

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

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

SEPTEMBER 30, 2014 AND 2013



Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA

Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Yap State Public Service Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of the Yap State Public Service Corporation (YSPSC), a component unit of the State of Yap, which comprise the statements of net position as of September 30, 2014 and 2013, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Yap State Public Service Corporation as of September 30, 2014 and 2013, and the changes in its net position and its cash flows, for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 to 8 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 11, 2015 on our consideration of the YSPSC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the YSPSC's internal control over financial reporting and compliance.

Deloitte & Touche LLP

June 11, 2015

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

Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

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, 2014 and 2013. 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, 2014, 2013 and 2012. 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 2014, 2013 and 2012.

	<u>2014</u>	<u>2013</u>	<u>2012</u>
ASSETS			
Plant in Service, net	\$ 7,299,700	\$ 7,830,122	\$ 7,895,778
Work in progress, net of current portion	2,100,431	1,048,391	116,519
Current and other assets	3,346,238	3,456,011	3,751,940
Total assets	<u>\$ 12,746,369</u>	<u>\$ 12,334,524</u>	<u>\$ 11,764,237</u>
NET ASSETS AND LIABILITIES			
Invested in capital assets, net of related debt	\$ 6,644,571	\$ 6,277,955	\$ 5,013,820
Restricted	1,747,297	1,698,928	1,931,051
Unrestricted	556,546	608,062	(405,911)
Total net assets	<u>8,948,414</u>	<u>8,584,945</u>	<u>6,538,960</u>
Notes payable, net of current portion	2,710,143	2,555,141	4,017,176
Current portion of notes payable	45,417	45,417	320,526
Other current liabilities	1,042,395	1,149,021	887,575
Total liabilities	<u>3,797,955</u>	<u>3,749,579</u>	<u>5,225,277</u>
Total net asset and liabilities	<u>\$ 12,746,369</u>	<u>\$ 12,334,524</u>	<u>\$ 11,764,237</u>
REVENUES, EXPENSES, AND NET ASSETS			
Operating revenues	\$ 6,003,204	\$ 6,291,565	\$ 6,063,666
Operating expenses	6,676,568	6,539,253	6,789,033
Income (Loss) from operations	<u>(673,364)</u>	<u>(247,688)</u>	<u>(725,367)</u>

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

Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Grants	446,184	2,113,081	725,775
Interest expense	(5,421)	(1,693)	(17,724)
Interest income	2,096	2,224	7,037
Training expense	(352,157)	(406,216)	(365,136)
Other grant expense	--	--	(165,269)
Gain (loss) on disposal of utility plant	--	(28,014)	--
Foreign exchange loss	307	(14,630)	(5,781)
Other income/(expenses)	6,592	10,490	14,129
Net income (loss)	(575,763)	1,427,554	(532,336)
Capital contributions	939,232	618,431	883,221
Change in net assets	363,469	2,045,985	350,885
Net assets, beginning	8,584,945	6,538,960	6,188,075
Net assets, ending	\$ 8,948,414	\$ 8,584,945	\$ 6,538,960

FINANCIAL OPERATIONS OVERVIEW

The Yap State Public Services Corporation (the Corporation) has ended another year of unprecedented accomplishments and groundbreaking initiatives amidst ongoing financial and economic challenges. Even though the Corporation has experienced a reprieve from fluctuating fuel prices for the past two years, the sluggish local economy has not allowed the Corporation to pass any savings on to its customers.

Rigorous efforts by the Corporation to collect its accounts led to the disconnection of services to delinquent customers during the year. Many of the customers, already financially overburdened, chose not to reapply for utility services after their services were disconnected. Thus, 2014 saw the erosion of the Corporation's customer base to its lowest level in years.

Efforts to contain costs and improve collections and lower fuel prices did not prevent the Corporation from ending the year with an operating loss of \$673,364. It was hoped that the stable fuel prices in 2014 would improve the financial results of the Corporation. But, with the continued shrinkage of its electric customer base and the increased costs of other production supplies, the 2014 deficit was unavoidable.

Results of Operations

Operating Loss: The operating loss for fiscal year 2014 of \$673,364 was not as high as the loss in 2012 of \$725,367 but it was 172% more than the loss in 2013 of \$247,688. Operating revenues fell by 5% in 2014 while operating expenses grew 2% over 2013.

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

Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

Electric Revenue: The fiscal year 2014 revenue of \$5,549,838 represents a decline of 4% over fiscal year 2013. The decrease is in line with the 6% drop in kilowatt hours billed to customers in 2014 as compared to 2013. 2013 saw a modest increase in electric revenue, however, that increase was attributable to efforts to collect on past due accounts. However, much like 2012, actual electric revenue earned is approximately \$421,000 less than tariff projections due to lower consumption by customers.

Kilowatt Hours Billed: Electricity consumption fell 6% in 2014. The previous two years, consumption had remained flat - the 9.8 million kilowatt hours billed in 2013 was only slightly higher than the 9.7 million kilowatt hours billed for 2012. But in 2014, total kilowatt hours billed dropped to 9.194 million. Consumption for residences showed the largest decline of 11%, followed by a 4% decline for the Commercial class and a 2% decrease for the Government.

Water Revenue: Water revenue of \$453,366 for the year ended September 30, 2014 showed a decline of 9% over revenue collected in 2013 of \$495,555. Gallons billed declined 6% to 80.7 million in 2014. The commercial and residential classes showed declines of 11% and 5% respectively, while the government class showed a modest increase of 3%. In 2013, water consumption had dropped to 86.1 million down from 90.5 million gallons in 2012. The decline in consumption for water appears directly connected to the decline in electricity consumption because of the current policy to disconnect all utility services to customers when their accounts become delinquent.

Production Fuel: The YSPSC expended \$353,435 or 8% less for fuel in 2014 as compared to 2013 and \$122,385 more in 2013 than in 2012. The price per gallon of fuel reached \$5.036 in April 2012 but began to subside in the subsequent months. The average monthly fuel price paid by the YSPSC in 2014 was \$4.58 compared to \$4.73 in 2013, and \$4.77 in 2012. Production fuel expense of \$4,188,644 and \$4,517,597 comprised roughly 70% of total operating expenses of \$6,676,568 and \$6,539,253 for 2014 and 2013, respectively.

Other Operating Expenses – Other operating expenses increased 25% in 2014 over 2013. The major part of the 2014 increase is attributable to “Other Production Costs” which showed a 1050% increase (\$310,012) over 2013 mainly because unlike 2013, other production costs incurred during FY14 did not qualify for capitalization. Depreciation and administrative and general expenses also showed increases of 18% and 31% respectively as compared to 2013. The change in other operating expenses in 2013 over 2012 was a decrease of 12%.

Significant Changes to Net Assets

Cash – Ending cash at September 30, 2014 of \$1.023 million was 17% less than at fiscal year 2013 of \$1.2 million. \$1.3 million of 2014 income was still tied up in accounts receivable at the end of the fiscal year. Therefore, cash available at year-end consisted primarily of restricted grant proceeds, primarily the EFII grant and Pre-Payment Meter grant.

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

Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

Receivables – Twenty percent of electric customers and thirty-two percent of water customers who were disconnected for delinquency during 2014 did not reapply for utility services. Consequently, 2014 saw a 16% increase in customer receivables. In 2013, efforts to step up collection of past due accounts resulted in a 6% decrease in customer receivables as compared to 2012. In fiscal year 2012, customer receivables had increased 35% to \$1,280,386 as compared to fiscal year 2011. The increase was the result of revisions to YSPSC's disconnection policy after it was brought to management's attention that customers should be disconnected only after 90 days of delinquency, instead of the 60 days that had been the practice.

Long-term Debt – At September 30, 2012, YSPSC owed a combined total of \$4,337,702 for four loans of which \$320,526 was current. During 2013, the Yap State Legislature passed Bill No. 8-126 which became Law No. 8-47 on August 20, 2013 to forgive the two loans YSPSC owed to the Yap State Government with combined outstanding principals of \$1,672,192. The amount forgiven was recorded as a grant from the Yap State Government in 2012. The loan from the U.S. Rural Housing Authority matured in September 30, 2013. Consequently, at September 30, 2013, YSPSC had only one loan outstanding – the ADB Loan for water projects with outstanding principal of \$2,555,141. Another ADB loan for the Yap Renewable Energy Development Project was executed during 2014, increasing principal outstanding on long-term debts to \$2,710,143 at September 30, 2014. Current portion of long-term debt at September 30, 2014 and 2013 was \$45,417. Please refer to Note 5 to the financial statements for additional information related to long-term debt.

Current Liabilities – Total current liabilities decreased 9% from 2013 to 2014. The previous year, it had decreased 1% in 2013 as compared to 2012. In particular, accounts payable declined 17% in 2014 and deferred revenue also decreased 18% over 2013. In contrast, accounts payable had increased 28% in 2013 as compared to 2012. The increase from 2011 to 2012 was 34%. The lower fuel prices helped alleviate the strain on working capital in 2014 and 2013.

Capital Projects – Ongoing capital projects in 2014 and 2013 were the ongoing renewable energy projects for the neighboring islands funded by the European Union and South Pacific Commission North Rep. \$939,232 and \$618,431 was recorded in 2014 and 2013, respectively, as capital contributions from the European Union Energy Facility Grant for solar projects in the neighboring islands.

U.S. Federal, Local and Other Grants

Pacific Linemen Training Program – 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. YSPSC received \$150,403 and \$203,134, respectively, in fiscal years 2014 and 2013 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 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 \$108,119 and \$28,426 in 2014 and 2013, respectively, infor cost reimbursements for this program.

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

Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

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 and 2014. Expenditures for the EFII project of \$978,212 and \$618,431 was recorded as capital contributions for the years ended September 30, 2014 and 2013, respectively.

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). on five outer islands; namely, Falalop and Mogmog in Ulithi, Fais, Falalop, Woleai and Satawal. The European Union is funding this program through the SPC North-Rep. Procurement and installation of the solar 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. A major portion of the installation work for the systems were completed in 2014, however customer hookups were still pending. Project funds of \$12,000 were received in 2014.

ADB Loan for Small Generator and Yap Proper Renewable Energy Projects – ADB has approved \$9 million in funding for Yap Proper Renewable Energy Development Projects consisting of a wind farm which is expected to generate power equivalent to about 18% of the current delivered energy supply, grid-connected solar panels which will be installed on about 21 government buildings will produce energy equivalent to 4% and a new fuel-efficient diesel generator that will replace the existing equipment and is expected to reduce fuel consumption by 25%. A road to the wind mast site is in place and the wind mast has been installed. In 2014, the project was in the tendering phase; the contract for the purchase of the solar components was awarded, but the suppliers for the generator and the wind components of the project have yet to be selected.

PEC Fund – PEC is a Japanese Grant to the FSM for solar systems. This grant is for 5 entities (the four states and the national government). Yap's share of the grant is approximately 200KWP capacities of solar PVs. The 200KWP panels were received and installed on YSPSC buildings in 2014.

HIGHLIGHTS FOR FISCAL YEAR 2015

In addition to the ongoing projects discussed above, in the short-term the following projects will also be the primary focus of activities for the Yap State Public Services Corporation:

French Embassy Grants: A total of \$93,191.24 was received in 2014 through the French Embassy for water improvement and optimization (\$76,121.24) and wind monitoring (\$17,070) projects. The water project funds the cost of travel for two missions of experts to evaluate the three existing water systems on Yap Proper with the goal of improving and optimizing their management. The wind project aims to fund the cost of one expert mission to assess the development of wind energy in Yap State.

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

Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

World Bank – World Bank has made available to the FSM a grant of U.S. \$12 million to support the development of the energy sector in the FSM. The FSM national government is still in the discussion stages with the FSM states regarding priorities of their state energy plans. YSPSC at this time is in communication with the FSM national government on what projects are to be funded under the grant and is also discussing the technical issues with its consultants.

Prepayment Meters – In June 2014, Yap State Legislature appropriated under YSL 8-69, \$586,839 from Special Revenue Funds for the purchase and installation of prepayment meters for residential customers on Yap Proper. The purchase and installation of prepaid meters are expected to be completed in 2015.

Sewer and Water Tank and Treatment Facility Assessment and Repair – In December 2013, YSPSC entered into a contract with an Alaskan firm for the evaluation of YSPSC's water tank and sewer treatment facility. The contract calls for the production of a master plan for the sewer and water operations as well as the bidding and selection of contractors for the repair of the water plant and the sewer plant and lift stations. The project budget is \$397,495.65 and is derived from the Yap State Compact Infrastructure Maintenance Fund.

SPC Fais Sahagow Well Project – In January 2015, The Secretariat of the Pacific Community (SPC) awarded \$30,143.28 from the European Union Funds for Global Climate Change Alliance to YSPSC through Yap State to promote the Fais Community's ability to mitigate the effects of climate change by improving their rainwater harvesting infrastructure and retrofitting the Sahagow Well with a solar pumping system.

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.

The Management Discussion and Analysis for the years ended September 30, 2013 and 2012 is set forth in the report on the audit of YSPSC's financial statements which is dated June 18, 2014. That Discussion and Analysis explains in more detail major factors affecting the 2013 and 2012 financial statements.

YAP STATE PUBLIC SERVICE CORPORATION
(A Component Unit of the State of Yap)

Statements of Net Position
September 30, 2014 and 2013

<u>ASSETS</u>	<u>2014</u>	<u>2013</u>
Non-current assets:		
Utility plant:		
Depreciable capital assets:		
Plant in service	\$ 21,752,898	\$ 21,420,636
Less accumulated depreciation	(14,453,198)	(13,590,514)
Depreciable utility plant, net	7,299,700	7,830,122
Non-depreciable capital assets:		
Work in progress	2,100,431	1,048,391
Utility plant, net	9,400,131	8,878,513
Current assets:		
Cash and cash equivalents	1,023,778	1,228,876
Accounts receivable and unbilled accrued revenue, net of allowance for doubtful accounts	1,320,903	1,130,131
Other receivables	293,638	284,144
Inventory	694,139	791,085
Prepaid expenses	13,780	21,775
Total current assets	3,346,238	3,456,011
	<u>\$ 12,746,369</u>	<u>\$ 12,334,524</u>
 <u>NET POSITION AND LIABILITIES</u> 		
Net position:		
Net investment in capital assets	\$ 6,644,571	\$ 6,277,955
Restricted	1,747,297	1,698,928
Unrestricted	556,546	608,062
Total net position	8,948,414	8,584,945
Commitments and contingencies		
Current liabilities:		
Current portion of notes payable	45,417	45,417
Accounts payable	440,557	530,029
Employees' annual leave and accrued payroll	73,818	82,864
Accrued taxes and other liabilities	1,260	1,260
Refunds payable to customers	181,318	181,368
Deferred revenue	148,578	180,431
Other payables and customer deposits	196,864	173,069
Total current liabilities	1,087,812	1,194,438
Notes payable, net of current portion	2,710,143	2,555,141
Total liabilities	3,797,955	3,749,579
	<u>\$ 12,746,369</u>	<u>\$ 12,334,524</u>

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION
(A Component Unit of the State of Yap)

Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2014 and 2013

	2014	2013
Operating revenues:		
Electricity sales	\$ 5,549,838	\$ 5,796,010
Water sales and wastewater services	453,366	495,555
Total operating revenues	6,003,204	6,291,565
Operating expenses:		
Production fuel	4,188,644	4,542,079
Depreciation	1,000,834	851,561
Salaries and wages and related expenses	831,423	875,331
Other production costs	339,550	29,538
Administrative and general	316,117	240,744
Total operating expenses	6,676,568	6,539,253
Operating loss	(673,364)	(247,688)
Nonoperating income (loss):		
Interest income	2,096	2,224
Foreign exchange gain (loss)	307	(14,630)
Operating grants and subsidies	446,184	2,113,081
Interest expense	(5,421)	(1,693)
Grant expenses	(352,157)	(406,216)
Other income, net	6,592	10,490
Loss on disposal of utility plant	-	(28,014)
Total nonoperating income, net	97,601	1,675,242
Net (loss) income before capital contributions	(575,763)	1,427,554
Capital contributions	939,232	618,431
Change in net position	363,469	2,045,985
Net position at beginning of year	8,584,945	6,538,960
Net position at end of year	\$ 8,948,414	\$ 8,584,945

See accompanying notes to financial statements.

YAP STATE PUBLIC SERVICE CORPORATION
(A Component Unit of the State of Yap)

Statements of Cash Flows
Years Ended September 30, 2014 and 2013

	2014	2013
Cash flows from operating activities:		
Cash received from customers	\$ 5,826,733	\$ 6,399,181
Cash refunds paid to customers	(50)	-
Cash paid to suppliers	(4,828,842)	(4,704,270)
Cash paid to employees	(840,469)	(876,436)
Net cash provided by operating activities	157,372	818,475
Cash flows from investing activities:		
Interest and other income (loss)	2,403	(12,406)
Cash flows from noncapital financing activities:		
Proceeds from operating grants and subsidies	414,331	565,980
Other income	6,592	10,490
Expenses paid from operating grant proceeds	(352,157)	(406,216)
Net cash provided by noncapital financing activities	68,766	170,254
Cash flows from capital and related financing activities:		
Capital contributions	939,232	618,431
Acquisition of utility plant	(1,522,452)	(1,745,791)
Interest paid	(5,421)	(1,693)
Proceeds from loans	200,488	-
Repayment of loans payable	(45,486)	(64,952)
Net cash used in capital and related financing activities	(433,639)	(1,194,005)
Net change in cash and cash equivalents	(205,098)	(217,682)
Cash and cash equivalents at beginning of year	1,228,876	1,446,558
Cash and cash equivalents at end of year	\$ 1,023,778	\$ 1,228,876
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	\$ (673,364)	\$ (247,688)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation	1,000,834	851,561
Decrease (increase) in assets:		
Receivables	(190,772)	66,522
Inventory	96,946	(13,239)
Prepaid expenses	7,995	9,787
Other receivables	(9,494)	15,177
Increase (decrease) in liabilities:		
Accounts payable	(89,472)	115,543
Employees' annual leave and accrued payroll	(9,046)	(1,105)
Accrued taxes and other withholdings	-	(4,000)
Refunds payable to customers	(50)	-
Other payables and customer deposits	23,795	25,917
Net cash provided by operating activities	\$ 157,372	\$ 818,475

Non-cash financing activity:

In 2013, notes payable to Yap State of \$332,375 and \$1,339,225 were forgiven and recorded as operating grants and subsidies.

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, 2014 and 2013

(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 of Yap with the advice and consent of the Yap State Legislature.

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. 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. The Government Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Net Position

Net position represents the residual interest in YSPSC's assets and deferred outflows of resources after liabilities and deferred inflows of resources are deducted and consist of the following net position categories:

- Net investment in capital assets:
 - Net investment in capital assets includes restricted and unrestricted capital 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 position subject to externally imposed stipulations that require YSPSC to maintain them permanently.
 - Expendable – Net position 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 with the passage of time.
- Unrestricted:
 - Net position that is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

YSPSC has no nonexpendable restricted net position at September 30, 2014 and 2013.

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

Notes to Financial Statements
September 30, 2014 and 2013

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

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. Plant assets acquired after April 1, 1996 are carried at cost. YSPSC generally capitalizes utility plant with a cost of \$500 or more. 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 position 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. Bad debts are written off against the allowance using the specific identification method.

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.

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 basis. At September 30, 2014 and 2013, unbilled revenues of \$227,828 and \$227,018, 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.

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

Notes to Financial Statements
September 30, 2014 and 2013

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

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. Actual results could differ from those estimates.

New Accounting Standards

During the year ended September 30, 2014, YSPSC implemented the following pronouncements:

- GASB 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.
- GASB Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans.
- GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement.

The implementation of these statements did not have a material effect on the accompanying financial statements.

In June 2012, GASB issued 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 68 are effective for fiscal years beginning after June 15, 2014. 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, 2014 and 2013

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

New Accounting Standards

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*, which improves accounting and financial reporting for state and local governments' combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. A disposal of government operations can occur through a transfer to another government or a sale. The provisions in Statement 69 are effective for fiscal years beginning after December 15, 2013. Management does not believe the implementation of this statement will have a material effect on the financial statements of YSPSC.

In November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68, Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. The provisions in Statement 71 are effective for fiscal years beginning after June 15, 2014. Management does not believe the implementation of this statement will have a material effect on the financial statements of YSPSC.

Reclassifications

Certain 2013 balances in the accompanying financial statements have been reclassified to conform to the 2014 presentation.

(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, 2014 and 2013, the carrying amount of the YSPSC's total cash and cash equivalents was \$1,023,778 and \$1,228,876, respectively, and the corresponding bank balances were \$1,006,116 and \$1,248,030, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. At September 30, 2014 and 2013, bank deposits in the amount of \$468,302 and \$307,889, respectively, were FDIC insured. Collateralization of deposits is not required; therefore deposits in excess of the FDIC insured amounts are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

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

Notes to Financial Statements
September 30, 2014 and 2013

(3) Accounts Receivable and Accrued Unbilled Revenue

YSPSC's accounts receivable, less allowance for doubtful accounts, and accrued unbilled revenue at September 30, 2014 and 2013 were as follows:

	<u>2014</u>	<u>2013</u>
Gross accounts receivable	\$ 1,169,428	\$ 1,130,516
Less allowance for doubtful accounts	<u>(76,353)</u>	<u>(227,403)</u>
Net accounts receivable	1,093,075	903,113
Accrued unbilled revenue	<u>227,828</u>	<u>227,018</u>
Net accounts receivable and accrued unbilled revenue	\$ <u>1,320,903</u>	\$ <u>1,130,131</u>

(4) Utility Plant

A summary of changes in capital assets for the years ended September 30, 2014 and 2013 is as follows:

	<u>Beginning Balance October 1, 2013</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Ending Balance September 30, 2014</u>
Depreciable plant:				
Production plant	\$ 11,050,693	\$ 119,338	\$ (1,525)	\$ 11,168,506
Distribution plant	8,685,594	175,331	(107,347)	8,753,578
General plant	<u>1,684,349</u>	<u>175,743</u>	<u>(29,278)</u>	<u>1,830,814</u>
	21,420,636	470,412	(138,150)	21,752,898
Less accumulated depreciation	<u>(13,590,514)</u>	<u>(1,000,834)</u>	<u>138,150</u>	<u>(14,453,198)</u>
Net depreciable plant	7,830,122	(530,422)	-	7,299,700
Non-depreciable plant:				
Work in progress	<u>1,048,391</u>	<u>1,068,677</u>	<u>(16,637)</u>	<u>2,100,431</u>
	\$ <u>8,878,513</u>	\$ <u>538,255</u>	\$ <u>(16,637)</u>	\$ <u>9,400,131</u>
	<u>Beginning Balance October 1, 2012</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Ending Balance September 30, 2013</u>
Depreciable plant:				
Production plant	\$ 10,487,037	\$ 649,545	\$ (85,889)	\$ 11,050,693
Distribution plant	8,818,561	24,520	(157,487)	8,685,594
General plant	<u>1,544,495</u>	<u>151,508</u>	<u>(11,654)</u>	<u>1,684,349</u>
	20,850,093	825,573	(255,030)	21,420,636
Less accumulated depreciation	<u>(12,954,315)</u>	<u>(851,561)</u>	<u>215,362</u>	<u>(13,590,514)</u>
Net depreciable plant	7,895,778	(25,988)	(39,668)	7,830,122
Non-depreciable plant:				
Work in progress	<u>116,519</u>	<u>1,048,057</u>	<u>(116,185)</u>	<u>1,048,391</u>
	\$ <u>8,012,297</u>	\$ <u>1,022,069</u>	\$ <u>(155,853)</u>	\$ <u>8,878,513</u>

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

Notes to Financial Statements
September 30, 2014 and 2013

(5) Notes Payable

Notes payable at September 30, 2014 and 2013 are as follows:

	<u>2014</u>	<u>2013</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.	\$ 2,555,072	\$ 2,600,558
Guaranteed loan with a maximum amount in various currencies equivalent to 2,896,000 SDR payable to ADB borrowed through FSM and Yap State for the Yap Renewable Energy Development Project. YSPSC is liable to Yap State for interest at 0.76% which includes a 0.20% maturity premium, net of a 0.16% rebate.	<u>200,488</u>	<u>-</u>
Total notes payable	2,755,560	2,600,558
Less current portion	<u>45,417</u>	<u>45,417</u>
	<u>\$ 2,710,143</u>	<u>\$ 2,555,141</u>

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2015	\$ 45,417	\$ -	\$ 45,417
2016	45,417	-	45,417
2017	83,272	-	83,272
2018	121,126	-	121,126
2019	125,136	1,505	126,641
2020 through 2024	637,710	6,904	644,614
2025 through 2029	661,769	5,148	666,917
2030 through 2034	665,552	2,864	668,416
2035 through 2039	<u>370,161</u>	<u>642</u>	<u>370,803</u>
	<u>\$ 2,755,560</u>	<u>\$ 17,063</u>	<u>\$ 2,772,623</u>

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

Notes to Financial Statements
September 30, 2014 and 2013

(5) Notes Payable, Continued

Changes in long-term liabilities for the years ended September 30, 2014 and 2013 are as follows:

	Outstanding September 30, 2013	<u>Increases</u>	<u>Decreases</u>	Outstanding September 30, 2014	<u>Current</u>
ADB loan (1459)	\$ 2,600,558	\$ -	\$ 45,486	\$ 2,555,072	\$ 45,417
ADB loan (3004)	-	<u>200,488</u>	-	<u>200,488</u>	-
	<u>\$ 2,600,558</u>	<u>\$ 200,488</u>	<u>\$ 45,486</u>	<u>\$ 2,755,560</u>	<u>\$ 45,417</u>
	Outstanding September 30, 2012	<u>Increases</u>	<u>Decreases</u>	Outstanding September 30, 2013	<u>Current</u>
ADB loan	\$ 2,660,995	\$ -	\$ 60,437	\$ 2,600,558	\$ 45,417
Yap State loan	332,375	-	332,375	-	-
YSL 7-38 loan	1,339,225	-	1,339,225	-	-
USA loan	<u>5,107</u>	-	<u>5,107</u>	-	-
	<u>\$ 4,337,702</u>	<u>\$ -</u>	<u>\$ 1,737,144</u>	<u>\$ 2,600,558</u>	<u>\$ 45,417</u>

(6) Commitments and 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.

Payable to Federated States of Micronesia

In February 2008, the Yap State Legislature enacted YSL No. 7-25 to amend No. 4-4, YSPSC's enabling legislation, mandating that YSPSC credit back certain charges to prior customers. YSL 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 \$181,318 at September 30, 2014, and is included as a current liability in the Statement of Net Position. Although FSM National Government has not asserted a claim to this liability, it has not forgiven this debt.

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

Notes to Financial Statements
September 30, 2014 and 2013

(6) Commitments and Contingencies, Continued

Lease Commitments

YSPSC's future annual rental commitments under a long-term operating lease for the Yap Renewable Energy Development Project site assuming YSPSC exercises its option to extend the terms are as follows:

<u>Year ending September 30.</u>	
2015	\$ 25,000
2016	25,000
2017	25,000
2018	25,000
2019	25,000
2020 through 2024	125,000
2025 through 2029	125,000
2030 through 2034	125,000
2035 and over	<u>468,750</u>
Total	\$ <u>968,750</u>

(7) Grants

YSPSC received the following grants and capital contributions during the years ended September 30, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
U.S. Department of the Interior grants	\$ 258,522	\$ 231,610
Yap State matching and operating grants	586,839	1,672,192
French Embassy operating grant	57,183	-
European Union (EU) capital grant	391,373	732,297
SPC-North REP	12,000	82,239
ADB	79,499	-
Other	<u>-</u>	<u>13,174</u>
	\$ <u>1,385,416</u>	\$ <u>2,731,512</u>

(8) Restricted Net Position

Restricted net position consists of the following at September 30, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Unexpended portion of EU capital grant	\$ 724,013	\$ 1,059,037
Unexpended portion of Yap State matching grant	320,920	563,052
Unexpended portion of Yap State grant	586,839	-
Unexpended portion of French Embassy operating grant	57,183	-
Unexpended portion of SPC-North REP	<u>58,342</u>	<u>76,839</u>
	\$ <u>1,747,297</u>	\$ <u>1,698,928</u>

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

Notes to Financial Statements
September 30, 2014 and 2013

(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.