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February 21, 2019

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 of and for the year ended September 30, 2018, (on which we have issued our report dated February 21, 2019), 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, 2018 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated February 21, 2019, 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,

A handwritten signature in black ink that reads "Deloitte + Stacke LLP". The signature is written in a cursive, slightly stylized font.

**SECTION I - DEFICIENCIES**

We identified the following deficiencies involving the Company's internal control over financial reporting as of September 30, 2018 that we wish to bring to your attention:

**Bank Reconciliation**

Stale checks of \$2,320 for the payroll account were noted as of September 30, 2018.

Recommendation: We recommend management determine appropriate action to resolve outstanding stale checks. This matter was reported in the prior year letter to management.

**Inventories**

Of 13 inventory items tested, 8 yielded a net cost overstatement of \$11,363. The total extrapolated difference amounted to \$21,840.

Of 22 inventory items counted, 1 item differed from the quantity reflected on the final inventory valuation report, which yielded a net cost overstatement of \$99. The total extrapolated difference amounted to \$206.

Further, the following were noted during our physical count:

- Inventories from Power Plant do not appear to be arranged in an orderly manner.
- Some inventories do not have specific identification numbers or descriptions.
- Obsolete, used, old or non-inventory items stored in the warehouse are not properly segregated and marked as non-inventory items.
- Second counts were not performed by a different team.

Also, documentation of the FY18 inventory obsolescence assessment was not provided.

Recommendation: We recommend management adopt and implement appropriate internal control policies over recording, monitoring, and valuation of inventories. Further, we recommend YSPSC maintain and document the allowance for inventory obsolescence rationale and continue to assess the adequacy. This matter was reported in the prior year letter to management.

**Journal Entries**

Independent review prior to posting of journal entries as evidenced by a preparer and a reviewer signature were not consistently performed throughout the year.

Recommendation: We recommend that adequate review and approval of journal entries occur. This matter was reported in the prior year letter to management.

**Fuel Meters**

The Corporation relies on FSMPC's meter readings and the loading manifest to measure the quantity of fuel delivered and invoiced. YSPSC has no control procedure in place to independently verify quantities of fuel delivered as tank meters are not fully functional.

Recommendation: We recommend YSPSC maintain functional meters to verify actual gallons of fuel received. This matter was reported in the prior year letter to management.

**SECTION I –DEFICIENCIES, CONTINUED**

**Utility Plant**

A physical verification of fixed assets was not performed during the year. Also, the source of funding was not indicated in the fixed asset register.

Recommendation: We recommend management perform periodic physical counts and update the fixed asset register to reflect the source of funding.

**Allowance for Doubtful Accounts**

Documentation of the allowance assessment for FY18 was not provided. We further noted that YSPSC did not regularly review cash power accounts to identify nonmovements.

Recommendation: We recommend that YSPSC maintain and document the allowance rationale and continue to assess its adequacy. We further recommend that YSPSC perform at least a quarterly review of cash power accounts for nonmovement. This is a reiteration of a prior year management letter comment.

**Credit Card Transactions**

As of September 30, 2018, we noted a personal credit card transaction of \$2,445. Further, we noted some credit card transactions were recorded as travel expense when the nature of the purchase was not related to travel.

Recommendation: We recommend management establish policies and procedures related to credit card transactions.

**Line Losses**

Power generation and internal consumption from outer island power plants does not appear to be adequately monitored.

Recommendation: We recommend that the Company adopt appropriate measures to monitor line losses. This matter was reported in the prior year letter to management.

**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.