

OFFICE OF THE YAP STATE PUBLIC AUDITOR
ANNUAL REPORT TO THE GOVERNOR AND THE LEGISLATURE
For the period January 1 to December 31, 2011

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INTRODUCTION

This report is submitted in accordance with 13 YSC 704 which states, “The Public Auditor shall file an annual report with the Governor and the Legislature within five days after the convening of each January regular session of the Legislature.” The report focuses on the activities of the Office of the Yap State Public Auditor (Yap OPA) during the period January 01, 2011 to December 31, 2011.

The year 2011 represents the 11th consecutive year since 2000 that the Office of the Yap State Public Auditor has been in continuous operation. Since its establishment in 1983, the office has suffered closure every two years as the State Legislature searches for replacements for expatriate public auditors who generally completed their two-year contracts and vacate the office. Because of the lack of continuity in the early years, opportunities for testing the sufficiency of the Office’s enabling legislation had never presented itself. As previously mentioned in the FY 2007, 2008, 2009 and FY2010 annual reports, there were several events, activities, and circumstances which illuminated the need to revisit and revamp the Public Auditor Act, to update the language, to make it more responsive to the current auditing and accounting environment and to broaden the types of engagement the Office is authorized to conduct if the office to effectively fulfill its mission.

As mentioned in the previous five annual reports, some of the existing deficiencies of the Public Auditor Act are as follows:

- (1) The Public Auditor Act does not require the audit office to follow any recognized auditing standards.*
- (2) The Public Auditor Act appears to limit the type of audits that could be conducted by the Office to financial and financial-related audits, whereas the majority of audits conducted by government audit organizations are performance or “effectiveness and efficiency” audits.*
- (3) To comply with auditing standards, the staff as well as the Public Auditor need to be free of the confines of the Public Service System Act. The Act appears to imply that OPA employees should be subjected to the PSSR..*
- (4) The Office of the Public Auditor should be allowed to make use of regional expertise and other available resources, including staff of regional audit offices, but the current language appears to allow the Office to cooperate only with the FSM National Public Auditor and external financial statement auditors.*

For more discussion on the above matters, we have reprinted the detailed discussion of the above mentioned that was included in the 2007 annual report, please refer to pages 7 to 10 of this report.

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SUMMARY OF ACTIVITIES

The highlights of activities for the Office of the Yap State Public Auditor for calendar year 2011 are presented below:

Financial Highlights:

Our overall budget for FY11 was \$196,680 consisting only of Compact Capacity Building Sector Grant funds. Actual expended plus encumbrances at September 30, 2011 was \$189,372, with \$7,208 in unexpended balance.

Our approved budget for fiscal year 2012 is \$193,930; all from Compact Capacity Building Sector Grants. Currently, \$68,783 has been allotted of which \$56,333 has been expended or encumbered.

Audits and Other Engagements:

As compared to the past calendar years, 2011 was one of the busier years that OPA has ever had. We were able to issue fourteen reports composing of nine financial audit reports (six for FY09 and three for FY10), three requested audits, one inspection report and one evaluation report. As of the last quarter of the calendar year, we have already conducted the exit conference for one FY10 audit and are in the process of finalizing the report. We are also in the evaluation process for the performance audit of one department and we have already started the FY12 audit of the two component units that will be included in the single audit report for the state.

Other Highlights

During the inspection of the Sports Development Fund and the Excise Tax collections, we were able to uncover \$108,746 worth of undercollected Excise Tax for the period December 2008 to January 2010. Due to the discovery, the appropriate department have already corrected the tax table they're using thus avoiding further undercollections of taxes.

Audit of the International Water Project, revealed that \$37,276 worth of reimburseable expenses for the mentioned project from 2003 onwards were not received by Yap State from the FSM National Government due to the untimely request of cash drawdown. Due to the delay of the request for drawdowns, management was compelled to use the State's limited resourced to fund the expenses of the project.

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Planned Activities for Calendar Year 2012:

As previously mentioned, we have already initiated the audit of the two component units that will be included in the single audit report of Yap State for FY2012. We are aiming to finish the two component units on or before May 31st since it's the last date that they can be included in the single audit report. We are also aiming to finish the four other component units before the year end. We are also going to try to finish the requested audit of one of the Department and our self-initiated audit that we started in FY11 before the year end. Aside from these, there are two pending requests for audits that hopefully could start within the year. The audits of the component units however, will take priority over other requests for audits. In order to accommodate all of these projects, we will take the necessary steps in prioritizing the workload, the basics of which will be dictated by available resources.

Staffing and Other Matters:

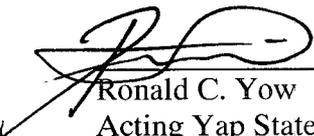
As of December 31, 2011, the office is fully staffed. In FY2011, \$253,000 worth of grants were awarded to our office by OIA. In FY2012, we are preparing to establish our own White Collar Investigation Department and also be hiring an expat supervisor to help us improve the quality of audit that we do. But, all of these will be dependent on when we will actually be able to use the grants.

Problems and Constraints:

As discussed in our introduction and in the previous annual reports, our enabling legislation, which is more than 20 years old, needs to be updated and revised to reflect the changes in the auditing profession and to make it more responsive to the mission and goals of the Office of the Yap State Public Auditor. For this purpose, we will be soliciting the support of the Governor and the Legislature on this endeavor.

Another problem that confronts this office is the slow process of the Appropriation of the grants that we received from OIA. In August 28, 2011 we received two 18-month grants from OIA totalling \$253,000 for the hiring of an expat supervisor and for the establishment of our White Collar Investigation Department. We submitted it to Legislature in September of 2011 and as of December 31, 2011 or four months within the 18 months of the grants term, no action has been made in order for us to use the grants. By prolonging the appropriation, we will not be able to maximize the usage of the grant or 22% of the grants totaling \$55,660 have been lost due to the delay.

Respectfully submitted,



Ronald C. Yow

Acting Yap State Public Auditor

January 19, 2012

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FINANCIAL INFORMATION

Fiscal Year ended September 30, 2011: Our approved budget for FY11 consisted of Compact Capacity Building Sector Grants of \$196,680. The detailed financial information below as compiled from the advices of allotment obtained from the Office of Planning and Budget and the Fundware reports from Finance for the fiscal year ended September 30, 2011 is set forth hereunder.

Description	Budget	Actual Expenditures	PY Encumbrance	CY Encumbrance	Balance (Over)/Under
Personnel	\$ 126,880	\$ 123,700	\$ 0	\$ 0	\$ 3,180
Travel	32,455	30,375	0	668	2,080
Contractual Services	17,345	15,522	0	1,500	1,823
OCE	15,800	15,780	0	369	20
Fixed Assets	4,200	3,995	0	0	205
TOTAL	\$ 196,680	\$ 189,372	\$ 0	\$ 2,537	\$ 7,308

Some of the unexpended balance for fiscal year 2011 can be broken down as follows:

- a. Personnel Budget : \$ 3,180
 - aa) Staff turn-over and planned salary increases under our staff training and development plan \$ 3,180
- b. The \$2,080 unexpended in travel relates to the unused PEIC seminar that did not take place as of September 30, 2011.
- c. The \$1,823 unexpended funds in Contractual Services represent the discount in the lease rental of the office. Since our budget was cut, we were allowed, once, to negotiate our lease rental in such away that we will be paying less this year. The increases for 2011 and 2012 will be included in our FY2012 lease rental.

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Ist Quarter Ended December 31, 2011: Our budget for fiscal year 2012 of \$193,930 is funded entirely from Compact Capacity Building Sector Grants. The financial information below was accumulated using the Fundware Reports from Finance as of December 31, 2011, representing allotments and expenditures to date:

Description	Budget	Actual Expenditures	PY Encumbrance	CY Encumbrance	Balance (Over)/Under
Personnel	\$ 127,730	\$ 34,305	\$ 0	\$ 0	\$ 93,425
Travel	24,700	9,264	0	0	15,436
Contr. Svcs.	21,000	6,000	0	4,500	15,000
OCE	19,800	6,064	0	316	13,736
Fixed Assets	700	700	0	0	0
TOTAL	\$ 193,930	\$ 56,333		\$ 4,816	\$ 137,597

AUDITS AND OTHER ENGAGEMENT ACTIVITIES

During 2011, Yap OPA released nine (6 FY2009 and 3 FY2010) component financial audit reports, three requested audits, one inspection report and one evaluation report and 1 final draft report. More details relating to the status of audits and other engagements are provided below.

Completed Engagement Activities:

Following is a list of final audit reports issued by the Office of the Public Auditor during the reporting period. Copies of the reports are provided herein as Exhibit A.

- ◆ *Yap Sports Council , Financial Statements and Independent Auditor’s Report for the years ended September 30, 2009 and 2008*
- ◆ *Gagil-Tomil Water Authority, Financial Statements and Independent Auditor’s Report for the years ended September 30, 2009 and 2008*
- ◆ *Southern Yap Water Authority, Financial Statements and Independent Auditor’s Report for the years ended September 30, 2009 and 2008*
- ◆ *Public Transportation System, Financial Statements and Independent Auditor’s Report for the years ended September 30, 2009 and 2008*
- ◆ *Yap Fishing Authority, Financial Statements and Independent Auditor’s Report for the year ended September 30, 2009*
- ◆ *Yap Community Action Program, Financial Statements and Independent Auditor’s Report for the years ended September 30, 2009 and 2008*

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- ◆ *Public Transportation System, Financial Statements and Independent Auditor's Report for the years ended September 30, 2010 and 2009*
- ◆ *Yap Fishing Authority, Financial Statements and Independent Auditor's Report for the years ended September 30, 2010 and 2009*
- ◆ *Southern Yap Water Authority, Financial Statements and Independent Auditor's Report for the years ended September 30, 2010 and 2009*
- ◆ *Department of Youth and Civic Affairs, compliance audit for the Fiscal Year 2008*
- ◆ *International Water Project*
- ◆ *Evaluation Report – Yap State Government Vehicle Regulation and Use*
- ◆ *Yap Traditional Navigation Society, (requested audit) Financial Audit and Independent Auditor's Report for the years ended September 30, 2009, 2008 and 2007*
- ◆ *Inspection Report on the Sports Development Fund and Excise Tax Collections*

Other Ongoing Engagement Activities:

- Gagil-Tomil Water Authority, Financial Audit for FY2010 – Finalized and pending release due to Management Representation Letter.
- Yap Community Action Program, Financial Audit for FY2010 – Field work phase.
- Yap Sports Council, Financial Audit for FY2010 – Field work phase
- Cooperative Performance Audit on Access to Safe Drinking Water (PASAI)
- Cooperative Performance Audit on Managing Sustainable Fisheries (PASAI)
- Performance Audit of Public Works and Transportation Department – Survey Phase

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Planned Audit and Other Engagement Activities for Calendar Year 2012

Annual Financial Audit Calendar – Of the eight component units of the State Government, three are audited annually under the Single Audit contract, and five are audited annually by the Yap OPA. The drafts for two of these audits need to be completed by May 31st for inclusion in the State of Yap single audit report.

Requested Audits – In addition to the long list of audits requested by the Legislature several years back, we also have request for audits from departments and cooperative audits with PASAI (Pacific Association of Supreme Audit Institutions). As previously stated in the “Other Ongoing Engagement Activities” portion, currently we are in the survey process of one of the three requested audits. We will simultaneously do the PW& T audit and hopefully, upon completion of audits of the component units.

Self-initiated Audits – Since the bulk of funds expended each year by the Government passes through the State Finance, the most value to the State that could be derived from the OPA should be the strengthening of internal control policies and procedures in the primary government. In 2011, we were able to finish 1 evaluation audit, Evaluation of the Usage of Government Vehicles, and hopefully we will be able to start the Evaluation of Income and Expense of M/V Hapilmohol in 2012.

STRENGTHENING THE AUDIT OFFICE

Beginning in fiscal year 2007 and continuing in 2011 and beyond, we have begun efforts to strengthen the audit office to better meet its objectives. The first step was the rewording of our mission statement to align it with the Public Sector Management section of the FSM Strategic Development Plan. We already came up with our new mission statement which reads as follows: “*We perform audits and evaluations to recommend improvements in government service and accountability.*” Previously, our mission statement had read as follow: “*To enhance governance, accountability, and performance in the public sector through delivery of independent assurance services.*”

As previously mentioned in the FY 2007 annual report, there were several events, activities, and circumstances which required our review of the Public Auditor Act. Such reviews have illuminated the need to revisit and revamp the Public Auditor Act, to update the language to make it more responsive to the current auditing and accounting environment and to broaden the types of engagement the Office is authorized to conduct in order for the office to effectively fulfill its mission in accordance with the FSM Strategic Development Plan. Below, is the re-issued portion of the FY2007 annual report that delves on the events, issues and discussions about the Public Auditors Act.

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In August 2011, the U.S. Comptroller General issued the latest revision to *Government Auditing Standards*, more commonly known as the “Yellow Book” or GAGAS (generally accepted government auditing standards). The new standards, among others:

- (1) Heightened the emphasis on ethical principles that should guide the work of those who audit government programs and operations.
- (2) Clarified and discussed the impact of non-audit services on auditor independence: Conceptual Framework
- (3) Enhanced and clarified the requirements of the audit organization’s system of internal control by specifying the elements that the organization’s policies and procedures should address.
- (4) Enhanced performance auditing standards to better explain the concepts of reasonable assurance and its relationship to audit risk, significance and the levels of evidence used to support findings and conclusions.
- (5) Reinforced the key role of auditing to maintaining accountability and good governance.

The above developments necessitated a review of our enabling legislation which found the language to be in need of revision to better meet the changing audit environment.

Some of the areas where the Act has been found to be deficient are discussed below:

1. The Act does not require the Public Auditor to follow any professional accounting or auditing standards. This is primarily because *Government Auditing Standards* (the “Yellow Book”) was not issued by the Comptroller General until 1988 whereas the Public Auditor Act was promulgated in 1983. The latest revision to the Yellow Book dated August 2011 has totally changed the face of government auditing, putting additional burden on the audit organization to ensure that it conducts high quality audits with competence, integrity, objectivity, and independence.

Although our enabling legislation does not require us to follow any kind of auditing or accounting standards, we have elected to adopt *Government Auditing Standards* mostly due to the fact that we are performing financial statement audits of the component units for inclusion in the State of Yap financial statements. If we did not follow *Government Auditing Standards*, the State’s financial statement auditors would not accept our audits of the component units, thereby, requiring the State to expend additional funds to procure audits of those component units.

Moreover, given public awareness of the failure by the auditors of Enron and World Com, the public is suspicious of any audit report issued without reference to recognized standards. Therefore, if the law is not amended to require the office to follow generally accepted government auditing standards, such as those promulgated by the U.S. Comptroller General, it leaves the office and the State vulnerable to future auditors who

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may elect to take the easy road and revert to issuing reports outside the framework of generally accepted auditing standards.

2. The Public Auditor Act appears to limit the type of audits that could be conducted by the Office to financial statement and financial-related audits. Section 703 of the Public Auditor Act provides only for financial or financial-related audits. These are only two types of audits contained in *Government Auditing Standards*. Other types of audits or engagements covered by the Yellow Book are performance audits (also known as “effectiveness and efficiency audits”) and attestation engagements both are different in scope than audits. For the past 9 years, the Office only performed non-financial audits based on requests from departments and agencies. Therefore, there is a clear need to revise the language of the Act to broaden the types of audits that the office can conduct and recommendations (Section 705), it can issue.

3. To comply with auditing standards, the staff as well as the Public Auditor need to be free of the confines of the Public Service System Act thereby restricting any competitive compensation plan comparable to the other Audit Offices. Section 141 of Title 8, specifically exempts the Public Auditor from the Public Service System. But, the employees of the Office are not exempted. Accordingly, we have had difficulty recruiting and retaining qualified individuals for the positions within the office. Moreover, the protection that the PSS accords to employees prevents the office from enforcing the basic principles of independence, objectivity, confidentiality, and integrity critical for staff members. Should a staff member breach an office policy relating to such principles, he could not be removed without first going through the PSS disciplinary and grievance process which could take months.

4. The Office of the Public Auditor should be allowed to make use of regional expertise and other available resource, including staff of regional audit offices. In December 2007, an ADB consultant visited our office as part of a technical assistance package to strengthen Pacific Island audit offices. One of the potential means of cooperation between audit offices within the region that was entertained was the sharing of information and staff members. Technological innovations have now made possible the sharing of technical information at nominal costs between audit offices within the Pacific region and all over the world. However, the OPA Enabling Act in Section 713 authorizes the office to only cooperate with private accounting firms and the FSM National Public Auditors office. The Office’s access to experts and specialists could be greatly improved if the Enabling Act expanded the sphere of cooperation allowed between the OPA and other audit organizations.

Thus far, these are the only problematic sections of the Public Auditor Act that we have identified in the course of the ten years of operation. However, our review of the Act has been cursory at best. We believe that if careful attention is given to the language of the Office’s enabling legislation, we can better identify the areas requiring improvements. It is a goal of the office to work with the Executive and Legislative Branches of

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Government in the coming years to update and strengthen the Act to better meet the needs of the State of Yap.

STAFF RECRUITMENT, DEVELOPMENT AND TRAINING:

Staff Movements

During calendar year 2011, the Office was able to move one former administrative staff to staff auditor and hired a new Admin. Asst./Auditor-trainee.

Our current staff members consist of the following individuals – Maria Mitrad, a Staff Auditor II (Dev.) who has been with us for over ten years; Brian Y. Dabgusiy, a Junior Auditor, who has been with us for over four years; Michelle Chutinag, Achilles Defngin and Paula Mitmow, staff auditors, hired in 2010; and Janice Fanaglibuw, Admin. Asst./Auditor-Trainee, hired in 2011.

Mr. Ronald C. Yow was appointed by the Yap State Legislature as the Temporary Yap State Public Auditor effective Dec. 8, 2010. Mr. Wilfred Oliver L. Dolosa, the Audit Manager, has been with the office for almost four years. Mr. Patrick Zachinni, the Audit Supervisor was hired in May 2011.

During 2011, we did two performance evaluations for the senior auditors.

Though some of our auditors still lack audit experience, we still believe that all of our goals can be achieved through teamwork. We are also in the process of developing an updated manual with the help of the newly hired Audit Supervisor. Once the manual is completed it will help clarify guidelines and procedures for each audit. Furthermore, we hope to conduct more frequent staff evaluations which will aid in the development and retention of staff members.

Local Training Workshop

In addition to the regular on the job training provided to staff members, we are coordinating with some government entities for staff development training opportunities that may be provided locally. Our plan is to let auditors attend the training and share what they learned through an in-house seminar which they will facilitate. In so doing, all of the auditors will be at par with each other as to the knowledge they gained through these seminars.

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Off-island Training Workshop

The Government Auditing Standards' Continuing Professional Education (CPE) requirements require 40 CPE hours per auditing staff annually and in order to comply with this, the Public Auditor and staff auditors participated in the following off-island training workshops during the year:

PASAI Conferences – two auditors attended seminars in New Zealand and in Fiji (no CPE credits).

APIPA Training Conference – 5 staff auditors, the Audit Manager, the Audit Supervisor and the Acting Public Auditor attended the annual Association of Pacific Islands Public Auditors conference held in the Republic of the Marshall Islands in the first week of July 2011. These annual workshop is the main source of our required CPE credits and it's funded by the office.

Planned Activities for FY2012:

- WIGAF/PEIC - The Public Auditor will be attending the 2012 conference that will probably be held either in Guam or Hawaii.
- APIPA Annual Conference – The 2012 APIPA Conference will be held in the Republic of Palau. The Public Auditor, Audit Manager, Audit Supervisor and the 5 staff auditors will be attending.
- We are still in the process of trying to identify free seminars as well as outside trainings that we could send our auditors to further develop their auditing skills.