

POHNPEI UTILITIES CORPORATION

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2001 AND 2000

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INDEPENDENT AUDITORS' REPORT

The Board of Directors
Pohnpei Utilities Corporation:

We have audited the accompanying balance sheets of the Pohnpei Utilities Corporation (PUC), a component unit of the Government of the State of Pohnpei, as of September 30, 2001 and 2000, and the related statements of operations and capitalization and cash flows for the years then ended. These financial statements are the responsibility of the PUC's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Pohnpei Utilities Corporation as of September 30, 2001 and 2000, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The additional information on pages 11-13 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. This additional information is the responsibility of the Company's management. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements of Pohnpei Utilities Corporation as of and for the year ended September 30, 2001, and in our opinion, is fairly stated, in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 8, 2002, on our consideration of PUC's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is stylized and appears to be written in a cursive or semi-cursive script.

February 8, 2002

POHNPEI UTILITIES CORPORATION

Balance Sheets
September 30, 2001 and 2000

<u>Assets</u>	<u>2001</u>	<u>2000</u>
Utility plant, at cost (notes 2 and 9):		
Electric plant in service	\$ 34,917,726	\$ 34,790,980
Water and sewer plant in service	10,897,743	10,114,136
Construction work-in-process	2,823,553	2,147,051
	<u>48,639,022</u>	<u>47,052,167</u>
Less accumulated depreciation	(18,358,782)	(16,389,680)
Total utility plant	<u>30,280,240</u>	<u>30,662,487</u>
Other noncurrent assets:		
Self insurance fund (note 3)	121,331	115,632
Scholarship fund (note 4)	3,881	3,881
Interest receivable	1,130	1,130
Materials inventory	261,919	242,665
Settlement notes receivable (note 7)	-	18,916
Total other noncurrent assets	<u>388,261</u>	<u>382,224</u>
Current assets:		
Cash (note 11)	362,393	511,061
Internally restricted investments (note 12)	542,429	602,293
Accounts receivable, net (notes 5 and 6)	2,506,523	2,643,449
Grants receivable	41,536	140,979
Prepayments	34,846	48,104
Materials and fuel inventory	965,874	1,014,248
Total current assets	<u>4,453,601</u>	<u>4,960,134</u>
	<u>\$ 35,122,102</u>	<u>\$ 36,004,845</u>
<u>Capitalization and Liabilities</u>		
Capitalization:		
Contributed capital (note 9)	\$ 23,688,294	\$ 25,340,061
Retained earnings	<u>9,378,102</u>	<u>9,087,914</u>
Total capitalization	<u>33,066,396</u>	<u>34,427,975</u>
Current liabilities:		
Accounts payable:		
Fuel oil	72,566	105,094
Operations	72,891	195,620
Deferred revenue	63,213	60,192
Accrued taxes and other liabilities	181,978	164,059
Employees' annual leave	190,279	208,907
Total current liabilities	<u>580,927</u>	<u>733,872</u>
Noncurrent liabilities:		
Notes payable (note 8)	<u>1,474,779</u>	<u>842,998</u>
Total liabilities	<u>2,055,706</u>	<u>1,576,870</u>
Contingencies (notes 3 and 11)	<u>\$ 35,122,102</u>	<u>\$ 36,004,845</u>

See accompanying notes to financial statements.

POHNPEI UTILITIES CORPORATION

Statements of Operations and Capitalization
Years Ended September 30, 2001 and 2000

	2001	2000
Operating revenues:		
Electricity sales	\$ 6,782,776	\$ 6,172,812
Water sales	954,221	895,027
Other sales	151,418	260,616
	7,888,415	7,328,455
Operating and maintenance expenses:		
Production fuel	3,562,248	3,121,639
Administrative and general	2,434,471	1,863,773
Depreciation	1,969,104	1,934,062
Generation	724,371	860,610
Water and sewer	689,816	620,648
Distribution	499,039	433,980
	9,879,049	8,834,712
Total operating expenses	9,879,049	8,834,712
Operating loss	(1,990,634)	(1,506,257)
Nonoperating revenues:		
Federal grants (note 10)	549,982	604,398
Spurline projects	127,207	139,954
Ngetik solar	-	38,281
Interest (expense) income, net	(49,493)	60,261
Other income	1,359	8,690
	629,055	851,584
Total nonoperating revenues	629,055	851,584
Net loss	(1,361,579)	(654,673)
Add depreciation on fixed assets acquired by capital contributions that reduce contributed capital	1,651,767	1,618,194
	290,188	963,521
Increase in retained earnings	290,188	963,521
Retained earnings at beginning of year	9,087,914	8,124,393
	9,378,102	9,087,914
Retained earnings at end of year	9,378,102	9,087,914
Contributed capital at beginning of year	25,340,061	26,958,255
Less depreciation on assets acquired by capital contributions	(1,651,767)	(1,618,194)
	23,688,294	25,340,061
Contributed capital at end of year	23,688,294	25,340,061
Total capitalization at end of year	\$ 33,066,396	\$ 34,427,975

See accompanying notes to financial statements.

POHNPEI UTILITIES CORPORATION

Statements of Cash Flows
Years Ended September 30, 2001 and 2000

	2001	2000
Cash flows from operating activities:		
Cash received from customers	\$ 7,967,507	\$ 7,085,189
Cash payments to suppliers and employees	(7,991,896)	(6,848,188)
Net cash (used for) provided by operating activities	(24,389)	237,001
Cash flows from investing activities:		
Payments to self insurance fund	(5,699)	(10,973)
Decrease in PUC sinking fund, restricted investment	59,864	(49,650)
Net provided by (used for) investing activities	54,165	(60,623)
Cash flows from noncapital financing activities:		
Proceeds from notes payable	631,781	592,998
Operating grants received	649,425	560,745
Spurline projects	127,207	178,235
Net cash provided by noncapital financing activities	1,408,413	1,331,978
Cash flows from capital and related financing activities:		
Acquisition of utility plant	(1,586,857)	(1,480,939)
Net cash used for capital and related financing activities	(1,586,857)	(1,480,939)
Net (decrease) increase in cash	(148,668)	27,417
Cash at beginning of year	511,061	483,644
Cash at end of year	\$ 362,393	\$ 511,061
<u>Reconciliation of operating loss to net cash (used for) provided</u>		
<u>by operating activities:</u>		
Operating loss	\$ (1,990,634)	\$ (1,506,257)
Adjustments to reconcile operating loss to net cash (used for)		
provided by operating activities:		
Depreciation	1,969,104	1,934,062
Provision for bad debts	948,711	469,520
Other (expense) income	(48,134)	68,951
(Increase) decrease in assets:		
Accounts receivable	(811,785)	(781,737)
Settlement notes receivable	18,916	27,598
Prepayments	13,258	(45,464)
Inventory	29,120	49,684
Increase (decrease) in liabilities:		
Accounts payable	(155,257)	(22,767)
Deferred revenue	3,021	(19,747)
Accrued taxes and other liabilities	17,919	24,475
Employees' annual leave	(18,628)	38,683
Net cash (used for) provided by operating activities	\$ (24,389)	\$ 237,001

See accompanying notes to financial statements.

POHNPEI UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(1) Summary of Significant Accounting Policies

The accounting policies of Pohnpei Utilities Corporation conform with accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. Governmental Auditing Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting", requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. PUC has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

General: The Pohnpei Utilities Corporation (PUC) is a component unit of the Government of the State of Pohnpei. PUC commenced operations on October 1, 1991, with assets and liabilities of the Division of Public Utilities of the Pohnpei State Department of Public Works transferred as of that date. PUC has adopted the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC). As of October 1, 1993 the assets, liabilities, and operations of the Division of Water and Sewer of the Pohnpei State Department of Public Works were also transferred to PUC as the result of Pohnpei State Law 3L-41-93.

Utility Plant: Utility plant assets were transferred to PUC at the carrying value of the Division of Public Utilities and Division of Water and Sewer of the Pohnpei State Department of Public Works as of October 1, 1991 and 1993, for the electric plant and water and sewer plants, respectively, except as to certain utility plant assets which are stated at estimated net book value in the absence of documents to support cost. At September 30, 2001 and 2000, approximately 17.8 percent and 18.3 percent, respectively, of utility plant was stated at estimated cost. The net book value of the electric plant assets transferred was \$17,191,311 as of October 1, 1991, and the net book value of the water and sewer plant assets transferred was \$6,708,112 as of October 1, 1993.

Depreciation: Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Depreciation expense for 2001 and 2000 is approximately five percent of the cost of depreciable properties.

PUC follows the generally accepted accounting principle of closing depreciation expense on assets acquired through contributed capital to the related contributed capital account.

Annual and Sick Leave: Earned but unused annual leave is paid to employees upon termination of their employment. Accordingly, PUC accrues these benefits in the period earned. It is the policy of PUC to record the cost of sick leave when leave is actually taken and an expense is actually incurred. The accumulated estimated amount of sick leave at September 30, 2001 was \$119,013.

Revenues: Sales of electricity and water are recorded as billed to customers on a monthly billing cycle basis. At September 30, 2001 and 2000, unbilled revenues are accrued based on the most recent billing cycles.

Inventory: Materials and fuel inventory are substantially carried at the lower of cost (weighted average) or market. Inventory is classified as current or long-term based on anticipated usage in planned projects.

POHNPEI UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(1) Summary of Significant Accounting Policies, Continued

Federal Grants and Subsidies: PUC receives federal grants as a subrecipient from Pohnpei State in addition to Pohnpei State Legislature appropriated subsidies and matching funds for federal programs as required.

Cash: For purposes of the balance sheets and statements of cash flows, cash includes cash on hand and cash in banks. Of the cash, up to \$100,000 is covered by the FDIC. PUC does not require collateralization of its deposits. Therefore, the amounts which exceed FDIC insurable limitations are characterized as uncollateralized.

Investments: Investments are carried at market values.

Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent 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.

(2) Utility Plant

Utility plant consists of the following at September 30, 2001 and 2000:

	<u>Estimated Useful Life</u>	<u>2001</u>	<u>2000</u>
Production plant	5 - 40 years	\$ 22,081,519	\$ 22,064,569
Distribution plant	5 - 30 years	11,019,040	10,909,244
General plant	3 - 20 years	<u>1,817,167</u>	<u>1,817,167</u>
Electric plant in service		<u>34,917,726</u>	<u>34,790,980</u>
Water production plant	5 - 40 years	4,710,528	4,482,962
Sewage collection and treatment plant	20 - 40 years	4,617,568	4,387,101
Water distribution plant	20 - 30 years	1,124,567	885,287
General plant	3 - 7 years	<u>445,080</u>	<u>358,786</u>
Water and sewer plant in service		<u>10,897,743</u>	<u>10,114,136</u>
Total utility plant in service		45,815,469	44,905,116
Less accumulated depreciation		<u>(18,358,782)</u>	<u>(16,389,680)</u>
		<u>27,456,687</u>	<u>28,515,436</u>
Construction work-in-process:			
Electric plant		1,050,388	580,259
Water and sewer plant		<u>1,773,165</u>	<u>1,566,792</u>
		<u>2,823,553</u>	<u>2,147,051</u>
		<u>\$ 30,280,240</u>	<u>\$ 30,662,487</u>

POHNPEI UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(3) Self Insurance Fund

In accordance with section 2(5) of State Law 3L-41-93, an amendment to the enabling legislation for the PUC, a self-insurance fund was established to defray costs of any unforeseen accidents or disasters. The funds are accumulated in a restricted self-insurance fund, held by a trustee, in the name of the PUC. PUC also carries life insurance on behalf of its employees. Pohnpei Utilities Corporation is substantially self-insured for all other risks. Management is of the opinion that no material losses have been sustained as a result of this practice.

(4) Scholarship Fund

The scholarship fund is designated to account for funds to be used for scholarships in exchange for a related term of employment with PUC subsequent to graduation. Funds are provided by voluntary donations.

(5) Accounts Receivable

Bills are issued to customers near mid-month approximately one month subsequent to providing the service. Therefore, approximately forty-five days of service is accrued at September 30, 2001 and 2000, which is classified as accounts receivable - unbilled. Accounts receivable at September 30, 2001 and 2000, are summarized as follows:

	<u>2001</u>	<u>2000</u>
Accounts receivable - electrical:		
Residential	\$ 1,648,737	\$ 1,406,512
Commercial	1,546,357	1,148,368
Government	208,190	128,210
Unbilled	<u>687,201</u>	<u>822,500</u>
	<u>4,090,485</u>	<u>3,505,590</u>
Accounts receivable - water and sewer:		
Residential	873,099	714,133
Commercial and government	197,903	121,559
Unbilled	<u>120,527</u>	<u>121,214</u>
	<u>1,191,529</u>	<u>956,906</u>
Other	5,282,014	4,462,496
	<u>8,532</u>	<u>16,264</u>
	5,290,546	4,478,760
Less allowance for doubtful receivables	<u>(2,784,023)</u>	<u>(1,835,311)</u>
	\$ <u>2,506,523</u>	\$ <u>2,643,449</u>

All of PUC's accounts receivable are with customers and government agencies based in Pohnpei.

POHNPEI UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(5) Accounts Receivable, Continued

PUC commenced a prepaid cash power meter system in which a portion of customer payments are used to satisfy balances in arrears. Percentages are applied depending on the amount of arrears (45% for arrears \$1,000 and above, 35% for \$500 to \$999 and 25% for under \$500). The cash power meters are primarily installed for residential customers. As of September 30, 2001 and 2000, the amount of receivables related to customers who are enrolled in the cash power meter system are \$789,306 and \$0, respectively.

(6) Allowance for Doubtful Accounts

An analysis of the change in the allowance for doubtful receivables is as follows:

	<u>2001</u>	<u>2000</u>
Beginning balance	\$ 1,835,311	\$ 1,365,790
Allowance for Pohnpei Fisheries Corporation (PFC)	558,625	453,609
Allowance for Economic Development Authority (EDA)	304,375	-
General allowance	<u>85,712</u>	<u>15,912</u>
Ending balance	\$ <u>2,784,023</u>	\$ <u>1,835,311</u>

(7) Notes Receivable

PUC has entered into several settlement agreements with customers who have large outstanding balances resulting from inaccurate billings in previous years. The agreements have terms of from one to five years, including interest at eight to fifteen percent. Management is of the opinion that the current portion of notes receivable is not material to the financial statements.

(8) Notes Payable

Notes payable consist of the following at September 30, 2001 and 2000:

	<u>2001</u>	<u>2000</u>
Amount drawn on a note payable with an available total of \$1,851,000 to the State of Pohnpei, facilitated by an Asian Development Bank loan to the FSM, interest at 6.85%, due in semi-annual principal installments commencing October 10, 2007. The loan is ultimately collateralized by a Pohnpei State pledge of Compact of Free Association revenues to the FSM National Government. The State of Pohnpei has not imposed collateralization on the Corporation.	\$ <u>1,474,779</u>	\$ <u>842,998</u>

(9) Contributions

During the year ended September 30, 1995, sole use rights for the Nanpohnmal Power Plant were contributed to PUC by the FSM National Government through the State of Pohnpei. These assets were donated to the FSM National Government through the Japanese Foreign Aid Program. Official title to the ownership of these assets rests with the FSM National Government. However, substantial revenue is generated by PUC from the use of these assets and PUC bears responsibility for all costs associated with the operation of these assets. Therefore, PUC has recorded these assets as contributed capital in the accompanying financial statements.

POHNPEI UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(10) Federal Grants

Federal grants and subsidies comprise the following for the years ended September 30, 2001 and 2000:

	<u>2001</u>	<u>2000</u>
U.S. Department of the Interior:		
Operations and maintenance improvement program (OMIP) - electrical year four	\$ -	\$ 180,811
OMIP - electrical year five	61,889	163,556
OMIP - electrical year six - apprentice training	18,000	34,345
OMIP - water year two	16,452	47,381
OMIP - water year three	49,935	92,003
OMIP - water year four	140,294	86,302
Continuation of prepaid meter program	250,000	-
Utility development 2001	<u>13,412</u>	<u>-</u>
	<u>\$ 549,982</u>	<u>\$ 604,398</u>

(11) Contingencies

PUC is party to various legal proceedings, the ultimate impact of which is not currently predictable. Therefore, no liability has been recorded in the accompanying financial statements due to management's inability to predict the ultimate outcome of these proceedings. PUC also has a line of credit with a local bank for \$250,000 collateralized by a savings account. No drawdowns against this line were outstanding at September 30, 2001 or 2000.

(12) Sinking Fund

During fiscal year 1998, Pohnpei Utilities Corporation management established a sinking fund. The purpose of this fund is to finance future expansion and upgrade of the power plant and equipment. The goal of PUC is to build this fund to \$2,000,000 by June of 2003, in anticipation of certain equipment purchases and upgrades.

The sinking fund is comprised of the following at September 30, 2001 and 2000:

	<u>2001</u>	<u>2000</u>
Money market funds	\$ 18,831	\$ 18,647
U.S. Government Obligations	89,691	84,475
Corporate bonds and others	309,799	156,733
Common stock	<u>124,108</u>	<u>342,438</u>
	<u>\$ 542,429</u>	<u>\$ 602,293</u>

POHNPEI UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2001 and 2000

(13) Retirement Plan

The Corporation's retirement plan (the Plan) is a self-administered program established to pay retirement, disability and survivor income to employees and their survivors to supplement similar benefits that employees received from the FSM Social Security System. The Plan is a contributory plan in which the Corporation contributes a matching percent of the participant's contribution, up to 10% of the participant's annual salary. The participant may contribute 3 or more percent from his or her annual salary. Participation is optional. The Corporation's comptroller is the designated Plan administrator. Contributions to the Plan during the years ended September 30, 2001 and 2000 were \$95,795 and \$0, respectively. Management is of the opinion that the plan does not represent an asset or liability of the Corporation. For the years ended September 30, 2001 and 2000, plan assets were \$144,325 and \$0, respectively.

(14) Subsequent Event

Pohnpei Utilities Corporation obtained a loan with a local bank for \$500,000 in October 2001.

POHNPEI UTILITIES CORPORATION

Combining Balance Sheet

September 30, 2001

(With comparative totals as of September 30, 2000)

<u>Assets</u>	Power and Utility	Water and Sewer	Eliminating Entries	Totals	
				2001	2000
Utility plant, at cost:					
Electric plant in service	\$ 34,917,726	\$ -	\$ -	\$ 34,917,726	\$ 34,790,980
Water and sewer plant in service	-	10,897,743	-	10,897,743	10,114,136
Construction work-in-process	1,050,388	1,773,165	-	2,823,553	2,147,051
	35,968,114	12,670,908	-	48,639,022	47,052,167
Less accumulated depreciation	(14,918,005)	(3,440,777)	-	(18,358,782)	(16,389,680)
Total utility plant	21,050,109	9,230,131	-	30,280,240	30,662,487
Other noncurrent assets:					
Self insurance fund	121,331	-	-	121,331	115,632
Scholarship fund	3,881	-	-	3,881	3,881
Interest receivable	1,130	-	-	1,130	1,130
Inventory parts-generation	112,510	-	-	112,510	122,682
Inventory parts-distribution	125,158	-	-	125,158	89,312
Inventory parts-water/sewer	-	24,251	-	24,251	30,671
Settlement notes receivable	-	-	-	-	18,916
Total other noncurrent assets	364,010	24,251	-	388,261	382,224
Current assets:					
Cash	778,302	(415,909)	-	362,393	511,061
Internally restricted investments	542,429	-	-	542,429	602,293
Accounts receivable, net	1,915,809	590,714	-	2,506,523	2,643,449
Grants receivable	3,259	38,277	-	41,536	140,979
Prepayments	34,846	-	-	34,846	48,104
Fuel and material inventory	687,708	278,166	-	965,874	1,014,248
Total current assets	3,962,353	491,248	-	4,453,601	4,960,134
	\$ 25,376,472	\$ 9,745,630	\$ -	\$ 35,122,102	\$ 36,004,845
<u>Capitalization and Liabilities</u>					
Capitalization:					
Contributed capital	\$ 17,061,581	\$ 6,626,713	\$ -	\$ 23,688,294	\$ 25,340,061
Retained earnings	7,874,773	1,503,329	-	9,378,102	9,087,914
Total capitalization	24,936,354	8,130,042	-	33,066,396	34,427,975
Current liabilities:					
Accounts payable:					
Fuel oil	72,566	-	-	72,566	105,094
Operations	43,734	29,157	-	72,891	195,620
Deferred revenue	63,213	-	-	63,213	60,192
Accrued taxes and other liabilities	127,384	54,594	-	181,978	164,059
Employees' annual leave	133,221	57,058	-	190,279	208,907
Total current liabilities	440,118	140,809	-	580,927	733,872
Noncurrent liabilities:					
Notes payable	-	1,474,779	-	1,474,779	842,998
Total liabilities	440,118	1,615,588	-	2,055,706	1,576,870
	\$ 25,376,472	\$ 9,745,630	\$ -	\$ 35,122,102	\$ 36,004,845

See accompanying Independent Auditors' Report

POHNPEI UTILITIES CORPORATION

Combining Statement of Operations and Capitalization
 Year Ended September 30, 2001
 (With comparative totals for the year ended September 30, 2000)

	Power and Utility	Water and Sewer	Eliminating Entries	Totals	
				2001	2000
Operating revenues:					
Residential	\$ 1,435,119	\$ 621,638	\$ -	\$ 2,056,757	\$ 2,855,498
Commercial	2,596,091	151,516	-	2,747,607	2,275,408
Government	1,938,115	181,067	-	2,119,182	1,936,933
Cash power	813,451	-	-	813,451	-
Intercompany sales	101,709	-	(101,709)	-	-
Other sales	39,197	112,221	-	151,418	260,616
	<u>6,923,682</u>	<u>1,066,442</u>	<u>(101,709)</u>	<u>7,888,415</u>	<u>7,328,455</u>
Total operating revenues					
Operating and maintenance expenses:					
Production fuel	3,562,248	-	-	3,562,248	3,121,639
Depreciation	1,532,100	437,004	-	1,969,104	1,934,062
Administrative and general:					
Employee benefits	438,273	-	-	438,273	391,802
Salaries and wages	368,298	-	-	368,298	316,127
Consumables	185,128	-	-	185,128	131,535
General repairs	128,756	-	-	128,756	111,955
Training and safety	65,593	-	-	65,593	107,141
Customer service and collection	51,536	-	-	51,536	67,004
Vehicle, POL	117,146	-	-	117,146	107,646
Legal fees	17,250	-	-	17,250	4,332
Communications	32,641	-	-	32,641	60,911
Travel	66,864	-	-	66,864	93,300
Insurance	14,275	-	-	14,275	2,500
Utility expense	26,181	-	(26,181)	-	-
Bad debts	664,308	284,403	-	948,711	469,520
	<u>2,176,249</u>	<u>284,403</u>	<u>(26,181)</u>	<u>2,434,471</u>	<u>1,863,773</u>
Generation:					
Salaries and wages	455,289	-	-	455,289	414,638
Repairs and maintenance	249,950	-	-	249,950	425,780
Other production	19,132	-	-	19,132	20,192
	<u>724,371</u>	<u>-</u>	<u>-</u>	<u>724,371</u>	<u>860,610</u>
Water and sewer:					
Salaries and wages	-	387,875	-	387,875	335,824
Employee benefits	-	61,827	-	61,827	63,957
Repairs and maintenance	-	153,099	-	153,099	141,777
Training and safety	-	20,773	-	20,773	24,081
Chemicals	-	47,424	-	47,424	48,066
Utility expense	-	75,528	(75,528)	-	-
Other production	-	18,818	-	18,818	6,943
	<u>-</u>	<u>765,344</u>	<u>(75,528)</u>	<u>689,816</u>	<u>620,648</u>
Distribution:					
Salaries and wages	332,916	-	-	332,916	289,210
Repairs and maintenance	166,123	-	-	166,123	144,770
	<u>499,039</u>	<u>-</u>	<u>-</u>	<u>499,039</u>	<u>433,980</u>
Total operating expenses	<u>8,494,007</u>	<u>1,486,751</u>	<u>(101,709)</u>	<u>9,879,049</u>	<u>8,834,712</u>
Operating loss	<u>(1,570,325)</u>	<u>(420,309)</u>	<u>-</u>	<u>(1,990,634)</u>	<u>(1,506,257)</u>

See accompanying Independent Auditors' Report

POHNPEI UTILITIES CORPORATION

Combining Statement of Operations and Capitalization, Continued
 Year Ended September 30, 2001
 (With comparative totals for the year ended September 30, 2000)

	Power and Utility	Water and Sewer	Eliminating Entries	Totals	
				2001	2000
Nonoperating revenues:					
Federal grants and subsidies	329,889	220,093	-	549,982	604,398
Spurline projects	127,207	-	-	127,207	139,954
Ngetik Solar	-	-	-	-	38,281
Interest (expense) income, net	(49,493)	-	-	(49,493)	60,261
Other income	1,359	-	-	1,359	8,690
	408,962	220,093	-	629,055	851,584
Total nonoperating revenues					
Net loss	(1,161,363)	(200,216)	-	(1,361,579)	(654,673)
Add depreciation on fixed assets acquired by capital contributions that reduce contributed capital	1,280,101	371,666	-	1,651,767	1,618,194
Increase in retained earnings	118,738	171,450	-	290,188	963,521
Retained earnings at beginning of year	7,756,035	1,331,879	-	9,087,914	8,124,393
Retained earnings at end of year	7,874,773	1,503,329	-	9,378,102	9,087,914
Contributed capital at beginning of year	18,341,682	6,998,379	-	25,340,061	26,958,255
Less depreciation on assets acquired by capital contributions	(1,280,101)	(371,666)	-	(1,651,767)	(1,618,194)
Contributed capital at end of year	17,061,581	6,626,713	-	23,688,294	25,340,061
Total capitalization at end of year	\$ 24,936,354	\$ 8,130,042	\$ -	\$ 33,066,396	\$ 34,427,975

See accompanying Independent Auditors' Report

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL
CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

The Board of Directors
Pohnpei Utilities Corporation:

We have audited the financial statements of the Pohnpei Utilities Corporation (PUC), as of and for the year ended September 30, 2001, and have issued our report thereon dated February 8, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

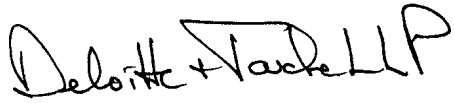
As part of obtaining reasonable assurance about whether PUC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered PUC's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

However, we noted other matters involving the internal control over financial reporting that we have reported to management of PUC in a separate letter dated February 8, 2002.

This report is intended for the information of the Board of Directors and management of PUC, federal awarding agencies, pass-through entities, cognizant audit and other federal agencies and is not intended to be, and should not be, used by anyone other than those specified parties.

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

February 8, 2002



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND
INTERNAL CONTROL OVER COMPLIANCE APPLICABLE TO EACH
MAJOR FEDERAL AWARD PROGRAM AND ON THE SCHEDULE
OF EXPENDITURES OF FEDERAL AWARDS**

The Board of Directors
Pohnpei Utilities Corporation:

Compliance

We have audited the compliance of the Pohnpei Utilities Corporation (PUC) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its one major federal program for the year ended September 30, 2001. PUC's major federal program is identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (page 19). Compliance with the requirements of laws, regulations, contracts and grants applicable to its one major federal program is the responsibility of PUC's management. Our responsibility is to express an opinion on PUC's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about PUC's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on PUC's compliance with those requirements.

In our opinion, PUC complied, in all material respects, with the requirements referred to above that are applicable to its one major federal program for the year ended September 30, 2001.

Internal Control Over Compliance

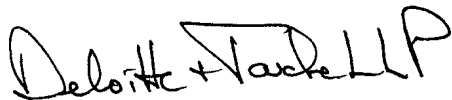
The management of PUC is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered PUC's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the Pohnpei Utilities Corporation, as of and for the year ended September 30, 2001, and have issued our report thereon dated February 8, 2002. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. This schedule is the responsibility of the management of the Pohnpei Utilities Corporation. Such information has been subjected to the auditing procedures applied in our audit of the financial statements and, in our opinion, is fairly stated, in all material respects when considered in relation to the financial statements taken as a whole.

This report is intended for the information of the Board of Directors and management of PUC, federal awarding agencies, pass-through entities, the cognizant audit and other federal agencies, and is not intended to be, and should not be, used by anyone other than these specified parties.

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

February 8, 2002

POHNPEI UTILITIES CORPORATION

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2001

Grantor/Program Title	CFDA No.	Total Authorizations	Prior Years' Expenditures	Expenditures for the Year Ended Sept. 30, 2001	Total Program Expenditures
<u>U.S. Department of the Interior:</u>					
Office of Territorial and					
International Affairs:					
<u>Compact of Free Association:</u>					
Energy Program funds, Section 214(B)	15.875	\$ 2,774,370	\$ 2,822,274	\$ -	\$ 2,822,274
Capital Account funds, Section 211(A):	15.875				
OMIP-First Year Electrical Match		322,250	296,592	-	296,592
OMIP-First Year Water and Sewer Match		1,535,250	1,535,250	-	1,535,250
Power Hook-Ups		492,500	492,500	-	492,500
Kolonias Sewer		33,119	33,119	-	33,119
OMIP-Second Year Water and Sewer Match		280,425	280,425	-	280,425
Second Year Water and Sewer Subsidy		110,200	110,200	-	110,200
Pingelap Solar		196,000	217,046	-	217,046
		<u>2,969,744</u>	<u>2,965,132</u>	<u>-</u>	<u>2,965,132</u>
<u>Operations and Maintenance Improvement</u>					
<u>Programs (OMIP):</u>					
	15.875				
Initialization of the PUC		430,250	430,249	-	430,249
Pohnpei Water, Sewage, and Solid Waste					
Utilities Development, First-Year		810,000	809,999	-	809,999
Pohnpei Water, Sewage, and Solid Waste					
Utilities Development, Second-Year		665,000	636,822	16,452	653,274
Pohnpei Water, Sewage, and Solid Waste					
Utilities Development, Third-Year		443,500	319,014	49,935	368,949
Pohnpei Water, Sewage, and Solid Waste					
Utilities Development, Fourth-Year		285,000	139,204	140,294	279,498
Pohnpei Power Generation and Distribution Second-Year		273,468	273,468	-	273,468
Pohnpei Power Generation and Distribution Third-Year		370,000	370,000	-	370,000
Pohnpei Power Generation and Distribution Fourth-Year		465,498	473,070	-	473,070
Pohnpei Power Generation and Distribution Fifth-Year		456,000	394,111	61,889	456,000
Pohnpei Power Generation and Distribution Sixth-Year					
Apprenticeship training		60,000	34,345	18,000	52,345
Continuation of Prepaid Meter Program		250,000	-	250,000	250,000
Utility Development 2001		117,668	-	13,412	13,412
OMIP Bench		71,000	71,000	-	71,000
		<u>4,697,384</u>	<u>3,951,282</u>	<u>549,982</u>	<u>4,501,264</u>
<u>Technical Assistance:</u>					
	15.875				
PUC FSM-58		110,000	110,000	-	110,000
ALCO Repairs		25,000	25,000	-	25,000
Y2K Program		55,665	55,665	-	55,665
		<u>190,665</u>	<u>190,665</u>	<u>-</u>	<u>190,665</u>
Meter Calibration/Facility Inventory	15.875	100,000	100,000	-	100,000
Overhaul ALCO Generators-Pohnpei State	15.875	100,000	100,000	-	100,000
DOI Hazard Mitigation Program	15.875	1,100,000	1,086,021	-	1,086,021
Audit Grant	15.875	32,000	32,000	-	32,000
		<u>1,332,000</u>	<u>1,318,021</u>	<u>-</u>	<u>1,318,021</u>
<u>Trust Territory of the Pacific Islands (TTPI)</u>					
<u>Deficiency Funding:</u>					
	15.875				
Pohnpei Power		328,271	328,271	-	328,271
Kolonias Sewer		659,328	797,411	-	797,411
		<u>987,599</u>	<u>1,125,682</u>	<u>-</u>	<u>1,125,682</u>
Kolonias Water Improvements	15.875	290,700	290,700	-	290,700
		<u>\$ 13,242,462</u>	<u>\$ 12,663,756</u>	<u>\$ 549,982</u>	<u>\$ 13,213,738</u>

Note: The schedule of expenditures of federal awards is prepared on the accrual basis of accounting

POHNPEI UTILITIES CORPORATION

Schedule of Findings and Questioned Costs
Year Ended September 30, 2001

Part I - Summary of Auditors' Results

1. The Independent Auditors' Report on the financial statements expressed an unqualified opinion.
2. Reportable conditions in internal control over financial reporting were not identified.
3. No instance of noncompliance considered material to the financial statements was disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal awards programs were not identified.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed an unqualified opinion.
6. The audit disclosed no findings required to be reported by OMB Circular A-133.
7. The Organization's major program was:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
Other U.S. Department of the Interior Operations and Maintenance Improvement Programs – Continuation of Prepaid Meter Program	15.875

8. A threshold of \$300,000 was used to distinguish between Type A and Type B programs, as those terms are defined in OMB Circular A-133.
9. The Organization did qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

Part II - Financial Statement Findings Section

No matters are reportable.

Part III - Federal Award Findings and Questioned Cost Section

No matters are reportable.

POHNPEI UTILITIES CORPORATION

Summary Schedule of Prior Audit Findings
Year Ended September 30, 2001

There are no prior audit findings relative to Federal awards.