funds

General Fund:

Note receivable from the Yap Fishing Corporation, appropriated under YSL No. 2-96, uncollateralized, due and payable on or before June 11, 2004. This note has been fully provided for in the allowance for uncollectibles.	\$ 6,400,000
Note receivable from the Yap Fishing Corporation, appropriated under YSL No. 3-8, uncollateralized, due September 30, 2004, interest at 6% per annum. This note has been fully provided for in the allowance for uncollectibles.	1,000,000
Note receivable from the Yap State Public Service Corporation, uncollateralized, due in quarterly interest only payments through March 2003; monthly principal and interest payments of \$5,651 starting June 1, 2003; interest at 2%, maturing in May 2017.	<u>650,913</u>
	<u>8,050,913</u>

Nonmajor Governmental Funds

Note receivable from the Yap Fishing Corporation, appropriated under YSL No. 3-67, uncollateralized, non-interest bearing and payable on demand. This note has been fully provided for in the allowance for uncollectibles.	<u>2,000,000</u>
	<u>\$ 10,050,913</u>

(4) Interfund Receivables and Payables

Receivables and payables between funds reflected as due to/from other funds in the combined balance sheet at September 30, 2006, are summarized as follows:

Receivable Fund	Payable Fund	Amount
General	U.S. Federal Grants	\$ 4,518
General	Other U.S. Grants	916,436
General	Compact Sector Grants	777,367
General	Compact Capital Projects	13,322,189
General	Nonmajor governmental funds	427,778
Compact Sector Grants	General	467,860
Nonmajor governmental funds	General	<u>1,520,606</u>
		<u>\$ 17,436,754</u>

STATE OF YAP
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Notes to Financial Statements
September 30, 2006

(5) Fixed Assets

Capital asset activities of the primary government for the year ended September 30, 2006, are as follows:

	Balance October 1, 2005	Additions	Retirements	Balance September 30, 2006
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 3,120,610	\$ -	\$ -	\$ 3,120,610
Construction in progress	-	299,425	-	299,425
	<u>3,120,610</u>	<u>299,425</u>	<u>-</u>	<u>3,420,035</u>
Capital assets, being depreciated:				
Buildings	13,080,658	-	-	13,080,658
Heavy equipment	2,567,407	760,209	-	3,327,616
Vehicles	871,822	268,655	-	1,140,477
Boats	1,253,687	51,000	-	1,304,687
Infrastructure	82,316,716	-	-	82,316,716
Total capital assets, being depreciated	<u>100,090,210</u>	<u>1,079,864</u>	<u>-</u>	<u>101,170,154</u>
Less accumulated depreciation for:				
Buildings	(5,462,622)	(467,466)	-	(5,930,088)
Heavy equipment	(2,372,717)	(227,842)	-	(2,600,559)
Vehicles	(463,315)	(128,745)	-	(592,060)
Boats	(1,208,478)	(10,422)	-	(1,218,900)
Infrastructure	(54,582,449)	(2,140,133)	-	(56,722,582)
	<u>(64,089,581)</u>	<u>(2,974,608)</u>	<u>-</u>	<u>(67,064,189)</u>
Total capital assets, being depreciated, net	<u>36,000,709</u>	<u>(1,894,744)</u>	<u>-</u>	<u>34,105,965</u>
Governmental activities capital assets, net	<u>\$ 39,121,319</u>	<u>\$ (1,595,319)</u>	<u>\$ -</u>	<u>\$ 37,526,000</u>
Business-type activities:				
Capital assets, being depreciated:				
Buildings	\$ 34,656	\$ -	\$ -	34,656
Vehicles	716,211	4,900	-	721,111
Other equipment	96,875	14,336	(2,113)	109,098
Total capital assets, being depreciated	<u>847,742</u>	<u>19,236</u>	<u>(2,113)</u>	<u>864,865</u>
Less accumulated depreciation	<u>(722,389)</u>	<u>(50,117)</u>	<u>1,442</u>	<u>(771,064)</u>
Business-type activities capital assets, net	<u>\$ 125,353</u>	<u>\$ (30,881)</u>	<u>\$ (671)</u>	<u>\$ 93,801</u>

Depreciation expense was charged to functions/programs of the primary government's governmental activities as follows:

Council of traditional leaders	\$ 999
Public auditor	2,147
General government	80,579
Economic development	90,848
Public safety	195,982
Community affairs	282,894
Education	98,995
Public works and transportation	2,180,849
Health services	34,693
Boards and commissions	<u>6,622</u>
	<u>\$ 2,974,608</u>

STATE OF YAP
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Notes to Financial Statements
September 30, 2006

(6) Operating Transfers In/Out

Operating transfers in/out for each major governmental fund and nonmajor governmental funds in the aggregate, for the year ended September 30, 2006, are as follows:

<u>Source</u>	<u>Recipient</u>	<u>Transfers Out</u>	<u>Transfers In</u>
<u>Major Governmental Funds</u>			
General	Other U.S. grants	\$ <u>75,671</u>	\$ <u>-</u>
Compact Capital Projects	Other U.S. grants funds	\$ <u>173,776</u>	\$ <u>-</u>
General and Capital Projects	Other U.S. grants	\$ <u>-</u>	\$ <u>249,447</u>

Transfers are used to: 1) move revenues from the fund that enabling legislation or budget requires to collect them to the fund that enabling legislation or budget requires to expend them, 2) use unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations and U.S. federal matching requirements, and 3) record reductions in interfund loans for amounts that are not expected to be repaid.

(7) Long-Term Obligations

Primary Government

Land Acquisition Claims Payable

As of September 30, 2006, \$249,607 in long-term payments due under land purchase agreements were identified by the State. This total comprises indefinite land use payments and other lease payments for which payment dates cannot be determined due to heirship disputes.

Asian Development Bank (ADB) Early Retirement Program Loan

During the year ended September 30, 1998, the State implemented an Early Retirement Scheme (ERS) in which employees holding certain nonessential positions as identified by the State were retired early with a payout of the equivalent of two-years' wages. This ERS program is funded by a \$3,500,000 loan from the ADB through the FSM National Government. The activities of the ERS Program are recorded in the General Fund.

The ADB loan has a grace period of ten years with the first payment due in February 2008 and the last payment in August 2038. However, pursuant to the terms of the Financing Agreement between the State and the FSM National Government, the State is required to deposit into the ERS Trust account held in the name of the State within the FSM National Government investment portfolio, 100% of the outstanding principal balance by September 30, 2002.

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Notes to Financial Statements
September 30, 2006

(7) Long-term Obligations, Continued

Primary Government, Continued

Asian Development Bank (ADB) Early Retirement Program Loan, Continued

During the year ended September 30, 2003, the State entered into an agreement with the Federated States of Micronesia National Government (FSM) to borrow a portion of the proceeds of the FSM Program Loan with ADB (Loan Number 1873 (SF) and Loan Number 1874 FSM (SF)), for the purpose of promoting private sector development in Yap, with interest at 1 to 1½%. As of September 20, 2006, total drawdowns received were \$397,015. The principal payments shall be made in 32 equal semi-annual payments with the first payment due on May 15, 2011 and the last payment on November 15, 2026.

Annual debt service requirements to maturity for principal and interest are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ -	\$ -	\$ -
2008	116,667	-	116,667
2009	116,667	-	116,667
2010	116,667	-	116,667
2011	141,841	3,047	144,888
2012 – 2016	698,640	25,799	724,439
2017 – 2021	707,585	16,853	724,438
2022 – 2026	715,621	8,817	724,438
2027 – 2031	583,335	-	583,335
2032 – 2036	583,335	-	583,335
2037 – 2038	<u>116,657</u>	<u>-</u>	<u>116,657</u>
	<u>\$3,897,015</u>	<u>\$54,516</u>	<u>\$3,951,531</u>

Funds for the repayment of the ADB loan are expected to be derived from the annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The Financing Agreement requires the State to continue to appropriate salaries for the abolished positions and deposit the appropriate funds into the ERS Trust Account. \$3,500,000 identified for future debt service payments is included in the General Fund reserve for related assets of which \$2,459,505 is actually deposited in an investment account held jointly with the FSM National Government. That investment account is restricted for the repayment of this debt.

Other long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2006, the following changes occurred in the primary government's long-term liabilities in the statement of net assets:

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2006

(7) Long-term Obligations, Continued

Primary Government, Continued

	Balance October 1, 2005	<u>Additions</u>	<u>Reductions</u>	Balance September 30, 2006	<u>Due Within One Year</u>
Loan payable:					
ADB loan	\$ 3,500,000	\$ 397,015	\$ -	\$ 3,897,015	\$ -
Other:					
Compensated absences	502,683	99,181	(85,655)	516,209	85,655
Land acquisition claims	<u>249,607</u>	<u>-</u>	<u>-</u>	<u>249,607</u>	<u>-</u>
	<u>752,290</u>	<u>99,181</u>	<u>(85,655)</u>	<u>765,816</u>	<u>85,655</u>
	<u>\$ 4,252,290</u>	<u>\$ 496,196</u>	<u>\$ (85,655)</u>	<u>\$ 4,662,831</u>	<u>\$ 85,655</u>

Discretely Presented Component Units

Yap State Public Service Corporation (YSPSC)

Loan payable to the FSM National Government for construction of certain water projects. This loan is uncollateralized and is a subsidiary loan to a loan agreement between the Asian Development Bank (ADB) and the FSM National Government, with interest at 6.82% on the outstanding balance; however, the FSM National Government 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.

\$ 2,270,837

Uncollateralized note payable to the State; monthly principal and interest payments of \$5,651 starting June 1, 2003; interest at 2%, maturing in May 2017.

650,875

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% commencing March 26, 2003 and maturing in September 2013. The note is collateralized by YSPSC's equipment, furniture and fixtures located at YSPSC's office.

71,355

2,993,067

The Diving Seagull, Inc.

On July 28, 2006, the Company signed a five-year loan agreement with the Federated States of Micronesia Development Bank (FSMDB) authorizing a maximum loan of \$1,300,000 to cover the dry-dock costs of the fishing vessel. The agreement stipulates a 1.5% loan fee and interest rate of 9%. Interest is due monthly during the six-month grace period. Interest and principal are payable in monthly installments of \$26,986 beginning January 30, 2007. The note is collateralized by a chattel mortgage on all property and equipment, including the fishing vessel Mathawmarfach. Part of the loan agreement requires the Company to establish a joint account with FSMDB and to deposit \$3,000 per month until the loan is fully paid. On August 11, 2006, the Company paid-off its existing loan with FSMDB as a condition to the granting of the new loan.

793,374

\$ 3,786,441

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Notes to Financial Statements
September 30, 2006

(7) Long-term Obligations, Continued

Discretely Presented Component Units, Continued

Annual debt service requirements to maturity for principal and interest are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 247,671	\$ 98,620	\$ 346,291
2008	342,674	107,283	449,957
2009	365,927	84,030	449,957
2010	266,129	55,269	321,398
2011	117,110	9,016	126,126
2012 – 2016	562,676	21,529	584,205
2017 – 2021	612,644	338	612,982
2022 – 2026	605,630	-	605,630
2027 – 2031	605,630	-	605,630
2032	60,350	-	60,350
	<u>\$ 3,786,441</u>	<u>\$ 376,085</u>	<u>\$ 4,162,526</u>

(8) Continuing Appropriations

Continuing appropriations as of September 30, 2006, are as follows:

Major Governmental Funds

General Fund:

Autopsies (YSL No. 5-47)	\$ 18,191
Can recycling (YSL No. 5-46 and 5-85)	10,768
Disaster/Search and Rescue (YSL No. 5-84)	1,952
YWADaycare Bldg Matching/Yap State Scholarship (YSL No. 6-48)	71,470
DOE – Gilman Elementary (YSL No. 6-5)	10,711
Typhoon Sudal PA Management Costs (YSL No. 6-41)	13,000
FEMA/HMGP Chata'an Match (YSL No. 6-43)	231,113
Infrastructure Maintenance Fund (YSL No. 6-52)	184,848
Political Ed on Proposed Amendments/DOE – School Facilities Upgrade (YSL No. 6-65)	21,937
Aluminum Can Recycling Program (YSL No. 6-72)	50,000
Xavier High School	4,600
Office of the Attorney General	8,000
Council of Tamol, Utility Cost	900
	<u>\$ 627,490</u>

Compact Capital Projects Fund:

Yap State Development Investment Loan (YSL No. 5-1)	\$ 200,000
FEMA State Matching, Typhoon Lupit, Typhoon Sudal, Fence Construction, Yap Evangelical Church (YSL No. 6-62)	882,260
Ngolog Powerline Extension, Road Project, Gurung Heights Powerline Extension (YSL No. 6-65)	28,820
Mobil Fuel Farm Retaining Wall	161,000
Removal of M/V Cecilia	100,000
Development of Jet Fuel Alternate Source	300,000
Lamer Village Power Extension	31,130
Okaw/Adubwee Youth Recreational Park	25,000
Aff Village Power Extension	1,250
	<u>\$ 1,729,460</u>

STATE OF YAP
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Notes to Financial Statements
September 30, 2006

(8) Continuing Appropriations, Continued

Nonmajor Governmental Funds

Yap Community Development Program matching (YSL No. 5-34) \$ 150,000

(9) Contingencies

Sick Leave

It is the policy of the State to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave as of September 30, 2006 is currently not determinable.

Insurance Coverage

The State does not maintain insurance coverage for a significant amount of fixed assets. In the event of a catastrophe, the State may be self-insured to a material extent. The State has not recognized material losses in its financial statements as a result of this matter.

Federal Grants

The State participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of \$869,278 relating to fiscal years 1999 through 2006 have been set forth in the State's Single Audit Report for the year ended September 30, 2006. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

Litigation

The State is party to several legal proceedings arising from governmental operations. Claims are filed with the State's Attorney General. Approved claims are usually paid under general appropriations to the affected government agency. At September 30, 2006, there existed several unapproved claims. The State's Attorney General is of the opinion that the State Liability Act has established claims limits of \$40,000 for wrongful injuries and \$20,000 for deaths. Current claims against the State exist but do not appear to be material. Management has not provided for such claims in the accompanying financial statements as it is not currently possible to estimate the State's potential liability, if any, arising from these claims.

Indefinite Land Use Sites

Payment obligations on rental lands termed "Indefinite Land Use Sites" were originally undertaken by the Trust Territory of the Pacific Islands (TTPI), for which obligation on these lands ceased in May, 1984. Subsequent to May 1984, responsibility to rent or purchase the sites was transferred to the State. The State's Division of Land and Surveys has estimated that the State may be responsible for funding the indefinite land use sites for back rent with interest. The State is actively attempting to negotiate purchase prices for these properties.

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Notes to Financial Statements
September 30, 2006

(10) Individual Deficit Fund Balances

Specific individual funds which had individual deficit fund balances as at September 30, 2006, are as follows:

Nonmajor Governmental Funds

CFSM Capital Projects Fund	\$ <u>1,085</u>
Yap State Public Projects Fund	\$ <u>64,369</u>
CFSM Grants	\$ <u>10,403</u>

STATE OF YAP
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REQUIRED SUPPLEMENTARY INFORMATION
YEAR ENDED SEPTEMBER 30, 2006

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Schedule of Revenues, Expenditures and Changes in Fund Balance
Budget and Actual - General Fund
Year Ended September 30, 2006

	Budgeted Amounts		Actual - Budgetary	Variance with Final Budget
	Original	Final	Basis (see Note 1)	
Revenues:				
Revenue sharing	-	-	2,432,156	2,432,156
Excise taxes	-	-	1,349,732	1,349,732
Fees and charges	-	-	368,337	368,337
Departmental charges	-	-	186,761	186,761
Net increase in the fair value of investments	-	-	4,546,506	4,546,506
Other	7,378,717	7,622,830	564,608	(7,058,222)
Total revenues	<u>7,378,717</u>	<u>7,622,830</u>	<u>9,448,100</u>	<u>1,825,270</u>
Expenditures:				
Current:				
Judiciary	-	-	-	-
Council of traditional leaders	207,599	207,599	211,956	(4,357)
Public auditor	14,500	14,500	9,468	5,032
General government	2,839,850	2,839,850	1,539,727	1,300,123
Economic development	103,770	103,770	48,458	55,312
Public safety	229,350	229,350	220,603	8,747
Community affairs	379,292	379,292	443,212	(63,920)
Education	537,480	537,480	510,124	27,356
Public works and transportation	2,452,194	2,452,194	2,039,113	413,081
Health services	-	-	32,134	(32,134)
Boards and commissions	46,640	46,640	61,607	(14,967)
Payments to component units	170,592	170,592	151,105	19,487
Other appropriations	397,450	397,450	388,088	9,362
Other expenses	-	-	289,764	(289,764)
Total expenditures	<u>7,378,717</u>	<u>7,378,717</u>	<u>5,945,359</u>	<u>1,433,358</u>
Excess of revenues over expenditures	<u>-</u>	<u>244,113</u>	<u>3,502,741</u>	<u>3,258,628</u>
Other financing uses:				
Operating transfers out	-	(244,113)	(1,865,824)	(1,621,711)
Special Items:				
Impairment loss on investment in stock	-	-	(500,000)	(500,000)
Net change in unreserved fund balance	-	-	1,136,917	1,136,917
Other changes in unreserved fund balance:				
Decrease in reserve for related assets	-	-	981,700	981,700
Increase in reserve for continuing appropriations	-	-	(490,579)	(490,579)
Decrease in reserve for capital projects	-	-	637,993	637,993
Unreserved fund balance at the beginning of the year	<u>20,186,296</u>	<u>20,186,296</u>	<u>29,606,229</u>	<u>9,419,933</u>
Unreserved fund balance at the end of the year	<u>\$ 20,186,296</u>	<u>\$ 20,186,296</u>	<u>\$ 31,872,260</u>	<u>\$ 11,685,964</u>

See accompanying notes to required supplementary information - budgetary reporting.

STATE OF YAP
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Notes to Required Supplementary Information - Budgetary Reporting
September 30, 2006

(1) Budgetary Information

An annual appropriated budget is adopted by the State's Legislature for the General Fund and Compact Programs through an Appropriations Act. However, additional appropriations and budget modifications occur throughout the year. The majority of unencumbered appropriations lapse as of year end unless specifically extended by the State's Legislature. Budgets for special revenue funds, except the Compact Program Fund, are not included in the annual Appropriations Act. Accordingly, a budget to actual presentation for special revenue funds, except the Compact Program Fund, is not required or presented. Project-length financial plans are generally adopted for all capital project funds.

Encumbrance accounting is utilized for budgetary control purposes. Encumbrances outstanding at year-end are reported as reservations of fund balance and will be funded as expenditures in the ensuing year. Encumbrances remain as reservations of fund balance until becoming expended or canceled. If an encumbrance is subsequently canceled, the funds revert to the applicable unreserved fund balance unless otherwise required by law.

Budgetary expenditures, which are on a basis other than GAAP, represent current charges against appropriations; current charges consist of all current year liquidated and unliquidated encumbrances. Budgetary expenditures are therefore determined by subtracting both current year liquidations of prior year encumbrances and unliquidated prior year encumbrances from the combined total of current year. When reviewed in relation to respective budgets, budgetary expenditures provide the principal means of evaluating current year operating performance and management stewardship. Amounts included on the Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual - General Fund (which are presented on a non-GAAP budgetary basis) are reconciled to unreserved fund balance of the Combined Balance Sheet within the other charges in unreserved fund balance section of that statement.

Encumbrance accounting is employed in governmental funds. For budgetary purposes, the encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be reappropriated and honored during the subsequent fiscal year.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2006

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Combining Schedule of Expenditures by Account
Governmental Funds
Year Ended September 30, 2006
(with comparative totals for the year ended September 30, 2005)

	Special Revenue						Capital	Permanent	Other Governmental Funds	Totals	
	General	U.S Federal	Other U.S.	Compact	Compact	Compact	Trust	2006		2005	
		Grants	Grants	Sector	Capital	Projects					
Expenditures:											
Salaries and wages	\$ 1,286,266	\$ 2,096,926	\$ 107,677	\$ 4,872,681	\$ 4,965	\$ -	\$ 28,596	\$ 8,397,111	\$ 7,122,006		
Grants and subsidies	761,289	3,750	71,892	415,676	-	-	211,333	1,463,940	1,343,757		
Utilities	475,077	11,261	-	707,991	-	-	8,434	1,202,763	899,748		
Contractual services	345,241	49,580	1,014,564	309,902	24,196	-	253,338	1,996,821	1,245,735		
Supplies and materials	29,026	62,140	15,675	250,071	-	-	873	357,785	221,472		
Scholarship and training	11,000	49,578	-	377,280	-	-	40,250	478,108	407,682		
Travel	283,362	199,336	7,902	502,151	3,140	-	16,610	1,012,501	944,915		
Capital outlay	80,673	323,038	38,671	749,497	50	-	71,282	1,263,211	4,033,777		
Rentals	5,338	63,458	-	8,541	-	-	-	77,337	91,265		
Food stuffs	41,165	-	-	96,919	-	-	2,692	140,776	84,064		
Communications	65,206	13,338	3,998	170,120	1,118	-	13,861	267,641	279,572		
Printing and reproduction	4,503	7,412	-	77,145	32	-	50	89,142	112,729		
Medical supplies	8,463	46,986	-	679,658	-	-	-	735,107	406,282		
Medical referral	60,675	-	-	112,519	-	-	-	173,194	324,733		
Repairs and maintenance	42,608	11,547	28,351	47,928	-	-	531	130,965	221,630		
Freight	5,130	2,033	40,691	108,199	-	-	1,213	157,266	241,890		
Professional services	-	43,086	-	246,694	-	-	13,763	303,543	301,054		
POL	349,705	23,745	678	69,483	1,538	-	1,516	446,665	387,803		
Allowances	112,270	425	-	-	-	-	-	112,695	177,874		
Leased housing	41,050	1,665	-	131,666	-	-	-	174,381	141,900		
Bad debt	289,764	-	-	-	-	-	-	289,764	-		
Other	1,000,903	62,940	571,119	560,675	1,812	-	324,362	2,521,811	1,362,535		
	<u>\$ 5,298,714</u>	<u>\$ 3,072,244</u>	<u>\$ 1,901,218</u>	<u>\$ 10,494,796</u>	<u>\$ 36,851</u>	<u>\$ -</u>	<u>\$ 988,704</u>	<u>\$ 21,792,527</u>	<u>\$ 20,352,423</u>		

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

GENERAL FUND

September 30, 2006

The general fund is used to account for resources traditionally associated with government which are not required legally or by sound financial management to be accounted for in another fund. The United States Compact of Free Association current account and inflation adjustment funds associated with the current account are accounted for in this fund in addition to local taxes and other revenues.

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function,
and Changes in Fund Balance - General Fund
Year Ended September 30, 2006
(with comparative totals for the year ended September 30, 2005)

	2006	2005
Revenues:		
Revenue sharing:		
Import tax	\$ 723,335	\$ 1,183,135
Fuel tax	98,296	97,462
Income tax	460,336	498,374
Business gross receipts tax	740,257	750,115
Unallocated	409,932	(189,195)
	2,432,156	2,339,891
Excise taxes:		
Alcoholic beverages	503,949	611,052
Gasoline and diesel	91,226	69,474
Tobacco	211,903	179,647
Other excise taxes	542,654	559,986
	1,349,732	1,420,159
Fees and charges:		
Licenses and permits	76,565	85,530
Fines/sale of confiscated property	70,795	63,375
Leases and other rentals	220,977	273,693
	368,337	422,598
Departmental charges:		
Sea transportation	187,211	170,498
Hospital services	1,510	165
Other	(1,960)	39,141
	186,761	209,804
Interest and dividends	29,856	23,155
Net increase in the fair value of investments	4,516,650	7,351,086
Other revenues	564,608	483,811
Total revenues	9,448,100	12,250,504
Expenditures:		
Current:		
Councils of Traditional Leaders:		
Council of Pilung	103,228	131,294
Council of Tamol	114,808	152,249
	218,036	283,543
Public Auditor	8,940	-
General government:		
Office of the Governor	178,068	183,410
State Legislature	398,873	405,080
Office of Administrative Services	863,693	337,068
Office of Planning, Budget and Statistics	10,846	-
Disaster relief programs	139,142	369,654
	1,590,622	1,295,212

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function,
and Changes in Fund Balance - General Fund, Continued
Year Ended September 30, 2006
(with comparative totals for the year ended September 30, 2005)

	2006	2005
Expenditures, continued:		
Current, continued:		
Economic Development:		
Department of Resources and Development	58,978	229,153
Public Safety:		
Department of Public Safety/Attorney General	222,006	269,906
Community Affairs		
Department of Public Affairs	343,232	344,522
Education:		
Department of Education	53,764	64,655
Public Works and Transportation:		
Department of Public Works and Transportation	1,903,661	1,203,882
Health Services:		
Department of Health Services	36,143	130,613
Boards and Commissions:		
Small Business Development Center	1,267	2,889
Farmers Home Administration	19,585	16,729
Historic Preservation Office	14,440	35,953
Yap Investment Trust	22,843	21,001
	58,135	76,572
Other expenses	289,764	-
Payments to component units:		
Yap Visitor's Bureau		102,020
Yap Public Library		31,283
Yap Fishing Authority		-
Public Transportation System	151,105	89,120
	151,105	222,423
Other appropriations:		
Micronesia Legal Services Corporation	41,280	41,280
Japan Overseas Cooperation Volunteers	14,412	9,020
Peace Corps Program	18,023	13,975
Yap Community Action Program	144,490	-
Other	146,123	8,726
	364,328	73,001
Total expenditures	5,298,714	4,193,482
Excess of revenues over expenditures	4,149,386	8,057,022
Other financing uses:		
Operating transfers out	(1,865,824)	(722,861)
Special Items:		
Impairment loss on investment in stock	(500,000)	-
Net change in fund balance	1,783,562	7,334,161
Fund balance at the beginning of the year	38,064,327	30,730,166
Fund balance at the end of the year	\$ 39,847,889	\$ 38,064,327

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures and Changes in Fund Balance
Budget and Actual - General Fund
Year Ended September 30, 2006

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final		
Revenues:				
Revenue sharing:				
Import tax	\$ -	\$ -	\$ 723,335	\$ 723,335
Fuel tax	-	-	98,296	98,296
Income tax	-	-	460,336	460,336
Business gross receipts tax	-	-	740,257	740,257
Unallocated	-	-	409,932	409,932
	<u>-</u>	<u>-</u>	<u>2,432,156</u>	<u>2,432,156</u>
Excise taxes:				
Alcoholic beverages	-	-	503,949	503,949
Gasoline and diesel	-	-	91,226	91,226
Tobacco	-	-	211,903	211,903
Other excise taxes	-	-	542,654	542,654
	<u>-</u>	<u>-</u>	<u>1,349,732</u>	<u>1,349,732</u>
Fees and charges:				
Licenses and permits	-	-	76,565	76,565
Fines/sale of confiscated property	-	-	70,795	70,795
Leases and other rentals	-	-	220,977	220,977
	<u>-</u>	<u>-</u>	<u>368,337</u>	<u>368,337</u>
Departmental charges:				
Sea transportation	-	-	187,211	187,211
Hospital services	-	-	1,510	1,510
Other	-	-	(1,960)	(1,960)
	<u>-</u>	<u>-</u>	<u>186,761</u>	<u>186,761</u>
Net increase in the fair value of investments	<u>-</u>	<u>-</u>	<u>4,546,506</u>	<u>4,546,506</u>
Other revenues	<u>7,378,717</u>	<u>7,622,830</u>	<u>564,608</u>	<u>(7,058,222)</u>
Total revenues	<u>7,378,717</u>	<u>7,622,830</u>	<u>9,448,100</u>	<u>1,825,270</u>
Expenditures:				
Current:				
Judiciary	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Councils of Traditional Leaders:				
Council of Pilung	100,869	100,869	103,349	(2,480)
Council of Tamol	106,730	106,730	108,607	(1,877)
	<u>207,599</u>	<u>207,599</u>	<u>211,956</u>	<u>(4,357)</u>
Public Auditor	14,500	14,500	9,468	5,032
General government:				
Office of the Governor	156,360	156,360	176,921	(20,561)
State Legislature	478,500	478,500	404,352	74,148
Office of Administrative Services	2,060,290	2,060,290	869,549	1,190,741
Office of Planning, Budget and Statistics	-	-	29,268	(29,268)
Disaster relief programs	144,700	144,700	59,637	85,063
	<u>2,839,850</u>	<u>2,839,850</u>	<u>1,539,727</u>	<u>1,300,123</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures and Changes in Fund Balance
Budget and Actual - General Fund, Continued
Year Ended September 30, 2006

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final		
Expenditures, continued:				
Current, continued:				
Economic Development:				
Department of Resources and Development	103,770	103,770	48,458	55,312
Public Safety:				
Department of Public Safety/Attorney General	229,350	229,350	220,603	8,747
Community Affairs:				
Department of Public Affairs	379,292	379,292	443,212	(63,920)
Education:				
Department of Education	537,480	537,480	510,124	27,356
Public Works and Transportation:				
Department of Public Works and Transportation	2,452,194	2,452,194	2,039,113	413,081
Health services:				
Department of Health Services	-	-	32,134	(32,134)
Boards and Commissions:				
EPA Administration Board	-	-	162	(162)
Small Business Development Center	-	-	-	-
Farmers Home Administration	19,420	19,420	19,501	(81)
Historic Preservation Office	-	-	17,874	(17,874)
Yap Investment Trust	27,220	27,220	24,070	3,150
	<u>46,640</u>	<u>46,640</u>	<u>61,607</u>	<u>(14,967)</u>
Payments to component units:				
Yap Visitor's Bureau	-	-	-	-
Yap Public Library	-	-	-	-
Public Transportation System	170,592	170,592	151,105	19,487
	<u>170,592</u>	<u>170,592</u>	<u>151,105</u>	<u>19,487</u>
Other appropriations:				
Micronesian Legal Services Corporation	41,280	41,280	41,280	-
Japan Overseas Cooperation Volunteers	17,600	17,600	16,532	1,068
Peace Corps Program	23,200	23,200	22,065	1,135
Yap CAP	144,490	144,490	163,811	(19,321)
Other	170,880	170,880	144,400	26,480
	<u>397,450</u>	<u>397,450</u>	<u>388,088</u>	<u>9,362</u>
Other expenses	-	-	289,764	(289,764)
Total expenditures	<u>7,378,717</u>	<u>7,378,717</u>	<u>5,945,359</u>	<u>1,433,358</u>
Excess of revenues over expenditures	-	244,113	3,502,741	391,912
Other financing uses:				
Operating transfers out	-	(244,113)	(1,865,824)	(1,621,711)
Special Items:				
Impairment loss on investment in stock	-	-	(500,000)	(500,000)
Net change in fund balance	-	-	1,136,917	(1,729,799)
Other changes in unreserved fund balance:				
Decrease in reserve for related assets	-	-	981,700	981,700
Increase in reserve for continuing appropriations	-	-	(490,579)	(490,579)
Decrease in reserve for capital projects	-	-	637,993	-
Unreserved fund balance at the beginning of the year	<u>20,186,296</u>	<u>20,186,296</u>	<u>29,606,229</u>	<u>9,419,933</u>
Unreserved fund balance at the end of the year	<u>\$ 20,186,296</u>	<u>\$ 20,186,296</u>	<u>\$ 31,872,260</u>	<u>\$ 8,181,255</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Combined Balance Sheet
Nonmajor Governmental Funds
September 30, 2006
(with comparative totals as of September 30, 2005)

	Other <u>Special Revenue</u>	Other <u>Capital Projects</u>	<u>Totals</u>	
			2006	2005
<u>ASSETS</u>				
Cash and cash equivalents	\$ 228,929	\$ -	\$ 228,929	\$ 193,565
Equity interest in internal investment pool	3,226,092	-	3,226,092	3,226,092
Receivables, net:				
CFSM	23,139	27,671	50,810	144,079
Other	-	-	-	20,000
Due from other funds	<u>296,268</u>	<u>131,510</u>	<u>427,778</u>	<u>580,847</u>
Total assets	<u>\$ 3,774,428</u>	<u>\$ 159,181</u>	<u>\$ 3,933,609</u>	<u>\$ 4,164,583</u>
<u>LIABILITIES AND FUND BALANCES</u>				
Liabilities:				
Accounts payable	\$ 60,046	\$ 30,350	\$ 90,396	\$ 104,380
Other liabilities and accruals	18,902	-	18,902	20,200
Deferred revenue	21,000	-	21,000	268,000
Due to other funds	<u>1,457,831</u>	<u>62,775</u>	<u>1,520,606</u>	<u>1,584,351</u>
Total liabilities	<u>1,557,779</u>	<u>93,125</u>	<u>1,650,904</u>	<u>1,976,931</u>
Fund balances:				
Reserved for:				
Encumbrances	147,303	160,913	308,216	176,876
Continuing appropriations	150,000	-	150,000	150,000
Unreserved:				
Special revenue funds	1,919,346	-	1,919,346	1,862,656
Capital projects funds	<u>-</u>	<u>(94,857)</u>	<u>(94,857)</u>	<u>(1,880)</u>
Total fund balances	<u>2,216,649</u>	<u>66,056</u>	<u>2,282,705</u>	<u>2,187,652</u>
Total liabilities and fund balances	<u>\$ 3,774,428</u>	<u>\$ 159,181</u>	<u>\$ 3,933,609</u>	<u>\$ 4,164,583</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Combined Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances
Nonmajor Governmental Funds
Year Ended September 30, 2006
(with comparative totals for the year ended September 30, 2005)

	Other <u>Special Revenue</u>	Other <u>Capital Projects</u>	<u>Totals</u>	
			2006	2005
Revenues:				
Federal contributions and other grants	\$ 431,156	\$ -	\$ 431,156	\$ 59,762
CFSM grants	105,511	186,020	291,531	478,993
Excise taxes	178,305	-	178,305	202,701
Fees and charges	78,172	-	78,172	3,210
Total revenues	<u>793,144</u>	<u>186,020</u>	<u>979,164</u>	<u>744,666</u>
Expenditures by function:				
Current:				
Judiciary	-	-	-	58,722
Councils of traditional leaders	-	-	-	97,426
General government	275,803	273,677	549,480	192,566
Economic development	294,458	-	294,458	89,543
Public safety	47,854	-	47,854	14,656
Education	57,970	-	57,970	4,630
Public works and transportation	-	15,000	15,000	163,315
Health services	23,942	-	23,942	35,940
Boards and commissions	-	-	-	858
Payments to component units	-	-	-	249,470
Total expenditures	<u>700,027</u>	<u>288,677</u>	<u>988,704</u>	<u>907,126</u>
Excess (deficiency) of revenues over (under) expenditures	<u>93,117</u>	<u>(102,657)</u>	<u>(9,540)</u>	<u>(162,460)</u>
Other financing sources:				
Operating transfers in	<u>20,000</u>	<u>84,593</u>	<u>104,593</u>	<u>99,050</u>
Net change in fund balances	113,117	(18,064)	95,053	(63,410)
Fund balances at the beginning of the year	<u>2,103,532</u>	<u>84,120</u>	<u>2,187,652</u>	<u>2,251,062</u>
Fund balances at the end of the year	<u>\$ 2,216,649</u>	<u>\$ 66,056</u>	<u>\$ 2,282,705</u>	<u>\$ 2,187,652</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Combined Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances
Nonmajor Governmental Funds
Year Ended September 30, 2006
(with comparative totals for the year ended September 30, 2005)

	Other	Other	Totals	
	Special Revenue	Capital Projects	2006	2005
Revenues:				
Federal contributions and other grants	\$ 431,156	\$ -	\$ 431,156	\$ 59,762
CFSM grants	105,511	186,020	291,531	478,993
Excise taxes	178,305	-	178,305	202,701
Fees and charges	78,172	-	78,172	3,210
Total revenues	<u>793,144</u>	<u>186,020</u>	<u>979,164</u>	<u>744,666</u>
Expenditures by account:				
Salaries and wages	28,596	-	28,596	42,637
Grants and subsidies	211,333	-	211,333	160,520
Utilities	8,434	-	8,434	8,554
Contractual services	95,431	157,907	253,338	272,419
Supplies and materials	873	-	873	2,445
Scholarship and training	40,250	-	40,250	-
Travel	16,610	-	16,610	20,615
Capital outlay	22,052	49,230	71,282	135,436
Rentals	-	-	-	45,195
Food stuffs	2,692	-	2,692	-
Communications	13,861	-	13,861	14,149
Printing and reproduction	50	-	50	3,193
Repairs and maintenance	531	-	531	1,213
Freight	709	504	1,213	7,564
Professional services	-	13,763	13,763	57,328
POL	1,516	-	1,516	648
Other	257,089	67,273	324,362	135,210
Total expenditures	<u>700,027</u>	<u>288,677</u>	<u>988,704</u>	<u>907,126</u>
Excess (deficiency) of revenues over (under) expenditures	<u>93,117</u>	<u>(102,657)</u>	<u>(9,540)</u>	<u>(162,460)</u>
Other financing sources:				
Operating transfers in	<u>20,000</u>	<u>84,593</u>	<u>104,593</u>	<u>99,050</u>
Net change in fund balances	113,117	(18,064)	95,053	(63,410)
Fund balances at the beginning of the year	<u>2,103,532</u>	<u>84,120</u>	<u>2,187,652</u>	<u>2,251,062</u>
Fund balances at the end of the year	<u>\$ 2,216,649</u>	<u>\$ 66,056</u>	<u>\$ 2,282,705</u>	<u>\$ 2,187,652</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS - SPECIAL REVENUE FUNDS

September 30, 2006

Special revenue funds are used to account for specific revenues that are legally restricted for particular purposes. A brief discussion of the State's Nonmajor Governmental Funds - Special Revenue Funds as of September 30, 2006, follows:

Section 221(b) Special Block Grant Fund

This fund is used to account for financial transactions related to the Compact program accounts under Section 221(b) of the Compact of Free Association.

Other U.S. Grants Fund

This fund is used to account for all Federal Emergency Management Agency (FEMA) grants received directly or in a subrecipient capacity through the FSM National Government.

Non-U.S. Grants Fund

This fund is used to account for all financial transactions related to certain direct and other grants received from various world organizations.

CFSM Grants Fund

This fund is used to account for appropriations made to the State from the Congress of the Federated States of Micronesia (CFSM). These grants are earned on a reimbursable basis.

Sports Development Fund

This fund accounts for certain funds dedicated to sports development in the State.

General Services Agency Fund

This fund accounts for funds dedicated to the acquisition of certain supplies for the State.

Other Special Revenue Funds

This fund accounts for funds dedicated to certain special purposes.

See Accompanying Independent Auditors' Report.

STATE OF YAP
 FEDERATED STATES OF MICRONESIA
 NONMAJOR GOVERNMENTAL FUNDS
 SPECIAL REVENUE FUNDS

Combining Balance Sheet
 September 30, 2006
 (with comparative totals as of September 30, 2005)

	Section 221(b) Special Block Grant	Non-U.S. Grants	CFSM Grants	Sports Development	General Services Agency	Other Special Revenue	Totals	
							2006	2005
ASSETS								
Cash and cash equivalents	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 228,929	\$ 228,929	\$ 193,565
Equity interest in internal investment pool	3,226,092	-	-	-	-	-	3,226,092	3,226,092
Receivables, net:								
CFSM	-	-	23,139	-	-	-	23,139	59,486
Other	-	-	-	-	-	-	-	20,000
Due from other funds	-	82,203	-	83,057	75,030	55,978	296,268	421,875
Total assets	\$ 3,226,092	\$ 82,203	\$ 23,139	\$ 83,057	\$ 75,030	\$ 284,907	\$ 3,774,428	\$ 3,921,018
LIABILITIES AND FUND BALANCES								
Liabilities:								
Accounts payable	\$ 1,098	\$ 3,323	\$ 8,275	\$ 47,325	\$ -	\$ 25	\$ 60,046	\$ 75,218
Other liabilities and accruals	12,636	-	1,812	-	4,454	-	18,902	19,422
Deferred revenue	-	21,000	-	-	-	-	21,000	268,000
Due to other funds	1,434,376	-	23,455	-	-	-	1,457,831	1,454,846
Total liabilities	1,448,110	24,323	33,542	47,325	4,454	25	1,557,779	1,817,486
Fund balances:								
Reserved for:								
Encumbrances	13,354	92,344	40,425	-	-	1,180	147,303	90,876
Continuing appropriations	150,000	-	-	-	-	-	150,000	150,000
Unreserved (deficit)	1,614,628	(34,464)	(50,828)	35,732	70,576	283,702	1,919,346	1,862,656
Total fund balances (deficits)	1,777,982	57,880	(10,403)	35,732	70,576	284,882	2,216,649	2,103,532
Total liabilities and fund balances	\$ 3,226,092	\$ 82,203	\$ 23,139	\$ 83,057	\$ 75,030	\$ 284,907	\$ 3,774,428	\$ 3,921,018

STATE OF YAP
 FEDERATED STATES OF MICRONESIA
 NONMAJOR GOVERNMENTAL FUNDS
 SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures By Function,
 and Changes in Fund Balances (Deficits)
 Year Ended September 30, 2006
 (with comparative totals for the year ended September 30, 2005)

	Section 221(b) Special Block Grant	Non-U.S. Grants	CFSM Grants	Sports Development	General Services Agency	Other Special Revenue	Totals	
							2006	2005
Revenues:								
Federal contributions and other grants	\$ -	\$ 431,156	\$ -	\$ -	\$ -	\$ -	\$ 431,156	\$ 59,762
CFSM grants	-	-	105,511	-	-	-	105,511	234,283
Excise taxes	-	-	-	148,364	-	29,941	178,305	202,701
Fees and charges	-	-	-	-	43,254	34,918	78,172	3,210
Total revenues	-	431,156	105,511	148,364	43,254	64,859	793,144	499,956
Expenditures by function:								
Current:								
Judiciary	-	-	-	-	-	-	-	33,722
Councils of traditional leaders	-	-	-	-	-	-	-	79,870
General government	-	55,674	60,268	148,364	10,652	845	275,803	56,412
Economic development	-	294,458	-	-	-	-	294,458	89,543
Public safety	-	-	47,854	-	-	-	47,854	14,656
Education	-	-	57,970	-	-	-	57,970	4,630
Public works and transportation	-	-	-	-	-	-	-	32,946
Health services	-	23,942	-	-	-	-	23,942	35,940
Boards and commissions	-	-	-	-	-	-	-	858
Payments to component units	-	-	-	-	-	-	-	192,142
Total expenditures	-	374,074	166,092	148,364	10,652	845	700,027	540,719
Excess (deficiency) of revenues over (under) expenditures	-	57,082	(60,581)	-	32,602	64,014	93,117	(40,763)
Other financing sources:								
Operating transfers in	-	-	20,000	-	-	-	20,000	99,050
Net change in fund balances (deficit) the year	-	57,082	(40,581)	-	32,602	64,014	113,117	58,287
Fund balances (deficits) at the beginning of the year	1,777,982	798	30,178	35,732	37,974	220,868	2,103,532	2,045,245
Fund balances (deficits) at the end of the year	\$ 1,777,982	\$ 57,880	\$ (10,403)	\$ 35,732	\$ 70,576	\$ 284,882	\$ 2,216,649	\$ 2,103,532

See Accompanying Independent Auditors' Report.

STATE OF YAP
 FEDERATED STATES OF MICRONESIA
 NONMAJOR GOVERNMENTAL FUNDS
 SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures By Account,
 and Changes in Fund Balances (Deficits)
 Year Ended September 30, 2006
 (with comparative totals for the year ended September 30, 2005)

	Section 221(b) Special Block Grant	Non-U.S. Grants	CFSM Grants	Sports Development	General Services Agency	Other Special Revenue	Totals	
							2006	2005
Revenues:								
Federal contributions and other grants	\$ -	\$ 431,156	\$ -	\$ -	\$ -	\$ -	\$ 431,156	\$ 59,762
CFSM grants	-	-	105,511	-	-	-	105,511	234,283
Excise taxes	-	-	-	148,364	-	29,941	178,305	202,701
Fees and charges	-	-	-	-	43,254	34,918	78,172	3,210
Total revenues	-	431,156	105,511	148,364	43,254	64,859	793,144	499,956
Expenditures by account:								
Salaries and wages	-	9,636	18,960	-	-	-	28,596	29,885
Grants and subsidies	-	62,969	-	148,364	-	-	211,333	160,520
Utilities	-	-	8,434	-	-	-	8,434	8,554
Contractual services	-	94,791	640	-	-	-	95,431	83,305
Supplies and materials	-	235	638	-	-	-	873	2,445
Scholarship and training	-	40,250	-	-	-	-	40,250	-
Travel	-	5,470	10,716	-	-	424	16,610	20,615
Capital outlay	-	11,421	-	-	10,631	-	22,052	59,637
Rentals	-	-	-	-	-	-	-	45,195
Food stuffs	-	1,624	1,068	-	-	-	2,692	-
Communications	-	8,066	5,560	-	-	235	13,861	14,149
Printing and reproduction	-	50	-	-	-	-	50	3,193
Repairs and maintenance	-	435	148	-	-	96	531	1,168
Freight	-	561	-	-	-	-	709	4,597
POL	-	450	1,066	-	-	-	1,516	648
Other	-	138,116	118,862	-	21	90	257,089	106,808
Total expenditures	-	374,074	166,092	148,364	10,652	845	700,027	540,719
Excess (deficiency) of revenues over (under) expenditures	-	57,082	(60,581)	-	32,602	64,014	93,117	(40,763)
Other financing sources:								
Operating transfers in	-	-	20,000	-	-	-	20,000	99,050
Net change in fund balances (deficit)	-	57,082	(40,581)	-	32,602	64,014	113,117	58,287
Fund balances (deficits) at the beginning of the year	1,777,982	798	30,178	35,732	37,974	220,868	2,103,532	2,045,245
Fund balances (deficits) at the end of the year	\$ 1,777,982	\$ 57,880	\$ (10,403)	\$ 35,732	\$ 70,576	\$ 284,882	\$ 2,216,649	\$ 2,103,532

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS - CAPITAL PROJECTS FUNDS

September 30, 2006

Capital projects funds are used to account for the acquisition and construction of major capital facilities other than those financed by proprietary funds and trust funds. A brief discussion of the State's Nonmajor Governmental Funds - Capital Projects Funds as of September 30, 2006, follows:

Public Infrastructure Development Fund

This fund accounts for United States Congress appropriations under United States Public Law 99-239, as amended, Title II, Article I, Section 211(d) and approved by the FSM Congress.

CFSM Capital Projects Fund

This fund is used to account for grants awarded by the Congress of the Federated States of Micronesia (CFSM) for improvement and betterment projects within the State.

Yap State Public Projects Fund

This fund is used to account for an appropriation from the FSM National Government which initially has been loaned to the Yap Fishing Corporation (through YEDA) and after repayment will be used to fund certain capital projects. Appropriations by the State's Legislature for capital improvement projects funded by the General Fund are also accounted for within this fund.

Water Development Projects Revolving Fund

This fund was established pursuant to YSL No. 4-69 to account for loan proceeds and other funds designated for State Water Development Projects.

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA
NONMAJOR GOVERNMENTAL FUNDS
CAPITAL PROJECTS FUNDS

Combining Balance Sheet
September 30, 2006
(with comparative totals as of September 30, 2005)

	Public Infrastructure Development	CFSM Capital Projects	Yap State Public Projects	Water Development Projects Revolving	Totals	
					2006	2005
<u>ASSETS</u>						
Receivables:						
CFSM	\$ -	\$ 27,671	\$ -	\$ -	\$ 27,671	\$ 84,593
Due from other funds	-	-	-	131,510	131,510	158,972
	<u>\$ -</u>	<u>\$ 27,671</u>	<u>\$ -</u>	<u>\$ 131,510</u>	<u>\$ 159,181</u>	<u>\$ 243,565</u>
 <u>LIABILITIES AND FUND BALANCES (DEFICITS)</u>						
Liabilities:						
Accounts payable	\$ -	\$ 30,350	\$ -	\$ -	\$ 30,350	\$ 29,162
Other liabilities and accruals	-	-	-	-	-	778
Due to other funds	-	(1,594)	64,369	-	62,775	129,505
Total liabilities	<u>-</u>	<u>28,756</u>	<u>64,369</u>	<u>-</u>	<u>93,125</u>	<u>159,445</u>
Fund balances (deficits):						
Reserved for:						
Encumbrances	-	160,913	-	-	160,913	86,000
Unreserved	-	(161,998)	(64,369)	131,510	(94,857)	(1,880)
Total fund balances (deficits)	<u>-</u>	<u>(1,085)</u>	<u>(64,369)</u>	<u>131,510</u>	<u>66,056</u>	<u>84,120</u>
Total liabilities and fund balances (deficits)	<u>\$ -</u>	<u>\$ 27,671</u>	<u>\$ -</u>	<u>\$ 131,510</u>	<u>\$ 159,181</u>	<u>\$ 243,565</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
CAPITAL PROJECTS FUNDS

Combining Statement of Expenditures by Function,
and Changes in Fund Balances (Deficits)
Year Ended September 30, 2006
(with comparative totals for the year ended September 30, 2005)

	Public Infrastructure Development	CFSM Capital Projects	Yap State Public Projects	Water Development Projects Revolving	Totals	
					2006	2005
Revenues:						
CFSM grants	\$ -	\$ 186,020	\$ -	\$ -	\$ 186,020	\$ 244,710
	<u>-</u>	<u>186,020</u>	<u>-</u>	<u>-</u>	<u>186,020</u>	<u>244,710</u>
Expenditures by function:						
Current:						
Judiciary	-		-	-	-	25,000
Councils of traditional leaders	-		-	-	-	17,556
General government	-	246,215	-	27,462	273,677	136,154
Public works and transportation	-	15,000	-	-	15,000	130,369
Payments to component units	-	-	-	-	-	57,328
Total expenditures	<u>-</u>	<u>261,215</u>	<u>-</u>	<u>27,462</u>	<u>288,677</u>	<u>366,407</u>
Excess (deficiency) of revenues over (under) expenditures	<u>-</u>	<u>(75,195)</u>	<u>-</u>	<u>(27,462)</u>	<u>(102,657)</u>	<u>(121,697)</u>
Other financing sources:						
Operating transfers in	<u>-</u>	<u>84,593</u>	<u>-</u>	<u>-</u>	<u>84,593</u>	<u>-</u>
Net change in fund balances (deficits)	<u>-</u>	<u>9,398</u>	<u>-</u>	<u>(27,462)</u>	<u>(18,064)</u>	<u>(121,697)</u>
Fund balances (deficits) at the beginning of the year	<u>-</u>	<u>(10,483)</u>	<u>(64,369)</u>	<u>158,972</u>	<u>84,120</u>	<u>205,817</u>
Fund balances (deficits) at the end of the year	<u>\$ -</u>	<u>\$ (1,085)</u>	<u>\$ (64,369)</u>	<u>\$ 131,510</u>	<u>\$ 66,056</u>	<u>\$ 84,120</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
CAPITAL PROJECTS FUNDS

Combining Statement of Expenditures by Account,
and Changes in Fund Balances (Deficits)
Year Ended September 30, 2006
(with comparative totals for the year ended September 30, 2005)

	Public Infrastructure Development	CFSM Capital Projects	Yap State Public Projects	Water Development Projects Revolving	Totals	
					2006	2005
Revenues:						
CFSM grants	\$ -	\$ 186,020	\$ -	\$ -	\$ 186,020	\$ 244,710
	-	186,020	-	-	186,020	244,710
Expenditures by account:						
Contractual services	-	157,907	-	-	157,907	189,114
Capital outlay	-	49,230	-	-	49,230	75,799
Salaries and wages	-	-	-	-	-	12,752
Freight	-	504	-	-	504	2,967
Repairs and maintenance	-	-	-	-	-	45
Professional services	-	-	-	13,763	13,763	57,328
Other	-	53,574	-	13,699	67,273	28,402
Total expenditures	-	261,215	-	27,462	288,677	366,407
Excess (deficiency) of revenues over (under) expenditures	-	(75,195)	-	(27,462)	(102,657)	(121,697)
Other financing sources:						
Operating transfers in	-	84,593	-	-	84,593	-
Net change in fund balances (deficits)	-	9,398	-	(27,462)	(18,064)	(121,697)
Fund balances (deficits) at the beginning of the year	-	(10,483)	(64,369)	158,972	84,120	205,817
Fund balances (deficits) at the end of the year	\$ -	\$ (1,085)	\$ (64,369)	\$ 131,510	\$ 66,056	\$ 84,120

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA
COMPACT OF FREE ASSOCIATION
SECTION 211(a) SECTOR GRANT FUNDS

Combining Balance Sheet
September 30, 2006
(with comparative totals as of September 30, 2005)

	Education Sector	Health Sector	Private Sector Development	Environment Sector	Capacity Building Sector	Supplemental Education	Totals	
							2006	2005
ASSETS								
Receivables:								
CFSM	\$ 545,128	\$ 343,704	\$ 237,572	\$ 93,061	\$ 79,572	\$ 360,257	\$ 1,659,294	\$ 1,499,656
Due from other funds	-	362,781	141,979	82,591	190,016	-	777,367	200,389
	\$ 545,128	\$ 706,485	\$ 379,551	\$ 175,652	\$ 269,588	\$ 360,257	\$ 2,436,661	\$ 1,700,045
LIABILITIES AND FUND BALANCES (DEFICITS)								
Liabilities:								
Accounts payable	\$ 84,947	\$ 47,601	\$ 84,892	\$ 25,824	\$ 41,267	\$ 9,029	\$ 293,560	\$ 498,206
Other liabilities and accruals	-	1,486	(1,486)	-	-	-	-	163,742
Deferred revenue	342,965	657,398	183,754	149,828	228,741	-	1,562,686	142,525
Due to other funds	117,216	-	-	-	-	350,644	467,860	895,508
Total liabilities	\$ 545,128	\$ 706,485	\$ 267,160	\$ 175,652	\$ 270,008	\$ 359,673	\$ 2,324,106	\$ 1,699,981
Fund balances (deficits):								
Reserved for:								
Encumbrances	310,431	1,261,515	68,351	83,019	72,552	378,563	2,174,431	1,301,402
Unreserved	(310,431)	(1,261,515)	44,040	(83,019)	(72,972)	(377,979)	(2,061,876)	(1,301,338)
Total fund balances (deficits)	-	-	112,391	-	(420)	584	112,555	64
Total liabilities and fund balances	\$ 545,128	\$ 706,485	\$ 379,551	\$ 175,652	\$ 269,588	\$ 360,257	\$ 2,436,661	\$ 1,700,045

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA
COMPACT OF FREE ASSOCIATION
SECTION 211(a) SECTOR GRANT FUNDS

Combining Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances (Deficits)
Year Ended September 30, 2006
(with comparative totals for the year ended September 30, 2005)

	2006					Totals		
	Education Sector	Health Sector	Private Sector Development	Environment Sector	Capacity Building Sector	Supplemental Education	2006	2005
Revenues:								
Compact funding	\$ 2,939,978	\$ 2,796,580	\$ 883,161	\$ 386,316	\$ 1,313,024	\$ 1,639,839	\$ 9,958,898	\$ 8,875,264
Fees and charges	\$ 2,165	\$ 284,308	\$ 196,443	\$ 80	\$ 319	\$ 584	\$ 483,899	\$ 220,144
	<u>2,942,143</u>	<u>3,080,888</u>	<u>1,079,604</u>	<u>386,396</u>	<u>1,313,343</u>	<u>1,640,423</u>	<u>10,442,797</u>	<u>9,095,408</u>
Expenditures by function:								
Current:								
Judiciary	-	-	-	-	-	-	-	166,785
Public auditor	-	-	-	-	-	-	-	154,289
General government	-	-	-	350,875	1,313,343	-	1,664,218	456,954
Economic development	-	-	659,695	-	-	-	659,695	526,848
Public safety	-	-	-	-	-	-	-	337,914
Education	2,942,143	-	-	-	-	1,804,329	4,746,472	3,717,507
Public works and transportation	-	-	-	-	-	-	-	88,401
Health services	-	3,080,888	-	-	-	-	3,080,888	2,542,203
Boards and commissions	-	-	-	-	-	-	-	326,973
Payment to component units	-	-	308,002	-	-	-	308,002	777,534
Other	-	-	-	35,521	-	-	35,521	-
Total expenditures	<u>2,942,143</u>	<u>3,080,888</u>	<u>967,697</u>	<u>386,396</u>	<u>1,313,343</u>	<u>1,804,329</u>	<u>10,494,796</u>	<u>9,095,408</u>
Excess (deficiency) of revenues over (under) expenditures	-	-	111,907	-	-	(163,906)	(51,999)	-
Other financing sources:								
Operating transfers in	-	-	-	-	-	164,490	164,490	-
Net change in fund balances (deficits)	-	-	111,907	-	-	584	112,491	-
Fund balances (deficits) at the beginning of the year	-	-	484	-	(420)	-	64	64
Fund balances (deficits) at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 112,391</u>	<u>\$ -</u>	<u>\$ (420)</u>	<u>\$ 584</u>	<u>\$ 112,555</u>	<u>\$ 64</u>

STATE OF YAP
FEDERATED STATES OF MICRONESIA
COMPACT OF FREE ASSOCIATION
SECTION 211(a) SECTOR GRANT FUNDS

Combining Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances (Deficits)
Year Ended September 30, 2006
(with comparative totals for the year ended September 30, 2005)

	Education Sector	Health Sector	Private Sector Development	Environment Sector	Capacity Building Sector	Supplemental Education	Totals	
							2006	2005
Revenues:								
Compact funding	\$ 2,939,978	\$ 2,796,580	\$ 883,161	\$ 386,316	\$ 1,313,024	\$ 1,639,839	\$ 9,958,898	\$ 8,875,264
Fees and charges	2,165	284,308	196,443	80	319	584	483,899	220,144
	<u>2,942,143</u>	<u>3,080,888</u>	<u>1,079,604</u>	<u>386,396</u>	<u>1,313,343</u>	<u>1,640,423</u>	<u>10,442,797</u>	<u>9,095,408</u>
Expenditures by account:								
Salaries and wages	1,768,896	940,107	301,934	172,067	812,151	877,526	4,872,681	3,830,169
Grants and subsidies	16,121	-	363,834	35,721	-	-	415,676	777,534
Utilities	228,655	297,864	48,911	9,452	42,483	80,626	707,991	511,255
Contractual services	7,410	117,242	57,771	88,996	38,483	-	309,902	480,165
Supplies and materials	117,151	29,707	20,025	4,814	49,508	28,866	250,071	125,422
Scholarship and training	2,554,336	-	159	-	-	121,685	377,280	361,600
Travel	63,318	62,038	42,170	14,158	97,334	223,133	502,151	533,358
Capital outlay	236,413	301,781	57,738	16,815	71,690	65,060	749,497	340,045
Rentals	4,191	223	1,735	794	1,598	-	8,541	2,742
Food stuffs	400	1,619	284	284	-	94,616	96,919	16,407
Communications	20,837	25,942	18,630	15,841	15,204	73,666	170,120	120,334
Printing and reproduction	36,100	10,467	7,017	2,024	9,794	11,743	77,145	75,556
Medical supplies	-	677,586	-	-	-	2,072	679,658	348,576
Medical referral	-	112,519	-	-	-	-	112,519	276,727
Repairs and maintenance	4,469	6,044	4,602	5,329	17,821	9,663	47,928	94,769
Freight	14,653	84,167	2,418	333	2,440	4,188	108,199	150,984
Professional services	-	178,589	-	-	48,105	20,000	246,694	186,901
POL	17,036	9,971	495	4,754	17,985	19,242	69,483	64,480
Leased housing	49,150	48,503	-	6,000	16,713	11,300	131,666	115,737
Other	101,907	176,519	40,258	9,014	72,034	160,943	560,675	682,647
	<u>2,942,143</u>	<u>3,080,888</u>	<u>967,697</u>	<u>386,396</u>	<u>1,313,343</u>	<u>1,804,329</u>	<u>10,494,796</u>	<u>9,095,408</u>
Excess (deficiency) of revenues over (under) expenditures	-	-	111,907	-	-	(163,906)	(51,999)	-
Other financing sources:								
Operating transfers in	-	-	-	-	-	164,490	164,490	-
Net change in fund balances (deficits)	-	-	111,907	-	-	584	112,491	-
Fund balances at the beginning of the year	-	-	484	-	(420)	-	64	64
Fund balances (deficits) at the end of the year	\$ -	\$ -	\$ 112,391	\$ -	\$ (420)	\$ 584	\$ 112,555	\$ 64

See Accompanying Independent Auditors' Report.

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

Honorable Sebastian Anafel
Governor, State of Yap
Federated States of Micronesia:

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Yap as of and for the year ended September 30, 2006, which collectively comprise the State of Yap's basic financial statements and have issued our report thereon dated June 25, 2007. Our report was modified to include a reference to other auditors and expressed an adverse opinion on the aggregate discretely presented component units due to the lack of audited financial statements of Yap Fishing Authority and Yap Fresh Tuna, Inc. Except as discussed in the preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

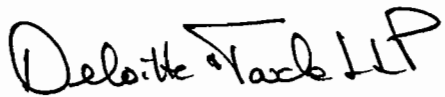
In planning and performing our audit, we considered the State of Yap's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the State of Yap's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs (pages 81 through 92) as items 2006-07 through 2006-09.

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 caused by error or fraud 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Yap's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the management of the State of Yap, federal awarding agencies, pass-through entities, 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.

A handwritten signature in black ink that reads "Deloitte Touche LLP". The signature is written in a cursive, stylized font.

June 25, 2007

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND INTERNAL CONTROL
OVER COMPLIANCE APPLICABLE TO EACH MAJOR FEDERAL AWARD PROGRAM
AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

Honorable Sebastian Anafel
Governor, State of Yap
Federated States of Micronesia:

Compliance

We have audited the compliance of the State of Yap with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2006. The State of Yap's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 81 and 82). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the State of Yap's management. Our responsibility is to express an opinion on the State of Yap's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the State of Yap's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the State of Yap's compliance with those requirements.

As described in items 2006-01 through 2006-04 and 2006-08 (Equipment and Real Property Management) in the accompanying Schedule of Findings and Questioned Costs, the State of Yap did not comply with requirements regarding equipment and real property management, procurement and suspension and debarment, period of availability and allowable costs/cost principles that are applicable to its major federal programs as described in the Federal Award Findings and Questioned Cost Section (page 82). Compliance with such requirements is necessary, in our opinion, for the State of Yap to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the State of Yap complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2006.

Internal Control Over Compliance

The management of the State of Yap is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the State of Yap's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

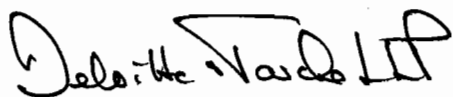
We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the State of Yap's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 2006-01 to 2006-06 and 2006-08 (Equipment Real Property Management).

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 noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Yap as of and for the year ended September 30, 2006, and have issued our report thereon dated June 25, 2007. Our report was modified to include reference to other auditors and we expressed an adverse opinion on the aggregate discretely presented component units due to the lack of audited financial statements of Yap Fishing Authority and Yap Fresh Tuna, Inc. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the State of Yap's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards (pages 72 through 78) is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the State of Yap. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the management of the State of Yap, federal awarding agencies, pass-through entities, 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.



June 25, 2007

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards
Federal Grants Fund
Year Ended September 30, 2006

<u>Grantor Program Title</u>	<u>CFDA No./ Grant No.</u>	<u>2006 Fiscal Year Expenditures</u>
<u>U.S. Department of Education:</u>		
2004 - PVIEP	84.048B	\$ 34,035
2005 - PVIEP	84.048B	61,537
Total CFDA # 84.048B		<u>95,572</u>
FY05 Special Education	84.027B	110,062
FY06 Special Education	84.027B	492,082
Total CFDA # 84.027B		<u>602,144</u>
Freely Associated States Ed Grant 7/03-6/04	84.256A	114,610
Total CFDA # 84.256A		<u>114,610</u>
Early Childhood Education Book Project	84.310A	242
Total CFDA # 84.310A		<u>242</u>
FY-04 Teacher Quality Enhancement	84.336	4,870
Total CFDA # 84.336		<u>4,870</u>
Total U.S. Department of Education		<u>817,438</u>
<u>U.S. Department of Labor:</u>		
2003 WIA Title I - Administration	17.255	337
2004 WIA Title I - Administration	17.255	6,869
Total CFDA # 17.255		<u>7,206</u>
2003 WIA Title I - Adult	17.258	12,060
2004 WIA Title I - Adult	17.258	8,737
Total CFDA # 17.258		<u>20,797</u>
2003 WIA Title I - Youth	17.259	961
2004 WIA Title I - Youth	17.259	8,530
Total CFDA # 17.259		<u>9,491</u>
2003 WIA Title I - Dislocated Worker	17.260	36,979
2004 WIA Title I - Dislocated Worker	17.260	24,912
Total CFDA # 17.260		<u>61,891</u>
Yap WIA National Emergency Grant	EM-14570-05-60	1,444,389
Total U.S. Department of Labor		<u>1,543,774</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Federal Grants Fund
Year Ended September 30, 2006

U.S. Department of Agriculture:

03 Forestry Urban Community	10.664	0
04 Cooperative Forestry Assistance	10.664	1,710
04 Forestry Urban Community	10.664	259
04 Yap Forest Health Project	10.664	1,475
04 FRM / RNGR	10.664	155
04 Suppression Fund	10.664	0
04 Yap Conservation Education	10.664	171
04 FRM	10.664	124
04 FSP Sudal Relief	10.664	436
05 Cooperative Forestry Assistance	10.664	5,146
06 Cooperative Forestry Assistance	10.664	220
06 Forestry Urban Community	10.664	30,474
06 Yap Conservation Education	10.664	3,553
06 Yap Forest Health Project	10.664	4,167
06 Yap Frstry Stewardship	10.664	8,918
Total CFDA # 10.664		56,808
Total U.S. Department of Agriculture		56,808

U.S. Department of the Interior:

FY02 HPO Archaeology	15.904	856
FY04 HPO Professional	15.904	60,715
FY04 HPO Special Project	15.904	967
FY04 HPO Regular Operation	15.904	3,665
FY05 HPO Special Project	15.904	2,175
FY05 HPO Regular Operation	15.904	20,926
FY06 HPO Regular Operation	15.904	4,273
FY06 HPO Special Project	15.904	19,088
Total CFDA # 15.904		112,665
Total U.S. Department of the Interior		112,665

U.S. Department of Health and Human Services:

FY06 Children's Oral Health Care	93.110	2,235
Total CFDA # 93.110		2,235
FY05 Tuberculosis Control Programs (B)	93.116	8,249
FY06 Tuberculosis Control Programs (B)	93.116	7,373
Total CFDA # 93.116		15,622
FY 05/06/07 Family Planning	93.217	34,364
Total CFDA # 93.217		34,364
FY06 Community Health Center	93.224	298,506
Total CFDA # 93.224		298,506
2005 Immunization Program	93.268	9,995
2006 Immunization Program	93.268	17,152
Total CFDA # 93.268		27,147

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Federal Grants Fund
Year Ended September 30, 2006

U.S. Department of Health and Human Services, Continued:

FY 04/05/06 Tobacco Prevention	93.283	3,450
FY-05 Tobacco Free Coalition	93.283	3,985
FY-06 CDC BT Pan Flu	93.283	3,750
Total CFDA # 93.283		11,185
 Yap Seed		
2005 - Yap Seed Program	93.959	54
2006 - Yap Seed Program	93.959	10,563
FY05 Substance Abuse Mental Health	93.959	1,740
FY06 Substance Abuse Mental Health	93.959	44,008
Total CFDA # 93.959		56,365
 FY 05 Diabetes Program		
FY05 Diabetes Program	93.988	16,263
FY06 Diabetes Program	93.988	4,949
Total CFDA # 93.988		21,212
 FY04 MCH		
FY04 MCH	93.994	215
FY05 MCH	93.994	50,730
FY06 MCH	93.994	1,508
Total CFDA # 93.994		52,453
 2005 AIDS Prevention		
2005 AIDS Prevention	93.940	3,627
2006 AIDS Prevention	93.940	11,840
Total CFDA # 93.940		15,467
 2006 Bioterrorism Hospital CB #2.1		
2006 Bioterrorism Hospital CB #2.1	93.889	4,900
2006 Bioterrorism Hospital CB #2.10	93.889	578
2006 Bioterrorism Hospital CB #3	93.889	3,106
Total CFDA # 93.889		8,584
 FY02 PHHS - 17.9 Diabetes Death		
FY02 PHHS - 17.9 Diabetes Death	93.991	866
Total CFDA # 93.991		866
 Total U.S. Department of Health and Human Services		544,006
 Total Federal Grants Fund		\$ 3,074,691
 Reconciliation to financial statements:		
Balance per above		3,074,691
Other		(2,447)
Balance per financial statements		\$ 3,072,244

Note: With the exception of CFDA #84.048B, CFDA #84.256A, CFDA #84.310A and CFDA #93.224 which are received in a direct capacity from the U.S. Department of Education and U.S. Department of Health and Human Services, all other awards are received in a subrecipient capacity through the FSM National Government

See accompanying notes to Schedule of Expenditures of Federal Awards.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Schedule of Expenditures of Federal Awards, Continued
Other U.S. Grants Fund
Year Ended September 30, 2006

<u>Grantor</u> <u>Program</u>	<u>CFDA No.</u>	<u>2006</u> <u>Fiscal Year</u> <u>Expenditures</u>
U.S. Department of Homeland Security grants:		
Public Assistance Grants	83.544	\$ 1,571,730
Hazard Mitigation Grant	83.548	329,488
Total U.S. Department of Homeland Security		<u>\$ 1,901,218</u>

The above represents the federal share of expenditures, net of the State of Yap's matching share.

The above award is received in a subrecipient capacity from the FSM National Government.

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association Compact Capital Fund
Section 211 (A) Capital Account (CFDA No. 15.875)
Year Ended September 30, 2006

<u>Grantor</u> <u>Program Title</u>	2006 Fiscal Year <u>Expenditures</u>
<u>Office of Insular Affairs</u>	
Other Compact Capital Projects	\$ 24,196
Trochus Harvest Program	11,605
Cultural Public Museum - A&E	1,000
Jet Fuel Alternative Source and Operation	50
	36,851
Total Compact of Free Association Capital Projects Fund 211 (A)	\$ 36,851

The above award is received in a subrecipient capacity from the FSM National Government.

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association Compact Program Funds
Year Ended September 30, 2006

<u>Grantor</u> <u>Program Title</u>	<u>2006</u> <u>Fiscal Year</u> <u>Expenditures</u>
<u>Compact Section 211 (a) (1) Education Sector Grants:</u>	
FY 2005	\$ 174,321
FY 2006	<u>2,767,772</u>
Total Compact Section 211 (a)(1) Education Sector	<u>2,942,093</u>
<u>Compact Section 211 (a) (2) Health Sector Grants:</u>	
FY 2004	108,316
FY 2005	460,299
FY 2006	<u>2,512,273</u>
Total Compact Section 211 (a)(2) Health Sector	<u>3,080,888</u>
<u>Compact Section 211 (a) (3) Private Sector Development Grants:</u>	
FY 2004	64,783
FY 2005	19,754
FY 2006	<u>883,161</u>
Total Compact Section 211 (a)(3) Private Sector Development	<u>967,698</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association Compact Program Funds
Year Ended September 30, 2006

Compact Section 211 (a) (4) Public Sector Capacity Building Grants:

FY 2005	73,300
FY 2006	1,240,043
Total Compact Section 211 (a)(4) Public Sector Capacity Building	<u>1,313,343</u>

Compact Section 211 (a) (5) Environment Sector Grants:

FY 2004	15,912
FY 2005	77,229
FY 2006	293,255
Total Compact Section 211 (a)(5) Environment Sector	<u>386,396</u>

Compact Section 231 Supplemental Education Grant

FY 2005	<u>1,804,328</u>
Total Compact of Free Association Section 211 Grants	<u>\$ 10,494,746</u>

The above awards are received in a subrecipient capacity from the FSM National Government.

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2006

(1) Scope

The Yap State Government is a governmental entity governed by its own Constitution. All significant operations of the State of Yap are included in the scope of the OMB Circular A-133 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as the State's cognizant agency for the Single Audit.

A. Programs Subject to Single Audit

- U.S. Department of Agriculture
- U.S. Department of Education
- U.S. Department of Health and Human Services
- U.S. Department of Homeland Security
- U.S. Department of the Interior
- U.S. Department of Labor

(2) Summary of Significant Accounting Policies

A. Basis of Accounting

For purposes of this report, certain accounting procedures were followed which help illustrate the expenditures of the individual programs. All expenses and capital outlays are reported as expenditures. The Schedule of Expenditures of Federal Awards is prepared on the accrual basis of accounting.

B. Reporting Entity

The Yap State Government, for purpose of the financial statements, includes all of the funds of the primary government as defined by Governmental Accounting Standards Board (GASB) Statement 14, "The Financial Reporting Entity".

C. CFDA #15.875

CFDA #15.875 represents the Office of Insular Affairs (OIA), U. S. Department of the Interior. Funding from this source is subject to varying rules and regulations since OIA administers the Compact of Free Association, which is a treaty, and is not a federal program. The Compact is comprised of various funded programs, each with separate compliance requirements. To maximize audit coverage of OIA funding, the OIG has recommended that programs administered under CFDA #15.875 be grouped by like compliance requirements and such groupings be separately evaluated as major programs.

(3) Component Units

The Yap State Public Service Corporation (YSPSC) programs are received in a subrecipient capacity. No federal awards were expended in fiscal year 2006 exceeding the threshold and therefore, compliance testing was not performed.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Programs Selected for
Audit In Accordance With OMB Circular A-133
Year Ended September 30, 2006

<u>Grantor Program Title</u>	<u>CFDA No Grant No.</u>	<u>2006 Fiscal Year Expenditures</u>
<u>U.S. Department of the Interior</u> Compact of Free Association, Sector Grants	15.875	\$ <u>10,494,746</u>
<u>U.S. Department of Homeland Security</u> Public Assistance Grants	97.036/83.544	\$ <u>1,571,730</u>
<u>U.S. Department of Labor</u> WIA Cluster	17.255/17.258/ 17.259/17.260	\$ <u>1,543,774</u>
<u>U.S. Department of Education</u> Special Education	84.027B	\$ <u>602,144</u>
Total U.S. Federal program expenditures selected		\$ <u>14,212,394</u>
Total U.S. Federal program expenditures		\$ <u>15,507,506</u>
% of total U.S. Federal expenditures covered by major programs		<u>91%</u>

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2006

Part I - Summary of Auditors' Results Section

1. The Independent Auditor's Report on the financial statements of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information expressed an unqualified opinion and an adverse opinion on the financial statements of the aggregate discretely presented component units, due to the lack of audited financial statements of Yap Fishing Authority and Yap Fresh Tuna, Inc.
2. Reportable conditions in internal control over financial reporting were identified, none of which is considered to be a material weakness.
3. Instances of noncompliance considered material to the financial statements were not disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal award programs were identified, none of which is considered to be a material weakness.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. The State's major programs were:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number/Grant No.</u>
Compact of Free Association, Sector Grants	15.875
WIA Cluster	17.255/17.258/17.259/17.260
Public Assistance Grants	97.036/83.544
Special Education	84.027B

8. A threshold of \$465,225 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
9. The State did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

Part II - Financial Statement Findings Section

<u>Reference Number</u>	<u>Findings</u>
2006-07	Prior Year Internal Control Findings
2006-08	Fixed Assets
2006-09	Travel

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Part III - Federal Award Findings and Questioned Cost Section

<u>Reference</u>	<u>CFDA/Grant</u>		
<u>Number</u>	<u>Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
2006-01	15.875	Period of Availability	\$ 55,334
2006-02	15.875	Procurement	\$346,733
2006-03	EM-14570-05-60		
	17.260	Procurement	\$ 26,441
2006-04	83.544/ 97.036	Allowable Costs/Cost Principles/Procurement	\$ 95,943
2006-05	84.256A	Allowable Costs/Cost Principles	\$ 35,458
2006-06	84.048	Allowable Costs/Cost Principles/Procurement	\$ 16,449
2006-07	All major programs	Equipment and Real Property Management	\$ -

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-01
 CFDA #: 15.875
 Agency: U. S. Department of the Interior, Office of Insular Affairs
 Grant #: CSG-FSM-2005-HLT, CSG-FSM-2005-EDU, CSG-FSM-2005 CAP, CSG-FSM-2005-PSD
 Program Name: Compact of Free Association Sector Grants
 Requirement: Period of Availability
 Questioned Costs: \$55,334

Criteria: Per the grant terms and conditions of the fiscal year 2006 Compact Sector grants “Grants may not be used for any obligation or expenditure incurred prior to the effective date of the grant, October 1, 2005.”

Condition: For 4 of 107 (4%) non-payroll expenditures (\$55,334 of the aggregate amount of \$2,278,091 tested), expenditures from prior years were charged to the current year grant.

<u>Fund</u>	<u>Org #</u>	<u>Yr</u>	<u>GL Account Name</u>	<u>PO #</u>	<u>Ck No</u>	<u>Details per audit</u>	<u>Amount</u>
11	70-70-11100	06	Utilities	None	18334	Yap Memorial Hospital \$25,589 pertains to 9/26/05 and prior	\$ 25,589
11	70-72-11350	06	Medical Supplies	P23367	19360	Medical supplies for FY05 - charged in FY06	591
11	70-72-11350	06	Pharmaceuticals	P24992	20999	Medical Supplies	1,026
11	70-72-11350	06	Utilities	None	18099	Yap Hospital Aug - Sept 05	<u>28,128</u>
						Total	<u>\$55,334</u>

Cause: There appears to be a lack of control over ensuring compliance with the criteria.

Effect: The Government appears to be in noncompliance with the criteria and questioned costs result.

Recommendation: The Government should comply with Compact Sector program requirements.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The Department concerned has been informed of the findings and are currently working with their Grantor in addressing them. The State will work with the Grantor in addressing future issues as this remains an open item with the State and the Grantor.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-02
 CFDA #: 15.875
 Agency: U. S. Department of the Interior, Office of Insular Affairs
 Grant #: CSG-FSM-2005-HLT, CSG-FSM-2005-EDU, CSG-FSM-2005 CAP, CSG-FSM-2005-PSD
 Program Name: Compact of Free Association Sector Grants
 Requirement: Procurement
 Questioned Costs: \$346,733

Criteria: The Fiscal Procedures Agreement requires evidence of competitive procurement in support of procurement determinations. Procurements shall provide full and open competition among vendors, and any allowable exceptions should be approved and documented in the procurement file. Waivers of competitive procurement can only be authorized by designated U.S. program administrators.

Condition: For 13 of 107 (12%) non-payroll expenditures (\$346,733 of the aggregate amount of \$2,278,091 tested), there was insufficient documentation to support competitive procurement requirements.

<u>GL Account Name</u>	<u>PO #</u>	<u>CK</u>	<u>APV Amount</u>	<u>Details per audit</u>	<u>Rational</u>
Equipment	P32152	20473	\$157,258	Medical equipment	waiver issued, no competitive procurement undertaken
Equipment	P6267	21845	1,118	Custom taxes for cargo Van amounting to \$27k	no solicitation made for Guam vendors
Vehicles	P10002	22949	35,300	Vehicle purchase for DOA	Pending
Equipment General Contractual Srvc	P6267	21035	27,940	Cargo Van	no solicitation made for Guam vendors
General Contractual Srvc	C31763 / C4430		26,913	Construction Maap Health Center	waiver issued, no competitive procurement undertaken
General Contractual Srvc	C31764		24,873	Repair Gagil Dispensary	waiver issued, no competitive procurement undertaken
Professional Services	C10831		21,873	Data system installation in Dept Health Services	Justification only, however there should be cost analyses to show price was competitive or rationale as to why the system cannot be installed by another vendor.
Vehicles		23457	11,085	YA-07569, YA-07570, YA-07571 used vehicles	waiver issued, no competitive procurement undertaken
Professional Services **	P36070 / P2074		20,373	Termite pest control & installation at Yap Hospital	waiver issued, no competitive procurement undertaken
Professional Services **	c34713	20556	10,000	professional service	Only justification is required technical expertise procurement waiver as a basis for substantive.
Professional Services	c34713	22899	<u>10,000</u>	professional service	
			<u>\$346,733</u>		

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-02, Continued
CFDA #: 15.875
Agency: U. S. Department of the Interior, Office of Insular Affairs
Grant #: CSG-FSM-2005-HLT, CSG-FSM-2005-EDU, CSG-FSM-2005 CAP, CSG-FSM-2005-PSD
Program Name: Compact of Free Association Sector Grants
Requirement: Procurement
Questioned Costs: \$346,733

Cause: There appears to be a lack of control over ensuring compliance with the criteria. Additionally, the State appears of the opinion that it can waive Sector grant competitive procurement requirements.

Effect: The Government appears to be in noncompliance with the criteria and questioned costs result.

Recommendation: The Government should comply with Compact Sector program requirements and monitor proper control on budget against actual expenditures.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The Department concerned has been informed of the findings and were informed to work with their Grantor in addressing them. The Division of Procurement and Property Management is now handling the procurement on government purchases. The Chief of Finance & Treasury and the Chief of Procurement will strengthen the existing method by devising better screening process in ensuring that adequate documentations/justifications are in place before processing a transaction. Such guidelines should be ready for implementation by the end of fiscal year 2007.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-03
 Grant No.: EM-14570-05-60
 Grantor Agency: Department of Labor
 Grant Name: WIA National Emergency Grants
 Program Area: Procurement
 Questioned Costs: \$26,441

Criteria: Procurements shall provide full and open competition among vendors and allowable exceptions should be approved by the appropriate party and be documented in the procurement file. Suspension of competitive procurement activities can only be authorized by the President of the United States of America or the U.S. Departmental Secretary or their designee.

Condition: For 5 of 16 (31%) non payroll expenditures tested (\$26,441 of the aggregate population of \$92,691), there was no grantor approval on file that waived applicable procurement requirements. Instead, the Governor of the State waived competitive procurement requirements.

FD	Org #	GL Account Name	Ck No	APV	Details	Outstanding
20	30-44-23201	Repairs & Maintenance	19852	\$ 221	NATIONAL EMERGENCY GRANT	No competitive procurement except for a waiver
20	30-44-23201	Rental Chrgs	19854	4,920	NEG-SUZUKI ESCUDO RENTAL	No competitive procurement except for a waiver
20	30-44-23201	Rental Chrgs	19912	8,250	NEG-BOAT RENTAL	No competitive procurement except for a waiver
20	30-44-23201	Rental Chrgs	19854	5,000	NEG-BOAT RENTAL	No competitive procurement except for a waiver
20	30-44-23201	Rental Chrgs	19845	8,250	NEG-BOAT RENTAL	No competitive procurement except for a waiver
				<u>\$26,441</u>		

Cause: There appears to be weak internal controls over ensuring that competitive procurement documentation is maintained to substantiate compliance.

Effect: Noncompliance with procurement requirements results from this condition. Additionally, questioned costs result due to the absence of competitive procurement.

Recommendation: We recommend that Yap State Government comply with the program requirement.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The Department concerned has been informed of the findings and were informed to work with their Grantor in addressing them. The Division of Procurement and Property Management is now handling the procurement on government purchases. The Chief of Finance & Treasury and the Chief of Procurement will strengthen the existing method by devising better screening process in ensuring that adequate documentations/justifications are in place before processing a transaction. Such guidelines should be ready for implementation by the end of fiscal year 2007.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-04
 CFDA #: 83.544/97.036
 Agency: U.S. Department of Homeland Security
 Grant #: EMF-2004-GR-0409
 Program Name: Public Assistance Grants
 Requirement: Allowable Costs/Cost Principles/Procurement
 Questioned Costs: \$95,943

Criteria: Financial and programmatic records should be maintained on file for at least three years.

Condition: Receiving reports provided were incomplete for the following and the State is unable to justify that products or services were received and are chargeable to the program.

<u>Fund</u>	<u>Org Name</u>	<u>GL Account Name</u>	<u>PO #</u>	<u>APV</u>	<u>Apv amount</u>	<u>Outstanding</u>
22	Outer Island Taro Project - HMGP	Construction	C4745		\$39,763	Incomplete receiving report
22	Outer Island Taro Project - HMGP	Construction	C4745	11905	19,881	Incomplete receiving report
					<u>\$59,644</u>	

In three of 99 (3%) non payroll samples (\$36,299 of the aggregate sample population of \$1,328,207), the following contracts evidenced insufficient competitive procurement documentation.

<u>Acct Name</u>	<u>Amount</u>	<u>Ref</u>	<u>Enc Ref</u>	<u>Enc Amount</u>	<u>PW #</u>
General Contractual Svc	\$ 9,962	1472	C30769	\$18,781	PW#420 Public Works and Trans EQUIPMENT BARN (Renovation)
General Contractual Svc	20,539	25055	C25055	37,343	PW#355 - Marine Facilities Bldg & Doc
Construction	<u>5,798</u>	6896	C6640	7,731	PW#114 - DOE Technology Building
	<u>\$36,299</u>				

Cause: There appears to be a lack of control over ensuring compliance with the criteria.

Effect: The Government appears to be in noncompliance with the criteria and questioned costs result.

Recommendation: The Government should comply with program requirements.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The Department concerned has been informed of the findings and were informed to work with their Grantor in addressing them. The Division of Procurement and Property Management is now handling the procurement on government purchases. The Chief of Finance & Treasury and the Chief of Procurement will strengthen the existing method by devising better screening process in ensuring that adequate documentations/justifications are in place before processing a transaction. Such guidelines should be ready for implementation by the end of fiscal year 2007.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-05
 CFDA #: 84.256A
 Agency: U.S. Department of Education
 Grant #:
 Program Name: FASEG
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$35,458

Criteria: Expenditures should be necessary and reasonable for program needs. Procurements shall provide full and open competition among vendors, and allowable exceptions should be approved and be documented in the procurement file. For fixed asset acquisitions with an individual cost of \$5,000 or more, the Grantee is to obtain prior approval from the Grantor authorizing the purchase.

Condition: We could not locate evidence of prior Grantor approval for the purchase of the assets described below.

We also noted an expenditure that does not appear to be within the program objectives and needs.

<u>Acct Name</u>	<u>Amount</u>	<u>REF_1</u>	<u>REF_2</u>	<u>Description</u>	<u>Outstanding</u>
Equipment	\$29,996	J612003	P7697	Printer and 2 copiers	Prior Grantor approval was not obtained
Equipment	<u>5,462</u>	J612003	P7697	11 each of 1GB Ipod Shuffle and 60GB Ipod Video	Nature of expenditure does not appear reasonable and relevant to program needs
	<u>\$35,458</u>				

Cause: There appears to be a lack of control over ensuring compliance with the criteria.

Effect: The Yap Sate Government appears to be in noncompliance with the criteria and questioned costs result.

Recommendation: The State should ensure that it meets prior approval requirements relative to the acquisition of fixed assets. Additionally, expenditures should be reasonable and related to the conduct of the program.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The Department concerned has been informed of the findings and are currently working with their Grantor in addressing them. The Division of Procurement and Property Management is now handling the procurement on government purchases. The Chief of Finance & Treasury and the Chief of Procurement will strengthen the existing method by devising better screening process in ensuring that adequate documentations/justifications are in place before processing a transaction. Such guidelines should be ready for implementation by the end of fiscal year 2007.

**STATE OF YAP
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-06
 CFDA #: 84.048
 Agency: U.S. Department of Education
 Grant #:
 Program Name: PVEIP
 Requirement: Allowable Costs/Cost Principles/Procurement
 Questioned Costs: \$16,449

Criteria: For fixed asset purchases with an individual cost of \$5,000 or more, the Grantee is to obtain prior approval from the Grantor if the asset acquired is not specifically approved in the budget process. Procurements shall provide full and open competition among vendors.

Condition: We could not locate prior grantor approval for the purchase of the following asset:

<u>Acct Name</u>	<u>Amount</u>	<u>REF 1</u>	<u>REF 2</u>	<u>Description</u>
Equipment	\$16,449	J611013	P33302	Tractor

For 1 of 5 non payroll expenditures tested for this program, the procurement selection was not properly conducted.

<u>Acct Name</u>	<u>Amount</u>	<u>REF 1</u>	<u>REF 2</u>	<u>PO Amount</u>	<u>Outstanding</u>
Equipment	\$9,965	1461	P30386	\$20,409	Procurement selection was based on a specific name brand, which could have limited open competition. The brand did not specify "or an equivalent".

Cause: There appears to be a lack of control over ensuring compliance with the criteria.

Effect: The Government appears to be in noncompliance with the criteria and questioned costs result. No questioned costs result for the \$9,965 procurement as the State was able to evidence that sufficient competitive procurement occurred and the reference to a brand name does not appear to have altered the outcome of this procurement.

Recommendation: The State should comply with the criteria and should ensure that if a brand name is utilized, the procurement should specify that "an equivalent item" is acceptable.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The Department concerned has been informed of the findings and are currently working with their Grantor in addressing them. The Departments and Office of Administrative Services will ensure that the bidding requirements are complied with in the future. The Chief of Finance & Treasury and the Chief of Procurement will strengthen the existing method by devising better screening process in ensuring that adequate documentations/justifications are in place before processing a transaction. Such guidelines should be ready for implementation by the end of fiscal year 2007.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-07
Area: Prior Year Internal Control Findings

Criteria: Prior year internal control findings should be timely resolved through appropriate corrective action.

Condition: The following internal control findings from fiscal year 2005 have not been corrected during the year ended September 30, 2006:

Finding 2005-02	Equipment and Real Property Management
Finding 2005-04	Travel Advances
Finding 2005-05	Approval of Payroll Master File Changes
Finding 2005-07	Approval of Journal Vouchers
Finding 2005-08	Purchase Advances

Cause: The cause of this condition is that inadequate corrective action occurred during fiscal year 2006.

Effect: The effect of this condition is the same cited in each of the abovementioned prior year internal control findings.

Recommendation: The Department of Administration should ensure that corrective action occurs to resolve the abovementioned issues.

Auditee Response and Corrective Action Plan:

Finding 2005-02: We agree with the finding and recommendation. The Director of Office of Administrative Services & Administration will pursue completing the corrective action plan as provided for in the response to the audit for fiscal year 2005 and have it ready by November 30, 2007.

Finding 2005-04: We agree with the finding and recommendation. The Chief of Finance & Treasury will pursue completing the corrective action plan as provided for in the response to the audit for fiscal year 2005 and have it ready by September 30, 2007.

Finding 2005-05: We agree with the finding and recommendation. The Director of Administrative Services will pursue completing the corrective action plan as provided for in the response to the audit for fiscal year 2005 as well as automating the procedure through the system.

Finding 2005-06: We agree with the finding and recommendation. The Chief of Finance & Treasury has implemented the corrective action plan in FY 2007.

Finding 2005-07: The Director of Administrative Services will pursue completing the corrective action plan as provided for in the response to the audit for fiscal year 2005 and have it ready by December 31, 2007

**STATE OF YAP
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-08
Area: Fixed Assets

Criteria: Fixed asset additions should be supported by invoices and capitalization of the items should timely occur.

Condition: Of \$1,818,553 in acquisitions and additions to construction in progress tested, we noted the following:

- A fuel truck (YA-07835) with a cost of \$160,258 was not acquired until December 2006. This matter was corrected through a proposed audit adjustment.
- School buildings of \$469,538 were completed in a prior year for which related expenditures were recognized in fiscal year 2005. This matter has been corrected through a restatement of beginning balances.
- Of total Yap High School CIP addition of \$361,735 per fixed assets register \$319,846 were related to assets already capitalized. This has been corrected through a proposed audit adjustment.

Cause: The cause of this condition is untimely recordation of fixed asset additions and a lack of support acquired to support asset additions.

Effect: The effect of this condition is a potential for incorrect fixed asset additions to be recorded.

Recommendation: Fixed assets should be capitalized on a quarterly basis and files reflecting the cost of the additions should be maintained.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The Chief Accountant from the Division of Finance & Treasury and the Procurement Division will ensure that the recommendations are carried out by the end of Fiscal Year 2007 and is fully implemented in Fiscal Year 2008.

**STATE OF YAP
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-09
Area: Travel

Criteria: The State should attempt to utilize competitive procedures in the acquisition of travel services.

Condition: No travel agencies operate in the State and the State is serviced by only one air line. However, once a traveler reaches Guam or Hawaii, multiple airline choices result. Due to the absence of a travel agent and due to the absence of a State credit card, travel arrangements are conducted solely with one airline.

Cause: Due to the absence of a travel agent and a State credit card, the State believes that it has no other option.

Effect: The State is not engaging in competitive procurement procedures in its choice of travel services.

Recommendation: We understand that no travel agency conducts business in the State. However, the State has not documented its attempts to obtain a State credit card. If the State acquired such a card, it would be able to potentially engage the services of alternative airlines, once the traveler reaches Guam or Hawaii. We therefore recommend that the State formally establish whether it can obtain a credit card and engage in competitively procured travel services.

Auditee Response and Corrective Action: We agree with the finding and recommendation. The State will look into the benefits of acquiring the credit card and respond by December 31, 2007.

**STATE OF YAP
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Unresolved Prior Year Findings and Questioned Costs
Year Ended September 30, 2006

QUESTIONED COSTS

For the year ended September 30, 2006, the following questioned costs remain unresolved.

	Questioned Costs Set Forth in Prior Audit Report <u>2005</u>	<u>Questioned Costs Resolved</u>	<u>Questioned Costs at September 30, 2006</u>
Unresolved Questioned Costs FY 99	\$ 68,619	\$ -	\$ 68,619
Unresolved Questioned Costs FY 00	30,010	-	30,010
Unresolved Questioned Costs FY 01	58,279	-	58,279
Unresolved Questioned Costs FY 03	101,558	-	101,558
Unresolved Questioned Costs FY 04	12,446	-	12,446
Unresolved Questioned Costs FY 05	22,008	-	22,008
Unresolved Questioned Costs FY 06	<u>-</u>	<u>-</u>	<u>576,358</u>
	\$ <u>292,920</u>	\$ <u>-</u>	\$ <u>869,278</u>

The prior year status of findings is contained in the accompanying Schedule of Findings and Questioned Costs.