

**YAP STATE PUBLIC SERVICE CORPORATION,
A COMPONENT UNIT OF YAP STATE GOVERNMENT**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

SEPTEMBER 30, 2008 AND 2007

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Yap State Public Service Corporation:

We have audited the accompanying statements of net assets of the Yap State Public Service Corporation, a component unit of Yap State Government, as of September 30, 2008 and 2007, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Yap State Public Service Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of Yap State Public Service Corporation as of September 30, 2008 and 2007, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that Yap State Public Service Corporation will continue as a going concern. As discussed in note 11 to the financial statements, Yap State Public Service Corporation recorded a reduction of net assets for the year ended September 30, 2008 of \$3.6 million and is experiencing difficulty in generating sufficient cash flow to meet its obligations and to sustain its operations. These conditions raise substantial doubt about its ability to continue as a going concern without substantial operating subsidies from Yap State Government. Management's plans in regard to these matters are also discussed in note 11. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The Management's Discussion and Analysis on pages 1 to 5 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of Yap State Public Service Corporation's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurements and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 6, 2009, on our consideration of the Yap State Public Service Corporation's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Deloitte & Touche LLP

April 6, 2009

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)

Management's Discussion and Analysis
Years Ended September 30, 2008 and 2007

The following Management's Discussion and Analysis is required by GASB Statement No. 34 issued by the U.S. Governmental Accounting Standards Board. Its objective is to provide the reader with an introduction and overview of the financial statements of the Yap State Public Service Corporation (YSPSC) for the years ended September 30, 2008 and 2007. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto which follow this section.

GASB 34 of the U.S. Governmental Accounting Standards Board requires that published financial statements must contain a management discussion and analysis. This section of the YSPSC's annual report presents our discussion of YSPSC's performance for the years ended September 30, 2008, 2007 and 2006.

The following table summarizes the financial condition and operations of YSPSC as of and for the years ended September 30, 2008, 2007 and 2006.

ASSETS	<u>2008</u>	<u>2007</u>	<u>2006</u>
Plant in service, net	\$ 9,085,334	\$ 8,846,342	\$ 9,213,120
Work in progress	176,003	823,692	74,890
Current and other assets	<u>2,500,958</u>	<u>2,590,027</u>	<u>2,054,301</u>
Total assets	\$ <u>11,762,295</u>	\$ <u>12,260,061</u>	\$ <u>11,342,311</u>
 NET ASSETS AND LIABILITIES			
Invested in capital assets, net of related debt	\$ 6,360,740	\$ 6,769,437	\$ 6,294,943
Restricted	-	108,127	121,443
Unrestricted	<u>(888,049)</u>	<u>2,213,619</u>	<u>1,362,169</u>
Total net assets	<u>5,472,691</u>	<u>9,091,183</u>	<u>7,778,555</u>
Notes payable, net of current portion	2,679,432	2,793,156	2,905,255
Current portion of notes payable	113,723	107,441	87,812
Other current liabilities	<u>3,496,449</u>	<u>268,281</u>	<u>570,689</u>
Total liabilities	<u>6,289,604</u>	<u>3,168,878</u>	<u>3,563,756</u>
Total net assets and liabilities	\$ <u>11,762,295</u>	\$ <u>12,260,061</u>	\$ <u>11,342,311</u>
 REVENUES, EXPENSES AND NET ASSETS			
Operating revenues	\$ 1,023,556	\$ 5,020,612	\$ 4,492,869
Operating expenses	<u>6,702,017</u>	<u>5,015,866</u>	<u>4,693,241</u>
Income (loss) from operations	<u>(5,678,461)</u>	<u>4,746</u>	<u>(200,372)</u>

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Management's Discussion and Analysis Years Ended September 30, 2008 and 2007

Grants	2,182,373	236,600	9,017
FEMA proceeds in excess of typhoon expenses	-	-	35,296
Interest expense	(13,034)	(16,599)	(17,143)
Interest income	16,623	13,120	3,022
Gain on disposal of utility plant	-	296	1,282
Other income (expenses)	<u>(487,536)</u>	<u>(190,253)</u>	<u>37,086</u>
Net income (loss)	(3,980,035)	47,910	(131,812)
Capital contributions	<u>361,543</u>	1,264,718	33,765
Change in net assets	(3,618,492)	1,312,628	(98,047)
Net assets, beginning	<u>9,091,183</u>	<u>7,778,555</u>	<u>7,876,602</u>
Net assets, ending	\$ <u>5,472,691</u>	\$ <u>9,091,183</u>	\$ <u>7,778,555</u>

FINANCIAL OPERATIONS OVERVIEW

2008 was a tumultuous financial year for the YSPSC. Not only did the YSPSC see per gallon diesel prices peak at \$5.99 in June 2008 but also legislative action by the State repealed the variable fuel charge adopted in March 2006 and created a \$3.1 million liability comprising revenue from the variable fuel charge required to be refunded to electric customers. These events caused the ending net assets of YSPSC to decrease by \$3.6 million and created cash flow problems which raised substantial doubt about YSPSC's ability to continue as a going-concern without significant operating subsidies from the State, a fact that has been disclosed in the YSPSC's financial audit report for fiscal year 2008.

Results of Operations

Operating Loss – The YSPSC ended fiscal year 2008 with a 80% decrease in net operating revenues and 34% increase in operating expenses as compared to fiscal year 2007, resulting in an unprecedented \$5.7 million operating loss for fiscal year 2008 after having just realized a modest gain the previous year. The events and circumstances described below contributed to the financial operating results for fiscal year 2008:

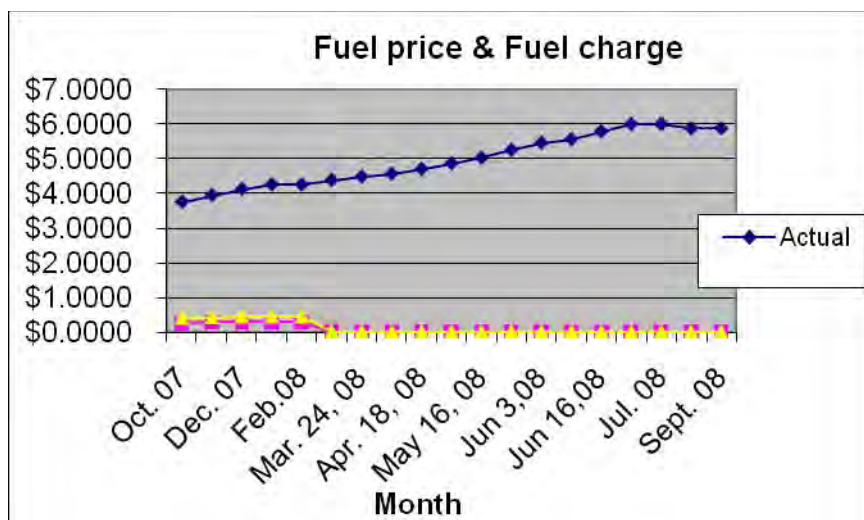
Fuel prices: Like the rest of the world, the YSPSC saw its cost of fuel increase to historical levels in fiscal year 2008. When it began the fiscal year in October 2007, the YSPSC was paying \$3.76 per gallon of diesel fuel as compared to \$2.37 in October 2006. The cost of fuel to the YSPSC increased steadily on a monthly basis finally peaking at \$5.99 in June 2008. When it closed fiscal year 2008 in September, YSPSC was still paying \$5.87 per gallon. Escalating fuel prices contributed to the 69% increase in production fuel cost to YSPSC in fiscal year 2008 as compared to fiscal year 2007 and caused the 34% increase in operating expenses for fiscal year 2008 over the previous year.

Repeal of the 2006 Variable Fuel Charge: In February 2008, a gallon of diesel fuel cost YSPSC \$4.26; the variable fuel charge in effect allowed YSPSC to assess slightly over 29 cents to customers per kilowatt hour used to defray the cost of fuel. On March 6, 2008, two years after the variable fuel charge became effective, the Governor signed into law YSL 7-25 which repealed the variable fuel charge and established a \$0.035 fuel charge instead. The law also directed the YSPSC to refund back to customers the portion of fuel charges billed and paid by customers for the period from March 6, 2006 to March 6, 2008 in excess of the three and a half cents per kilowatt hour authorized by YSL 7-25. The repeal of the variable fuel charge caused a 19% decrease in electric revenue in fiscal year 2008 to \$3.7 million

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Management's Discussion and Analysis
Years Ended September 30, 2008 and 2007

compared to \$4.6 million in 2007. Moreover, the refund to customers required a downward adjustment of \$3.1 million to fiscal year 2008 electric revenue. The adjustment reduced net operating revenue for 2008 from \$4,144,853 to \$1,023,556 as compared to \$5,020,612 for fiscal year 2007.



KWH Billed – The continued decline in electric consumption also contributed to the decrease in revenue for fiscal year 2008, dropping by 4% as compared to 2007. Usage for residential and commercial consumers dropped by 7% and 4%, respectively, while government consumption remained steady at approximately 2.9 million kWh.

Water Revenue – Revenue from water sales decreased slightly to \$462,650 for 2008 compared to \$470,252 for fiscal year 2007, despite the second installment of the water tariff increase which became effective at the beginning of fiscal year 2008. Overall water usage declined by approximately 9.5% as compared to 2007. The government's water usage saw the greatest decline – from 15 million gallons in 2007 to 13 million gallons in 2008, a decrease of 14%. Water consumption by residential customers also contracted by 10.8% as compared to 2007, while consumption by commercial customers held steady at 23 million gallons.

Other Operating Expenses – In order to survive the impact of the high production fuel costs, all other operating expenses were significantly reduced. Accordingly, administrative expenses and other production costs declined 18% from \$1,464,180 in 2007 to \$1,202,963 in fiscal year 2008. Other production costs which consist primarily of spare parts for machinery and equipment suffered the biggest cuts – from \$401,469 in 2007 to \$200,672 in 2008 – a decrease of 50%.

Significant Changes to Net Assets

Cash – Cash collected from customers decreased slightly by 6% to \$4.3 million in 2008, due to lower electric sales. The high cost of electricity to consumers has slightly increased the number of past due accounts, however, active collection efforts by the Billing section has been effective in keeping the allowance for bad debts at the same level for 2008 and 2007 of \$143,670.

Current Liabilities – While current assets remained at the same levels for 2008 and 2007, current liabilities increased by 861% from \$375,722 in fiscal year 2007 to \$3,610,172 in 2008. The primary cause of the increase is due to the \$3,121,297 in fuel surcharge refunds to electric customers required by Yap State Law No. 7-25. There were no new loans in 2008. Refer to Note 4 to the financial statements for additional information concerning YSPSC debt.

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis
Years Ended September 30, 2008 and 2007

Capital Projects – In the aftermath of Typhoon Sudal in April 2004, YSPSC was awarded \$2.18 million by the U.S. Federal Emergency Management Agency (FEMA) for the repair and improvement of YSPSC's facilities and equipment. At September 30, 2007, all, but two of the projects, were completed – a rolled-up door for the Yap Power Plant and permanent repairs and mitigation for the power distribution system. These projects were completed in fiscal year 2008 and account for the approximately \$1 million increase in the cost of the utility plant in 2008 as compared to 2007. Please refer to Note 3 to the financial statements for additional information concerning capital assets.

U.S. Federal, Local and Other Grants

Pacific Linemen Training Program – YSPSC took over administration of the training program from the American Samoa Power Authority (ASPA) with the revision of the program in 2007 to segregate training for Micronesian linemen from those of American Samoa. Funded by the U.S. Dept. of the Interior Office of Insular Affairs Operations and Maintenance Improvement Program (OMIP) funds, with matching share by participating utilities, the continuing program aims to train professional linemen for the Micronesian island utilities; specifically, Guam Power Authority, Palau Public Utility Corporation, Pohnpei Utilities Corporation and Yap State Public Service Corporation. YSPSC received \$532,437 and \$236,600, respectively in fiscal years 2008 and 2007 in cost reimbursements for the training program.

Operating Subsidies – From May to August 2008 Yap State appropriated \$1,551,065 under YSL No. 7-27, 7-31, 7-33, and 7-34 to defray the costs of power generation fuel for the YPSCS. Another \$100,000 received from the FSM Congress under PL 15-36, brings total 2008 operating subsidies for the YSPSC to \$1,649,936.

Renewable Energy program – In light of the high cost of fossil fuel, YSPSC is continuing to explore alternative sources of energy and seek grants from outside sources to implement renewable energy projects that may help lower the cost of power generation. One such project is the electrification of Asor and Fadrai in Ulithi Atoll using mini grids powered by solar panels. The project was authorized a budget of EU719,062 in 2007 and is funded by the 9th European Development Fund. US\$230,000 was received in fiscal year 2008 for site preparation, the building of the mini grids and power houses for battery banks and electronics.

HIGHLIGHTS FOR FISCAL YEAR 2009

Given the dismal financial results for fiscal year 2008, YSPSC's efforts in fiscal year 2009 will focus not only on surviving on a daily basis, but also on redirecting its long term strategies and plans to ensure the continued viability of the Corporation and set goals to improve its financial position and lessen its dependence on State subsidies.

Fuel Surcharge Refund to customers – In October 2008, the State of Yap appropriated \$1.6 million as a loan to YSPSC to provide the cash needed to settle the \$3.12 million owed to customers in fuel surcharge refunds. The loan is sufficient to cover only 66% of the total refunds owed to residential and commercial electric customers. YSPSC will continue to work with the State government to determine the best approach to take to fully satisfy the liability owed to customers.

Revision of Electric Tariff – With the repeal of the 2006 variable fuel charge directed by YSL 7-25, the YSPSC was tasked to amend the electric tariff. The new tariff, adopted by the Board of Directors in November 2008, went into effect in January 2009. The revenue from the new tariff will not be realized until March 2009. Whether the new tariff would be sufficient to alleviate its current cash crisis will be the focus of YSPSC's review and analysis in the coming months.

YAP STATE PUBLIC SERVICE CORPORATION

Management's Discussion and Analysis Years Ended September 30, 2008 and 2007

Strategic Plan and Rate Study – YSPSC was successful in obtaining a grant from U.S. DOI/OIA to contract with appropriate utility and financial experts to develop a strategic plan to allow YSPSC to weather its current financial crisis and set its course for the next ten years. The plan will include a utility rate study that will be used to help revise customer rates. The project is currently ongoing with the deadline for submission of the final strategic plan and rate study set for June 2009.

Micronesian Water and Wastewater Training program – Patterned after the successful Pacific Linemen Training Program, the YSPSC submitted a grant proposal to U.S. DOI/OIA in September 2008 for basic courses and skills training for water and wastewater division personnel for the Micronesian utility companies.

Renewable Energy Program – In an effort to lessen its dependence on fossil fuel, YSPSC has stepped up its efforts to identify alternative energy sources and obtain grants for implementation of pilot projects. Because it recognizes that total independence from diesel fuel is impractical, if not impossible, YSPSC has been seeking funding for the acquisition and installation of a new smaller generator which will potentially reduce fuel use by a minimum of 3%. YSPSC's request of \$5.4 million which was not funded in 2008 is still active with JEMCO. In addition, in 2008, a renewable energy plan for Yap State was presented to the YSPSC board and the leadership of Yap which proposed that 75% of diesel electricity be replaced by renewable energy. Also underway for 2009 are other renewable energy proposals requesting grant funds for alternative energy projects such as for preparation of wind maps for Yap Proper and PV solar projects for both the outer islands and Yap Proper.

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Management's Discussion and Analysis for the year ended September 30, 2007 is set forth in YSPSC's report on the audit of financial statements, which is dated December 5, 2007. That Discussion and Analysis explains the major factors impacting the 2007 financial statements and can be viewed at the FSM Office of the Public Auditors' website at www.fsmpublicauditor.fm.

YAP STATE PUBLIC SERVICE CORPORATION

Statements of Net Assets
September 30, 2008 and 2007

<u>ASSETS</u>	<u>2008</u>	<u>2007</u>
Non-current assets:		
Utility plant:		
Plant in service	\$ 20,053,495	\$ 19,049,424
Work in progress	176,003	823,692
Less accumulated depreciation	<u>(10,968,161)</u>	<u>(10,203,082)</u>
Utility plant, net	<u>9,261,337</u>	<u>9,670,034</u>
Current assets:		
Cash and cash equivalents	706,850	947,504
Accounts receivable, net of an allowance for doubtful accounts of \$143,670 at September 30, 2008 and 2007	767,466	868,650
Other receivables	8,253	7,580
Inventory	903,516	745,824
Prepaid expenses	<u>114,873</u>	<u>20,469</u>
Total current assets	<u>2,500,958</u>	<u>2,590,027</u>
	<u>\$ 11,762,295</u>	<u>\$ 12,260,061</u>
 <u>NET ASSETS AND LIABILITIES</u>		
Net assets (deficit):		
Invested in capital assets, net of related debt	\$ 6,468,182	\$ 6,769,437
Restricted	-	108,127
Unrestricted	<u>(995,491)</u>	<u>2,213,619</u>
Total net assets	<u>5,472,691</u>	<u>9,091,183</u>
Contingencies		
Current liabilities:		
Current portion of notes payable	113,723	107,441
Refunds payable to customers	3,121,297	-
Accounts payable	61,900	40,125
Employees' annual leave and accrued payroll	46,167	78,291
Accrued taxes and other liabilities	42,898	32,441
Deferred revenue	134,816	46,631
Other payables and customer deposits	<u>89,371</u>	<u>70,793</u>
Total current liabilities	3,610,172	375,722
Notes payable, net of current portion	<u>2,679,432</u>	<u>2,793,156</u>
Total liabilities	<u>6,289,604</u>	<u>3,168,878</u>
	<u>\$ 11,762,295</u>	<u>\$ 12,260,061</u>

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Operating revenues:		
Electricity sales	\$ 3,682,203	\$ 4,550,360
Water sales	<u>462,650</u>	<u>470,252</u>
Operating revenues	4,144,853	5,020,612
Refunds to customers	<u>(3,121,297)</u>	<u>-</u>
Net operating revenues	<u>1,023,556</u>	<u>5,020,612</u>
Operating expenses:		
Production fuel	4,733,975	2,794,658
Depreciation	765,079	757,028
Salaries and wages and related expenses	720,799	750,195
Administrative and general	281,492	312,516
Other production costs	<u>200,672</u>	<u>401,469</u>
Total operating expenses	<u>6,702,017</u>	<u>5,015,866</u>
Operating (loss) income	(5,678,461)	4,746
Interest and other nonoperating income, net	16,623	28,549
Foreign exchange loss	(1,304)	(4,941)
Operating grants and subsidies	2,182,373	236,600
Interest expense	(13,034)	(16,599)
Training expense	(486,232)	(196,741)
Other expense	-	(4,000)
Gain on disposal of utility plant	<u>-</u>	<u>296</u>
Net (loss) earnings before capital contributions	(3,980,035)	47,910
Capital contributions	<u>361,543</u>	<u>1,264,718</u>
Change in net assets	(3,618,492)	1,312,628
Net assets at beginning of year	<u>9,091,183</u>	<u>7,778,555</u>
Net assets at end of year	<u>\$ 5,472,691</u>	<u>\$ 9,091,183</u>

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION

Statements of Cash Flows
Years Ended September 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:		
Cash received from customers	\$ 4,333,547	\$ 4,621,493
Cash paid to suppliers	(5,417,422)	(3,739,967)
Cash paid to employees	(752,924)	(746,742)
Net cash (used in) provided by operating activities	<u>(1,836,799)</u>	<u>134,784</u>
Cash flows from investing activities:		
Interest and other income	<u>15,319</u>	<u>23,608</u>
Net cash provided by investing activities	<u>15,319</u>	<u>23,608</u>
Cash flows from noncapital financing activities:		
Proceeds from operating grants and subsidies	2,182,373	245,617
Other expense	(486,232)	(200,741)
Net cash provided by noncapital financing activities	<u>1,696,141</u>	<u>44,876</u>
Cash flows from capital and related financing activities:		
Capital contributions	361,543	1,056,360
Acquisition of utility plant	(356,382)	(930,694)
Proceeds from disposal of utility plant	-	296
Interest paid	(13,034)	(16,599)
Repayment of notes payable	(107,442)	(92,470)
Net cash provided by (used in) capital and related financing activities	<u>(115,315)</u>	<u>16,893</u>
Net change in cash and cash equivalents	(240,654)	220,161
Cash and cash equivalents at beginning of year	<u>947,504</u>	<u>727,343</u>
Cash and cash equivalents at end of year	\$ <u><u>706,850</u></u>	\$ <u><u>947,504</u></u>
Reconciliation of operating (loss) income to net cash (used in) provided by operating activities:		
Operating (loss) income	\$ (5,678,461)	\$ 4,746
Adjustments to reconcile operating (loss) income to net cash (used in) provided by operating activities:		
Depreciation	765,079	757,028
Decrease (increase) in assets:		
Receivables	101,184	(276,902)
Inventory	(157,692)	(40,016)
Prepaid expenses	(94,404)	(84)
Other receivables	(673)	(7,580)
Increase (decrease) in liabilities:		
Refunds payable to customers	3,121,297	-
Accounts payable	21,775	(178,684)
Employees' annual leave and accrued payroll	(32,124)	2,321
Accrued taxes and other withholdings	10,457	1,132
Deferred revenue	88,185	(114,637)
Other payables and customer deposits	18,578	(12,540)
Net cash (used in) provided by operating activities	\$ <u><u>(1,836,799)</u></u>	\$ <u><u>134,784</u></u>

Supplemental disclosure of non-cash capital and related financing activity:

During the year ended September 30, 2007, Yap State contributed equipment valued at \$208,358 to YSPSC.

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)

Notes to Financial Statements
September 30, 2008 and 2007

(1) Organization and Summary of Significant Accounting Policies

Organization

Yap State Public Service Corporation (YSPSC) is a legally separate component unit of the Government of Yap State. YSPSC provides electrical, water and sewer services in the State of Yap. YSPSC commenced operations on April 1, 1996, with the assets and liabilities of the Division of Public Utilities of the Yap State Department of Public Utilities and Contracts transferred as of that date. YSPSC is governed by a seven member Board of Directors who are nominated by the Governor with the advice and consent of the Legislature of the State of Yap.

Basis of Accounting

The accounting policies of YSPSC conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. All proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with operations are included in the statements of net assets. The accrual basis of accounting is utilized by proprietary funds. Under this method of accounting, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Governmental Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting," requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. YSPSC has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

YSPSC has adopted GASB Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments" (GASB 34) as amended by GASB Statement Nos. 37 and 38. GASB 34 establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following net asset categories:

- Invested in capital assets, net of related debt:

Net assets invested in capital assets include restricted and unrestricted net assets, net of accumulated depreciation and reduced by outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

- Restricted:

- Nonexpendable – Net assets subject to externally imposed stipulations that require YSPSC to maintain them permanently.
- Expendable – Net assets whose use by YSPSC is subject to externally imposed stipulations that can be fulfilled by actions of YSPSC pursuant to those stipulations or that expire by the passage of time.

**YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)**

Notes to Financial Statements
September 30, 2008 and 2007

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

Basis of Accounting, Continued

- Unrestricted:

Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action by management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

YSPSC has no nonexpendable restricted net assets at September 30, 2008 and 2007.

Utility Plant

Utility plant assets were transferred from Division of Public Utilities to YSPSC as of April 1, 1996 at the estimated net book value in the absence of documents to support cost. The net book value of the utility plant assets transferred was \$6,805,075 as of April 1, 1996. Depreciation is computed using the straight-line method over the estimated useful lives of the assets (3 - 40 years for plant assets). Depreciation expense for each of the years ended September 30, 2008 and 2007 was approximately four percent of the cost of depreciable properties. YSPSC currently capitalizes all plant assets that have a useful life of more than one year.

Cash and Cash Equivalents

For purposes of the statements of net assets and the statements of cash flows, cash and cash equivalents are defined as cash on hand, cash in bank and time certificates of deposit with original maturities of three months or less. Time certificates of deposit with original maturities in excess of three months are classified separately.

At September 30, 2008 and 2007, cash and cash equivalent balances of \$100,000 are insured by the Federal Deposit Insurance Corporation (FDIC). The remaining balances consist of uninsured and uncollateralized cash and time certificates of deposit. YSPSC has not experienced any credit losses in such accounts.

Receivables

All receivables are due from government agencies, businesses and individuals located within the State of Yap and are interest free and uncollateralized. The allowance for uncollectible accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts and prior collection experience. The allowance is established through a provision for bad debts charged to expense.

Inventory

Supply inventories are carried at specific identification cost or at estimated values when contributed by the State of Yap.

Fuel inventories are carried at cost determined using the first in-first out method.

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Notes to Financial Statements
September 30, 2008 and 2007

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

Annual and Sick Leave

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

Revenues

Sales of electricity and water are recorded as billed to customers on a monthly billing cycle basis. At September 30, 2008 and 2007, unbilled revenues of \$128,994 and \$179,541, respectively, are estimated and accrued based on the most recent billing cycles.

Operating and Non-operating Revenues and Expenses

YSPSC considers revenues and expenses directly related to utility operations to be operating revenues and expenses. Revenues and expenses related to investing, financing and capital activities and revenues and expenses related to natural disasters are reflected as non-operating.

Risk Management

YSPSC is exposed to various risks of loss from torts, theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; and natural disasters. Commercial insurance coverage has been obtained for claims arising from most of these matters.

YSPSC is self-insured for typhoon risks. Management is of the opinion that no material losses have sustained as a result of this practice during the past three years.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

New Accounting Standards

During the year ended September 30, 2008, YSPSC implemented GASB 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 implementation of this statement did not have a material effect on the financial statements of YSPSC.

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)

Notes to Financial Statements
September 30, 2008 and 2007

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

New Accounting Standards, Continued

During the year ended September 30, 2008, YSPSC implemented GASB 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 implementation of this statement did not have a material effect on the financial statements of YSPSC.

During the year ended September 30, 2008, YSPSC implemented GASB 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 postemployment benefits. The implementation of this statement did not have a material effect on the financial statements of YSPSC.

In July 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 postemployment 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 YSPSC 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 YSPSC.

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 YSPSC.

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 YSPSC.

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)

Notes to Financial Statements
September 30, 2008 and 2007

1) Organization and Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB Statement No. 53 is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. 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 YSPSC.

(2) Cash and Cash Equivalents

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.

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 YSPSC or its agent in YSPSC'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 YSPSC'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 YSPSC'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, YSPSC'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 but not in YSPSC's name. YSPSC does not have a deposit policy for custodial credit risk.

As of September 30, 2008 and 2007, the carrying amount of YSPSC's total cash and time certificates of deposit was \$706,850 and \$947,504, respectively, and the corresponding bank balances were \$750,310 and \$913,461, respectively. All of the bank balances are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2008 and 2007, bank deposits of \$100,000 were FDIC insured. YSPSC 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. YSPSC has not experienced any losses in such accounts and management believes it is not exposed to any significant credit risk on its deposits.

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)

Notes to Financial Statements
September 30, 2008 and 2007

(3) Utility Plant

A summary of changes in capital assets for the years ended September 30, 2008 and 2007 is as follows:

	<u>Beginning Balance</u> <u>October 1, 2007</u>	<u>Transfers and</u> <u>Additions</u>	<u>Transfers and</u> <u>Deletions</u>	<u>Ending Balance</u> <u>September 30, 2008</u>
Depreciable plant:				
Production plant	\$ 9,759,000	\$ 34,521	\$ -	\$ 9,793,521
Distribution plant	7,216,030	942,416	-	8,158,446
General plant	<u>2,074,394</u>	<u>27,134</u>	<u>-</u>	<u>2,101,528</u>
	19,049,424	1,004,071	-	20,053,495
Less accumulated depreciation	(10,203,082)	(765,079)	-	(10,968,161)
Non-depreciable plant:				
Work in progress	<u>823,692</u>	<u>269,298</u>	<u>(916,987)</u>	<u>176,003</u>
	<u>\$ 9,670,034</u>	<u>\$ 508,290</u>	<u>\$ (916,987)</u>	<u>\$ 9,261,337</u>
	<u>Beginning Balance</u> <u>October 1, 2006</u>	<u>Transfers and</u> <u>Additions</u>	<u>Transfers and</u> <u>Deletions</u>	<u>Ending Balance</u> <u>September 30, 2007</u>
Depreciable plant:				
Production plant	\$ 9,673,056	\$ 85,944	\$ -	\$ 9,759,000
Distribution plant	7,138,769	77,261	-	7,216,030
General plant	<u>1,847,349</u>	<u>227,045</u>	<u>-</u>	<u>2,074,394</u>
	18,659,174	390,250	-	19,049,424
Less accumulated depreciation	(9,446,054)	(757,028)	-	(10,203,082)
Non-depreciable plant:				
Work in progress	<u>74,890</u>	<u>803,523</u>	<u>(54,721)</u>	<u>823,692</u>
	<u>\$ 9,288,010</u>	<u>\$ 436,745</u>	<u>\$ (54,721)</u>	<u>\$ 9,670,034</u>

Utility plant at cost, is comprised of the following components:

	<u>2008</u>	<u>2007</u>
Electric plant	\$ 13,233,981	\$ 12,264,028
Water plant	<u>6,819,514</u>	<u>6,785,396</u>
	<u>\$ 20,053,495</u>	<u>\$ 19,049,424</u>

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)

Notes to Financial Statements
September 30, 2008 and 2007

(4) Notes Payable

Notes payable at September 30, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
Loan of original principal of \$2,270,837 payable to the Asia Development Bank (ADB) borrowed through the Federated States of Micronesia (FSM) and Yap State for construction of certain water projects. YSPSC was to be liable to Yap State for interest at 6.82% on the outstanding balance; however, Yap State has waived the interest payment requirement. The loan is repayable in Special Drawing Rights commencing August 2007 with the final payment due in February 2032. The loan is collateralized by the guarantee of the FSM National Government.	\$ 2,202,712	\$ 2,248,129
Uncollateralized note of original principal of \$827,420 payable to Yap State in quarterly interest only payments through March 2003; monthly principal and interest payments of \$5,651 starting June 1, 2003; interest at 2%, maturing in May 2017. The proceeds of the note were used for the construction of the warehouse facility and main office.	539,163	590,919
Note of original principal of \$103,000 payable to United States of America, acting through the Rural Housing Service, for the construction of the warehouse facility and main office. The note is payable in monthly installments of \$1,075 including interest at 4.625% starting March 26, 2003 and maturing in September 2013. The note is collateralized by equipment, furniture and fixtures located at YSPSC's office.	<u>51,280</u>	<u>61,549</u>
Total notes payable	2,793,155	2,900,597
Less current portion	<u>113,723</u>	<u>107,441</u>
	<u>\$ 2,679,432</u>	<u>\$ 2,793,156</u>

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)

Notes to Financial Statements
September 30, 2008 and 2007

(4) Notes Payable, Continued

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2009	\$ 113,723	\$ 12,404	\$ 126,127
2010	115,393	10,733	126,126
2011	117,110	9,016	126,126
2012	118,876	7,250	126,126
2013	112,874	5,468	118,342
2014 through 2018	580,192	9,149	589,341
2019 through 2023	605,630	-	605,630
2024 through 2028	605,630	-	605,630
2029 through 2032	<u>423,727</u>	<u>-</u>	<u>423,727</u>
	<u>\$ 2,793,155</u>	<u>\$ 54,020</u>	<u>\$ 2,847,175</u>

Changes in long-term liabilities for the years ended September 30, 2008 and 2007 are as follows:

	<u>Outstanding September 30, 2007</u>	<u>Increases</u>	<u>Decreases</u>	<u>Outstanding September 30, 2008</u>	<u>Current</u>	<u>Noncurrent</u>
ADB loan	\$ 2,248,129	\$ -	\$ 45,417	\$ 2,202,712	\$ 45,416	\$ 2,157,296
Yap State loan	590,919	-	51,756	539,163	57,553	481,610
USA loan	<u>61,549</u>	<u>-</u>	<u>10,269</u>	<u>51,280</u>	<u>10,754</u>	<u>40,526</u>
	<u>\$ 2,900,597</u>	<u>\$ -</u>	<u>\$ 107,442</u>	<u>\$ 2,793,155</u>	<u>\$ 113,723</u>	<u>\$ 2,679,432</u>
	<u>Outstanding September 30, 2006</u>	<u>Increases</u>	<u>Decreases</u>	<u>Outstanding September 30, 2007</u>	<u>Current</u>	<u>Noncurrent</u>
ADB loan	\$ 2,270,837	\$ -	\$ 22,708	\$ 2,248,129	\$ 45,416	\$ 2,202,713
Yap State loan	650,875	-	59,956	590,919	51,756	539,163
USA loan	<u>71,355</u>	<u>-</u>	<u>9,806</u>	<u>61,549</u>	<u>10,269</u>	<u>51,280</u>
	<u>\$ 2,993,067</u>	<u>\$ -</u>	<u>\$ 92,470</u>	<u>\$ 2,900,597</u>	<u>\$ 107,441</u>	<u>\$ 2,793,156</u>

(5) Contingencies

YSPSC does not currently hold title to real property underlying its operating sites. Such property substantially is held in the name of the State of Yap. YSPSC is not charged for use of this property.

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)

Notes to Financial Statements
September 30, 2008 and 2007

(6) Significant Revenue Sources

Power and water billings to Yap State Government agencies accounted for 22% and 34%, respectively, of operating revenues for the years ended September 30, 2008 and 2007.

(7) Restricted Net Assets

Restricted net assets at September 30, 2007 consist of unexpended balances of a Yap State capital grant.

(8) Grants

YSPSC received the following grants and capital contributions during the years ended September 30, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
U.S. Federal Emergency Management Agency (FEMA) grants	\$ 133,183	\$ 942,053
U.S. Department of the Interior grants	532,437	236,600
Yap State operating grants	1,649,936	114,307
European Union	169,935	-
Donated equipment (Yap State)	<u>58,425</u>	<u>208,358</u>
	\$ <u>2,543,916</u>	\$ <u>1,501,318</u>

(9) Related Party Transactions

In the ordinary course of business, YSPSC enters into transactions with the State of Yap and private businesses in which certain of YSPSC's board members hold positions of influence. Several board members hold management positions with the State of Yap, of which YSPSC is a component unit. Several board members hold management positions with private companies with which YSPSC, from time to time, engages in business transactions. YSPSC management is of the opinion that its transactions with related parties are executed under the same laws and conditions as are entered into with unrelated entities.

(10) Variable Fuel Charge Refund and Going Concern

Prior to March 2006, YSPSC's electricity rate structure included a \$0.035 fuel surcharge per kWh used by consumers. Effective with the March 2006 meter readings, YSPSC implemented a new rate structure which included a variable fuel charge for electrical customers. With the new rate structure, electricity rates billed to customers increased or decreased in proportion to the fuel price changes of the fuel purchased by YSPSC.

In February 2008, the Yap State Legislature enacted Law No. 7-25 to amend Yap State Law No.4-4, YSPSC's enabling legislation. Yap State Law No. 7-25 directed YSPSC to repeal all fuel surcharges and fees in excess of \$0.035 per kWh and to refund to customers all fuel surcharges and fees collected in excess of \$0.035 per kWh from March 2006 to February 2008. At September 30, 2008, the total variable fuel charge refund payable to customers amounted to \$3,121,297.

YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)

Notes to Financial Statements
September 30, 2008 and 2007

(10) Variable Fuel Charge Refund and Going Concern, Continued

In large part because of Law 7-25, YSPSC recorded a reduction of net assets of \$3,618,492 in the year ended September 30, 2008. YSPSC is unable to generate sufficient revenues to pay its obligations and is completely dependent on operating subsidies from the Yap State Government. These conditions raise significant doubt about YSPSC's ability to continue as a going concern.

In August 2008, Yap State approved a \$1.6 million loan to YSPSC, which funds are to be used solely to pay fuel surcharge refunds. The funds were drawn in October 2008.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Board of Directors
Yap State Public Service Corporation:

We have audited the financial statements of the Yap State Public Service Corporation (YSPSC), as of and for the year ended September 30, 2008, and have issued our report thereon dated April 6, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered YSPSC's internal control over financial reporting 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 YSPSC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of YSPSC'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 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 (page 27) as finding 2008-1 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 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, the significant deficiency described above as finding 2008-1 is considered to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether YSPSC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matter that is required to be reported under *Government Auditing Standards* and which is described in the accompanying Schedule of Findings and Questioned Costs (page 27) as finding 2008-1.

We noted certain matters that we reported to management of YSPSC in a separate letter dated April 6, 2009.

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

This report is intended solely for the information and use of management, the Board of Directors, others within the entity, federal awarding agencies, pass-through entities, and the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties. However, this report is also a matter of public record.

Deloitte & Touche LLP

April 6, 2009

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133 AND ON THE
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

The Board of Directors
Yap State Public Service Corporation:

Compliance

We have audited the compliance of the Yap State Public Service Corporation (YSPSC) 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 its one major federal program for the year ended September 30, 2008. Yap State Public Service Corporation's major federal program is identified in the Summary of Auditors' Results Section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its one major federal program is the responsibility of Yap State Public Service Corporation's management. Our responsibility is to express an opinion on Yap State Public Service Corporation's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about YSPSC'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 YSPSC's compliance with those requirements.

As described in item 2008-1 in the accompanying Schedule of Findings and Questioned Costs, YSPSC did not comply with requirements regarding procurement and suspension and debarment that are applicable to its Economic, Social and Political Development of the Territories (CFDA#15.875) program. Compliance with such requirements is necessary, in our opinion, for YSPSC to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, YSPSC complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended September 30, 2008.

Internal Control Over Compliance

The management of YSPSC is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered YSPSC'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 YSPSC'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 a certain deficiency in internal control over compliance that we consider to be a significant deficiency and a material weakness.

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 YSPSC'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 deficiency in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as item 2008-1 to be a significant deficiency.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We consider the significant deficiency in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as finding 2008-1 to be a material weakness.

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

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of the Yap State Public Service Corporation, as of and for the year ended September 30, 2008, and have issued our report thereon dated April 6, 2009. Our audit was performed for the purpose of forming an opinion on basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes 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 YSPSC's management. 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 management, the Board of Directors, others within the entity, federal awarding agencies, pass-through entities, and the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties. However, this report is also a matter of public record.

Deloitte & Touche LLP

April 6, 2009

**YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)**

**Schedule of Expenditures of Federal Awards
Year Ended September 30, 2008**

<u>Grantor/Program Title</u>	<u>CFDA No.</u>	<u>Total Authorizations</u>	<u>Unearned Revenue (Receivable) at Beginning of Year</u>	<u>Expenditures for the Year Ended September 30, 2008</u>	<u>Cash Receipts the Year Ended September 30, 2008</u>	<u>Unearned Revenue at End of Year</u>
<u>U.S. Department of the Interior:</u>						
Office of Territorial and International Affairs:						
Economic, Social, and Political Development						
of the Territories/ <u>Operations and Maintenance</u>						
<u>Improvement Programs (OMIP)</u>						
	15.875					
Pacific Lineman Training		\$ 662,583	\$ -	\$ 486,231	\$ 560,982	\$ 74,751
Hire experienced water/wastewater specialist		<u>65,000</u>	<u>-</u>	<u>46,207</u>	<u>46,207</u>	<u>-</u>
		<u>727,583</u>	<u>-</u>	<u>532,438</u>	<u>607,189</u>	<u>74,751</u>
<u>U.S. Department of Homeland Security:</u>						
Federal Emergency Management Agency:						
Public Assistance Grants	83.544	<u>1,783,250</u>	<u>46,631</u>	<u>133,183</u>	<u>86,552</u>	<u>-</u>
		<u>\$ 2,510,883</u>	<u>\$ 46,631</u>	<u>\$ 665,621</u>	<u>\$ 693,741</u>	<u>\$ 74,751</u>

Note 1: The Schedule of Expenditures of Federal Awards is prepared on the accrual basis of accounting.

Note 2: The grant from U.S. DHS was passed through the Yap State Government. The grants from US DOI were received in a direct capacity.

**YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2008

Part I - Summary of Auditors' Results Section

Financial Statements

- | | |
|--|---------------|
| 1. Type of auditors' report issued: | Unqualified |
| Internal control over financial reporting: | |
| 2. Material weakness(es) identified? | Yes |
| 3. Significant deficiency(ies) identified that are not considered to be material weaknesses? | None reported |
| 4. Noncompliance material to the financial statements noted? | Yes |

Federal Awards

Internal control over major programs:

- | | |
|---|---------------|
| 5. Material weakness(es) identified? | Yes |
| 6. Significant deficiency(ies) identified that are not considered to be material weaknesses? | None reported |
| 7. Type of auditors' report issued on compliance for major programs: | Qualified |
| 8. Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? | Yes |
| 9. YSPSC's one major program: | |

<u>CFDA Number</u>	<u>Name of Federal Program</u>
--------------------	--------------------------------

15.875	Economic, Social, and Political Development of the Territories
--------	--

- | | |
|---|-----------|
| 10. Dollar threshold used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133: | \$300,000 |
| 11. YSPSC qualified as a low-risk auditee as that term is defined in OMB Circular A-133? | No |

**YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2008

Part II –Financial Statement Finding Section

<u>Finding #</u>	<u>Finding</u>
2008-1	Procurement and Suspension and Debarment

Part III - Federal Award Findings and Questioned Cost Section

<u>Finding #</u>	<u>CFDA #</u>	<u>Finding</u>	<u>Questioned Costs</u>
2008-1	15.875	Procurement and Suspension and Debarment	
		\$0	

**YAP STATE PUBLIC SERVICE CORPORATION
(A COMPONENT UNIT OF THE STATE OF YAP)**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2008

Finding No.: 2008-1
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social, and Political Development of the Territories
Grant Number: OMIP Yap 2008-2
Area: Procurement and Suspension and Debarment
Questioned Cost: \$0

Criteria: In accordance with applicable procurement requirements, the grantee will maintain records sufficient to detail the rationale for the method of procurement and selection of vendors. Allowable exceptions should be approved and documented.

Condition: No procurement documents were provided to support the selection of instructors to provide professional certification training for power linemen from Chuuk, Guam, Palau, CNMI and Yap.

Cause: There appears to be inadequate documentation of controls over compliance with applicable procurement requirements. The names of the instructors were included in the grant application submitted to the grantor. When the grant was awarded, YSPSC assumed the instructors included in the application were approved by the grantor as a sole source to provide the training.

Effect: YSPSC is in noncompliance with applicable procurement requirements. No questioned cost exists as the grantor agency appear to accept the use of instructors as described above as a sole source, based on the letter from the Director of Budget and Grants Management Office of Insular Affairs, dated April 28, 2009.

Recommendation: YSPSC should strengthen controls relating to compliance with established procurement procedures. Waiver of procurement requirements, if any, should be formally obtained from the grantor and adequately documented in a timely manner.

Auditee Response and Corrective Action Plan: We accept the finding. More importantly, we appreciate it for the chance it has given us to review our procedures for documenting compliance with procurement requirements. To strengthen existing controls over compliance with procurement regulations, we will henceforth ensure that documentary evidence of our compliance with competitive procurement requirements are filed with procurement records such as contracts and purchase orders.

**YAP STATE PUBLIC SERVICE CORPORATION
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Summary Schedule of Prior Year Findings
Year Ended September 30, 2008

There are no unresolved prior year findings.