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June 11, 2015

Mr. Faustino Yangmog
General Manager
Yap State Public Service Corporation
P.O. Box 667
Colonia, Yap 96943

Dear Mr. Yangmog:

In planning and performing our audit of the financial statements of the Yap State Public Service Corporation (the Corporation), a component unit of the State of Yap, as September 30, 2014, (on which we have issued our report dated June 11, 2015), 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, we considered the Corporation's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, in connection with our audit, we identified, and included in the attached Appendix I, deficiencies related to the Corporation's internal control over financial reporting and other matters as of September 30, 2014 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated June 11, 2015, on our consideration of the Corporation'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 definition of a deficiency is also set forth in the attached Appendix I.

A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with this report.

This report is intended solely for the information and use of the Board of Directors, management, others within the organization, and the Office of the FSM National Public Auditor and is not intended to be and should not be used by anyone other than these specified parties.

We will be pleased to discuss the attached comments with you and, if desired, to assist you in implementing any of the suggestions.

We wish to thank the staff and management of the Corporation for their cooperation and assistance during the course of this engagement.

Very truly yours,

Deloitte & Touche LLP

SECTION I - DEFICIENCIES

We identified the following deficiencies involving the Company's internal control over financial reporting as of September 30, 2014 that we wish to bring to your attention:

Grant Expense

Comments:

1. Grant reimbursable payroll costs are allocated based on program budgets or an allocation percentage instead of actual time spent per program.

2. Grant agreements and related grant terms and conditions for grant #'s MAP-YSPSC-2013-1 and 2013-2 were not available.

3. Expenditures for grant MA-YSPSC 2013-2 were recorded in grant OMIP-YSPSC 2011-1 in the Corporation's Schedule of Expenditures of Federal Awards (SEFA).

Recommendations: Payroll charges should be based on actual time spent per program. Grant documents should be maintained on file. The SEFA should be reconciled and agreed with the general ledger.

Utility Plant

Comments: Test of utility plant disclosed the following:

1. No physical inventory of utility plant occurred during fiscal year 2014. Also, there is no unique identification number for each asset.

2. Accumulated depreciation per the plant register was less than the general ledger balance by $36,782.

3. A prior year overhaul of rotors was included as a current year addition in the plant register for check #34965 ($5,943), #35106 ($13,262) and #35770 ($38,012).

4. Labor costs of $30,943 related to site preparation, battery charging and assembling of plant assets were not capitalized. In addition, a capitalizable item of $30,047 was expensed.

5. One project (19100) of $38,087 completed at September 30, 2014, was not transferred from construction in progress to plant.

6. Physical existence testing of fixed assets disclosed the following:

   a. Four assets were unserviceable and three assets cannot be located aggregating $138,150. The assets are fully depreciated. This matter was corrected through a proposed audit adjustment.

Account	Asset	Acquisition Date	Cost
12012	Cabinet, W/dust Collector	10/7/1986	$ 1,525
12025	Reconditioned Line Truck	10/13/2003	64,915
12034	Drill Rig compressor	10/15/1998	34,427
12034	Fiberglass pick-up body	2/1/1999	8,005
12053	1 lot Elect Petro computers - inv1334	3/21/2001	17,261
12053	Dell Optiplex Workstations [4]	6/1/2005	7,664
12055	1 lot furniture YCA inv 93487	3/15/2001	4,353
			$ 138,150

SECTION I –DEFICIENCIES, CONTINUED

Utility Plant, Continued

b. Two vehicles sighted (YP-0324 & YP-0637) have the same plate number but different vehicle identification number (VIN) per vehicle registration.

Items 2-6a were corrected through proposed audit adjustments.

Recommendation: We recommend that management adopt fixed asset policies and procedures to govern property acquisition, capitalization, disposal, reconciliation, physical inventory and depreciation.

Construction in Progress (CIP)

Comments:

1. Test of CIP related to the Yap Renewable Energy Development Project, disclosed the following:

   a. A capital asset contribution of $79,499 received on November 29, 2013 was not recorded. Further, the capital asset technical assistance agreement was not provided.

   b. The access road to the project site completed in November 2013 for $66,553, was recorded as CIP at September 30, 2014.

   c. Operating lease expense of $18,750 was recorded as CIP.

   The above were corrected through a proposed audit adjustment.

2. Test of CIP related to solar panels from the EU noted the following:

   a. Bills of lading or receiving reports related to ck#36369 and ck#36648 totaling $11,257 were not provided.

   b. Construction materials and shipping costs were initially expensed. Receiving report/items receipt were not provided for the following:

Check No.	Check Date	Amount
36619	9/24/2014	$ 53,233
36338	9/16/14	39,910
36362	9/16/14	31,041
Total		$ 124,184

   Recording was corrected through a proposed audit adjustment.

   c. Batteries are stored in unsecured open space.

   d. Spare parts including 2 units of 12V solar panels, 16 aluminum mounting rails (set), 28 units of 200 Ah batteries, 1 marine grade steel storage box for SHS, and 12 units of 420 Ah batteries were not separately recorded.

Recommendation: We recommend that management adopt policies and procedures to properly document receipt of items. Assets should be stored in a secure location. Review and monitoring of CIP projects should be performed.

SECTION I –DEFICIENCIES, CONTINUED

Cash

Comment: Bank reconciliations include long-outstanding reconciling items aggregating $2,025.

Years Outstanding:	
1 to 2 years	$ 1,542
Over 2 years	483
Total	$ 2,025

Recommendation: The Corporation should research long outstanding reconciling items and adjust as necessary.

Inventory

Comments:

1. YSPSC does not maintain perpetual inventory records.

2. No assessment of inventory obsolescence was performed. Further, 57% of items in the inventory subsidiary ledger have no aging information.

3. At September 30, 2014, general ledger inventory accounts were not reconciled to the inventory valuation reports:

Acct. No.	Account	Per General Ledger	Per Subsidiary Ledger	Variance
11073	Inventory - Water & Sewer	$ 94,762	$ 102,677	$ (7,915)
11075	Inventory - Power Distribution	277,823	203,884	73,939
				$ 66,024

   The above condition was corrected through a proposed audit adjustment.

Recommendation: We recommend that management adopt inventory policies and procedures to specifically identify obsolete inventories and review inventory schedules for accuracy. Further, we recommend that YSPSC consider implementing a perpetual inventory system.

Receivable Credit Balances

Comment: The accounts receivable subsidiary ledger includes a credit balance of $13,199 representing unclaimed customer refunds mandated by Yap State Public Law # 7-25. YSPSC was unable to provide listing of customers owed refunds.

Recommendation: YSPSC should research and compile a listing of customer refunds payable under YSL #7-25.

Allowance for Doubtful Accounts

Comment: YSPSC does not have procedures to assess collectability of its receivables. The Corporation wrote off $151,050 of fully allowed for accounts without Board of Director approval.

Recommendation: We recommend that management establish written policies and procedures to evaluate the collectability of receivables. The Corporation should comply with its policy to obtain Board approval before writing off accounts receivable

SECTION I –DEFICIENCIES, CONTINUED

Retained Earnings

Comment: Beginning retained earnings differed by $1,279 from the FY2013 ending audited retained earnings. This was corrected through a proposed audit adjustment.

Recommendation: Beginning retained earnings should reconcile with the prior year ending retained earnings.

Accounts Payable - Vendor

Comment: $5,058 of $298,119 payables tested have been outstanding for more than one year.

Recommendation: Management should investigate long outstanding payables.

Customer Deposits

Comments: Tests of customer's deposits disclosed the following:

1. YSPSC has unidentified customers' deposits or payments aggregating $34,751.

2. YSPSC was unable to provide a listing of deposits received or paid out/credited during the year.

3. Deposits of $3,960 are for closed customer accounts. No assessment of the validity of these deposits has been performed.

4. A customer credit balance of $2,945 resulted because YSPSC failed to bill for the installation of meters.

Recommendation: Unidentified customer payments should be researched and applied to the appropriate customer accounts. Customer credit balances should be researched to determine why customers paid in advance of receiving services.

Journal Entries

Comment: The following journal entries were not timely reviewed:

Journal Entry No.	Date	Journal Entry No.	Date
GJ 14' 10-01	10/31/2013	GJ 14' 05-10	5/31/2014
GJ 14' 11-01	11/30/2013	35824	6/20/2014
CR06640	12/31/2013	GJ 14' 06-10	6/30/2014
GJ 14' 01-01	1/31/2014	GJ 14' 07-12	7/31/2014
35539	4/14/2014	35991	8/6/2014
GJ 14' 04-07	4/30/2014	12239	9/30/2014
CR06722	5/22/2014	GJ 14' 09-05	9/30/2014
GJ 14' 07-07	7/31/14	GJ 14' 09-13	9/30/14
GJ 14' 12-04	12/31/13		

Several late adjustments were provided after the trial balance was provided.

Recommendation: We recommend that journal entries be reviewed and be timely recorded.

SECTION I –DEFICIENCIES, CONTINUED

Daily Collection/Deposit Report

Comment: Daily collection/deposit reports for 7/08/14 and 9/12/2014 are not signed by the reviewer and approver.

Recommendation: Collection/deposit reports should be reviewed daily.

Salaries and Wages

Comments:

1. The personnel action form for employee number 700879, was not signed by a supervisor and was not approved by management.

2. The payroll register and journal for PPE 7/31/14 are not signed by the reviewer and approver.

3. The personnel action form for one employee (057248) was not provided.

4. Overtime was charged to a grant for an employee who was not so entitled.

5. The employer's share of social security charged to grants is understated by 0.05%.

Recommendation: YSPSC should maintain approved personnel action forms. Payroll registers and journals should be reviewed by management before recording.

Subsidiary Ledgers

Comment: At September 30, 2014, general ledger balances for the following accounts were not reconciled to the subsidiary ledger:

Acct. No.	Account	Per General Ledger	Per Subsidiary Ledger	Variance
11050	Accounts Receivable - Customer	$1,359,163	$1,156,229	$202,934
21021	Customer Deposits	201,699	183,665	18,034

The above condition was corrected during the audit process.

Recommendation: Monthly reconciliations of subsidiary ledgers and the general ledger should be performed.

Expenses

Comments: Tests of expenses noted the following:

1. Supporting receipts and invoices for TA-14-11 and TA-14-12 relating to a conference and hotel accommodation were not provided.

2. Training expenses of $11,243 were recorded as office supplies expense. This matter was corrected through a proposed reclassification.

SECTION I –DEFICIENCIES, CONTINUED

Expenses, Continued

Recommendation: All expenses should be supported by invoices or other documents and should be classified appropriately.

Electric Revenue

Comments: Test of electricity revenues noted the following:

1. Meter reading reports for customer #396600 for September 2014 were not reviewed for unusually high or low usage and were not compared to previous and average consumption, resulting in an overbilling of $48,949. This matter was corrected through a proposed audit adjustment.

2. Supervisory review of customers billing classification (government, commercial or residential) for new hook ups or meter installations is not performed. Changes to customer classification are not monitored. Customer classification procedures are manually performed, and are prone to errors.

3. Official receipts for the following collections were not provided.

Account	Date	Amount
403000	6/30/14	$ 129
100900	11/29/13	146
216105	5/02/14	65
319500	11/15/13	21
67601	2/03/14	62
9102	10/17/14	715
397700	10/01/14	567
85500	10/31/14	3,645
407200	3/4/2014	24
408500	3/19/2014	150
409400	4/2/2014	3
409600	4/21/2014	6
410400	5/30/2014	2
410600	6/27/2014	20
415000	9/1/2014	102
307100	9/30/2014	60
350803	1/5/2015	153
409300	4/2/2014	9
		$ 5,879

4. Power consumption for two customers (215300 & 115600) with unusual electric meter readings were not investigated.

SECTION I –DEFICIENCIES, CONTINUED

Electric Revenue, Continued

5. Corporate policy states that a 1% late fee be assessed on outstanding balances not paid by due dates. Late fees aggregating $89.48 were not assessed the following past due accounts:

Customer No.	Billing Date	Past due	Late fees
144400	April '14	$ 423.47	$ 4.23
42304	June '14	8,256.99	82.57
212003	July '14	10.17	0.10
283100	August '14	55.38	0.55
67500	August '14	37.60	0.38
379900	August '14	5.00	0.05
324601	August '14	56.17	0.56
148600	August '14	67.54	0.68
409100	August '14	36.44	0.36
Total			$ 89.48

6. Data on KWH generated on outer islands was not available.

Recommendation: Unusually high or low power consumption should be investigated. Assignment of and changes to customer billing classifications should be subject to review and monitored by someone than the individual inputting the transaction. KWH generation statistics in the outer islands should be accumulated for comparison with KWH billed.

Board of Directors' Meetings

Comment: We were informed that there was only one official Board meeting held during the year. YSPSC bylaws require quarterly Board meetings.

Recommendations: Quarterly board meetings should occur.

Fuel Meters

Comment: YSPSC relies on fuel vendor meters when receiving fuel deliveries.

Recommendation: We recommend that YSPSC have functional meters to independently verify fuel receipts.

SECTION II – DEFINITION

The definition of a deficiency is as follows:

A *deficiency* in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, INTERNAL CONTROL OVER FINANCIAL REPORTING

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

Management's Responsibility

The Corporation's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

Objectives of Internal Control over Financial Reporting

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

Inherent Limitations of Internal Control over Financial Reporting

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.