

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

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

SEPTEMBER 30, 2012 AND 2011



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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 (YSPSC), a component unit of the State of Yap, as of September 30, 2012, and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the YSPSC's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of YSPSC as of and for the year ended September 30, 2011 were audited by other auditors whose report, dated December 2, 2011, expressed an unqualified opinion.

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 YSPSC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to previously present fairly, in all material respects, the financial position of YSPSC as of September 30, 2012, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

We also examined the adjustments described in note 10 that were applied to restate the 2011 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 29, 2013 on our consideration of YSPSC'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 considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 1 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Deloitte & Touche LLP

June 29, 2013

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

Management's Discussion and Analysis
Years Ended September 30, 2012 and 2011

The following Management's Discussion and Analysis is required by Statement No. 34 issued by the U.S. Governmental Accounting Standards Board (GASB). 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, 2012 and 2011. 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 Statement 34 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, 2012, 2011 and 2010. It should be read in conjunction with financial statements that follow this section.

The following table summarizes the financial condition and operations of YSPSC as of 2012, 2011 and 2010.

	<u>2012</u>	<u>2011</u> <u>as restated</u>	<u>2010</u> <u>as restated</u>
ASSETS			
Plant in Service, net			
Work in progress	\$ 7,895,778	\$ 7,880,872	\$ 8,231,830
Current and other assets	116,519	485,383	255,864
Total assets	<u>3,751,940</u>	<u>3,174,010</u>	<u>2,118,800</u>
	<u>\$ 11,764,237</u>	<u>\$ 11,540,265</u>	<u>\$ 10,606,494</u>
NET ASSETS AND LIABILITIES			
Net Assets:			
Invested in capital assets, net of related debt			
Restricted	\$ 5,013,820	\$ 5,638,236	\$ 3,781,864
Unrestricted	1,931,051	1,168,832	-
Total net assets	<u>(405,911)</u>	<u>(618,993)</u>	<u>1,444,680</u>
Liabilities:	<u>6,538,960</u>	<u>6,188,075</u>	<u>5,226,544</u>
Notes payable, net of current portion	4,017,176	4,252,381	4,480,522
Current portion of notes payable	320,526	284,421	225,308
Other current liabilities	<u>887,575</u>	<u>815,388</u>	<u>674,120</u>
Total liabilities	5,225,277	5,352,190	5,379,950
Total net asset and liabilities	<u>\$ 11,764,237</u>	<u>\$ 11,540,265</u>	<u>\$ 10,606,494</u>
REVENUES, EXPENSES, AND NET ASSETS			
Operating revenues, net	\$ 6,063,666	\$ 5,682,964	\$ 5,634,641
Operating expenses	<u>6,789,033</u>	<u>6,172,497</u>	<u>5,670,790</u>
Operating loss	<u>(725,367)</u>	<u>(489,533)</u>	<u>(36,149)</u>

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	2012	2011 as restated	2010 as restated
Grants	725,775	709,686	703,485
Interest expense	(17,724)	(16,109)	(26,148)
Interest income	7,037	1,322	2,630
Training expense and grant expense	(530,405)	(384,713)	(749,440)
Other income/(expenses)	8,348	(27,954)	109,479
Net loss	(532,336)	(207,301)	(139)
Capital contributions	883,221	1,168,832	34,638
Change in net assets	350,885	961,531	34,499
Net assets, beginning	6,188,075	5,226,544	5,192,045
Net assets, ending	\$ 6,538,960	\$ 6,188,075	\$ 5,226,544

FINANCIAL OPERATIONS OVERVIEW

The Yap State Public Corporation has again managed to survive another fiscal year despite continued operating capital challenges. The new electric tariff which was adopted on February 16, 2012 in response to increased fuel prices did not improve the YSPSC's cash flow position for several reasons.

First, legal reinterpretation of YSPSC's enabling legislation required YSPSC's to amend its electric service disconnection policy from 60 days to 90 days negatively impacting YSPSC's ability to timely collect revenue from its customers.

Second, the fuel cost in the tariff of February 2012 was fixed at \$4.711 because the tariff was intended to be in use only for the short-term while YSPSC management worked with State officials to amend YSPSC's enabling legislation to include a fuel cost component in the electric tariff that will rise and fall with the cost of fuel. Following adoption of the tariff in February, fuel prices ranged from a high of \$5.036 per gallon in April 2012 to a low of \$4.384 per gallon in July 2012. Until YSPSC is able to legally adopt a tariff with a variable fuel cost component, it will continue to be at the mercy of the volatile fossil fuel market.

Third, electric power conservation encouraged by the higher tariff has resulted in an average monthly billing of only \$472,000 from March to September 2012 as compared to \$532,000 projected for the tariff. Until YSPSC invests in a smaller diesel generator and renewable energy systems as proposed in its loan package with the Asian Development Bank, energy conservation by customers will continue to *hurt* rather than *help* YSPSC.

Last, routine maintenance costs for the production plant which had been postponed from year to year due to a lack of funds suddenly had to be addressed in fiscal year 2012 just to keep operations going. All of the above plus many other smaller challenges contributed to the \$700,000 operating loss for the YSPSC for fiscal year 2012.

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Results of Operations

Operating Loss: The operating loss for fiscal year 2012 of \$725,367 represents an increase of 48% over fiscal year 2011. For fiscal year 2011, the disparity between fuel costs billed to customers and the actual paid by the YSPSC to its supplier contributed to the operating loss of \$489,533, an increase of 10% over fiscal year 2010.

Electric Revenue: The fiscal year 2012 revenue of \$5,651,175 represents an increase of 10% over fiscal year 2011. However, the actual revenue earned in 2012 was \$421,000 less than projections due primarily to lower electricity consumption by customers. Electric revenue for 2011 of \$5,123,712 was down 1% when compared with 2010. This was despite the additional \$0.035 fuel surcharge assessed to customers beginning in May 2011. The surcharge was expected to generate approximately \$168,000 from May to September 2011, but a decline in overall electricity consumption caused the 2011 electric sales to fall below the 2010 electric sales of \$5,164,759.

Kilowatt Hours Billed: Consistent with the prior years, the electricity customer base continued to contract. The rate of decrease was 6% in FY12 down to 9.7 million kwh from 10.3 million kwh in 2011 and 2% in 2011 down from 10.5 million kwh in 2010. Residences and commercial consumption contracted by 6% and the government class by 12% in fiscal year 2012. In fiscal year 2011, the residential class reflected a 5% decrease, while the government class decreased by 2%. After the new tariff was adopted in February 2012, total monthly electric billing was \$491,792 but steadily declined to \$448,000 by September 2012.

Water Revenue: Water consumption for fiscal year 2012 increased slightly to 90.5 million gallons. In contrast, water revenue decreased by 11% in fiscal year 2012. Total number of gallons billed to customers decreased to 89.2 million gallons in 2011 down from 92.9 million gallons in 2010. Consistent with fiscal year 2010, the lower usage was reflected in the consumption for the residential class. Despite the decrease in consumption, water sales showed a modest increase of 12% over 2010, from \$469,882 to \$559,252 in 2011. The contrasting relationship between consumption and collection for the Water Division is a weakness of the present billing system which lumps electric and water revenue receivables into one account. The situation is expected to be resolved with the upgrade of the utility billing system expected to be completed in the early part of fiscal year 2013.

Production Fuel: The YSPSC expended \$372,071 more for fuel in 2012 as compared to 2011 and \$467,199 more in 2011 than in 2010. The 9% and 12% increase in production fuel costs in 2012 and 2011 respectively is due to the higher average fuel prices paid in 2012 and 2011 compared to 2010. The average monthly fuel price paid by the YSPSC in 2010 was \$3.77 compared to \$4.468 in 2011, and \$4.77 for fiscal year 2012. Production fuel expense of \$4,639,982 and \$4,267,911 comprised 68% and 69% of total operating expenses of \$6,789,033 and \$6,172,502 for 2012 and 2011, respectively.

Other Operating Expenses: Other operating expenses increased \$219,000 in 2012 as compared to 2011. Specifically, other production costs increased by 113% in fiscal year 2012 due to pressing maintenance costs for the power production plant. Administrative and general expenses also increased by 80% due to travel costs associated with the upgrade of the billing software and participation in the Pacific Power Association conference held in Vanuatu. But salaries and wages decreased 12% due to the larger portion of Power Distribution crew labor being charged to grant funds. In fiscal year 2011, due to the shortage of working capital brought about by higher fuel prices, all other operating expenses, with the exception of salaries and wages, decreased as compared to fiscal year 2010. The increase in salaries and wages of 27% was attributable to one

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new position in Administration and wage increases for Linemen who had attained certification in the Pacific Linemen Training Program. The YSPSC also had to absorb the cost of part of the salary and recruitment and repatriation costs of the Heavy Equipment Trainer when DOI funding for the Heavy Equipment Training Program failed to materialize for its second year.

Significant Changes to Net Assets

Cash – Never in its seventeen year history has the YSPSC's cash position been as dire. Even though a new electric tariff was adopted in February 2012, the budget restrictions imposed by JEMCO on the use of Compact Sector grant to cover utility payments prompted the State Government to restrict its use of electricity thereby reducing its consumption by 12% over 2011. Consequently, electric revenue for fiscal year 2012 fell \$421,000 short of projections. This situation coupled with the redefinition of YSPSC's disconnection policy and other factors explained in the overview of this report, contributed to the depletion of cash at the end of fiscal year 2012.

Receivables – Net customer receivables increased 26% to \$1,196,653 at the end of fiscal year 2012 as compared to fiscal year 2011. In fiscal year 2011 customer receivables increased 7% to \$949,549 from \$889,919 in 2010. The increase is attributable to revisions to YSPSC's disconnection policy which came about after it was brought to management's attention that customers could be legally disconnected only after 90 days of delinquency, instead of the 60 days that had been the practice. The average number of days it took YSPSC to collect monthly billings from its customers increased to 76 days in fiscal year 2012 as compared to 61 days in fiscal year 2011. Another efficiency ratio which calculates the average number of times that YSPSC was able to collect from its customers during a year shows that in fiscal year 2012 the ratio decreased to 5.5 compared to 6.2 for fiscal year 2011. At the end of fiscal year 2012, 42% of net receivables were over 30 days delinquent compared to 27% for fiscal year 2011.

Long-term Debt – A total of \$199,100 was paid on principal for long-term debt in fiscal year 2012 compared to \$169,028 in FY11. These represent payments on the four loans currently being serviced by the YSPSC. Additional information on long-term debt for the Corporation can be found in Note 5 to the financial statements.

Current Liabilities – Current liabilities increased 10% in 2012 as compared to 2011. Accounts payable at September 30, 2012 represents an increase of 78% or \$181,729 over fiscal year 2011. The lack of working capital in 2012 and 2011 necessitated that only the most pressing bills were paid each month.

Capital Projects – Due to the severe cash shortages being experienced by the Corporation, YSPSC did not undertake any capital projects in 2012 and 2011 other than the ongoing renewable energy project funded by the European Union and South Pacific Commission North Rep. Please refer to note 4 to the financial statements for additional information on the Corporation's capital activity.

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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 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, Commonwealth Utilities Corporation, and Yap Public Services Corporation. Six linemen from Power Distribution Division successfully completed the Linemen Training Program and were certified in 2011. YSPSC received \$331,483 and \$317,651, respectively, in fiscal years 2012 and 2011 in cost reimbursements for the training program.

CRISP Monitoring and Evaluation – Due to its good track record in administering the various training programs funded by the U.S. Department of the Interior (DOI), DOI awarded YSPSC \$199,942 in 2011 to monitor and evaluate the Chuck Public Utilities Corporation's (CPUC) Capitalization, Recovery and Institutional Strengthening Project (CRISP). YSPSC received \$83,737 and \$49,081 in 2012 and 2011, respectively, for cost reimbursements for this program.

Renewable Energy program (European Union EFII) – As part of its ongoing renewable energy program, in 2011, YSPSC received \$33,562 from the French Embassy for solar systems training and \$1,168,832 from the European Union for the installation of solar systems in the neighboring islands. The European Union Energy Facility II grant project is worth approximately \$3.3 million and is designed to provide solar electricity to ten islands and atolls in the State of Yap, namely Ngulu, Falalus, Siliap, Tagailap and Wottegai in Woleai atoll, Eauripik, the two islands in the atoll of Faraulep (Falalop and Pigue) and finally Elato and Lamotrek. Yap State's required 25% matching share of \$843,750 was appropriated under YSL 8-3 and 8-9. The procurement process for the photovoltaic systems was begun in fiscal year 2012 with installations scheduled for fiscal year 2013.

Renewable Energy program (SPC North-Rep) – In July 2012 YSPSC entered into a Memorandum of Agreement with the Secretariat of the Pacific Community (SPC) for joint activities aimed at the implementation of the North Pacific ACP Renewable Energy and Energy Efficiency Project (North Rep). The European Union is funding this program through the SPC North-Rep. Procurement and installation of the systems will be the responsibility of North-Rep with assistance provided by YSPSC as needed; however, upon commissioning, operation and maintenance of the systems will transfer to YSPSC.

ADB Loan for Small Generator and Yap Proper Renewable Energy Projects – Throughout fiscal year 2012, YSPSC worked with ADB consultants to finalize and secure Yap State's support for a \$9 million loan package for renewable energy projects in Yap State. In September 2012, such approval was attained with the passage of Yap State Laws 8-23 and 8-24 specifically authorizing the Governor to enter into negotiations with the ADB for the loan and also to enter into negotiations with the National Government for a back-up security agreement for the loan.

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Woleai Cash Power – Towards the end of fiscal year 2010, Yap State Public Services Corporation entered into a contract with the Yap State Government, to among other things, procure and install cash power meters in Falalop Woleai for \$79,012. In the middle of the fiscal year 2012, the Falalop Woleai Power System was converted or changed over to Cash Power system. After the cash power meters arrived in Yap, transportation to the outer islands was arranged by the YSPSC main office for installation of the new cash-power meters and related training for YSPSC Woleai crew.

Utility Billing System Upgrade – In late fiscal year 2012, YSPSC purchased the upgraded version of its utility software to accommodate the integration of customers billing and payments with the general ledger in order to facilitate the maintenance, reporting and collection of customer accounts. The version of the Able Software currently in use does not allow integration with the general ledger, therefore, reconciliation with the general ledger is being done manually. In August 2012, four employees traveled to San Diego, California to attend a training provided by Able Software for the new version of Utility STAR. The Billing Section is scheduled to be fully functional with the new utility billing system by December of 2012.

HIGHLIGHTS FOR FISCAL YEAR 2013

In the short-term the following projects will be the primary focus of activities for the Yap State Public Services Corporation:

Amend Electric Tariff – Work was begun in 2010 to identify sections of the YSPSC enabling legislation that would require amendments in order to accommodate the new tariff proposed by the rate study funded by DOI in fiscal year 2008. However, before the YSPSC could seek the amendments to its enabling legislation, fuel prices rose sharply in the middle of 2011. Consequently, the YSPSC had to formulate a short-term rate to be adopted in the interim while the process of implementing a long-term rate was ongoing. The short-term rate, which was publicized in November 2011 and adopted in February 2012 is a fixed rate, much like the rate adopted in 2009. The long-term rate is envisioned to be one that includes a fuel cost component which would fluctuate with the rise and fall of fuel prices as recommended by the DOI tariff study. It is hoped that the amendments to YSPSC's enabling legislation that are necessary to accommodate the long-term rate would be enacted sometime during fiscal year 2013 in order to avoid the future cash flow problems as is currently being experienced by the YSPSC.

Collection of Accounts Receivable – YSPSC began the process in fiscal year 2012 to revise and standardize its promissory notes with delinquent customers to improve on collections of delinquent accounts. Other options being considered by management is the use of cash power meters for customers who have a history of delinquency and also amendment of the YSPSC enabling legislation to reduce the disconnection policy for delinquent accounts to 60 days from the current 90 days.

DOI Funded Training Programs – The highly successful training programs to equip utility personnel with the basic skills necessary to ensure safety and successful operation and delivery of utility services will continue with the Pacific Linemen Training, Water and Wastewater training and Heavy Equipment Mechanics Training. The Majuro Electric Company, the Marshall Islands utility company joined the rest of the Micronesian utility companies as a participant in the Pacific Linemen Training Program in 2011.

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European Union Energy Facility Grant – \$1,168,832 was received from the European Commission for a budget of EUR2.5 million to fund solar photovoltaic systems for 10 targeted outer islands of Yap State. The grant required a match of 25% or approximately USD\$843,750 which was appropriated by YSL 8-3 and 8-9. Purchase of the solar systems is expected to be tendered in early 2012 with installations to follow soon after the systems are received in Yap. It is estimated that by 2015, with the completion of EFII and similar projects, 100% of the Outer-islands' population of Yap State will be electrified with 100% renewable energy systems (14 islands with an approximate total population of 2,600 islanders.)

ADB Loan for Yap Energy Projects – Efforts are underway to secure the guarantee of the FSM Government for an \$8 million ADB loan package for the purchase of a smaller generator for the Yap Power Plant and the installation of wind turbines and photovoltaic systems on Yap Proper. This is part of the YSPSC's efforts to reduce its dependence on fossil fuel – the small generator is envisioned to effect a 4% reduction in diesel fuel while the renewable energy projects is hoped to result in a 28% reduction in diesel fuel consumption by the Yap Power Plant. The successful attainment of the loan largely depends on the availability of cofinanciers and also on whether the FSM National Government and/or the State of Yap will guarantee the debt as required by ADB loan policies.

The Management Discussion and Analysis for the year ended September 30, 2011 is set forth in the report on the audit of financial statements, which is dated December 2, 2011. That Discussion and Analysis explains the major factors affecting the 2011 financial statements and can be viewed at the FSM Office of the Public Auditor's website.

The management and staff of YSPSC will be pleased to answer any questions that may arise in relation to matters discussed in this report. Kindly refer your comments or questions to YSPSC at telephone no. (691) 350-4427, Colonia, Yap FM 96943.

YAP STATE PUBLIC SERVICE CORPORATION
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Statements of Net Assets
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<u>ASSETS</u>	<u>2012</u>	<u>2011</u> As Restated (Note 10)
Non-current assets:		
Utility plant:		
Depreciable capital assets:		
Plant in service	\$ 20,850,094	\$ 20,087,596
Less accumulated depreciation	(12,954,316)	(12,206,724)
Depreciable utility plant, net	7,895,778	7,880,872
Work in progress	116,519	485,383
Utility plant, net	8,012,297	8,366,255
Current assets:		
Cash and cash equivalents	1,446,558	1,288,666
Accounts receivable and unbilled accrued revenue, net of an allowance for doubtful accounts	1,196,653	949,549
Other receivables	299,321	13,587
Inventory	777,846	871,204
Prepaid expenses	31,562	51,004
Total current assets	3,751,940	3,174,010
	<u>\$ 11,764,237</u>	<u>\$ 11,540,265</u>
<u>NET ASSETS AND LIABILITIES</u>		
Net assets (deficit):		
Invested in capital assets, net of related debt	\$ 5,013,820	\$ 5,638,236
Restricted	1,931,051	1,168,832
Unrestricted	(405,911)	(618,993)
Total net assets	6,538,960	6,188,075
Contingencies		
Current liabilities:		
Current portion of notes payable	320,526	284,421
Refunds payable to customers	181,368	181,368
Accounts payable	414,486	232,757
Employees' annual leave and accrued payroll	83,969	86,335
Accrued taxes and other liabilities	5,260	-
Deferred revenue	55,340	149,500
Other payables and customer deposits	147,152	165,428
Total current liabilities	1,208,101	1,099,809
Notes payable, net of current portion	4,017,176	4,252,381
Total liabilities	5,225,277	5,352,190
	<u>\$ 11,764,237</u>	<u>\$ 11,540,265</u>

See accompanying notes to financial statements.

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Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2012 and 2011

	2012	2011 As Restated (Note 10)
Operating revenues:		
Electricity sales	\$ 5,651,175	\$ 5,123,712
Water sales and wastewater services	496,224	559,252
Total operating revenues	6,147,399	5,682,964
Less provision for uncollectible receivables	(83,733)	-
Net operating revenues	6,063,666	5,682,964
Operating expenses:		
Production fuel	4,639,982	4,267,911
Depreciation	747,591	722,303
Salaries and wages and related expenses	751,418	853,239
Administrative and general	292,709	161,980
Other production costs	357,333	167,064
Total operating expenses	6,789,033	6,172,497
Operating loss	(725,367)	(489,533)
Nonoperating income (loss):		
Interest income	7,037	1,322
Foreign exchange loss	(5,781)	(3,627)
Operating grants and subsidies	725,775	709,686
Interest expense	(17,724)	(16,109)
Training expense	(365,136)	(384,713)
Grant expenses	(165,269)	-
Other income (expense)	14,129	(24,327)
Total nonoperating income (loss), net	193,031	282,232
Net loss before capital contributions	(532,336)	(207,301)
Capital contributions	883,221	1,168,832
Change in net assets	350,885	961,531
Net assets at beginning of year	6,188,075	5,226,544
Net assets at end of year	\$ 6,538,960	\$ 6,188,075

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION
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Statements of Cash Flows
Years Ended September 30, 2012 and 2011

	2012	2011 As Restated (Note 10)
Cash flows from operating activities:		
Cash received from customers	\$ 5,808,838	\$ 5,623,148
Cash refunds paid to customers	(21,741)	(141,932)
Cash paid to suppliers	(4,995,495)	(4,484,825)
Cash paid to employees	(748,524)	(864,807)
Net cash provided by operating activities	43,078	131,584
Cash flows from investing activities:		
Interest and other income	1,256	1,322
Cash flows from noncapital financing activities:		
Proceeds from operating grants and subsidies	357,070	801,657
Other income	14,129	-
Expenses paid from operating grant proceeds	(530,405)	(412,667)
Net cash (used in) provided by noncapital financing activities	(159,206)	388,990
Cash flows from capital and related financing activities:		
Capital contributions	883,221	1,168,832
Acquisition of utility plant	(393,633)	(600,864)
Interest paid	(17,724)	(16,109)
Repayment of notes payable	(199,100)	(169,028)
Net cash provided by capital and related financing activities	272,764	382,831
Net change in cash and cash equivalents	157,892	904,727
Cash and cash equivalents at beginning of year	1,288,666	383,939
Cash and cash equivalents at end of year	\$ 1,446,558	\$ 1,288,666
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	\$ (725,367)	\$ (489,533)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation	747,591	722,303
Provision for uncollectible receivables	83,733	-
Decrease (increase) in assets:		
Receivables	(330,837)	(59,630)
Inventory	93,358	(77,510)
Prepaid expenses	19,442	(13,157)
Other receivables	(11,189)	(186)
Increase (decrease) in liabilities:		
Refunds payable to customers	-	(145,278)
Accounts payable	181,729	202,797
Employees' annual leave and accrued payroll	(2,366)	(418)
Accrued taxes and other withholdings	5,260	(11,150)
Other payables and customer deposits	(18,276)	3,346
Net cash provided by operating activities	\$ 43,078	\$ 131,584

See accompanying notes to financial statements.

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Notes to Financial Statements
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(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.

Net Assets

Net assets represent the residual interest in YSPSC's assets after liabilities are deducted and consist of the following net assets 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
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Notes to Financial Statements
September 30, 2012 and 2011

(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, 2012 and 2011.

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).

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.

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 estimated 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 collectability 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 and are determined using the first in-first out method.

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.

YAP STATE PUBLIC SERVICE CORPORATION
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Notes to Financial Statements
September 30, 2012 and 2011

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

Revenues

Sales of electricity and water are recorded as billed to customers on a monthly billing basis. At September 30, 2012 and 2011, unbilled revenues of \$243,235 and \$224,374, 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 been 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. The most significant estimates are depreciation and allowance for doubtful accounts. Actual results could differ from those estimates.

New Accounting Standards

During the year ended September 30, 2012, YSPSC implemented the following pronouncements:

- GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to the frequency and timing of measurements for actuarial valuations first used to report funded status information in OPEB plan financial statements. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

YAP STATE PUBLIC SERVICE CORPORATION
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Notes to Financial Statements
September 30, 2012 and 2011

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

New Accounting Standards, Continued

- GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions (an amendment of GASB Statement No. 53)*, which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

In December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of YSPSC.

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*, which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of YSPSC.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of YSPSC.

In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management has not yet determined the effect of implementation of this statement on the financial statements of YSPSC.

In April 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of YSPSC.

YAP STATE PUBLIC SERVICE CORPORATION
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Notes to Financial Statements
September 30, 2012 and 2011

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

New Accounting Standards, Continued

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of YSPSC.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements 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. 40 requires disclosures for 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 or held by the pledging financial institution but not in the depositor-government's name. YSPSC does not have a deposit policy for custodial credit risk.

As of September 30, 2012, the carrying amount of the YSPSC's total cash and cash equivalents was \$1,446,558, and the corresponding bank balance was \$1,365,566, which is maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. At September 30, 2012, bank deposits in the amount of \$946,173 were FDIC insured. Collateralization of deposits is not required; therefore \$419,393 is uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

YAP STATE PUBLIC SERVICE CORPORATION
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Notes to Financial Statements
September 30, 2012 and 2011

(3) Accounts Receivable and Accrued Unbilled Revenue

YSPSC's accounts receivable, less allowance for doubtful accounts, and accrued unbilled revenue at September 30, 2012 and 2011 were as follows:

	<u>2012</u>	<u>2011</u>
Gross accounts receivable	\$ 1,180,821	\$ 868,845
Less allowance for doubtful accounts	<u>(227,403)</u>	<u>(143,670)</u>
Net accounts receivable	953,418	725,175
Accrued unbilled revenue	<u>243,235</u>	<u>224,374</u>
Net accounts receivable and accrued unbilled revenue	\$ <u>1,196,653</u>	\$ <u>949,549</u>

(4) Utility Plant

A summary of changes in capital assets for the years ended September 30, 2012 and 2011 is as follows:

	<u>Beginning Balance</u> <u>October 1, 2011</u>	<u>Transfers and</u> <u>Additions</u>	<u>Transfers and</u> <u>Deletions</u>	<u>Ending Balance</u> <u>September 30, 2012</u>
Depreciable plant:				
Production plant	\$ 9,792,283	\$ 694,754	\$ -	\$ 10,487,037
Distribution plant	8,794,455	24,106	-	8,818,561
General plant	<u>1,500,858</u>	<u>43,637</u>	-	<u>1,544,495</u>
	20,087,596	762,497	-	20,850,093
Less accumulated depreciation	<u>(12,206,724)</u>	<u>(747,591)</u>	-	<u>(12,954,315)</u>
Net depreciable plant	7,880,872	14,906	-	7,895,778
Non-depreciable plant:				
Work in progress	<u>485,383</u>	<u>117,735</u>	<u>(486,599)</u>	<u>116,519</u>
	\$ <u>8,366,255</u>	\$ <u>132,641</u>	\$ <u>(486,599)</u>	\$ <u>8,012,297</u>
	<u>Beginning Balance</u> <u>October 1, 2010</u>	<u>Transfers and</u> <u>Additions</u>	<u>Transfers and</u> <u>Deletions</u>	<u>Ending Balance</u> <u>September 30, 2011</u>
Depreciable plant:				
Production plant	\$ 9,709,703	\$ 82,580	\$ -	\$ 9,792,283
Distribution plant	7,871,829	288,765	633,861	8,794,455
General plant	<u>2,134,719</u>	-	<u>(633,861)</u>	<u>1,500,858</u>
	19,716,251	371,345	-	20,087,596
Less accumulated depreciation	<u>(11,484,421)</u>	<u>(722,303)</u>	-	<u>(12,206,724)</u>
Net depreciable plant	8,231,830	(350,958)	-	7,880,872
Non-depreciable plant:				
Work in progress	<u>255,864</u>	<u>229,519</u>	-	<u>485,383</u>
	\$ <u>8,487,694</u>	\$ <u>(121,439)</u>	\$ -	\$ <u>8,366,255</u>

YAP STATE PUBLIC SERVICE CORPORATION
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Notes to Financial Statements
September 30, 2012 and 2011

(5) Notes Payable

Notes payable at September 30, 2012 and 2011 are as follows:

	<u>2012</u>	<u>2011</u>
Uncollateralized 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 semiannually in Special Drawing Rights (SDR) commencing August 2007. An SDR adjustment and additional consulting fees increased the loan balance by \$639,957 in fiscal year 2009.	\$ 2,660,995	\$ 2,706,412
Uncollateralized note of original principal of \$824,420 payable to Yap State in quarterly interest only payments through March 2003; monthly principal and interest payment 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.	332,375	383,006
Uncollateralized note of original principal of \$1,600,000 payable to Yap State in monthly principal and interest payments of \$10,202 starting November 1, 2009; interest at 1 %, maturing in October 2023. The proceeds of the note were used for the repayment to prior non-government utility customers pursuant to YSL Bill # 7-38 & 7-79.	1,339,225	1,429,915
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>5,107</u>	<u>17,469</u>
Total notes payable	4,337,702	4,536,802
Less current portion	<u>320,526</u>	<u>284,421</u>
	\$ <u>4,017,176</u>	\$ <u>4,252,381</u>

YAP STATE PUBLIC SERVICE CORPORATION
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Notes to Financial Statements
September 30, 2012 and 2011

(5) 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>
2013	\$ 320,526	\$ 14,945	\$ 335,471
2014	222,452	13,199	235,651
2015	224,215	11,436	235,651
2016	225,996	9,655	235,651
2017	266,224	7,892	274,116
2018 through 2023	1,449,074	22,176	1,471,250
2024 through 2028	605,632	-	605,632
2029 through 2033	605,632	-	605,632
2034 through 2036	<u>417,951</u>	<u>-</u>	<u>417,951</u>
	<u>\$ 4,337,702</u>	<u>\$ 79,303</u>	<u>\$ 4,417,005</u>

YSPSC has not made payments as scheduled on its two loans with Yap State. YSPSC has not been notified of any condition of default or noncompliance and has not recorded any adjustment as a result of this situation.

Changes in long-term liabilities for the years ended September 30, 2012 and 2011 are as follows:

	<u>Outstanding September 30, 2011</u>	<u>Increases</u>	<u>Decreases</u>	<u>Outstanding September 30, 2012</u>	<u>Current</u>
ADB loan	\$ 2,706,412	\$ -	\$ 45,417	\$ 2,660,995	\$ 45,417
Yap State loan	383,006	-	50,631	332,375	95,887
YSL 7-38 loan	1,429,915	-	90,690	1,339,225	174,115
USA loan	<u>17,469</u>	<u>-</u>	<u>12,362</u>	<u>5,107</u>	<u>5,107</u>
	<u>\$ 4,536,802</u>	<u>\$ -</u>	<u>\$ 199,100</u>	<u>\$ 4,337,702</u>	<u>\$ 320,526</u>
	<u>Outstanding September 30, 2010</u>	<u>Increases</u>	<u>Decreases</u>	<u>Outstanding September 30, 2011</u>	<u>Current</u>
ADB loan	\$ 2,751,829	\$ -	\$ 45,417	\$ 2,706,412	\$ 45,417
Yap State loan	422,877	-	39,871	383,006	81,343
YSL 7-38 loan	1,501,861	-	71,946	1,429,915	145,319
USA loan	<u>29,263</u>	<u>-</u>	<u>11,794</u>	<u>17,469</u>	<u>12,342</u>
	<u>\$ 4,705,830</u>	<u>\$ -</u>	<u>\$ 169,028</u>	<u>\$ 4,536,802</u>	<u>\$ 284,421</u>

(6) 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
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Notes to Financial Statements
September 30, 2012 and 2011

(6) Contingencies, Continued

Payable to Federated States of Micronesia

In February 2008, the Yap State Legislature enacted Law (YSL) No. 7-25 to amend No. 4-4, YSPSC's enabling legislation, mandating that YSPSC credit back certain charges to prior customers. 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, 2011, the total variable fuel charge refund has been repaid to residential and commercial customers. The repayment of those costs over the legislated \$0.035 was facilitated by a loan from the State of Yap for \$1,600,000 authorized by YSL No. 7-38.

YSL No. 39 then authorized the Governor to forgive any refund that may be owed by YSPSC to Yap State Government agencies for these declared excessive surcharges. The refund owed FSM National Government as a prior customer remains outstanding at \$181,368, and is included as a current liability in the Statement of Net Assets. Although FSM National Government has not asserted a claim to this liability, neither has it forgiven this debt.

(7) Grants

YSPSC received the following grants and capital contributions during the years ended September 30, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
U.S. Department of the Interior grants	\$ 415,220	\$ 510,426
Yap State matching and operating grants	883,221	165,697
Japan fuel grant	274,545	-
French Embassy grant	36,010	-
European Union (EU) capital grant	-	1,168,832
Other	<u>-</u>	<u>33,563</u>
	<u>\$ 1,608,996</u>	<u>\$ 1,878,518</u>

(8) Restricted Net Assets

Restricted net assets consist of the following at September 30, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Unexpended portion of EU capital grant	\$ 1,107,684	\$ 1,168,832
Unexpended portion of Yap State matching grant	<u>823,367</u>	<u>-</u>
	<u>\$ 1,931,051</u>	<u>\$ 1,168,832</u>

YAP STATE PUBLIC SERVICE CORPORATION
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Notes to Financial Statements
September 30, 2012 and 2011

(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 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) Restatement

The financial statements as of and for the year ended September 30, 2011 had been restated to reflect adjustments on notes payable to ADB of \$639,951 and to recognize capital contributions from the EU grant of \$1,168,832. The following accounts have been restated as of and for the year ended September 30, 2011:

	<u>As Originally Stated</u>	<u>As Restated</u>
Notes payable, net of current portion	\$ 3,612,430	\$ 4,252,381
Net assets at beginning of year	5,866,495	5,226,544
Deferred revenue	1,318,332	149,500
Capital contributions	-	1,168,832