

STATE OF YAP
FEDERATED STATES OF MICRONESIA

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEAR ENDED SEPTEMBER 30, 2007

STATE OF YAP
FEDERATED STATES OF MICRONESIA

FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2007

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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, 2007, 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. Those financial statements were audited by other auditors whose report thereon have been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for the Public Transportation System is 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 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 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 the other auditors provide a reasonable basis for our opinions.

While detailed property records exist for the State's capital assets, the State has not recorded a donated shipping vessel in the governmental activities as of September 30, 2007 and, accordingly, has not recorded corresponding program revenue for the year ended September 30, 2007. Accounting principles generally accepted in the United States of America require that donated assets be recorded at historical cost, which would increase the assets and net assets, and change the revenues of the governmental activities. The amount by which this departure would affect the assets, net assets and revenues of the governmental activities is not reasonably determinable.

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 10%, 13%, and 2%, respectively, of the assets, net assets, and revenues of the State's aggregate discretely presented component units.

Because of inadequacies in the accounting records, 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.

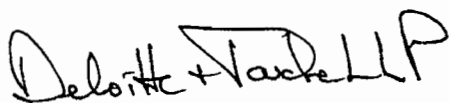
In our opinion, based on our audit and the report of other auditors, except for the effects of not recording a capital asset in the governmental activities, as discussed in the third paragraph above, the financial statements referred to above present fairly, in all material respects, the respective financial 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, 2007, 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 fourth and fifth 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, 2007, and the changes in financial position thereof for the year then ended.

The Management's Discussion and Analysis, on pages 3 through 8, as well as the Schedule of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual - General Fund and notes thereto, on pages 44 and 45, 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 30, 2008, on our consideration of the State's 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 30, 2008

YAP STATE GOVERNMENT

Management's Discussion and Analysis Year Ending September 30, 2007

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, 2007. We encourage readers to consider this information in conjunction with Yap State's financial statements, which follow. Fiscal year 2006 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, 2007, Yap State's total net assets increased by \$3.85 million (or 3.89%) from \$98.99 million in the prior year to \$102.83 million.
- During fiscal year 2007, Yap State's revenues of \$31.99 million exceeded total expenditures (\$28.14 million) by \$3.85 million. In comparison to fiscal year 2006, revenues were up by \$7.21 million (or 29.11%) and expenditures were up \$3.99 million (or 16.56%). The increase in revenues is primarily due to significant investment income. The increase in expenditure is evident across government with primary increases in public safety and payments to component units
- Yap State maintained solid budgetary position with a notable variance compared to the previous year. In fiscal year 2007, revenues available for appropriation were \$7.10 million more than budgeted for the general fund although actual expenditures were in excess of the budget by \$0.54 million. However, the overall excess of revenues over expenditures reflected a \$6.55 positive change in the general fund balance.
- The unreserved surplus of the General Fund increased by \$6.65 million (up 20.87%); increase from \$31.87 million in the prior year to \$38.52 million in fiscal year 2007. The rise is attributable to substantial gains made on Yap State's investment portfolio. Investment income realized on Yap State's investments totaled \$9.48 million in fiscal year 2007, an upward difference of \$4.94 million (or 108.81%) from the \$4.54 million earned in fiscal year 2006.

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, 2007

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 funds statement, or on the subsequent page, that explains and reconciles the relationship (or differences) between them.
- Proprietary funds. Services for which Yap State charge customers a fee are generally reported in proprietary funds. Proprietary funds, like the government-wide statements, provide both long- and short-term financial information.

YAP STATE GOVERNMENT

Management's Discussion and Analysis Year Ending September 30, 2007

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 2007, Yap State's assets exceeded liabilities by \$102.83 million. Of its total net assets, \$29.34 million (28.53%) are restricted as to the purposes they can be used for. Another \$35.37 million (34.39%) 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, 2007 with comparative figures for the prior year:

	<u>2007</u>	<u>2006</u>
Current and other non-capital assets	\$78,062,009	\$ 71,880,529
Capital assets	<u>35,368,911</u>	<u>37,619,801</u>
Total Assets	113,009,488	109,500,330
Other liabilities	4,843,211	5,936,917
Long-term liabilities	<u>5,332,141</u>	<u>4,577,176</u>
Total Liabilities	<u>10,175,352</u>	<u>10,514,093</u>
Net Assets		
Invested in capital assets, net of related debt	35,368,911	37,619,801
Restricted	29,341,722	26,020,531
Unrestricted	<u>38,123,503</u>	<u>35,345,905</u>
Total Net Assets	<u>\$102,834,136</u>	<u>\$98,986,237</u>

At the end of fiscal year 2007, Yap State's unrestricted assets show a surplus of \$38.12 million (37.08% 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 assets increased \$3.85 million (up 3.88%) from fiscal year 2006. Key elements of the increase and the differences from the prior year are shown in the following schedule:

	<u>2007</u>	<u>2006</u>
Revenues:		
Program Revenues:		
Charges for services	\$ 1,324,273	\$ 1,269,093
Operating grants and contributions	15,414,667	13,863,198
Capital Grants and contributions	1,229,664	186,020
General Revenues:		
Taxes	3,403,364	3,960,193
Unrestricted investment earnings	9,475,556	4,935,835
Other	<u>359,109</u>	<u>564,608</u>
Total revenues	<u>31,206,633</u>	<u>24,778,947</u>

YAP STATE GOVERNMENT

Management's Discussion and Analysis Year Ending September 30, 2007

	<u>2007</u>	<u>2006</u>
Expenses:		
General government	5,283,936	7,736,926
Health Services	4,293,830	3,393,744
Education	7,303,875	5,337,633
Economic development	1,583,352	1,032,690
Public Safety	628,132	270,178
Public works and transportation	4,094,336	3,791,605
Community affairs	892,923	735,920
Boards and commissions	78,624	48,957
Payments to components	1,417,913	530,999
Judiciary	163,933	-
Public auditor	2,647	11,087
Capital projects	-	347,072
Other	<u>1,615,233</u>	<u>908,648</u>
Total expenses	<u>27,358,734</u>	<u>24,145,459</u>
Change in net assets	3,847,899	133,488
Net assets at the beginning of the year	<u>98,986,237</u>	<u>98,852,749</u>
Net assets at the end of the year	<u>\$102,834,136</u>	<u>\$98,986,237</u>

Total revenues in fiscal year 2007 of \$31.21 million increased from the prior year's \$24.78 million (up 25.94%) primarily due to significant investment earnings.

Total expenses in fiscal year 2007 of \$27.36 million had increased over fiscal year 2006's \$24.15 million (up 13.31%).

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 2007, Yap State's governmental funds reported a combined fund balance of \$72.85 million, which represents an increase of \$6.89 million (or 10.45%) in comparison with fiscal year 2006. This increase is primarily attributable to investment income. Of the total fund balance, \$22.55 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 (\$13.05 million); 2) to liquidate contracts and purchase orders of the prior period (\$7.3 million); to fund specific general fund and compact CIP-related activities (\$2.24 million). The unreserved combined fund balance is \$50.31 million, an increase of \$5.18 million (or 11.48%) from fiscal year 2006. The difference is mainly accounted for by the increase in the unreserved fund balance of the general fund.

YAP STATE GOVERNMENT

Management's Discussion and Analysis
Year Ending September 30, 2007

GENERAL FUND BUDGETARY HIGHLIGHTS

Yap State maintained budgetary stability throughout fiscal year 2007, resulting in a \$6.55 million positive variance in the excess of revenues over expenditures. Moreover, the unreserved general fund surplus increased by \$6.65 million (up 20.87%) in fiscal year 2007; from \$31.87 million in fiscal year 2006 to \$38.52 million. This increase was due to the \$9.48 million in investment income earned in fiscal year 2007.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Yap State's investment in capital assets for the primary government as of September 30, 2007, amounted to \$102.10 million, net of accumulated depreciation of \$70.00 million, leaving a net book value of \$35.22 million. This represents a net decrease of \$2.40 million (or 6.37%) from fiscal year 2006. The table below summarizes Yap State's capital assets:

Yap State Capital Assets

	<u>2007</u>	<u>2006</u>
Land	\$ 3,120,610	\$ 3,120,610
Construction in progress	-	299,425
Buildings	7,018,758	7,150,570
Equipment	905,837	727,057
Furniture and Fixtures	10,372	-
Vehicles	644,686	548,417
Boats	70,321	85,787
Infrastructure	23,454,001	25,594,134
Public Transportation	<u>144,326</u>	<u>93,801</u>
	<u>\$35,368,911</u>	<u>\$37,619,801</u>

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 \$5.40 million at September 30, 2007. This debt is comprised of the non-current portion of the following ADB Loans: Early Retirement Program Loan, Private Sector Development Loan, and the Basic Social Services Loan with all three adding to \$4.68 million, liability for compensated absences of \$0.47 million and long-term payments due under land purchase agreements of \$0.25 million. Principal payments on the outstanding ADB loan will begin in 2008 and will be partially covered by \$2.63 million deposited in a restricted investment account jointly held with the FSM National Government.

YAP STATE GOVERNMENT

Management's Discussion and Analysis Year Ending September 30, 2007

Additional information on Yap States 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 2007 with a strong financial position as reflected in its increased unreserved general fund surplus. However, with the global rise in energy costs, the government is faced with consistently increasing prices and no evidence of economic growth in the near term. The few remaining recovery projects related to typhoon Sudal that were extended into fiscal year 2007 are being finalized. 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 2008 and beyond.

Yap State's investment is subject to the current volatile climate in the U.S. financial markets. Although fiscal year 2006 and 2007 resulted in unrealized portfolio gains, that may not occur during fiscal year 2008. Given the increasing energy costs, the uncertainties in the financial market and downturn in global economy, Yap State's strong hold on fiscal discipline is most needed for continued sound operating results and stable financial position during fiscal year 2008.

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, 2007

	Primary Government			Component Units
	Governmental Activities	Business-Type Activities	Total	
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 271,242	\$ 75,621	\$ 346,863	\$ 2,637,087
Cash and cash equivalents - restricted	331,642	-	331,642	-
Time certificates of deposit	-	-	-	1,566,000
Investments	61,442,235	-	61,442,235	-
Receivables, net of allowance for uncollectibles	963,516	1,428	964,944	1,886,786
Advances	556,929	-	556,929	-
Inventories	-	-	-	745,824
Other current assets	1,719,718	56,566	1,776,284	161,135
Total current assets	<u>65,285,282</u>	<u>133,615</u>	<u>65,418,897</u>	<u>6,996,832</u>
Noncurrent assets:				
Restricted assets:				
Investments	7,006,391	-	7,006,391	-
Investments	4,619,674	-	4,619,674	-
Loans	595,615	-	595,615	-
Capital assets, net of accumulated depreciation	35,224,585	144,326	35,368,911	14,062,633
Total noncurrent assets	<u>47,446,265</u>	<u>144,326</u>	<u>47,590,591</u>	<u>14,062,633</u>
Total assets	<u>\$ 112,731,547</u>	<u>\$ 277,941</u>	<u>\$ 113,009,488</u>	<u>\$ 21,059,465</u>
LIABILITIES				
Current liabilities:				
Current portion of long-term obligations	\$ 70,000	\$ -	\$ 70,000	\$ 522,525
Accounts payable	1,643,518	4,491	1,648,009	470,530
Compensated absences payable, net of current portion	85,655	-	85,655	-
Other liabilities and accruals	190,063	29,144	219,207	655,125
Deferred revenue	2,820,010	330	2,820,340	-
Total current liabilities	<u>4,809,246</u>	<u>33,965</u>	<u>4,843,211</u>	<u>1,648,180</u>
Noncurrent liabilities:				
Noncurrent portion of long-term obligations	4,611,366	-	4,611,366	4,739,601
Compensated absences payable	471,168	-	471,168	-
Other noncurrent liabilities	249,607	-	249,607	-
Total noncurrent liabilities	<u>5,332,141</u>	<u>-</u>	<u>5,332,141</u>	<u>4,739,601</u>
Total liabilities	<u>10,141,387</u>	<u>33,965</u>	<u>10,175,352</u>	<u>6,387,781</u>
Contingencies				
NET ASSETS				
Invested in capital assets, net of related debt	35,224,585	144,326	35,368,911	11,162,036
Restricted for:				
Nonexpendable:				
Future operations	7,006,391	-	7,006,391	-
Expendable:				
Compact related	19,041,183	-	19,041,183	-
Debt service	2,619,674	-	2,619,674	-
Other purposes	674,474	-	674,474	108,127
Unrestricted	38,023,853	99,650	38,123,503	3,401,521
Total net assets	<u>102,590,160</u>	<u>243,976</u>	<u>102,834,136</u>	<u>14,671,684</u>
Total liabilities and net assets	<u>\$ 112,731,547</u>	<u>\$ 277,941</u>	<u>\$ 113,009,488</u>	<u>\$ 21,059,465</u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Activities
Year Ended September 30, 2007

Functions/Programs	Program Revenues				Net (Expenses) Revenues and Changes in Net Assets			Component Units
	Expenses	Charges for Services	Operating	Capital	Primary Government		Total	
			Grants and Contributions	Grants and Contributions	Governmental Activities	Business-type Activities		
Primary government:								
Governmental activities:								
Judiciary	\$ 163,933	\$ -	\$ -	\$ -	\$ (163,933)	\$ -	\$ (163,933)	\$ -
Councils of traditional leaders	197,697	-	-	-	(197,697)	-	(197,697)	-
Public auditor	2,647	-	-	-	(2,647)	-	(2,647)	-
General government	5,283,936	692,162	2,696,601	185,173	(1,710,000)	-	(1,710,000)	-
Economic development	1,583,352	-	287,568	-	(1,295,784)	-	(1,295,784)	-
Public safety	628,132	-	46,050	-	(582,082)	-	(582,082)	-
Community affairs	892,923	-	86,989	-	(805,934)	-	(805,934)	-
Education	7,303,875	230,907	6,727,481	-	(345,487)	-	(345,487)	-
Public works and transportation	4,094,336	74,127	-	-	(4,020,209)	-	(4,020,209)	-
Health services	4,293,830	143,818	4,190,120	-	40,108	-	40,108	-
Boards and commissions	78,624	-	-	-	(78,624)	-	(78,624)	-
Payments to components	1,417,913	-	1,111,048	-	(306,865)	-	(306,865)	-
Other	2,401	-	-	-	(2,401)	-	(2,401)	-
Future operations	-	-	-	1,044,491	1,044,491	-	1,044,491	-
Other appropriations	267,283	-	50,316	-	(216,967)	-	(216,967)	-
Total governmental activities	26,210,882	1,141,014	15,196,173	1,229,664	(8,644,031)	-	(8,644,031)	-
Business-type activities:								
Public Transportation System	359,225	183,259	218,494	-	-	42,528	42,528	-
Total primary government	\$ 26,570,107	\$ 1,324,273	\$ 15,414,667	\$ 1,229,664	(8,644,031)	42,528	(8,601,503)	-
Component units:								
Yap Visitor's Bureau	\$ 277,027	\$ 8,739	\$ -	\$ -	-	-	-	(268,288)
Yap State Public Service Corporation	4,043,769	5,020,612	-	-	-	-	-	976,843
Yap Fishing Authority	920,403	229,190	-	-	-	-	-	(691,213)
The Diving Seagull, Inc.	5,244,319	5,501,572	-	-	-	-	-	257,253
Total component units	\$ 10,485,518	\$ 10,760,113	\$ -	\$ -	-	-	-	274,595
General revenues:								
Taxes:								
Revenue sharing					2,043,304	-	2,043,304	-
Excise taxes					1,360,060	-	1,360,060	-
Unrestricted investment earnings					9,475,556	-	9,475,556	97,564
Contributions from primary government					-	-	-	716,146
Other					324,814	34,295	359,109	-
Special items:								
Write-off of advances					(788,627)	-	(788,627)	-
Total general revenues and special items					12,415,107	34,295	12,449,402	813,710
Change in net assets					3,771,076	76,823	3,847,899	1,088,305
Net assets at the beginning of the year					98,819,084	167,153	98,986,237	13,583,379
Net assets at the end of the year	\$ 102,590,160	\$ 243,976	\$ 102,834,136	\$ 14,671,684				

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Balance Sheet
Governmental Funds
September 30, 2007

	General	Special Revenue U.S Federal Grants	Capital Projects Compact Capital Projects	Permanent Compact Trust	Other Governmental Funds	Total
ASSETS						
Cash and cash equivalents	\$ 41,965	\$ -	\$ -	\$ -	\$ 229,277	\$ 271,242
Equity interest in internal investment pool	53,946,010	-	4,270,133	-	3,226,092	61,442,235
Investments	2,000,000	-	-	-	-	2,000,000
Receivables, net:						
Loans	595,615	-	-	-	-	595,615
Federal agencies	-	26,130	-	-	-	26,130
FSM National Government	299,475	504,294	-	-	82,483	886,252
Other	51,134	-	-	-	-	51,134
Due from other funds	2,301,717	3,991,856	12,589,239	-	549,865	19,432,677
Advances	556,929	-	-	-	-	556,929
Prepaid items	1,719,718	-	-	-	-	1,719,718
Restricted assets:						
Cash and cash equivalents	331,642	-	-	-	-	331,642
Pooled investments	2,619,674	-	-	-	-	2,619,674
Investments	-	-	-	7,006,391	-	7,006,391
Total assets	\$ 64,463,879	\$ 4,522,280	\$ 16,859,372	\$ 7,006,391	\$ 4,087,717	\$ 96,939,639
LIABILITIES AND FUND BALANCES						
Liabilities:						
Accounts payable	\$ 1,151,068	\$ 404,490	\$ 18,097	\$ -	\$ 69,863	\$ 1,643,518
Other liabilities and accruals	134,280	64	249	-	55,470	190,063
Deferred revenue	30,074	2,760,506	-	-	29,430	2,820,010
Due to other funds	17,130,960	776,554	-	-	1,525,163	19,432,677
Total liabilities	18,446,382	3,941,614	18,346	-	1,679,926	24,086,268
Fund balances (deficits):						
Reserved for:						
Related assets	6,040,316	-	-	7,006,391	-	13,046,707
Encumbrances	867,230	5,511,719	667,332	-	218,534	7,264,815
Continuing appropriations	592,761	-	1,492,481	-	150,000	2,235,242
Unreserved:						
General fund	38,517,190	-	-	-	-	38,517,190
Special revenue funds	-	(4,931,053)	-	-	2,114,278	(2,816,775)
Capital projects funds	-	-	14,681,213	-	(75,021)	14,606,192
Total fund balances	46,017,497	580,666	16,841,026	7,006,391	2,407,791	72,853,371
Total liabilities and fund balances	\$ 64,463,879	\$ 4,522,280	\$ 16,859,372	\$ 7,006,391	\$ 4,087,717	

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

35,224,585

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 (4,681,366)
Compensated absences payable (556,823)
Land acquisition claims payable (249,607)

(5,487,796)

Net assets of governmental activities

\$ 102,590,160

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, 2007

	General	Special Revenue U.S Federal Grants	Capital Projects Compact Capital Projects	Permanent Compact Trust	Other Governmental Funds	Total
Revenues:						
Compact funding	\$ -	\$ 10,779,584	\$ -	\$ -	\$ -	\$ 10,779,584
Net increase in the fair value of investments	9,475,556	-	-	1,044,491	-	10,520,047
Federal contributions and other grants	-	4,213,931	-	-	92,875	4,306,806
Revenue sharing	2,043,304	-	-	-	-	2,043,304
Excise taxes	1,167,435	-	-	-	192,625	1,360,060
CFSM grants	-	-	-	-	294,956	294,956
Fees and charges	464,890	374,725	-	-	25,021	864,636
Departmental charges	276,378	-	-	-	-	276,378
Other	324,814	-	-	-	-	324,814
Total revenues	13,752,377	15,368,240	-	1,044,491	605,477	30,770,585
Expenditures:						
Current:						
Judiciary	171,378	-	-	-	-	171,378
Councils of traditional leaders	212,510	-	-	-	-	212,510
Public auditor	500	-	-	-	-	500
General government	1,134,717	3,578,809	118,839	-	353,121	5,185,486
Economic development	505,031	220,065	-	-	859,324	1,584,420
Public safety	582,019	-	-	-	47,297	629,316
Community affairs	472,613	86,989	51,626	-	-	611,228
Education	358,398	6,958,388	-	-	-	7,316,786
Public works and transportation	1,818,198	-	352,081	-	-	2,170,279
Health services	-	4,333,938	-	-	-	4,333,938
Boards and commissions	70,449	-	-	-	-	70,449
Payments to component units	199,232	1,111,048	-	-	5,000	1,315,280
Other appropriations	216,967	50,316	-	-	-	267,283
Total expenditures	5,742,012	16,339,553	522,546	-	1,264,742	23,868,853
Excess (deficiency) of revenues over (under) expenditures	8,010,365	(971,313)	(522,546)	1,044,491	(659,265)	6,901,732
Other financing sources (uses):						
Loan proceeds	-	-	-	-	784,351	784,351
Operating transfers in	164,490	1,445,121	-	-	-	1,609,611
Operating transfers out	(1,216,620)	(164,490)	(228,501)	-	-	(1,609,611)
Total other financing sources (uses), net	(1,052,130)	1,280,631	(228,501)	-	784,351	784,351
Special items:						
Write-off of advances	(788,627)	-	-	-	-	(788,627)
Net change in fund balances	6,169,608	309,318	(751,047)	1,044,491	125,086	6,897,456
Fund balances at the beginning of the year	39,847,889	271,348	17,592,073	5,961,900	2,282,705	65,955,915
Fund balances at the end of the year	\$ 46,017,497	\$ 580,666	\$ 16,841,026	\$ 7,006,391	\$ 2,407,791	\$ 72,853,371

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, 2007

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	\$ 6,897,456
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	(2,301,415)
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	(40,614)
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>(784,351)</u>
Change in net assets of governmental activities as presented on page 11.	\$ <u>3,771,076</u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Net Assets
Proprietary Funds
September 30, 2007

	<u>Public Transportation System</u>
<u>ASSETS</u>	
Current assets:	
Cash and cash equivalents	\$ 75,621
Receivables, net of allowance for uncollectibles	1,428
Other current assets	<u>56,566</u>
Total current assets	<u>133,615</u>
Noncurrent assets:	
Capital assets, net of accumulated depreciation	<u>144,326</u>
Total assets	<u>\$ 277,941</u>
<u>LIABILITIES</u>	
Current liabilities:	
Accounts payable	\$ 4,491
Other liabilities and accruals	29,144
Deferred revenue	<u>330</u>
Total liabilities	<u>33,965</u>
<u>NET ASSETS</u>	
Invested in capital assets	144,326
Unrestricted	<u>99,650</u>
Total net assets	<u>243,976</u>
	<u>\$ 277,941</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, 2007

	<u>Public Transportation System</u>
Operating revenues:	
Charges for services	\$ 170,945
Sales	<u>12,314</u>
Total operating revenues	<u>183,259</u>
Operating expenses:	
Cost of services	60,934
Administration costs	262,749
Depreciation and amortization	<u>35,542</u>
Total operating expenses	<u>359,225</u>
Operating loss	<u>(175,966)</u>
Nonoperating revenues:	
Other	<u>34,295</u>
Total nonoperating expenses	<u>34,295</u>
Loss before operating transfers	(141,671)
Operating transfers in	<u>218,494</u>
Change in net assets	76,823
Net assets at the beginning of the year	<u>167,153</u>
Net assets at the end of the year	<u>\$ 243,976</u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Cash Flows
Proprietary Funds
Year Ended September 30, 2007

	<u>Public Transportation System</u>
Cash flows from operating activities:	
Cash received from customers	\$ 184,065
Cash payments to employees	(192,441)
Cash payments to suppliers	(112,582)
Net cash used in operating activities	<u>(120,958)</u>
Cash flows from noncapital financing activities:	
Contributions from the primary government	<u>239,665</u>
Net cash provided by noncapital financing activities	<u>239,665</u>
Cash flows from capital and related financing activities:	
Purchases of capital assets	<u>(86,019)</u>
Net cash used in capital and related financing activities	<u>(86,019)</u>
Net change in cash and cash equivalents	32,688
Cash and cash equivalents at the beginning of the year	<u>42,933</u>
Cash and cash equivalents at the end of the year	<u>\$ 75,621</u>
Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	\$ (175,966)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation expense	35,542
Bad debts expense	
Changes in assets and liabilities:	
Receivables, net	719
Other current assets	10,305
Accounts payable	8,355
Deferred revenue	87
Net cash used in operating activities	<u>\$ (120,958)</u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Combining Statement of Net Assets
Component Units
September 30, 2007

	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	\$ 149,878	\$ 947,504	\$ -	\$ 1,539,705	\$ 2,637,087
Time certificate of deposit	-	-	-	1,566,000	1,566,000
Investments	-	-	-	-	-
Receivables, net:					
General	-	868,650	18,703	-	887,353
Other	90,967	7,580	710	900,176	999,433
Inventories	-	745,824	-	-	745,824
Other current assets	-	20,469	3,116	137,550	161,135
Total current assets	<u>240,845</u>	<u>2,590,027</u>	<u>22,529</u>	<u>4,143,431</u>	<u>6,996,832</u>
Noncurrent assets:					
Capital assets, net of accumulated depreciation	12,636	9,670,034	2,024,666	2,355,297	14,062,633
Total noncurrent assets	<u>12,636</u>	<u>9,670,034</u>	<u>2,024,666</u>	<u>2,355,297</u>	<u>14,062,633</u>
Total assets	<u>\$ 253,481</u>	<u>\$ 12,260,061</u>	<u>\$ 2,047,195</u>	<u>\$ 6,498,728</u>	<u>\$ 21,059,465</u>
<u>LIABILITIES</u>					
Current liabilities:					
Current portion of long-term debt	\$ -	\$ 107,441	\$ -	\$ 415,084	\$ 522,525
Accounts payable	29,701	40,125	19,862	380,842	470,530
Other liabilities and accruals	1,880	228,156	85,852	339,237	655,125
Total current liabilities	<u>31,581</u>	<u>375,722</u>	<u>105,714</u>	<u>1,135,163</u>	<u>1,648,180</u>
Noncurrent liabilities:					
Noncurrent portion of long-term debt	-	2,793,156	-	1,946,445	4,739,601
Total liabilities	<u>31,581</u>	<u>3,168,878</u>	<u>105,714</u>	<u>3,081,608</u>	<u>6,387,781</u>
<u>NET ASSETS</u>					
Invested in capital assets, net of related debt	12,636	6,769,437	2,024,666	2,355,297	11,162,036
Restricted	-	108,127	-	-	108,127
Unrestricted	209,264	2,213,619	(83,185)	1,061,823	3,401,521
Total net assets	<u>221,900</u>	<u>9,091,183</u>	<u>1,941,481</u>	<u>3,417,120</u>	<u>14,671,684</u>
	<u>\$ 253,481</u>	<u>\$ 12,260,061</u>	<u>\$ 2,047,195</u>	<u>\$ 6,498,728</u>	<u>\$ 21,059,465</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, 2007

	Yap Visitor's Bureau	Yap State Public Service Corporation	Yap Fishing Authority	The Diving Seagull, Inc.	Total
Operating revenues:					
Charges for services	\$ 8,307	\$ 4,550,360	\$ -	\$ 5,501,572	\$ 10,060,239
Sales	432	470,252	229,190	-	699,874
Total operating revenues	<u>8,739</u>	<u>5,020,612</u>	<u>229,190</u>	<u>5,501,572</u>	<u>10,760,113</u>
Operating expenses:					
Cost of services	-	3,946,322	268,795	4,687,935	8,903,052
Administration costs	266,955	312,516	-	11,558	591,029
Depreciation and amortization	10,750	757,028	211,666	342,035	1,321,479
Total operating expenses	<u>277,705</u>	<u>5,015,866</u>	<u>480,461</u>	<u>5,041,528</u>	<u>10,815,560</u>
Operating income (loss)	<u>(268,966)</u>	<u>4,746</u>	<u>(251,271)</u>	<u>460,044</u>	<u>(55,447)</u>
Nonoperating revenues (expenses):					
Contributions from the primary government	255,011	322,665	138,470	-	716,146
Interest income	-	13,120	-	84,444	97,564
Interest expense	-	(16,599)	-	(202,791)	(219,390)
Other	678	988,696	(439,942)	-	549,432
Total nonoperating revenues (expenses), net	<u>255,689</u>	<u>1,307,882</u>	<u>(301,472)</u>	<u>(118,347)</u>	<u>1,143,752</u>
Change in net assets	<u>(13,277)</u>	<u>1,312,628</u>	<u>(552,743)</u>	<u>341,697</u>	<u>1,088,305</u>
Net assets at the beginning 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>
Net assets at the end of the year	<u>\$ 221,900</u>	<u>\$ 9,091,183</u>	<u>\$ 1,941,481</u>	<u>\$ 3,417,120</u>	<u>\$ 14,671,684</u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2007

(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, 2007

(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, 2007

(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, 2007

(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 \$29,341,722 of restricted net assets, of which \$674,474 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, 2007

(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 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.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

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.

Proprietary funds and discretely presented component units 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 and discretely presented component units 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.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

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. The State elected to add certain other major funds that had specific public interest. 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:

U.S. Federal Grants Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for all financial transactions related to federal grants received from the United States government, including 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.

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 and discretely presented component units 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, 2007

(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 discretely presented 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).

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
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2007

(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 \$2,619,674 for the Yap State Early Retirement Scheme. Furthermore, cash and cash equivalents in the amount of \$331,642 is restricted for Compact Sector payments and investments in the amount of \$7,006,391 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. 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.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

N. 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.

O. 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, 2007, 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	\$ 880,326	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 880,326
Investments	2,000,000	-	-	-	-	-	2,000,000
Receivables:							
Loans	540,316	-	-	-	-	-	540,316
Restricted assets:							
Pooled investments	2,619,674	-	-	-	-	-	2,619,674
Investments	-	-	-	-	7,006,391	-	7,006,391
	<u>\$6,040,316</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$7,006,391</u>	<u>\$ -</u>	<u>\$13,046,707</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.

P. 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.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

Q. 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.

R. New Accounting Standards

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, 2006. 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 Postemployment 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, 2007. 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.

In December 2006, GASB issued Statement No. 49, Accounting and Financial Reporting for Pollution Remediation Obligations. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. 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 May 2007, GASB issued Statement No. 50, Pension Disclosures an amendment of GASB Statements No. 25 and 27. GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other post-employment benefits. The provisions of this statement are effective for periods beginning after June 15, 2007. Management does not believe the implementation of this statement will have a material effect on the financial statements of the State.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2007

(1) Summary of Significant Accounting Policies, Continued

R. New Accounting Standards, Continued

In June 2007, GASB issued statement No. 51, Accounting and Financial Reporting for Intangible Assets. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

S. Total Columns

Total columns are presented primarily to facilitate financial analysis. The Management's Discussion and Analysis includes certain prior year summarized comparative information in total. Such information does not include sufficient detail to constitute a full comparative presentation. Accordingly, such information should be read in conjunction with the State's financial statements for the year ended September 30, 2006 from which summarized information was derived.

(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.

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:

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

- 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.

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.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

A. Deposits, Continued

As of September 30, 2007, the carrying amount of the primary government's total cash and cash equivalents was \$678,504 and the corresponding bank balance was \$1,209,067, which is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2007, bank deposits in the amount of \$275,620 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.

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, 2007, the State's investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ <u>24,963,245</u>
Other investments:	
Domestic equities	45,915,883
Cash management account	<u>189,172</u>
	<u>46,105,055</u>
	\$ <u>71,068,300</u>

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

B. Investments, Continued

As of September 30, 2007, 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	\$ -	\$ 250,927	\$ 74,928	\$ 169,561	\$ 495,416
Corporate notes and bonds	A2	-	21,191	47,580	146,100	214,872
Corporate notes and bonds	A3	-	192,782	261,233	113,398	567,413
Corporate notes and bonds	Aa1	-	9,813	9,780	8,289	27,882
Corporate notes and bonds	Aa2	-	187,177	7,253	63,267	257,697
Corporate notes and bonds	Aa3	9,913	64,000	289,712	135,972	499,597
Corporate notes and bonds	Aaa	3,544,057	5,292,367	2,421,745	8,644,922	19,903,090
Corporate notes and bonds	Ab	40	-	-	-	40
Corporate notes and bonds	B2	-	94,161	-	338,766	432,927
Corporate notes and bonds	B3	-	-	-	297,321	297,321
Corporate notes and bonds	Ba1	-	56,175	-	-	56,175
Corporate notes and bonds	Ba3	-	40,205	-	-	40,205
Corporate notes and bonds	Baa1	-	536,452	285,810	36,493	858,756
Corporate notes and bonds	Baa2	-	270,184	241,128	140,317	651,629
Corporate notes and bonds	Baa3	-	229,598	-	44,944	274,542
Corporate notes and bonds	BaaI	-	141,853	-	-	141,853
Corporate notes and bonds	NA	-	-	117,390	111,100	228,490
Corporate notes and bonds	WR	8,090	-	7,250	-	15,340
		<u>\$3,562,100</u>	<u>\$7,330,710</u>	<u>\$3,763,809</u>	<u>\$10,250,450</u>	<u>\$24,963,245</u>

As of September 30, 2007, 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 equity investment in 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.

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, 2007.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2007

(2) Deposits and Investments, Continued

B. Investments, Continued

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, 2007, 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) holds on investment of 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. During the year ended September 30, 2007, YFA recorded an impairment in the value of its investment in the amount of \$398,016.

(3) Receivables

Receivables as of September 30, 2007, for the primary government's individual major funds and nonmajor funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	<u>General</u>	<u>U.S. Federal Grants</u>	<u>Compact Trust</u>	<u>Public Transportation System</u>	<u>Nonmajor And Other Funds</u>	<u>Totals</u>
Receivables:						
Loans	\$7,995,615	\$ -	\$ -	\$ -	\$2,000,000	\$ 9,995,615
Federal agencies	-	211,281	-	-	-	211,281
FSM National						
Government	299,475	3,695,407	-	-	2,511,278	6,506,160
Taxes	174,666	-	-	-	-	174,666
Other	384,720	-	-	19,142	-	403,862
	<u>8,854,476</u>	<u>3,906,688</u>	<u>-</u>	<u>19,142</u>	<u>4,511,278</u>	<u>17,291,584</u>
Less: allowance for uncollectible accounts	<u>(7,908,252)</u>	<u>(3,376,264)</u>	<u>-</u>	<u>(17,713)</u>	<u>(4,428,795)</u>	<u>(15,731,024)</u>
Net receivables	<u>\$ 946,224</u>	<u>\$ 530,424</u>	<u>\$ -</u>	<u>\$ 1,429</u>	<u>\$ 82,483</u>	<u>\$ 1,560,560</u>

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2007

(3) Receivables, Continued

Loans receivable of the primary government as of September 30, 2007 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>595,615</u>
	<u>7,995,615</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>9,995,615</u>

Receivables for the State's discretely presented component units include allowances for uncollectible accounts as follows:

	<u>General Receivables</u>	<u>Other Receivables</u>	<u>Total</u>
Yap Visitor's Bureau	\$ -	\$ 60,482	\$ 60,482
Yap State Public Service Corporation	143,670	-	143,670
Yap Fishing Authority	632,562	-	632,562
The Diving Seagull, Inc.	<u>649,342</u>	<u>-</u>	<u>649,342</u>
	\$ <u>1,425,574</u>	\$ <u>60,482</u>	\$ <u>1,486,056</u>

STATE OF YAP
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Notes to Financial Statements
September 30, 2007

(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, 2007, are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	U.S. Federal Grants	\$ 3,991,856
General	Compact Capital Projects	12,589,239
General	Nonmajor governmental funds	549,865
US Federal Grants	General	776,554
Nonmajor governmental funds	General	<u>1,525,163</u>
		<u>\$ 19,432,677</u>

(5) Fixed Assets

Capital asset activities of the primary government for the year ended September 30, 2007, are as follows:

	<u>Balance October 1, 2006</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance September 30, 2007</u>
Governmental activities:				
Capital assets not being depreciated:				
Land	\$ 3,120,610	\$ -	\$ -	\$ 3,120,610
Construction in progress	<u>299,425</u>	<u>-</u>	<u>(299,425)</u>	<u>-</u>
	<u>3,420,035</u>	<u>-</u>	<u>(299,425)</u>	<u>3,120,610</u>
Capital assets being depreciated:				
Buildings	13,080,658	344,130	-	13,424,788
Heavy equipment	3,327,616	300,130	-	3,627,746
Furniture and Fixtures		11,041		11,041
Vehicles	1,140,477	272,402	-	1,412,879
Boats	1,304,687	-	-	1,304,687
Infrastructure	<u>82,316,716</u>	<u>-</u>	<u>-</u>	<u>82,316,716</u>
Total capital assets being depreciated	<u>101,170,154</u>	<u>927,703</u>	<u>-</u>	<u>102,097,857</u>
Less accumulated depreciation for:				
Buildings	(5,930,088)	(475,942)	-	(6,406,030)
Heavy equipment	(2,600,559)	(121,350)	-	(2,721,909)
Furniture and Fixtures	-	(669)	-	(669)
Vehicles	(592,060)	(176,133)	-	(768,193)
Boats	(1,218,900)	(15,466)	-	(1,234,366)
Infrastructure	<u>(56,722,582)</u>	<u>(2,140,133)</u>	<u>-</u>	<u>(58,862,715)</u>
	<u>(67,064,189)</u>	<u>(2,929,693)</u>	<u>-</u>	<u>(69,993,882)</u>
Total capital assets being depreciated, net	<u>34,105,965</u>	<u>(2,001,990)</u>	<u>-</u>	<u>32,103,975</u>
Governmental activities capital assets, net	<u>\$ 37,526,000</u>	<u>\$(2,001,990)</u>	<u>\$(299,425)</u>	<u>\$35,224,585</u>
Business-type activities:				
Capital assets, being depreciated:				
Buildings	\$ 34,656	\$ 68,383	\$ -	\$ 103,039
Vehicles	721,111	-	(51,777)	669,334
Other equipment	<u>109,098</u>	<u>17,684</u>	<u>-</u>	<u>126,782</u>
Total capital assets, being depreciated	864,865	86,067	(51,777)	899,155
Less accumulated depreciation	<u>(771,064)</u>	<u>(35,542)</u>	<u>51,777</u>	<u>(754,829)</u>
Business-type activities capital assets, net	<u>\$ 93,801</u>	<u>\$ 50,525</u>	<u>\$ -</u>	<u>\$ 144,326</u>

STATE OF YAP
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Notes to Financial Statements
September 30, 2007

(5) Fixed Assets, Continued

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

Judiciary	\$ 3,205
Council of traditional leaders	1,687
Public auditor	2,147
General government	61,336
Economic development	106,511
Public safety	26,279
Community affairs	282,895
Education	139,468
Public works and transportation	2,126,205
Health services	71,144
Boards and commissions	8,816
Payment to component units	<u>100,000</u>
	<u>\$ 2,929,693</u>

(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, 2007, are as follows:

Source	Recipient	Transfers Out	Transfers In
<u>Major Governmental Funds</u>			
General	U.S. Federal Grants	\$ 1,216,620	\$ 1,216,620
Compact Capital Projects	U.S. Federal Grants	<u>228,501</u>	<u>228,501</u>
General and Capital Projects	U.S. Federal Grants	\$ <u>1,609,611</u>	\$ <u>1,609,611</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, 2007, \$249,607 in long-term payments due under land purchase agreements was identified by the State. This total comprises indefinite land use payments and other lease payments for which payment dates cannot be determined due to heir ship disputes.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2007

(7) Long-term Obligations, Continued

Primary Government, Continued

Asian Development Bank (ADB) Early Retirement Program Loan

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.

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, 2007, total drawdowns received were \$935,802. 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.

The State entered into an agreement with the FSM to borrow a portion of the proceeds of the Basic Social Services Program Loan with ADB (Loan Number 1816 FSM (SF)), for the purpose of promoting basic social services in Yap, non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing February 1, 2009, at which time the service charge increases to 1.5% per annum, with a maturity date of August 1, 2032. As of September 20, 2007, total drawdowns received were \$245,564.

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>
2008	\$ 70,000	\$ 46,814	\$ 116,814
2009	122,792	52,020	174,812
2010	122,792	50,529	173,320
2011	122,792	49,037	171,829
2012	122,792	47,545	170,337
2013 – 2017	712,519	213,548	926,068
2018 – 2022	961,160	165,701	1,126,861
2023 – 2027	967,160	142,289	1,109,449
2028 – 2032	779,359	58,725	838,085
2033 – 2037	700,000	21,000	721,000
	<u>\$ 4,681,366</u>	<u>\$847,208</u>	<u>\$5,528,574</u>

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2007

(7) Long-term Obligations, Continued

Primary Government, Continued

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

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 \$2,619,674 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, 2007, the following changes occurred in the primary government's long-term liabilities in the statement of net assets:

	Balance October 1, <u>2006</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, <u>2007</u>	Due Within <u>One Year</u>
Loan payable:					
ADB loan	\$ 3,897,015	\$ 784,351	\$ -	\$ 4,681,366	\$ 70,000
Other:					
Compensated absences	516,209	126,269	(85,655)	556,823	85,655
Land acquisition claims	249,607	-	-	249,607	-
	<u>765,816</u>	<u>126,269</u>	<u>(85,655)</u>	<u>806,430</u>	<u>85,655</u>
	<u>\$ 4,662,831</u>	<u>\$ 910,620</u>	<u>\$ (85,655)</u>	<u>\$ 5,487,796</u>	<u>\$ 155,655</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 February 2032. The loan is collateralized by the guarantee of the FSM National Government.

\$ 2,248,129

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.

590,919

STATE OF YAP
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Notes to Financial Statements
September 30, 2007

(7) Long-term Obligations, Continued

Discretely Presented Component Units, Continued

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.

61,549
2,900,597

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. 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. On February 16, 2007, a new loan was granted by FSMDB amounting to \$1,300,000 to cover additional dry dock cost of the fishing vessel at an interest rate of 9%. Interest and principal are payable in monthly installments of \$28,606 beginning June 15, 2007. The note is collateralized by a chattel mortgage on all property and equipment, including the fishing vessel Mathawmarfach.

2,361,529
\$ 5,262,126

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

<u>Year ending</u> <u>September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	\$ 522,525	\$199,194	\$ 721,719
2009	626,460	166,776	793,236
2010	676,228	117,007	793,235
2011	730,555	62,680	793,235
2012	378,304	12,808	391,112
2013 - 2017	571,940	14,617	586,557
2018 - 2022	605,630	-	605,630
2023 - 2027	605,630	-	605,630
2028 2032	544,854	-	544,854
	<u>\$5,262,126</u>	<u>\$573,082</u>	<u>\$5,835,208</u>

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2007

(8) Continuing Appropriations

Continuing appropriations as of September 30, 2007, are as follows:

Major Governmental Funds

General Fund:

Autopsies (YSL No. 5-47)	\$ 18,191
Disaster/Search and Rescue (YSL No. 5-84)	1,563
YWA Daycare Bldg Matching/Yap State Scholarship (YSL No. 6-48)	32,770
FEMA/HMGP Chata'an Match (YSL No. 6-43)	172,559
Infrastructure Maintenance Fund (YSL No. 6-52 and 6-82)	326,111
DOE – School Facilities Upgrade (YSL No. 6-65)	16,567
R&D Agriculture (YSL No. 7-7)	<u>25,000</u>
	<u>\$ 592,761</u>

Compact Capital Projects Fund:

Yap State Development Investment Loan (YSL No. 5-1)	\$ 200,000
FEMA State Matching, Typhoon Lupit, Typhoon Sudal, (YSL No. 6-62 and 6-81)	569,537
Gurung Heights Power line Extension (YSL No. 6-65)	4,300
Mobil Fuel Farm Retaining Wall (YSL No. 6-81)	397,465
Development of Jet Fuel Alternate Source, Jet Fuel Project (YSL No. 6-80 and 7-5)	62,802
Okaw/Adubwee Youth Recreational Park (YSL No. 6-80)	25,000
Aff Village Power Extension (YSL No. 6-80)	250
Youth Services Office Building (YSL No. 7-7)	12,024
Southern Road Culvert Repairs (YSL No. 7-7)	34,000
International Airport Seating and Immigration Booths (YSL No. 7-7)	68,063
Dock Repairs – Phase I (YSL No. 7-7)	80,000
Paved Road Repairs (YSL No. 7-7)	30,000
Tagreng/Tungunbinaw Buoy (YSL No. 7-7)	<u>8,040</u>
	<u>\$ 1,492,481</u>

Nonmajor Governmental Funds

Yap Community Development Program matching (YSL No. 5-34)	<u>\$ 150,000</u>
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(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, 2007 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.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2007

(9) Contingencies, Continued

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 \$2,036,443 relating to fiscal years 2001 through 2007 have been set forth in the State's Single Audit Report for the year ended September 30, 2007. 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, 2007, 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.

STATE OF YAP
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REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2007

STATE OF YAP
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Schedule of Revenues, Expenditures and Changes in Fund Balance
Budget and Actual - General Fund
Year Ended September 30, 2007

	Budgeted Amounts		Actual - Budgetary	Variance with Final Budget
	Original	Final	Basis (see Note 1)	
Revenues:				
Net increase in the fair value of investments	-	-	9,475,556	9,475,556
Other	5,165,971	6,652,149	4,276,821	(2,375,328)
Total revenues	<u>5,165,971</u>	<u>6,652,149</u>	<u>13,752,377</u>	<u>7,100,228</u>
Expenditures:				
Current:				
Judiciary	219,139	219,139	186,059	33,080
Council of traditional leaders	204,076	209,476	216,492	(7,016)
Public auditor	-	-	-	-
General government	1,304,897	1,334,457	1,129,537	204,920
Economic development	60,768	742,304	559,088	183,216
Public safety	642,335	645,335	622,213	23,122
Community affairs	341,694	415,824	406,586	9,238
Education	66,877	66,877	(9,786)	76,663
Public works and transportation	1,705,573	2,072,475	1,673,795	398,680
Health services	-	-	-	-
Boards and commissions	49,694	133,144	94,362	38,782
Payments to component units	112,447	354,647	285,072	69,575
Other appropriations	227,358	227,358	193,299	34,059
Total expenditures	<u>4,934,858</u>	<u>6,421,036</u>	<u>5,356,717</u>	<u>1,064,319</u>
Excess of revenues over expenditures	<u>231,113</u>	<u>231,113</u>	<u>8,395,660</u>	<u>8,164,547</u>
Other financing sources (uses):				
Operating transfers in	-	-	164,490	164,490
Operating transfers out	(231,113)	(231,113)	(1,216,620)	(985,507)
Total other financing sources (uses), net	<u>(231,113)</u>	<u>(231,113)</u>	<u>(1,052,130)</u>	<u>(821,017)</u>
Special Items:				
Write-off of advances	-	-	(788,627)	(788,627)
Net change in unreserved fund balance	<u>-</u>	<u>-</u>	<u>6,554,903</u>	<u>6,554,903</u>
Other changes in unreserved fund balance:				
Decrease in reserve for related assets	-	-	55,298	55,298
Increase in reserve for continuing appropriations	-	-	34,729	34,729
Unreserved fund balance at the beginning of the year	<u>31,872,260</u>	<u>31,872,260</u>	<u>31,872,260</u>	<u>-</u>
Unreserved fund balance at the end of the year	<u>\$ 31,872,260</u>	<u>\$ 31,872,260</u>	<u>\$ 38,517,190</u>	<u>\$ 6,644,930</u>

See accompanying notes to required supplementary information - budgetary reporting.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Required Supplementary Information - Budgetary Reporting
September 30, 2007

(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.

(2) Reconciliation – GAAP and Budgetary Bases of Accounting

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.

Net change in fund balance	\$ 6,169,608
Decrease in encumbrances	<u>385,295</u>
Net change in unresolved fund balance	\$ <u>6,554,903</u>

STATE OF YAP
FEDERATED STATES OF MICRONESIA

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2007

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Combining Schedule of Expenditures by Account
Governmental Funds
Year Ended September 30, 2007
(with comparative totals for the year ended September 30, 2006)

	General	Special Revenue	Capital Projects	Permanent	Other Governmental Funds	Totals	
		U.S Federal Grants	Compact Capital Projects	Compact Trust		2007	2006
Expenditures:							
Salaries and wages	\$ 2,463,509	\$ 5,082,975	\$ 10,201	\$ -	\$ 39,455	\$ 7,596,140	\$ 8,397,111
Grants and subsidies	404,846	1,434,962	22,500	-	125,756	1,988,064	1,463,940
Utilities	510,560	827,856	(81)	-	1,124	1,339,459	1,202,763
Contractual services	241,701	878,315	110,466	-	39,357	1,269,839	1,996,821
Supplies and materials	81,539	378,852	-	-	1,609	462,000	357,785
Scholarship and training	-	528,312	-	-	6,000	534,312	478,108
Travel	198,509	954,499	10,123	-	59,974	1,223,105	1,012,501
Capital outlay	136,364	1,345,925	186,342	-	27,222	1,695,853	1,263,211
Rentals	(31,766)	187,280	1,960	-	2,200	159,674	77,337
Food stuffs	47,664	158,602	-	-	1,983	208,249	140,776
Communications	115,152	168,259	124	-	-	283,535	267,641
Printing and reproduction	9,996	40,954	-	-	-	50,950	89,142
Medical supplies	109	782,502	-	-	-	782,611	735,107
Medical referral	-	236,682	-	-	-	236,682	173,194
Repairs and maintenance	31,371	154,384	-	-	8,058	193,813	130,965
Freight	9,821	372,083	8,728	-	450	391,082	157,266
Professional services	-	253,876	17,827	-	96,481	368,184	303,543
POL	590,684	96,502	21	-	7,865	695,072	446,665
Allowances	110,750	3,930	-	-	-	114,680	112,695
Leased housing	37,354	189,693	-	-	-	227,047	174,381
Other	783,849	2,263,110	154,335	-	847,208	4,048,502	2,521,811
	<u>\$ 5,742,012</u>	<u>\$ 16,339,553</u>	<u>\$ 522,546</u>	<u>\$ -</u>	<u>\$ 1,264,742</u>	<u>\$ 23,868,853</u>	<u>\$ 21,792,527</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

GENERAL FUND

September 30, 2007

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, 2007
(with comparative totals for the year ended September 30, 2006)

	2007	2006
Revenues:		
Revenue sharing:		
Import tax	\$ 785,883	\$ 723,335
Fuel tax	63,060	98,296
Income tax	636,531	460,336
Business gross receipts tax	808,851	740,257
Unallocated	(251,021)	409,932
	2,043,304	2,432,156
Excise taxes:		
Alcoholic beverages	372,058	503,949
Gasoline and diesel	108,287	91,226
Tobacco	184,263	211,903
Other excise taxes	502,827	542,654
	1,167,435	1,349,732
Fees and charges:		
Licenses and permits	87,663	76,565
Fines/sale of confiscated property	98,542	70,795
Leases and other rentals	278,685	220,977
	464,890	368,337
Departmental charges:		
Sea transportation	239,374	187,211
Hospital services	-	1,510
Other	37,004	(1,960)
	276,378	186,761
Interest and dividends	22,333	29,856
Net increase in the fair value of investments	9,453,223	4,516,650
Other revenues	324,814	564,608
Total revenues	13,752,377	9,448,100
Expenditures:		
Current:		
Judiciary	171,378	-
Councils of Traditional Leaders:		
Council of Pilung	96,100	103,228
Council of Tamol	116,410	114,808
	212,510	218,036
Public Auditor	500	8,940
General government:		
Office of the Governor	159,608	178,068
State Legislature	470,717	398,873
Office of Administrative Services	414,800	863,693
Office of Planning, Budget and Statistics	88,691	10,846
Disaster relief programs	901	139,142
	1,134,717	1,590,622

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, 2007
(with comparative totals for the year ended September 30, 2006)

	2007	2006
Expenditures, continued:		
Current, continued:		
Economic Development:		
Department of Resources and Development	505,031	58,978
Public Safety:		
Department of Public Safety/Attorney General	582,019	222,006
Community Affairs		
Department of Public Affairs	472,613	343,232
Education:		
Department of Education	358,398	53,764
Public Works and Transportation:		
Department of Public Works and Transportation	1,818,198	1,903,661
Health Services:		
Department of Health Services	-	36,143
Boards and Commissions:		
Small Business Development Center	-	1,267
Farmers Home Administration	21,412	19,585
Historic Preservation Office	32,605	14,440
Yap Investment Trust	16,432	22,843
	70,449	58,135
Other	-	289,764
Payments to component units:		
Yap Visitor's Bureau	109,304	-
Yap Public Library	-	-
Yap Fishing Authority	-	-
Public Transportation System	89,928	151,105
	199,232	151,105
Other appropriations:		
Micronesian Legal Services Corporation	50,000	41,280
Japan Overseas Cooperation Volunteers	9,191	14,412
Peace Corps Program	21,018	18,023
Yap Community Action Program	136,758	144,490
Other	-	146,123
	216,967	364,328
Total expenditures	5,742,012	5,298,714
Excess of revenues over expenditures	8,010,365	4,149,386
Other financing sources (uses):		
Operating transfers in	164,490	
Operating transfers out	(1,216,620)	(1,865,824)
Total other financing sources (uses), net	(1,052,130)	(1,865,824)
Special Items:		
Write-off of advances	(788,627)	(500,000)
Net change in fund balance	6,169,608	1,783,562
Fund balance at the beginning of the year	39,847,889	38,064,327
Fund balance at the end of the year	\$ 46,017,497	\$ 39,847,889

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, 2007

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final		
Revenues:				
Net increase in the fair value of investments	\$ -	\$ -	\$ 9,475,556	\$ 9,475,556
Other revenues	5,165,971	6,652,149	4,276,821	(2,375,328)
Total revenues	<u>5,165,971</u>	<u>6,652,149</u>	<u>13,752,377</u>	<u>7,100,228</u>
Expenditures:				
Current:				
Judiciary	219,139	219,139	186,059	33,080
Councils of Traditional Leaders:				
Council of Pilung	95,972	101,372	99,055	2,317
Council of Tamol	108,104	108,104	117,437	(9,333)
	<u>204,076</u>	<u>209,476</u>	<u>216,492</u>	<u>(7,016)</u>
Public Auditor	-	-	-	-
General government:				
Office of the Governor	164,320	181,520	167,921	13,599
State Legislature	450,568	462,928	422,455	40,473
Office of Administrative Services	567,823	567,823	454,255	113,568
Office of Planning, Budget and Statistics	107,234	107,234	84,906	22,328
Disaster relief programs	14,952	14,952	-	14,952
	<u>1,304,897</u>	<u>1,334,457</u>	<u>1,129,537</u>	<u>204,920</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, 2007

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final		
Expenditures, continued:				
Current, continued:				
Economic Development:				
Department of Resources and Development	60,768	742,304	559,088	183,216
Public Safety:				
Department of Public Safety/Attorney General	642,335	645,335	622,213	23,122
Community Affairs:				
Department of Public Affairs	341,694	415,824	406,586	9,238
Education:				
Department of Education	66,877	66,877	(9,786)	76,663
Public Works and Transportation:				
Department of Public Works and Transportation	1,705,573	2,072,475	1,673,795	398,680
Health services:				
Department of Health Services	-	-	-	-
Boards and Commissions:				
EPA Administration Board	-	-	(162)	162
Farmers Home Administration	23,674	23,674	21,412	2,262
Historic Preservation Office	-	83,450	55,256	28,194
Yap Investment Trust	26,020	26,020	17,856	8,164
	49,694	133,144	94,362	38,782
Payments to component units:				
Yap Visitor's Bureau	-	198,200	109,304	88,896
Public Transportation System	112,447	156,447	175,768	(19,321)
	112,447	354,647	285,072	69,575
Other appropriations:				
Micronesian Legal Services Corporation	50,000	50,000	50,000	-
Japan Overseas Cooperation Volunteers	17,600	17,600	7,605	9,995
Peace Corps Program	23,000	23,000	18,257	4,743
Yap CAP	136,758	136,758	117,437	19,321
	227,358	227,358	193,299	34,059
Total expenditures	4,934,858	6,421,036	5,356,717	1,064,319
Excess of revenues over expenditures	231,113	231,113	8,395,660	8,164,547
Other financing sources (uses):				
Operating transfers in			164,490	164,490
Operating transfers out	(231,113)	(231,113)	(1,216,620)	(985,507)
Total other financing sources (uses), net	(231,113)	(231,113)	(1,052,130)	(821,017)
Special Items:				
Write-off of investments	-	-	(788,627)	(788,627)
Net change in fund balance	-	-	6,554,903	6,554,903
Other changes in unreserved fund balance:				
Decrease in reserve for related assets	-	-	55,298	55,298
Increase in reserve for continuing appropriations	-	-	34,729	34,729
Unreserved fund balance at the beginning of the year	31,872,260	31,872,260	31,872,260	-
Unreserved fund balance at the end of the year	\$ 31,872,260	\$ 31,872,260	\$ 38,517,190	\$ 6,644,930

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Combined Balance Sheet
Nonmajor Governmental Funds
September 30, 2007
(with comparative totals as of September 30, 2006)

	Other <u>Special Revenue</u>	Other <u>Capital Projects</u>	<u>Totals</u>	
			2007	2006
<u>ASSETS</u>				
Cash and cash equivalents	\$ 229,277	\$ -	\$ 229,277	\$ 228,929
Equity interest in internal investment pool	3,226,092	-	3,226,092	3,226,092
Receivables, net:				
CFSM	80,850	1,633	82,483	50,810
Due from other funds	397,128	152,737	549,865	427,778
Total assets	<u>\$ 3,933,347</u>	<u>\$ 154,370</u>	<u>\$ 4,087,717</u>	<u>\$ 3,933,609</u>
<u>LIABILITIES AND FUND BALANCES</u>				
Liabilities:				
Accounts payable	\$ 66,720	\$ 3,143	\$ 69,863	\$ 90,396
Other liabilities and accruals	18,902	36,568	55,470	18,902
Deferred revenue	29,430	-	29,430	21,000
Due to other funds	1,460,794	64,369	1,525,163	1,520,606
Total liabilities	<u>1,575,846</u>	<u>104,080</u>	<u>1,679,926</u>	<u>1,650,904</u>
Fund balances:				
Reserved for:				
Encumbrances	93,223	125,311	218,534	308,216
Continuing appropriations	150,000	-	150,000	150,000
Unreserved:				
Special revenue funds	2,114,278	-	2,114,278	1,919,346
Capital projects funds	-	(75,021)	(75,021)	(94,857)
Total fund balances	<u>2,357,501</u>	<u>50,290</u>	<u>2,407,791</u>	<u>2,282,705</u>
Total liabilities and fund balances	<u>\$ 3,933,347</u>	<u>\$ 154,370</u>	<u>\$ 4,087,717</u>	<u>\$ 3,933,609</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, 2007
(with comparative totals for the year ended September 30, 2006)

	Other	Other	Totals	
	<u>Special Revenue</u>	<u>Capital Projects</u>	<u>2007</u>	<u>2006</u>
Revenues:				
Federal contributions and other grants	\$ 92,875	\$ -	\$ 92,875	\$ 431,156
CFSM grants	109,783	185,173	294,956	291,531
Excise taxes	192,625	-	192,625	178,305
Fees and charges	25,021	-	25,021	78,172
Total revenues	<u>420,304</u>	<u>185,173</u>	<u>605,477</u>	<u>979,164</u>
Expenditures by function:				
Current:				
General government	157,182	195,939	353,121	549,480
Economic development	859,324	-	859,324	294,458
Public safety	47,297	-	47,297	47,854
Education	-	-	-	57,970
Public works and transportation	-	-	-	15,000
Health services	-	-	-	23,942
Payments to component units	-	5,000	5,000	-
Total expenditures	<u>1,063,803</u>	<u>200,939</u>	<u>1,264,742</u>	<u>988,704</u>
Deficiency of revenues under expenditures	<u>(643,499)</u>	<u>(15,766)</u>	<u>(659,265)</u>	<u>(9,540)</u>
Other financing sources:				
Loan Proceeds	784,351	-	784,351	-
Operating transfers in	-	-	-	104,593
Total other financing sources	<u>784,351</u>	<u>-</u>	<u>784,351</u>	<u>104,593</u>
Net change in fund balances	140,852	(15,766)	125,086	95,053
Fund balances at the beginning of the year	2,216,649	66,056	2,282,705	2,187,652
Fund balances at the end of the year	<u>\$ 2,357,501</u>	<u>\$ 50,290</u>	<u>\$ 2,407,791</u>	<u>\$ 2,282,705</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, 2007
(with comparative totals for the year ended September 30, 2006)

	Other	Other	Totals	
	<u>Special Revenue</u>	<u>Capital Projects</u>	<u>2007</u>	<u>2006</u>
Revenues:				
Federal contributions and other grants	\$ 92,875	\$ -	\$ 92,875	\$ 431,156
CFSM grants	109,783	185,173	294,956	291,531
Excise taxes	192,625	-	192,625	178,305
Fees and charges	25,021	-	25,021	78,172
Total revenues	<u>420,304</u>	<u>185,173</u>	<u>605,477</u>	<u>979,164</u>
Expenditures by account:				
Salaries and wages	39,196	259	39,455	28,596
Grants and subsidies	125,756	-	125,756	211,333
Utilities	1,124	-	1,124	8,434
Contractual services	4,366	34,991	39,357	253,338
Supplies and materials	1,609	-	1,609	873
Scholarship and training	6,000	-	6,000	40,250
Travel	59,974	-	59,974	16,610
Capital outlay	29,922	(2,700)	27,222	71,282
Rentals	2,200	-	2,200	-
Food stuffs	1,983	-	1,983	2,692
Communications	-	-	-	13,861
Printing and reproduction	-	-	-	50
Repairs and maintenance	8,058	-	8,058	531
Freight	450	-	450	1,213
Professional services	57,737	38,744	96,481	13,763
POL	7,865	-	7,865	1,516
Other	717,563	129,645	847,208	324,362
Total expenditures	<u>1,063,803</u>	<u>200,939</u>	<u>1,264,742</u>	<u>988,704</u>
Deficiency of revenues under expenditures	<u>(643,499)</u>	<u>(15,766)</u>	<u>(659,265)</u>	<u>(9,540)</u>
Other financing sources:				
Loan proceeds	784,351	-	784,351	-
Operating transfers in	-	-	-	104,593
Total other financing sources	<u>784,351</u>	<u>-</u>	<u>784,351</u>	<u>104,593</u>
Net change in fund balances	140,852	(15,766)	125,086	95,053
Fund balances at the beginning of the year	<u>2,216,649</u>	<u>66,056</u>	<u>2,282,705</u>	<u>2,187,652</u>
Fund balances at the end of the year	<u>\$ 2,357,501</u>	<u>\$ 50,290</u>	<u>\$ 2,407,791</u>	<u>\$ 2,282,705</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS - SPECIAL REVENUE FUNDS

September 30, 2007

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, 2007, 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, 2007
(with comparative totals as of September 30, 2006)

	Section 221(b)	Non-U.S.	CFSM	Sports	General	Other	Totals	
	Special Block Grant						Grants	Grants
ASSETS								
Cash and cash equivalents	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 229,277	\$ 229,277	\$ 228,929
Investment pool	3,226,092	-	-	-	-	-	3,226,092	3,226,092
Receivables, net:								
CFSM	-	-	80,850	-	-	-	80,850	23,139
Other	-	-	-	-	-	-	-	-
Due from other funds	-	167,362	-	56,031	80,757	92,978	397,128	296,268
Total assets	<u>\$ 3,226,092</u>	<u>\$ 167,362</u>	<u>\$ 80,850</u>	<u>\$ 56,031</u>	<u>\$ 80,757</u>	<u>\$ 322,255</u>	<u>\$ 3,933,347</u>	<u>\$ 3,774,428</u>
LIABILITIES AND FUND BALANCES								
Liabilities:								
Accounts payable	\$ 1,098	\$ 38,124	\$ 6,559	\$ 20,299	\$ -	\$ 640	\$ 66,720	\$ 60,046
Other liabilities and accruals	12,636	-	1,812	-	4,454	-	18,902	18,902
Deferred revenue	-	29,430	-	-	-	-	29,430	21,000
Due to other funds	1,434,376	-	26,418	-	-	-	1,460,794	1,457,831
Total liabilities	<u>1,448,110</u>	<u>67,554</u>	<u>34,789</u>	<u>20,299</u>	<u>4,454</u>	<u>640</u>	<u>1,575,846</u>	<u>1,557,779</u>
Fund balances:								
Reserved for:								
Encumbrances	13,354	70,933	7,756	-	-	1,180	93,223	147,303
Continuing appropriations	150,000	-	-	-	-	-	150,000	150,000
Unreserved	1,614,628	25,818	41,362	35,732	76,303	320,435	2,114,278	1,919,346
Total fund balances	<u>1,777,982</u>	<u>96,751</u>	<u>49,118</u>	<u>35,732</u>	<u>76,303</u>	<u>321,615</u>	<u>2,357,501</u>	<u>2,216,649</u>
Total liabilities and fund balances	<u>\$ 3,226,092</u>	<u>\$ 164,305</u>	<u>\$ 83,907</u>	<u>\$ 56,031</u>	<u>\$ 80,757</u>	<u>\$ 322,255</u>	<u>\$ 3,933,347</u>	<u>\$ 3,774,428</u>

See Accompanying Independent Auditors' Report.

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, 2007
(with comparative totals for the year ended September 30, 2006)

	Section 221(b)	Non-U.S.	CFSM	Sports	General	Other	Totals	
	Special Block Grant						Grants	Grants
Revenues:								
Federal contributions and other grants	\$ -	\$ 92,875	\$ -	\$ -	\$ -	\$ -	\$ 92,875	\$ 431,156
CFSM grants	-	-	109,783	-	-	-	109,783	105,511
Excise taxes	-	-	-	85,256	-	107,369	192,625	178,305
Fees and charges	-	11,475	35	-	13,163	348	25,021	78,172
Total revenues	-	104,350	109,818	85,256	13,163	107,717	420,304	793,144
Expenditures by function:								
Current:								
General government	-	36,847	3,000	85,256	7,436	24,643	157,182	275,803
Economic development	-	812,983	-	-	-	46,341	859,324	294,458
Public safety	-	-	47,297	-	-	-	47,297	47,854
Education	-	-	-	-	-	-	-	57,970
Health services	-	-	-	-	-	-	-	23,942
Total expenditures	-	849,830	50,297	85,256	7,436	70,984	1,063,803	700,027
Excess (deficiency) of revenues over (under) expenditures	-	(745,480)	59,521	-	5,727	36,733	(643,499)	93,117
Other financing sources:								
Loan Proceeds	-	784,351	-	-	-	-	784,351	-
Operating transfers in	-	-	-	-	-	-	-	20,000
Total other financing sources	-	784,351	-	-	-	-	784,351	20,000
Net change in fund balances (deficit)	-	38,871	59,521	-	5,727	36,733	140,852	113,117
Fund balances (deficits) at the beginning of the year	1,777,982	57,880	(10,403)	35,732	70,576	284,882	2,216,649	2,103,532
Fund balances at the end of the year	\$ 1,777,982	\$ 96,751	\$ 49,118	\$ 35,732	\$ 76,303	\$ 321,615	\$ 2,357,501	\$ 2,216,649

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, 2007
 (with comparative totals for the year ended September 30, 2006)

	Section 221(b) Special Block Grant	Non-U.S. Grants	CFSM Grants	Sports Development	General Services Agency	Other Special Revenue	Totals	
							2007	2006
Revenues:								
Federal contributions and other grants	\$ -	\$ 92,875	\$ -	\$ -	\$ -	\$ -	\$ 92,875	\$ 431,156
CFSM grants	-	-	109,783	-	-	-	109,783	105,511
Excise taxes	-	-	-	85,256	-	107,369	192,625	178,305
Fees and charges	-	11,475	35	-	13,163	348	25,021	78,172
Total revenues	-	104,350	109,818	85,256	13,163	107,717	420,304	793,144
Expenditures by account:								
Salaries and wages	-	8,426	18,826	-	-	11,944	39,196	28,596
Grants and subsidies	-	40,500	-	85,256	-	-	125,756	211,333
Utilities	-	-	1,124	-	-	-	1,124	8,434
Contractual services	-	4,366	-	-	-	-	4,366	95,431
Supplies and materials	-	1,327	282	-	-	-	1,609	873
Scholarship and training	-	6,000	-	-	-	-	6,000	40,250
Travel	-	48,529	10,295	-	-	1,150	59,974	16,610
Capital outlay	-	14,125	10,512	-	5,285	-	29,922	22,052
Rentals	-	-	-	-	-	2,200	2,200	-
Food stuffs	-	-	-	-	-	1,983	1,983	2,692
Communications	-	-	-	-	-	-	-	13,861
Printing and reproduction	-	-	-	-	-	-	-	50
Repairs and maintenance	-	5,807	382	-	1,869	-	8,058	531
Freight	-	450	-	-	-	-	450	709
Professional services	-	57,737	-	-	-	-	57,737	-
POL	-	703	380	-	-	6,782	7,865	1,516
Other	-	661,860	8,496	-	282	46,925	717,563	257,089
Total expenditures	-	849,830	50,297	85,256	7,436	70,984	1,063,803	700,027
Excess (deficiency) of revenues over (under) expenditures	-	(745,480)	59,521	-	5,727	36,733	(643,499)	93,117
Other financing sources (uses):								
Loan Proceeds	-	784,351	-	-	-	-	784,351	-
Operating transfers in	-	-	-	-	-	-	-	20,000
Operating transfers out	-	-	-	-	-	-	-	-
Total other financing sources (uses), net	-	784,351	-	-	-	-	784,351	20,000
Net change in fund balances (deficit)	-	38,871	59,521	-	5,727	36,733	140,852	113,117
Fund balances (deficits) at the beginning of the year	1,777,982	57,880	(10,403)	35,732	70,576	284,882	2,216,649	2,103,532
Fund balances (deficits) at the end of the year	\$ 1,777,982	\$ 96,751	\$ 49,118	\$ 35,732	\$ 76,303	\$ 321,615	\$ 2,357,501	\$ 2,216,649

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS - CAPITAL PROJECTS FUNDS

September 30, 2007

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, 2007, 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, 2007
 (with comparative totals as of September 30, 2006)

	Public Infrastructure Development	CFSM Capital Projects	Yap State Public Projects	Water Development Projects Revolving	Totals	
					2007	2006
<u>ASSETS</u>						
Receivables:						
CFSM	\$ -	\$ 1,633	\$ -	\$ -	\$ 1,633	\$ 27,671
Due from other funds	-	63,626	-	89,111	152,737	131,510
	<u>\$ -</u>	<u>\$ 65,259</u>	<u>\$ -</u>	<u>\$ 89,111</u>	<u>\$ 154,370</u>	<u>\$ 159,181</u>
 <u>LIABILITIES AND FUND</u>						
<u>BALANCES (DEFICITS)</u>						
Liabilities:						
Accounts payable	\$ -	\$ 3,143	\$ -	\$ -	\$ 3,143	\$ 30,350
Other liabilities and accruals	-	36,568	-	-	36,568	-
Due to other funds	-	-	64,369	-	64,369	62,775
Total liabilities	<u>-</u>	<u>39,711</u>	<u>64,369</u>	<u>-</u>	<u>104,080</u>	<u>93,125</u>
Fund balances (deficits):						
Reserved for:						
Encumbrances	-	125,311	-	-	125,311	160,913
Unreserved	-	(99,763)	(64,369)	89,111	(75,021)	(94,857)
Total fund balances (deficits)	<u>-</u>	<u>25,548</u>	<u>(64,369)</u>	<u>89,111</u>	<u>50,290</u>	<u>66,056</u>
Total liabilities and fund balances (deficits)	<u>\$ -</u>	<u>\$ 65,259</u>	<u>\$ -</u>	<u>\$ 89,111</u>	<u>\$ 154,370</u>	<u>\$ 159,181</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, 2007
(with comparative totals for the year ended September 30, 2006)

	Public Infrastructure Development	CFSM Capital Projects	Yap State Public Projects	Water Development Projects Revolving	Totals	
					2007	2006
Revenues:						
CFSM grants	\$ -	\$ 162,465	\$ -	\$ 22,708	\$ 185,173	\$ 186,020
	<u>-</u>	<u>162,465</u>	<u>-</u>	<u>22,708</u>	<u>185,173</u>	<u>186,020</u>
Expenditures by function:						
Current:						
General government	-	130,832	-	65,107	195,939	273,677
Public works and transportation	-	-	-	-	-	15,000
Payments to component units	-	5,000	-	-	5,000	-
Total expenditures	<u>-</u>	<u>135,832</u>	<u>-</u>	<u>65,107</u>	<u>200,939</u>	<u>288,677</u>
Excess (deficiency) of revenues over (under) expenditures	<u>-</u>	<u>26,633</u>	<u>-</u>	<u>(42,399)</u>	<u>(15,766)</u>	<u>(102,657)</u>
Other financing sources (uses):						
Operating transfers in	-	-	-	-	-	84,593
Total other financing sources	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>84,593</u>
Net change in fund balances (deficits)	-	26,633	-	(42,399)	(15,766)	(18,064)
Fund balances (deficits) at the beginning 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>
Fund balances (deficits) at the end of the year	<u>\$ -</u>	<u>\$ 25,548</u>	<u>\$ (64,369)</u>	<u>\$ 89,111</u>	<u>\$ 50,290</u>	<u>\$ 66,056</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, 2007
(with comparative totals for the year ended September 30, 2006)

	Public Infrastructure Development	CFSM Capital Projects	Yap State Public Projects	Water Development Projects Revolving	Totals	
					2007	2006
Revenues:						
CFSM grants	\$ -	\$ 162,465	\$ -	\$ 22,708	\$ 185,173	\$ 186,020
	-	162,465	-	22,708	185,173	186,020
Expenditures by account:						
Contractual services	-	34,991	-	-	34,991	157,907
Capital outlay	-	(2,700)	-	-	(2,700)	49,230
Salaries and wages	-	259	-	-	259	-
Freight	-	-	-	-	-	504
Professional services	-	-	-	38,744	38,744	13,763
Other	-	103,282	-	26,363	129,645	67,273
Total expenditures	-	135,832	-	65,107	200,939	288,677
Excess (deficiency) of revenues over (under) expenditures	-	26,633	-	(42,399)	(15,766)	(102,657)
Other financing sources:						
Operating transfers in	-	-	-	-	-	84,593
Total other financing sources	-	-	-	-	-	84,593
Net change in fund balances (deficits)	-	26,633	-	(42,399)	(15,766)	(18,064)
Fund balances (deficits) at the beginning of the year	-	(1,085)	(64,369)	131,510	66,056	84,120
Fund balances (deficits) at the end of the year	\$ -	\$ 25,548	\$ (64,369)	\$ 89,111	\$ 50,290	\$ 66,056

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

U.S. FEDERAL GRANT FUNDS

Combining Balance Sheet
September 30, 2007
(with comparative totals as of September 30, 2006)

	Other	Department of	Education	Health	Private	Environment	Capacity	Supplemental	Totals	
	U.S. Grants	Homeland Security Grants	Sector	Sector	Sector Development	Sector	Building Sector	Education	2007	2006
ASSETS										
Receivables:										
Federal agencies	\$ 26,130	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 26,130	\$ 165,493
CFSM	293,266	211,028	-	-	-	-	-	-	504,294	3,257,050
Due from other funds	643,656	1,725,573	38,958	1,072,450	255,740	34,456	221,023	-	3,991,856	1,698,321
	<u>\$ 963,052</u>	<u>\$ 1,936,601</u>	<u>\$ 38,958</u>	<u>\$ 1,072,450</u>	<u>\$ 255,740</u>	<u>\$ 34,456</u>	<u>\$ 221,023</u>	<u>\$ -</u>	<u>\$ 4,522,280</u>	<u>\$ 5,120,864</u>
LIABILITIES AND FUND BALANCES (DEFICITS)										
Liabilities:										
Accounts payable	\$ 63,407	\$ 21,016	\$ 35,490	\$ 217,674	\$ 10,673	\$ 12,172	\$ 14,761	\$ 29,297	\$ 404,490	\$ 538,709
Other liabilities and accruals	104	229	(119)	1,461	(1,486)	-	(23)	(102)	64	498
Deferred revenue	746,894	1,909,512	-	104,100	-	-	-	-	2,760,506	3,842,449
Due to other funds	-	-	-	-	-	-	-	776,554	776,554	467,860
Total liabilities	<u>810,405</u>	<u>1,930,757</u>	<u>35,371</u>	<u>323,235</u>	<u>9,187</u>	<u>12,172</u>	<u>14,738</u>	<u>805,749</u>	<u>3,941,614</u>	<u>4,849,516</u>
Fund balances (deficits):										
Reserved for:										
Encumbrances	509,030	1,761,333	1,470,026	1,273,295	45,034	81,862	31,148	339,991	5,511,719	4,205,339
Unreserved	(356,383)	(1,755,489)	(1,466,439)	(524,080)	201,519	(59,578)	175,137	(1,145,740)	(4,931,053)	(3,933,991)
Total fund balances (deficits)	<u>152,647</u>	<u>5,844</u>	<u>3,587</u>	<u>749,215</u>	<u>246,553</u>	<u>22,284</u>	<u>206,285</u>	<u>(805,749)</u>	<u>580,666</u>	<u>271,348</u>
Total liabilities and fund balances	<u>\$ 963,052</u>	<u>\$ 1,936,601</u>	<u>\$ 38,958</u>	<u>\$ 1,072,450</u>	<u>\$ 255,740</u>	<u>\$ 34,456</u>	<u>\$ 221,023</u>	<u>\$ -</u>	<u>\$ 4,522,280</u>	<u>\$ 5,120,864</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

U.S. FEDERAL GRANT FUNDS

Combining Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances (Deficits)
Year Ended September 30, 2007
(with comparative totals for the year ended September 30, 2006)

	Other	Department of	Education	Health	Private	Environment	Capacity	Supplemental	Totals	
	U.S. Grants	Homeland Security Grants	Sector	Sector	Sector Development	Sector	Building Sector	Education	2007	2006
Revenues:										
Compact funding	\$ -	\$ -	\$ 4,266,866	\$ 3,870,492	\$ 455,460	\$ 310,844	\$ 471,933	\$ 1,403,989	\$ 10,779,584	\$ 9,958,898
Federal contributions and other grants	1,808,703	2,405,228	-	-	-	-	-	-	4,213,931	3,202,945
Fees and charges	24,790	-	7,754	310,404	29,189	457	1,828	303	374,725	483,899
	<u>1,833,493</u>	<u>2,405,228</u>	<u>4,274,620</u>	<u>4,180,896</u>	<u>484,649</u>	<u>311,301</u>	<u>473,761</u>	<u>1,404,292</u>	<u>15,368,240</u>	<u>13,645,742</u>
Expenditures by function:										
Current:										
General government	447,942	2,625,110	-	-	-	238,701	267,056	-	3,578,809	5,093,903
Economic development	-	-	-	-	220,065	-	-	-	220,065	659,695
Community affairs	86,989	-	-	-	-	-	-	-	86,989	109,794
Education	641,220	-	4,271,033	-	-	-	-	2,046,135	6,958,388	5,564,559
Health services	902,257	-	-	3,431,681	-	-	-	-	4,333,938	3,624,892
Payment to component units	-	980,626	-	-	130,422	-	-	-	1,111,048	379,894
Other	-	-	-	-	-	50,316	-	-	50,316	35,521
Total expenditures	<u>2,078,408</u>	<u>3,605,736</u>	<u>4,271,033</u>	<u>3,431,681</u>	<u>350,487</u>	<u>289,017</u>	<u>267,056</u>	<u>2,046,135</u>	<u>16,339,553</u>	<u>15,468,258</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(244,915)</u>	<u>(1,200,508)</u>	<u>3,587</u>	<u>749,215</u>	<u>134,162</u>	<u>22,284</u>	<u>206,705</u>	<u>(641,843)</u>	<u>(971,313)</u>	<u>(1,822,516)</u>
Other financing sources (uses):										
Operating transfers in	244,613	1,200,508	-	-	-	-	-	-	1,445,121	1,935,007
Operating transfers out	-	-	-	-	-	-	-	(164,490)	(164,490)	-
Total other financing sources (uses), net	<u>244,613</u>	<u>1,200,508</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(164,490)</u>	<u>1,280,631</u>	<u>1,935,007</u>
Net change in fund balances (deficits)	<u>(302)</u>	<u>-</u>	<u>3,587</u>	<u>749,215</u>	<u>134,162</u>	<u>22,284</u>	<u>206,705</u>	<u>(806,333)</u>	<u>309,318</u>	<u>112,491</u>
Fund balances (deficits) at the beginning of the year	<u>152,949</u>	<u>5,844</u>	<u>-</u>	<u>-</u>	<u>112,391</u>	<u>-</u>	<u>(420)</u>	<u>584</u>	<u>271,348</u>	<u>158,857</u>
Fund balances (deficits) at the end of the year	<u>\$ 152,647</u>	<u>\$ 5,844</u>	<u>\$ 3,587</u>	<u>\$ 749,215</u>	<u>\$ 246,553</u>	<u>\$ 22,284</u>	<u>\$ 206,285</u>	<u>\$ (805,749)</u>	<u>\$ 580,666</u>	<u>\$ 271,348</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

U.S. FEDERAL GRANT FUNDS

Combining Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances (Deficits)
Year Ended September 30, 2007
(with comparative totals for the year ended September 30, 2006)

	Other	Department of	Education	Health	Private	Environment	Capacity	Supplemental	Totals	
	U.S. Grants	Homeland Security Grants	Sector	Sector	Sector Development	Sector	Building Sector	Education	2007	2006
Revenues:										
Compact funding	\$ -	\$ -	\$ 4,266,866	\$ 3,870,492	\$ 455,460	\$ 310,844	\$ 471,933	\$ 1,403,989	\$ 10,779,584	\$ 9,958,898
Federal contributions and other grants	1,808,703	2,405,228	-	-	-	-	-	-	4,213,931	3,202,945
Fees and charges	24,790	-	7,754	310,404	29,189	457	1,828	303	374,725	483,899
	<u>1,833,493</u>	<u>2,405,228</u>	<u>4,274,620</u>	<u>4,180,896</u>	<u>484,649</u>	<u>311,301</u>	<u>473,761</u>	<u>1,404,292</u>	<u>15,368,240</u>	<u>13,645,742</u>
Expenditures by account:										
Salaries and wages	1,064,313	102,851	1,814,782	961,705	80,687	83,990	80,440	894,207	5,082,975	7,077,284
Grants and subsidies	-	1,002,059	43,807	208,358	130,422	50,316	-	-	1,434,962	491,318
Utilities	34,276	46,995	334,579	327,684	24,539	18,346	8,068	33,369	827,856	719,252
Contractual services	268,730	456,745	21,370	71,684	18,062	37,974	3,750	-	878,315	1,374,046
Supplies and materials	77,142	21,149	150,502	35,931	4,813	4,968	12,266	72,081	378,852	327,886
Scholarship and training	34,164	-	461,781	9,150	-	-	-	23,217	528,312	426,858
Travel	267,179	13,190	79,412	88,788	25,644	17,695	64,161	398,430	954,499	709,389
Capital outlay	92,435	179,720	603,130	346,058	7,425	29,025	34,665	53,467	1,345,925	1,111,206
Rentals	5,483	177,651	1,734	60	-	2,352	-	-	187,280	71,999
Food stuffs	2,039	7,756	48,635	14,204	-	230	-	85,738	158,602	96,919
Communications	18,519	10,921	28,753	15,508	6,972	13,238	6,286	68,062	168,259	187,456
Printing and reproduction	3,104	3,004	15,548	8,192	439	759	1,621	8,287	40,954	84,557
Medical supplies	54,312	146,174	-	581,203	-	-	-	813	782,502	726,644
Medical referral	-	-	-	236,682	-	-	-	-	236,682	112,519
Repairs and maintenance	20,748	53,244	54,466	19,210	43	578	687	5,408	154,384	87,826
Freight	9,699	15,204	165,683	146,674	353	-	993	33,477	372,083	150,923
Professional services	33,260	-	-	101,468	15,341	-	14,158	89,649	253,876	289,780
POL	21,448	2,069	35,872	17,210	1,734	2,160	426	15,583	96,502	93,906
Allowances	3,930	-	-	-	-	-	-	-	3,930	425
Leased housing	-	-	65,753	62,170	500	7,200	17,520	36,550	189,693	133,331
Other	67,627	1,367,004	345,226	179,742	33,513	20,186	22,015	227,797	2,263,110	1,194,734
Total expenditures	<u>2,078,408</u>	<u>3,605,736</u>	<u>4,271,033</u>	<u>3,431,681</u>	<u>350,487</u>	<u>289,017</u>	<u>267,056</u>	<u>2,046,135</u>	<u>16,339,553</u>	<u>15,468,258</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(244,915)</u>	<u>(1,200,508)</u>	<u>3,587</u>	<u>749,215</u>	<u>134,162</u>	<u>22,284</u>	<u>206,705</u>	<u>(641,843)</u>	<u>(971,313)</u>	<u>(1,822,516)</u>
Other financing sources:										
Operating transfers in	244,613	1,200,508	-	-	-	-	-	-	1,445,121	-
Operating transfers out	-	-	-	-	-	-	-	(164,490)	(164,490)	1,935,007
Total other financing sources (uses), net	<u>244,613</u>	<u>1,200,508</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(164,490)</u>	<u>1,280,631</u>	<u>1,935,007</u>
Net change in fund balances (deficits)	<u>(302)</u>	<u>-</u>	<u>3,587</u>	<u>749,215</u>	<u>134,162</u>	<u>22,284</u>	<u>206,705</u>	<u>(806,333)</u>	<u>309,318</u>	<u>112,491</u>
Fund balances at the beginning of year	<u>152,949</u>	<u>5,844</u>	<u>-</u>	<u>-</u>	<u>112,391</u>	<u>-</u>	<u>(420)</u>	<u>584</u>	<u>271,348</u>	<u>158,857</u>
Fund balances (deficits) at the end of year	<u>\$ 152,647</u>	<u>\$ 5,844</u>	<u>\$ 3,587</u>	<u>\$ 749,215</u>	<u>\$ 246,553</u>	<u>\$ 22,284</u>	<u>\$ 206,285</u>	<u>\$ (805,749)</u>	<u>\$ 580,666</u>	<u>\$ 271,348</u>

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 (the State) as of and for the year ended September 30, 2007, which collectively comprise the State's basic financial statements and have issued our report thereon dated June 30, 2008. Our report was modified to include a reference to other auditors and expressed a qualified opinion on the governmental activities due to the lack of recording a donated asset and 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.

For purposes of this report, our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts and grants, and other matters did not include the Yap State Public Service Corporation, the Yap Visitors Bureau and The Diving Seagull, Inc., which were all audited by us. We have issued separate reports on our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters for these entities. The findings, if any, included in those reports are not included herein.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State's internal control over financial reporting. Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency described in the accompanying Schedule of Findings and Questioned Costs (pages 79 through 98) as item 2007-11 to be a significant deficiency in internal control over financial reporting.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

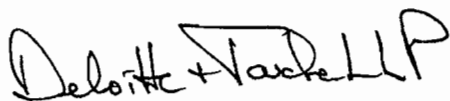
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State'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 one instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards*, and which is described in the accompanying Schedule of Findings and Questioned Costs as item 2007-12.

We noted certain matters that we reported to management of the State in a separate letter dated June 30, 2008.

The State's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the State's responses and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the management of the State, 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 30, 2008

**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 (the State) 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, 2007. The State's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 79 through 98). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the State's management. Our responsibility is to express an opinion on the State's compliance based on our audit.

As discussed in Note 2b to the Schedule of Expenditures of Federal Awards, the State's basic financial statements include the operations of certain entities whose federal awards are not included in the Schedule of Expenditures of Federal Awards for the year ended September 30, 2007. Our audit, described below, did not include the operations of the entities identified in Note 2b as these entities conducted separate audits in accordance with OMB Circular A-133, if required.

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's compliance with those requirements.

As described in items 2007-2, 2007-4, 2007-5, 2007-6, 2007-8, and 2007-11 in the accompanying Schedule of Findings and Questioned Costs, the State did not comply with requirements regarding allowable costs/cost principles, procurement and suspension and debarment, and equipment and real property management that are applicable to its Compact of Free Association Sector Grants major program (CFDA # 15.875), equipment and real property management that is applicable to its DOI Direct Grants major program (CFDA # 15.875) and its Public Assistance Grants major program (CFDA # 97.036), eligibility, and equipment and real property management that are applicable to its WIA Cluster major program (CFDA # 17.260), and allowable costs/cost principles, cash management, equipment and real property management, matching, and procurement and suspension and debarment that is applicable to its Community Health Center major program (CFDA # 93.224). Compliance with such requirements is necessary, in our opinion, for the State to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the State complied, in all material respects, with the requirements referred to above that are applicable to its Compact of Free Association Sector Grants major program (CFDA # 15.875), its DOI Direct Grants major program (CFDA # 15.875), its Public Assistance Grants major program (CFDA # 97.036), its WIA Cluster major program (CFDA # 17.260), and its Community Health Center major program (CFDA # 93.224) for the year ended September 30, 2007. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2007-1, 2007-3, 2007-7, 2007-9 and 2007-10.

Internal Control Over Compliance

The management of the State 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's internal control over compliance with the 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, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the State's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and others that we consider to be material weaknesses.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 2007-1 through 2007-11 to be significant deficiencies.

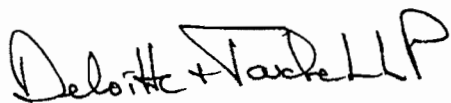
A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs, we consider items 2007-2, 2007-4, 2007-5, 2007-6, 2007-8, and 2007-11 to be material weaknesses.

The State's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the State's responses and, accordingly, we express no opinion on it.

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 as of and for the year ended September 30, 2007, and have issued our report thereon dated June 30, 2008. Our report was modified to include reference to other auditors and we expressed a qualified opinion on the governmental activities due to the lack of recording a donated asset and 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 76) 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. 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, 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 30, 2008

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards
Federal Grants Fund
Year Ended September 30, 2007

Grantor Program Title	CFDA No./ Grant No.	2007 Fiscal Year Expenditures
<u>U.S. Department of Education:</u>		
Special Education	84.027	\$ 632,788
Freely Associated States Ed Grant 7/03-6/04	84.256A	1,963
Early Childhood Education Book Project	84.310A	3,671
FY-04 Teacher Quality Enhancement	84.336	2,798
Total U.S. Department of Education		641,220
<u>U.S. Department of Labor:</u>		
WIA Title I - Administration	17.255	3,361
WIA Title I - Adult	17.258	26,066
WIA Title I - Youth	17.259	8,633
WIA Title I - Dislocated Worker	17.260	27,858
Yap WIA National Emergency Grant	EM-14570-05-60	329,722
Total U.S. Department of Labor		395,640
<u>U.S. Department of Agriculture:</u>		
Total Cooperative Forestry Assistance	10.664	51,999
<u>U.S. Department of the Interior:</u>		
Total Historic Prevention Fund Grant-in-Aid	15.904	86,989
<u>U.S. Department of Health and Human Services:</u>		
Children's Oral Health Care	93.110	3,468
Tuberculosis Control Programs (B)	93.116	9,950
Family Planning	93.217	44,242
Community Health Center	93.224	586,239
Immunization Program	93.268	25,613
AIDS Prevention	93.940	18,198
HIV Care II	93.917	664
Diabetes Program	93.988	18,496
Maternal and Child Health Services Block Grant to the States	93.994	50,212

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, 2007

Grantor Program Title	CFDA No./ Grant No.	2007 Fiscal Year Expenditures
<u>U.S. Department of Health and Human Services, Continued:</u>		
Center for Disease Control and Prevention - Investigation and Physical Assistance	93.283	15,112
Block Grant for Prevention and Treatment of Substance Abuse	93.959	72,307
National Bioterrorism Hospital Preparedness Program	93.889	<u>57,756</u>
Total U.S. Department of Health and Human Services		<u>902,257</u>
Total Federal Grants Fund		<u>\$ 2,078,105</u>

Note: With the exception of 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, 2007

Grantor Program Title	CFDA No.	2007 Fiscal Year Expenditures
U.S. Department of Homeland Security grants:		
Public Assistance Grants	97.036	\$ 3,110,537
Hazard Mitigation Grant	97.039	150,361
Total U.S. Department of Homeland Security		\$ 3,260,898

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 Program Funds
Year Ended September 30, 2007

<u>Grantor Program Title</u>	<u>CFDA No.</u>	<u>2007 Fiscal Year Expenditures</u>
Compact Section 211 (a) (1) Education Sector Grants	15.875	\$ 4,271,033
Compact Section 211 (a) (2) Health Sector Grants	15.875	3,431,681
Compact Section 211 (a) (3) Private Sector Development Grants	15.875	350,487
Compact Section 211 (a) (5) Environment Sector Grants	15.875	289,017
Compact Section 211 (a) (4) Public Sector Capacity Building Grants	15.875	267,056
Compact Section 231 Supplemental Education Grant	15.875	2,046,135
		<hr/>
Total Compact of Free Association Section 211 Grants		\$ 10,655,409
		<hr/>
Reconciliation to financial statements:		
Balance per above		\$ 15,994,412
Local matching share and others		345,141
		<hr/>
Balance per U.S. Federal Grants Fund		\$ 16,339,553
		<hr/>

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**

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, 2007

Grantor Program Title	2007 Fiscal Year Expenditures
<u>Office of Insular Affairs</u>	
Other Compact Capital Projects	\$ 127,264
Typhoon Sudal and Lupit Matching	228,501
Cultural Public Museum - A&E	109,764
Jet Fuel Alternative Source and Operation	285,518
Total Compact of Free Association Capital Projects Fund 211 (A)	\$ 751,047

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**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2007

(1) Scope of Audit

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

For purposes of complying with The Single Audit Act of 1984, as amended in 1996, the State's reporting entity is defined in Note 1A to its September 30, 2007 basic financial statements; and all of the discretely presented component units are excluded. Accordingly, the accompanying Schedule of Expenditures of Federal Awards presents the federal award programs administered by the State, as defined above, for the year ended September 30, 2007.

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 2007 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, 2007

<u>Grantor Program Title</u>	<u>CFDA No Grant No.</u>	<u>2007 Fiscal Year Expenditures</u>
<u>U.S. Department of the Interior</u>		
Compact of Free Association, Sector Grants	15.875	\$ 10,655,409
Compact of Free Association Capital Projects Fund 211 (A)	15.875	<u>751,047</u>
		<u>11,406,456</u>
<u>U.S. Department of Homeland Security</u>		
Public Assistance Grants	97.036	\$ <u>3,110,537</u>
<u>U.S. Department of Labor</u>		
WIA Cluster	17.255/17.258/ 17.259/17.260	\$ <u>395,640</u>
<u>U.S. Department of Health and Human Services</u>		
Community Health Center	93.224	\$ <u>586,239</u>
Total U.S. Federal program expenditures selected		\$ <u>15,498,872</u>
Total U.S. Federal program expenditures		\$ <u>16,745,459</u>
% of total U.S. Federal expenditures covered by major programs		<u>93%</u>

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2007

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 a qualified opinion on the governmental activities due to the lack of recording a donated asset and 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.
2. Significant deficiencies 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 disclosed by the audit.
4. Significant deficiencies in internal control over compliance with requirements applicable to major federal award programs were identified, some of which are 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
Compact of Free Association Capital Projects 211 (A)	15.875
WIA Cluster	17.255/17.258/17.259/17.260
Public Assistance Grants	97.036
Community Health Center	93.224

8. A threshold of \$502,364 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>
2007-11	Fixed Assets
2007-12	Prior Year Internal Control Findings

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Part III - Federal Award Findings and Questioned Cost Section

<u>Reference</u> <u>Number</u>	<u>CFDA/Grant</u> <u>Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
2007-01	15.875, 93.224 17.260, 97.036	Special Requirements – Contract Provisions	\$ -
2007-02	93.224	Matching	\$ -
2007-03	93.224	Reporting	\$ -
2007-04	93.224	Cash Management	\$ -
2007-05	93.224	Allowable Costs/Cost Principles and Procurement	\$101,236
2007-06	15.875	Allowable Costs/Cost Principles and Procurement	\$666,857
2007-07	15.875	Period of Availability of Federal Funds	\$118,511
2007-08	17.260	Eligibility	\$395,640
2007-09	97.036	Program Income/Reimbursements	\$ -
2007-10	15.875	Reporting	\$ -
2007-11	15.875, 97.036 43.224	Equipment and Real Property Management	\$ -

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-01

CFDA No.: 15.875
Grantor Agency: U.S. Department of the Interior
Program Name: Compact Sector Grants
Requirement: Contract Provisions
Questioned Cost: \$0

CFDA No.: 93.224
Grantor Agency: U.S. Department of Health and Human Services
Grant#: H80CS06653
Program Name: Community Health Center
Requirement: Contract Provisions
Questioned Cost: \$0

CFDA No.: 17.260
Grantor Agency: U.S. Department of Labor
Grant#: EM-14570-05-60
Program Name: WIA National Emergency Grants
Requirement: Contract Provisions
Questioned Cost: \$0

CFDA No.: 97.036
Grantor Agency: U.S. Department of Homeland Security
Grant#: EMF-2004-G-0409
Program Name: Public Assistance Grants
Requirement: Contract Provisions
Questioned Cost: \$0

Criteria: For all contracts, the following provisions should be included as applicable:

- (i) For contracts in excess of \$100,000, administrative, contractual, or legal remedies in instances where contractors violate or breach contract terms, and the provision of such sanctions and penalties as appropriate;
- (ii) For contracts in excess of \$100,000, termination for cause and for convenience by the Grantee or Sub-Grantee including the manner by which it will be effected and the basis for settlement;
- (iii) Compliance with local statutes regarding kickbacks and corrupt practices;
- (iv) Access by the Government of the Federated States of Micronesia and its Sub-Grantees, the Government of the United States, or any of their duly authorized representatives to any books, documents, papers, and records of the contractor which are directly pertinent to the contract for the purpose of making audit, examination, excerpts, and transcriptions;
- (v) Retention of all required records for three years after Grantees or Sub-Grantees make final payments and all other pending matters are closed; and
- (vi) Compliance with all applicable standards, orders, or requirements issued under local environmental laws.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-01, Continued

Condition: Many of the contracts entered into by the State do not include contract provisions (iii) to (v). For contracts that we examined that were in excess of \$100,000, we noted contract provision (ii) is also generally not included.

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

Effect: The State appears to be in noncompliance with the criteria.

The conditions cited relate to the provisions in the contracts and not to amounts incurred under contracts and therefore no questioned costs result from this finding.

Recommendation: We recommend that the State strengthen its control over ensuring that compliance with the criteria occurs.

Auditee Response and Corrective Action Plan: We agree with this finding. Director of Administrative Services will bring this item to the attention of the State Attorney General for advice and resolution.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-02
CFDA No.: 93.224
Grantor Agency: U.S. Department of Health and Human Services
Grant#: H80CS06653
Program Name: Community Health Center
Requirement: Matching Requirement
Questioned Cost: \$0

Criteria: A matching or cost sharing requirement may be matched by either (1) allowable costs incurred by the grantee, subgrantee or cost-type contractor under the assistance agreement. This includes allowable costs borne by non-Federal grants or other cash donations by other non-federal third parties. For this purpose, Compact sector grants are eligible for matching purposes. (2) The value of third party in-kind contributions applicable to the period through which the cost sharing or matching requirement applies.

Condition: Program management represented that an in-kind match occurred and an overall statement of the match components was presented. However, detail in support of the match components could not be provided. Therefore, we were not able to conduct sufficient tests to ensure that the match occurred.

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

Effect: The State appears to be in noncompliance with the criteria.

Recommendation: We recommend that the State provide documentation substantiating the details of the match components

Auditee Response and Corrective Action Plan: We agree with this finding. Office of Administrative Services will work with the Director of the Waab Community Health Center Program and the Director of Health Services to provide the documentation for the matching contribution.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-03
CFDA Number: 93.224
Agency: U.S. Department Of Health and Humans Services
CFDA Program: Community Health Center
Grant #: H80CS06653
Requirement: Reporting
Questioned Costs: \$0

Criteria: Financial Status Reports (FSR's) should be correctly completed and be submitted in accordance with grant terms and conditions. Moreover, reports submitted should reconcile with underlying programmatic records.

Condition: The final FSR submitted differed from the general ledger but the difference is less than \$10,000.

Effect: Noncompliance with reporting requirements results from this condition.

Recommendation: The State should comply with the criteria and should ensure that an amended FSR is submitted.

Auditee Response and Corrective Action Plan: We agree with this finding. Director of Administrative Services will ensure that an amended FSR is submitted.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-04
CFDA Number: 93.224
Agency: U.S. Department Of Health and Human Services
CFDA Program: Community Health Center
Grant #: H80CS06653
Requirement: Cash Management
Questioned Costs: Undeterminable

Criteria: In accordance with applicable cash management requirements, the time elapsed between the receipt of Federal Funds and the payout of funds for program cost should be minimized.

Condition: The State could not provide drawdown and receipt information as support of compliance with the criteria.

Cause: The cause of the above condition is a lack of internal control over cash management.

Effect: The effect of the above condition is noncompliance with applicable cash management requirements. However, no questioned costs result from the condition as insufficient documentation exists to be able to project the amount, if any, of interest due to the grantor.

Recommendation: We recommend that the State provide documentation sufficient to allow an interest rebate calculation to be performed.

Auditee Response and Corrective Action Plan: We agree with this finding. Chief of Finance will provide calculation of interest, if any, that may be due to grantor.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-05
 CFDA Number: 93.224
 Agency: U.S. Department Of Health and Human Services
 CFDA Program: Community Health Center
 Grant #: H80CS06653 and H80CS06653
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Costs: \$101,236

Criteria: Expenditures should be necessary and reasonable for program needs and should be in accordance with program requirements. Furthermore, financial and programmatic records should be maintained on file for at least three years. Also, procurements shall provide full and open competition among vendors, and any allowable exceptions should be approved and documented in the procurement file.

Condition: For 15 of 37 (4%) items non payroll expenditures, (\$64,328 of the aggregate amount of \$161,059) there was insufficient documentation to support competitive procurement requirements.

For 13 of 37 (8%) non payroll expenditures, (\$21,224 of the aggregate amount of \$161,059) there was insufficient documentation (i.e. accounts payable vouchers, invoices, receiving reports, travel liquidation documents and obligating documents) to support allowable requirements.

<u>Details</u>	<u>Ref/ Ck No</u>	<u>Procurement</u>	<u>Allowable Cost</u>	<u>Remarks</u>
Medical supplies	20925	\$23,278	\$ -	No competitive procurement documentation provided
Medical supplies reversal of advance received 7/31/2006, medical supplies		-	20,797	No documents were located to support the expenditure
	21427	4,660	-	No competitive procurement documentation provided
Medical supplies	AP13266	3,921	-	No competitive procurement documentation provided
Doppler, Fetal, Pocket	25582	3,294	-	No competitive procurement documentation provided
Trimline Plus illuminator	25582	3,200	-	No competitive procurement documentation provided
Renovate doors and porchs at tomil chc	24101	5,835	-	No competitive procurement documentation provided and no proof of completion
Renovate doors and porchs at tomil chc	24640	3,716	-	No competitive procurement documentation provided and no proof of project completion on file
Cost for training Board 10/19-21, 2006 materials	24148	3,100	-	No contract/po/invoice and no competitive procurement documentation on file. This transaction was supported only by a memo request.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-05, Continued

<u>Details</u>	<u>Ref/ Ck No</u>	<u>Procurement</u>	<u>Allowable Cost</u>	<u>Remarks</u>
1 TOYOTA STARLET AND NISSAN MARCH SEDAN (but per PO 2 nissan) laptop purchased by (PIPICA) on behalf of WCHC in Hawaii during a conference attended by certain Yap State attendees.	24325	5,900	-	Competitive procurement was waived by the State, no competitive procurement documentation provided and no approval by grantor agency to allow for waiver of competitive procurement.
	28838	2,885	-	No competitive procurement documentation provided.
		-	3,000	No documents were located to support the expenditure
travel liquidation , case manager WCHC	25396	-	780	2 days of training occurred but 9 days of per diem was paid. No rationale was provided for this excess. Thus, the excess 5 days per diem @ \$156 per day (\$780) has been questioned.
Per diem Travel to Hawaii for UDS Training	26534	-	780	2 days of training occurred but 9 days of per diem was paid. No rationale was provided for this excess. Thus, the excess 5 days per diem @ \$156 per day (\$780) has been questioned.
Materials for Sanitation Amin Toilet Facility Project	23848	1,971	-	No competitive procurement documentation has been provided
Renovate doors and porches at Tomil chc	24833	2,119	-	No competitive procurement documentation has been provided and no proof of project completion is on file
Provide UDS Consultation, make recommendation on how to improve and meet UDS requirements and reporting	25723	2,000	-	No competitive procurement documentation is on file.
Analyze and clean the survey data and prepare final report presentation to assist health Personnel and community to understand Assess health needs.	28287	<u>10,000</u>	-	No competitive procurement documentation is on file. Additionally, no evidence of project completion is on file.
		<u>\$75,879</u>	<u>\$25,357</u>	

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

Recommendation: The State should comply with grant requirements.

Auditee Response and Corrective Action Plan: We agree in part with this finding. We do not agree that all the costs should be questioned as we believe that adequate documentation exists to support compliance with the criteria for most of the transactions listed under this finding. However, we agree that the documents may not have been available for the auditors review. The Director of Administrative Services will obtain necessary documentation to support compliance with the criteria and will provide that documentation to the auditors or the FSM National Government within 45 days.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No: 2007-06
 Agency: U.S. Department of the Interior
 CFDA #: 15.875
 Grant #: CSG-FSM 2007, CSG-FSM 2006, CSG-FSM 2005, CSG-FSM 2004
 Program Name: Compact Sector Grants
 Requirement: Allowable Costs/Cost Principles and Procurement
 Questioned Costs: \$666,857

Criteria: Expenditures should be necessary and reasonable for program needs and should be in accordance with program requirements. Procurements shall provide full and open competition among vendors, and allowable exceptions should be approved and documented in the procurement file.

Condition:

1. For 19 (or 16%) of 116 Compact sector non-payroll expenditures aggregating \$2,557,157 tested, there was either insufficient documentation or none was provided to support competitive procurement requirements.
2. For 7 (or 6%) of 116 Compact sector non-payroll expenditures transactions tested, there were either partial or no financial and/or programmatic records (contract, receiving report, invoices, boarding pass, etc.) on file to substantiate the following transactions.

<u>Nature</u>	<u>Ref</u>	<u>Ck No</u>	<u>Procurement</u>	<u>Allowable Cost</u>	<u>Remarks</u>
Medical Supplies	J706012	23291	\$ 59,577	\$ -	No informal procurement documentation is on file Insufficient procurement documentation in support of the selection process and responses from other bidders were not available and therefore, this appears to be tantamount to sole source procurement
Medical Supplies	J712011	17896	109,357	-	No price quotation on file with the exception of a State waiver
Equipment	J710012	23300	14,110	-	No informal procurement documentation on file.
Equipment	J710012	25785	27,926	-	No informal procurement documentation on file
Equipment	J705005	23395	18,186	-	No informal procurement documentation on file
Equipment	J705005	23395	19,919	-	No informal procurement documentation on file
Equipment	18197	25745	26,000	-	No informal procurement documentation on file
Professional Services	17764	26566	21,763	-	No procurement documentation on file other than a State waiver
Equipment			208,351	-	The selection process and documentation in support of any other available bidders was not on file or available

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No: 2007-06, Continued

<u>Nature</u>	<u>Ref</u>	<u>Ck No</u>	<u>Procurement</u>	<u>Allowable Cost</u>	<u>Remarks</u>
Furniture & Fixtures	17506	26511	10,325	-	No price quotations provided or on file No transcript on file (thus no proof of attendance/study) Also, school started in July 2007. However, a check was issued in January 2007 and no support is on file that the student was taking courses during the Spring semester (January).
Scholarships	15654	25581	-	6,500	No transcript is on file (thus no proof of attendance/study), there is no State agreement on file and the salary/income of guardian/household is missing on the application form.
Scholarships	23971	29528	-	6,000	No transcript is on file and thus, we cannot determine if payee's standing qualifies for the scholarship
Scholarships	24063	29505	-	6,000	No informal quotation procurement documentation is on file
Equipment	J705005	23300	5,600	-	No price quotations in support of the procurement are on file
Repairs & Maintenance	21718	30385	4,850	-	No competitive procurement documentation was furnished in support of this matter
General Contractual Services	22624	28826	5,000	-	No competitive procurement documentation was furnished in support of this matter
General Contractual Services	17403	26459	10,000	-	There was no competitive procurement documentation on file
Professional Services	5707	25773	10,000	-	Proof of attendance, boarding passes and how the # of days of per diem was calculated was not provided
Travel & Trans	15202	25518	-	6,950	There was no competitive procurement documentation on file
Vehicles	J706005	25770	24,890	-	There was no competitive procurement documentation on file
Food	18019	27334	15,406	-	Item and vendor is off-island but price quotations were obtained solely from on-island vendors
Equipment	J707005		8,685	-	No supporting procurement documents on file
Equipment	17411		-	5,600	No supporting procurement documents on file
Equipment	J703006		6,350	-	No supporting procurement documents on file

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No: 2007-06, Continued

<u>Nature</u>	<u>Ref</u>	<u>Ck No</u>	<u>Procurement</u>	<u>Allowable Cost</u>	<u>Remarks</u>
					This relates to an EPA phone bill for November 2006. Overseas calls are noted on the bill of approximately \$3,200. In addition, the same number incurred charges of approximately \$1,800 in December 2006 (obligation 16343). We were not provided the rationale for various calls executed after office hours 10:00 pm -7:00am for the same number.
Communications	13658	25940	-	5,000	We cannot agree the amount to the underlying billings
Utilities	17627	26555	-	<u>24,512</u>	
			<u>\$606,295</u>	<u>\$ 60,562</u>	

3. For the Scholarship Program conducted under this federal program, two scholarship payments were executed without a formal college acceptance letter being on file. Additionally, three payments (inclusive of those in the prior sentence) were executed without a completed agreement between the State and the beneficiary. Two payments were also made solely to the student although policy is that checks be made to the student and the school.

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

Effect: For condition 1 and 2, the State appears to be in noncompliance with the criteria and questioned costs result.

For condition 3, there appears to be inconsistencies in the application of existing internal control procedures and policies.

Recommendation: We recommend that the State comply with the criteria and that documentation supporting competitive procurement be on file. Additionally, we recommend that documentation be on file to support

Auditee Response and Corrective Action Plan: We agree in part with this finding. We do not agree that all the costs should be questioned as we believe that adequate documentation exists to support compliance with the criteria for most of the transactions listed under this finding. However, we agree that the documents may not have been available for the auditors review. The Director of Administrative Services will obtain necessary documentation to support compliance with the criteria and will provide that documentation to the auditors or the FSM National Government within 45 days.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No: 2007-07
 Agency: U.S. Department of the Interior
 CFDA #: 15.875
 Grant #: CSG-FSM 2007
 Program Name: Compact Sector Grants
 Requirement: Period of Availability of Federal Funds
 Questioned Costs: \$118,511

Criteria: Per FY07 grant award, “grant funds may be used for allowable obligations or expenditures directly related to the purpose of the grant award retroactive October 1, 2006”.

Condition: For 4 (or 3%) of 116 Compact sector non-payroll expenditures aggregating \$2,557,157 tested, the following expenditures pertain to prior year and do not appear allowable as charges to the FY07 grant.

<u>Account</u>				<u>Questioned</u>	
<u>Description</u>	<u>Description</u>	<u>Ref</u>	<u>Ck No</u>	<u>Costs</u>	<u>Remarks</u>
					Hospital billings related to July and August
Health	Utilities	13564	24580	\$ 28,113	2006
Health	Utilities	22947		24,905	Billings for FY 2006
Health	Freight	22584	29576	29,304	PY expenses
Health	Utilities	13510		<u>36,189</u>	FY 2006 bills
	Total			<u>\$118,511</u>	

Cause: There appears to be no insufficient monitoring to ensure compliance with grant conditions.

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

Recommendation: We recommend that the State obtain prior grantor approval before charging Sector grants for potential eligible charges that may be outside the period of availability.

Auditee Response and Corrective Action Plan: We agree with this finding. Director of Administrative Services will work with Health Services to get resolution of this issue from the grantor.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No: 2007-08
CFDA No.: 17.260
Agency: U.S. Department of Labor
Grant Name: WIA National Emergency Grants
Grant #: EM-14570-05-60
Program Area: Eligibility
Questioned Costs: \$395,640

Criteria: In accordance with applicable WIA compliance supplement program, participants in the program are subject to certain eligibility requirements.

Condition: The State could not provide documentation to verify compliance with the eligibility requirement.

Cause: The cause of the above condition is the closure of the State WIA office and the absence of documentation that was held by that office.

Effect: The effect of the above condition is noncompliance with applicable federal requirements and questioned costs.

Recommendation: We recommend that the State obtain the eligibility documentation and submit such to the auditor.

Auditee Response and Corrective Action Plan: We agree with this finding. The Director of Administrative Services will bring this issue to the attention of the Cabinet to stress importance of internal controls over proper turnover and record keeping of files.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No: 2007-09
Agency: U.S. Department of Homeland Security
CFDA #: 97.036
Grant #: Public Assistance
Program Name: Public Assistance
Requirement: Program Income/Reimbursements
Questioned Costs: \$0

Criteria: Insurance and other recoveries received from insurance settlements, salvage, or other sources must be considered in determining allowable costs because allowable costs must be net of applicable credits.

Condition: In our examination of PW#172 for SDA School Project, there was an indication of insurance policy proceeds of \$22,500. However, we were not able to verify this amount as no documents were made available with respect to the manner in which the proceeds, if received, were accounted for.

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

Effect: The State appears to be in noncompliance with the criteria. However, no questioned costs result due to uncertainty surrounding the actual receipt of these proceeds.

Recommendation: We recommend that the State provide documentation showing whether these proceeds were received and if so, the manner in which such are reflected in the financial statements.

Auditee Response and Corrective Action Plan: We agree with this finding. Director of Administrative Services will work the Public Assistance Office to provide documentation of the proceeds, if any.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-10
Grantor: U.S. Department of the Interior
CFDA: 15.875
Program: Compact Sector Grants
Grant No.: 2006-EDU-GR670009; 2006-HLTH-GR670010; 2006 PSCB-GR67011; 2006
PSD GR67007; 2006-ENV-GR670008
Area: Reporting
Questioned Cost: Undeterminable

Criteria: Amounts reported on the Compact Financial Status Reports (FSR) should be traced to accounting records that support the audited financial statements and the schedule of expenditures of Federal awards.

Condition: We were not able to reconcile the 2006 Sector expenditures reported for the final FSR to the general ledger balances.

Cause: While the State may be able to reconcile the balances, a reconciliation was not readily available.

Effect: Noncompliance with reporting requirements could result from this condition.

Recommendation: We recommend that the State consider reconciling the final CFSR's with the audit reports and with details of subsequent expenditures to ensure that all applicable transactions are captured in the report.

Auditee Response and Corrective Action Plan: We agree with this finding. The Chief of Finance does have the reconciled numbers detailing the final CFSR numbers reconciling to the general ledger.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.:	2007-11
CFDA No.:	15.875
Grantor Agency:	U.S. Department of the Interior
Program Name:	Compact of Free Association Section Grants/Capital Projects Section 211A
Requirement:	Equipment and Real Property Management
Questioned Cost:	\$0
CFDA No.:	97.036
Grantor Agency:	U.S. Department of Homeland Security
Program Name:	Public Assistance Grants
Requirement:	Equipment and Real Property Management
Questioned Cost:	\$0
CFDA No.:	93.224
Grantor Agency:	U.S. Department of Health and Human Services
Program Name:	Community Health Center
Requirement:	Equipment and Real Property Management
Questioned Cost:	\$0

Criteria: Adequate maintenance procedures shall be developed to keep property in good condition. Additionally, a bi-annual inventory should be conducted and the results reconciled with underlying fixed asset records, including documentation of fixed asset additions.

Condition: No formal maintenance procedures for equipment are established and we could not determine the manner in which maintenance responsibilities are carried out. Additionally, while the State has conducted an inventory of capital assets, it has not yet reconciled those records to its fixed asset subsidiary records. During fiscal year 2007, the State acquired a ship through donation from a foreign party, which has not been included as a fixed asset due to lack of acquisition cost data.

Cause: It appears that a formal maintenance policy has not been adopted and the inventory has yet to be reconciled to the fixed asset records.

Effect: The effect of this condition is noncompliance with equipment management requirements.

Prior Year Status: This condition was cited in the 2006 Single Audit.

Recommendation: A formal maintenance program should be developed in accordance with federal compliance requirements.

Auditee Response and Corrective Action Plan: We agree with this finding. Director of Administrative Services will seek advice and assistance to develop a formal maintenance policy.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-12
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, 2007:

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 2007.

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: We agree with this finding. Director of Administrative Services will work with the Division Chiefs of Finance & Treasury, and Procurement & Supply to implement corrective action plans.

▪ Finding 2005-02 - Equipment and Real Property Management

Director of Administrative Services will work with Property Management Division Chief to address this finding.

▪ Finding 2005-04 - Travel Advances

The Division of Finance & Treasury will have a reconciled list of outstanding by the end of June 2007 to use as a basis for collection. The Division will actively start the collection process on outstanding travel advances by the end of July 2008.

▪ Finding 2005-05 - Approval of Payroll Master File Changes

Current FMIS does not have the capability of producing the essential report needed for complete oversight over edits or changes to master file. At present, this issue is addressed through the Personnel Chief's review and approval of actions and requests before processing.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2007

Finding No.: 2007-12, Continued

Auditee Response and Corrective Action Plan, Continued:

▪ Finding 2005-07 - Approval of Journal Vouchers

Our corrective action plan for Finding 2005-07 is to strengthen the approval process by formulating internal procedure on entering JVs. The Chief of Finance & Treasury will be responsible in ensuring that the new procedures are in place by the first week of July 2008.

▪ Finding 2005-08 Purchase Advances

The Chief of Procurement & Property Management is getting monthly outstanding list from Finance and using this report to follow up with departments. Chief of Procurement & Property Management also considers the number of outstanding purchase advances per department and per vendor because he approves incoming purchase advance requests. The Office of Administrative Services will consider the recommendation as provided for in the Single Audit Report for FY05.

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Unresolved Prior Year Findings and Questioned Costs
Year Ended September 30, 2007

QUESTIONED COSTS

For the year ended September 30, 2007, the following questioned costs remain unresolved.

	Questioned Costs Set Forth in Prior Audit Report <u>2006</u>	Questioned Costs Resolved	Questioned Costs at <u>September 30, 2007</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	16,450	41,829
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>576,358</u>	<u>-</u>	<u>576,358</u>
	\$ <u>869,278</u>	\$ <u>115,079</u>	754,199
Questioned Costs FY 07			<u>1,282,244</u>
			\$ <u>2,036,443</u>

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