

POHNPEI UTILITIES CORPORATION

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2002 AND 2001

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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, 2002 and 2001, 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, 2002 and 2001, 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 PUC'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, 2002, and in our opinion, is fairly stated, in all material respects when considered in relation to the basic financial statements taken as a whole.

As discussed in note 13 to the financial statements, the Authority changed its method of accounting for nonexchange transactions to conform with Government Accounting Standards Board Statement No. 33 and has restated the 2001 financial statements to reflect the change.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 8, 2003, 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.

April 8, 2003

POHNPEI UTILITIES CORPORATION

Balance Sheets
September 30, 2002 and 2001

<u>Assets</u>	<u>2002</u>	<u>2001</u>
Utility plant, at cost (notes 2 and 8):		
Electric plant in service	\$ 36,231,424	\$ 34,917,726
Water and sewer plant in service	11,779,097	10,897,743
Construction work-in-process	2,639,351	2,823,553
	<u>50,649,872</u>	<u>48,639,022</u>
Less accumulated depreciation	<u>(20,448,664)</u>	<u>(18,358,782)</u>
Total utility plant	<u>30,201,208</u>	<u>30,280,240</u>
Other noncurrent assets:		
Self insurance fund (note 3)	123,390	121,331
Scholarship fund (note 4)	3,881	3,881
Time certificate of deposit	100,000	-
Interest receivable	1,130	1,130
Inventory parts-generation	-	112,510
Inventory parts-distribution	-	125,158
Inventory parts-water/sewer	73,426	24,251
Total other noncurrent assets	<u>301,827</u>	<u>388,261</u>
Current assets:		
Cash (note 10)	626,421	362,393
Internally restricted investments (note 11)	474,511	542,429
Accounts receivable, net (notes 5 and 6)	3,894,333	2,506,523
Grants receivable	292	41,536
Prepayments	36,563	34,846
Materials and fuel inventory	1,074,894	965,874
Total current assets	<u>6,107,014</u>	<u>4,453,601</u>
	<u>\$ 36,610,049</u>	<u>\$ 35,122,102</u>
<u>Capitalization and Liabilities</u>		
Capitalization:		
Retained earnings (notes 13 and 14)	\$ 33,844,477	\$ 33,066,396
Current liabilities:		
Accounts payable:		
Fuel oil	51,615	72,566
Operations	202,514	72,891
Current portion of notes payable (note 7)	86,462	-
Deferred revenue	88,035	63,213
Accrued taxes and other liabilities	185,125	181,978
Employees' annual leave	124,181	190,279
Total current liabilities	<u>737,932</u>	<u>580,927</u>
Noncurrent liabilities:		
Notes payable (note 7)	<u>2,027,640</u>	<u>1,474,779</u>
Total liabilities	<u>2,765,572</u>	<u>2,055,706</u>
Contingencies (notes 3 and 10)	<u>\$ 36,610,049</u>	<u>\$ 35,122,102</u>

See accompanying notes to financial statements.

POHNPEI UTILITIES CORPORATION

Statements of Operations and Capitalization Years Ended September 30, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Operating revenues:		
Electricity sales	\$ 6,001,949	\$ 6,782,776
Water sales	934,265	954,221
Other sales	<u>184,556</u>	<u>151,418</u>
Total operating revenues	<u>7,120,770</u>	<u>7,888,415</u>
Operating and maintenance expenses:		
Production fuel	3,202,041	3,562,248
Administrative and general	1,219,826	2,434,471
Depreciation	2,086,994	1,969,104
Generation	642,028	724,371
Water and sewer	621,445	689,816
Distribution	<u>497,432</u>	<u>499,039</u>
Total operating expenses	<u>8,269,766</u>	<u>9,879,049</u>
Operating loss	<u>(1,148,996)</u>	<u>(1,990,634)</u>
Nonoperating revenues:		
Federal grants (note 9)	363,602	549,982
Spurline projects	29,569	127,207
Loss on investments	(67,918)	-
Interest (expense) income, net	(46,122)	(49,493)
Recovery of bad debts (note 6)	1,647,946	-
Other income	<u>-</u>	<u>1,359</u>
Total nonoperating revenues	<u>1,927,077</u>	<u>629,055</u>
Net income (loss)	778,081	(1,361,579)
Retained earnings at beginning of year	<u>33,066,396</u>	<u>34,427,975</u>
Retained earnings at end of year	<u>\$ 33,844,477</u>	<u>\$ 33,066,396</u>

See accompanying notes to financial statements.

POHNPEI UTILITIES CORPORATION

Statements of Cash Flows
Years Ended September 30, 2002 and 2001

	2002	2001
Cash flows from operating activities:		
Cash received from customers	\$ 7,380,906	\$ 7,967,507
Cash payments to suppliers and employees	(6,080,594)	(7,991,896)
Net cash provided by (used for) operating activities	1,300,312	(24,389)
Cash flows from investing activities:		
Payments to self insurance fund	(2,059)	(5,699)
Increase in time certificate of deposit	(100,000)	-
Decrease in PUC sinking fund, restricted investment	-	59,864
Net cash (used for) provided by investing activities	(102,059)	54,165
Cash flows from noncapital financing activities:		
Proceeds from notes payable	639,322	631,781
Operating grants received	404,846	649,425
Spurline projects	29,569	127,207
Net cash provided by noncapital financing activities	1,073,737	1,408,413
Cash flows from capital and related financing activities:		
Acquisition of utility plant	(2,007,962)	(1,586,857)
Net cash used for capital and related financing activities	(2,007,962)	(1,586,857)
Net increase (decrease) in cash	264,028	(148,668)
Cash at beginning of year	362,393	511,061
Cash at end of year	\$ 626,421	\$ 362,393
<u>Reconciliation of operating loss to net cash (used for) provided</u>		
<u>by operating activities:</u>		
Operating loss	\$ (1,148,996)	\$ (1,990,634)
Adjustments to reconcile operating loss to net cash (used for)		
provided by operating activities:		
Depreciation	2,086,994	1,969,104
Provision for bad debts	-	948,711
Other income (expense) (note 6)	1,601,824	(48,134)
(Increase) decrease in assets:		
Accounts receivable	(1,387,810)	(811,785)
Settlement notes receivable	-	18,916
Prepayments	(1,717)	13,258
Inventory	79,473	29,120
Increase (decrease) in liabilities:		
Accounts payable	108,672	(155,257)
Deferred revenue	24,822	3,021
Accrued taxes and other liabilities	3,147	17,919
Employees' annual leave	(66,097)	(18,628)
Net cash provided by (used for) operating activities	\$ 1,300,312	\$ (24,389)

See accompanying notes to financial statements.

POHNPEI UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2002 and 2001

(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, 2002 and 2001, 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 2002 and 2001 is approximately 4.3% of the cost of depreciable properties.

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, 2002 was \$119,175.

Revenues: Sales of electricity and water are recorded as billed to customers on a monthly billing cycle basis. At September 30, 2002 and 2001, 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, 2002 and 2001

(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, 2002 and 2001:

	<u>Estimated Useful Life</u>	<u>2002</u>	<u>2001</u>
Production plant	5 - 40 years	\$ 22,081,519	\$ 22,081,519
Distribution plant	5 - 30 years	12,332,738	11,019,040
General plant	3 - 20 years	<u>1,817,167</u>	<u>1,817,167</u>
Electric plant in service		<u>36,231,424</u>	<u>34,917,726</u>
Water production plant	5 - 40 years	4,725,907	4,710,528
Sewage collection and treatment plant	20 - 40 years	5,317,499	4,617,568
Water distribution plant	20 - 30 years	1,290,610	1,124,567
General plant	3 - 7 years	<u>445,081</u>	<u>445,180</u>
Water and sewer plant in service		<u>11,779,097</u>	<u>10,897,743</u>
Total utility plant in service		48,010,521	45,815,469
Less accumulated depreciation		<u>(20,448,664)</u>	<u>(18,358,782)</u>
		<u>27,561,857</u>	<u>27,456,687</u>
Construction work-in-process:			
Electric plant		283,657	1,050,388
Water and sewer plant		<u>2,355,694</u>	<u>1,773,165</u>
		<u>2,639,351</u>	<u>2,823,553</u>
		<u>\$ 30,201,208</u>	<u>\$ 30,280,240</u>

POHNPEI UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2002 and 2001

(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, 2002 and 2001, which is classified as accounts receivable - unbilled. Accounts receivable at September 30, 2002 and 2001, are summarized as follows:

	<u>2002</u>	<u>2001</u>
Accounts receivable - electrical:		
Residential	\$ 1,342,647	\$ 1,648,737
Commercial	974,014	1,546,357
Government	403,489	208,190
Unbilled	<u>616,054</u>	<u>687,201</u>
	<u>3,336,204</u>	<u>4,090,485</u>
Accounts receivable - water and sewer:		
Residential	977,477	873,099
Commercial and government	206,001	197,903
Unbilled	<u>129,333</u>	<u>120,527</u>
	<u>1,312,811</u>	<u>1,191,529</u>
	4,649,015	5,282,014
Other	<u>31,305</u>	<u>8,532</u>
	4,680,320	5,290,546
Less allowance for doubtful receivables	<u>(785,987)</u>	<u>(2,784,023)</u>
	\$ <u>3,894,333</u>	\$ <u>2,506,523</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, 2002 and 2001

(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, 2002 and 2001, the amount of receivables related to customers who are enrolled in the cash power meter system are \$784,308 and \$789,306, respectively.

(6) Allowance for Doubtful Accounts

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

	<u>2002</u>	<u>2001</u>
Beginning balance	\$ 2,784,023	\$ 1,835,311
Allowance for Pohnpei Fisheries Corporation (PFC)	-	558,625
Allowance for Economic Development Authority (EDA)	-	304,375
General allowance	<u>-</u>	<u>85,712</u>
	<u>2,784,023</u>	<u>2,784,023</u>
Less: Recovery of bad debts	(1,647,946)	-
Write offs	<u>(350,090)</u>	<u>-</u>
Ending balance	\$ <u>785,987</u>	\$ <u>2,784,023</u>

(7) Notes Payable

Notes payable consist of the following at September 30, 2002 and 2001:

	<u>2002</u>	<u>2001</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, 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 and has waived its rights to receive from PUC 6.82% in interest on the principal sum of the loan withdrawn and outstanding.	\$ 1,651,676	\$ 1,474,779

POHNPEI UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2002 and 2001

(7) Notes Payable, Continued

	<u>2002</u>	<u>2001</u>
Loan payable to FSM Development Bank, with a 5 year term, interest at 9%, collateralized by the Corporation's assignment of restricted investment of \$602,000 to FSM Development Bank. Pursuant to a loan agreement dated October 26, 2001, the Corporation is required to make monthly payments of both principal and interest in the amount \$10,379.	<u>462,426</u>	<u>-</u>
Total notes payable	2,114,102	1,474,779
Less: current portion	<u>86,462</u>	<u>-</u>
Long-term portion of notes payable	\$ <u>2,027,640</u>	\$ <u>1,474,779</u>

Future minimum principal and interest payments on all notes payable for subsequent years ending September 30, are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2003	\$ 86,462	\$ 38,088	\$ 124,550
2004	94,486	30,064	124,550
2005	103,437	21,113	124,550
2006	113,140	11,410	124,550
2007	64,901	1,789	66,690
Thereafter	<u>1,651,676</u>	<u>-</u>	<u>1,651,676</u>
	\$ <u>2,114,102</u>	\$ <u>102,464</u>	\$ <u>2,216,566</u>

(8) 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.

POHNPEI UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2002 and 2001

(9) Federal Grants

Federal grants and subsidies comprise the following for the years ended September 30, 2002 and 2001:

	<u>2002</u>	<u>2001</u>
U.S. Department of the Interior:		
Operations and maintenance improvement program (OMIP) - electrical year four	\$ -	\$ -
OMIP - electrical year five	-	61,889
OMIP - electrical year six - apprentice training	-	18,000
OMIP - water year two	11,729	16,452
OMIP - water year three	74,564	49,935
OMIP - water year four	5,502	140,294
Continuation of prepaid meter program	-	250,000
Utility development 2001	36,981	13,412
Utility development 2002	<u>234,826</u>	<u>-</u>
	<u>\$ 363,602</u>	<u>\$ 549,982</u>

(10) 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, 2002 or 2001.

(11) 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, 2002 and 2001:

	<u>2002</u>	<u>2001</u>
Money market funds	\$ 10,897	\$ 18,831
U.S. Government Obligations	112,513	89,691
Corporate bonds and others	172,005	309,799
Common stock	<u>179,096</u>	<u>124,108</u>
	<u>\$ 474,511</u>	<u>\$ 542,429</u>

POHNPEI UTILITIES CORPORATION

Notes to Financial Statements
September 30, 2002 and 2001

(12) 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, 2002 and 2001 were \$90,177 and \$95,795, 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, 2002 and 2001, plan assets were \$273,998 and \$144,325, respectively.

(13) Adoption of New Accounting Principle

Effective October 1, 2001, the Company adopted GASB Statement No. 33, "Accounting and Financial Reporting for Nonexchange Transactions." GASB No. 33 establishes more uniform revenue recognition criteria and financial reporting standards regarding the timing of recognition of the results of nonexchange transactions involving cash and other financial and capital resources. The provisions of GASB No. 33 were applied to all periods presented. Implementation of GASB No. 33 has no material impact on the 2001 financial statements.

(14) Reconciliation of Beginning Retained Earnings

Balance previously reported as of September 30, 2000	\$ 9,087,914
Inclusion of contributed capital at beginning of year	<u>25,340,061</u>
Balance as reported in the accompanying financial statements	\$ <u>34,427,975</u>

POHNPEI UTILITIES CORPORATION

Combining Balance Sheet

September 30, 2002

(With comparative totals as of September 30, 2001)

	Power and Utility	Water and Sewer	Eliminating Entries	Totals	
				2002	2001
<u>Assets</u>					
Utility plant, at cost:					
Electric plant in service	\$ 36,231,424	\$ -	\$ -	\$ 36,231,424	\$ 34,917,726
Water and sewer plant in service	-	11,779,097	-	11,779,097	10,897,743
Construction work-in-process	283,657	2,355,694	-	2,639,351	2,823,553
	<u>36,515,081</u>	<u>14,134,791</u>	<u>-</u>	<u>50,649,872</u>	<u>48,639,022</u>
Less accumulated depreciation	<u>(16,520,561)</u>	<u>(3,928,103)</u>	<u>-</u>	<u>(20,448,664)</u>	<u>(18,358,782)</u>
Total utility plant	<u>19,994,520</u>	<u>10,206,688</u>	<u>-</u>	<u>30,201,208</u>	<u>30,280,240</u>
Other noncurrent assets:					
Self insurance fund	123,390	-	-	123,390	121,331
Scholarship fund	3,881	-	-	3,881	3,881
Time deposit	100,000	-	-	100,000	-
Interest receivable	1,130	-	-	1,130	1,130
Inventory parts-generation	-	-	-	-	112,510
Inventory parts-distribution	-	-	-	-	125,158
Inventory parts-water/sewer	-	73,426	-	73,426	24,251
Total other noncurrent assets	<u>228,401</u>	<u>73,426</u>	<u>-</u>	<u>301,827</u>	<u>388,261</u>
Current assets:					
Cash	1,920,736	(1,294,315)	-	626,421	362,393
Internally restricted investments	474,511	-	-	474,511	542,429
Accounts receivable, net	2,863,483	1,030,850	-	3,894,333	2,506,523
Grants receivable	13	279	-	292	41,536
Prepayments	36,563	-	-	36,563	34,846
Fuel and material inventory	962,019	112,875	-	1,074,894	965,874
Total current assets	<u>6,257,325</u>	<u>(150,311)</u>	<u>-</u>	<u>6,107,014</u>	<u>4,453,601</u>
	<u>\$ 26,480,246</u>	<u>\$ 10,129,803</u>	<u>\$ -</u>	<u>\$ 36,610,049</u>	<u>\$ 35,122,102</u>
<u>Capitalization and Liabilities</u>					
Capitalization:					
Retained earnings	\$ 25,466,833	\$ 8,377,644	\$ -	\$ 33,844,477	\$ 33,066,396
Current liabilities:					
Accounts payable:					
Fuel oil	51,615	-	-	51,615	72,566
Operations	162,012	40,502	-	202,514	72,891
Current portion of notes payable	86,462	-	-	86,462	-
Deferred revenue	88,035	-	-	88,035	63,213
Accrued taxes and other liabilities	148,100	37,025	-	185,125	181,978
Employees' annual leave	101,225	22,956	-	124,181	190,279
Total current liabilities	<u>637,449</u>	<u>100,483</u>	<u>-</u>	<u>737,932</u>	<u>580,927</u>
Noncurrent liabilities:					
FSM Development Bank Loan	375,964	-	-	375,964	-
ADB Water Extension Loan	-	1,651,676	-	1,651,676	1,474,779
Total liabilities	<u>1,013,413</u>	<u>1,752,159</u>	<u>-</u>	<u>2,765,572</u>	<u>2,055,706</u>
	<u>\$ 26,480,246</u>	<u>\$ 10,129,803</u>	<u>\$ -</u>	<u>\$ 36,610,049</u>	<u>\$ 35,122,102</u>

See accompanying Independent Auditors' Report

POHNPEI UTILITIES CORPORATION

Combining Statement of Operations and Capitalization
Year Ended September 30, 2002
(With comparative totals for the year ended September 30, 2001)

	Power and Utility	Water and Sewer	Eliminating Entries	Totals	
				2002	2001
Operating revenues:					
Residential	\$ 707,018	\$ 692,159	\$ -	\$ 1,399,177	\$ 2,056,757
Commercial	2,132,449	115,143	-	2,247,592	2,747,607
Government	1,768,286	126,963	-	1,895,249	2,119,182
Cash power	1,394,196	-	-	1,394,196	813,451
Intercompany sales	66,385	-	(66,385)	-	-
Other sales	163,201	21,355	-	184,556	151,418
Total operating revenues	<u>6,231,535</u>	<u>955,620</u>	<u>(66,385)</u>	<u>7,120,770</u>	<u>7,888,415</u>
Operating and maintenance expenses:					
Production fuel	3,202,041	-	-	3,202,041	3,562,248
Depreciation	1,599,667	487,327	-	2,086,994	1,969,104
Administrative and general:					
Employee benefits	368,267	-	-	368,267	438,273
Salaries and wages	311,921	-	-	311,921	368,298
Consumables	139,896	-	-	139,896	185,128
General repairs	102,081	-	-	102,081	128,756
Training and safety	44,073	-	-	44,073	65,593
Customer service and collection	37,357	-	-	37,357	51,536
Vehicle, POL	108,875	-	-	108,875	117,146
Legal fees	35,000	-	-	35,000	17,250
Communications	41,687	-	-	41,687	32,641
Travel	30,669	-	-	30,669	66,864
Insurance	-	-	-	-	14,275
Utility expense	19,256	-	(19,256)	-	-
Bad debts	-	-	-	-	948,711
Total administrative and general	<u>1,239,082</u>	<u>-</u>	<u>(19,256)</u>	<u>1,219,826</u>	<u>2,434,471</u>
Generation:					
Salaries and wages	447,786	-	-	447,786	455,289
Repairs and maintenance	157,619	-	-	157,619	249,950
Other production	36,623	-	-	36,623	19,132
Total generation	<u>642,028</u>	<u>-</u>	<u>-</u>	<u>642,028</u>	<u>724,371</u>
Water and sewer:					
Salaries and wages	-	377,285	-	377,285	387,875
Employee benefits	-	63,094	-	63,094	61,827
Repairs and maintenance	-	71,199	-	71,199	153,099
Training and safety	-	11,972	-	11,972	20,773
Chemicals	-	77,035	-	77,035	47,424
Utility expense	-	47,129	(47,129)	-	-
Other production	-	20,860	-	20,860	18,818
Total water and sewer	<u>-</u>	<u>668,574</u>	<u>(47,129)</u>	<u>621,445</u>	<u>689,816</u>
Distribution:					
Salaries and wages	358,287	-	-	358,287	332,916
Repairs and maintenance	139,145	-	-	139,145	166,123
Total distribution	<u>497,432</u>	<u>-</u>	<u>-</u>	<u>497,432</u>	<u>499,039</u>
Total operating expenses	<u>7,180,250</u>	<u>1,155,901</u>	<u>(66,385)</u>	<u>8,269,766</u>	<u>9,879,049</u>
Operating loss	<u>(948,715)</u>	<u>(200,281)</u>	<u>-</u>	<u>(1,148,996)</u>	<u>(1,990,634)</u>

See accompanying Independent Auditors' Report

POHNPEI UTILITIES CORPORATION

Combining Statement of Operations and Capitalization, Continued
 Year Ended September 30, 2002
 (With comparative totals for the year ended September 30, 2001)

	Power and Utility	Water and Sewer	Eliminating Entries	Totals	
				2002	2001
Nonoperating revenues:					
Federal grants and subsidies	234,826	128,776	-	363,602	549,982
Spurline projects	29,569	-	-	29,569	127,207
Loss on investments	(67,918)	-	-	(67,918)	-
Interest (expense) income, net	(46,122)	-	-	(46,122)	(49,493)
Recovery of bad debts	1,328,839	319,107	-	1,647,946	-
Other income	-	-	-	-	1,359
Total nonoperating revenues	1,479,194	447,883	-	1,927,077	629,055
Net loss	530,479	247,602	-	778,081	(1,361,579)
Retained earnings at beginning of year	24,936,354	8,130,042	-	33,066,396	34,427,975
Retained earnings at end of year	\$ 25,466,833	\$ 8,377,644	\$ -	\$ 33,844,477	\$ 33,066,396

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, 2002, and have issued our report thereon dated April 8, 2003. 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

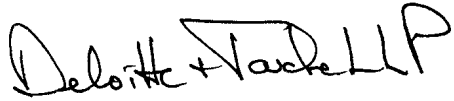
As part of obtaining reasonable assurance about whether PUC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination 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 April 8, 2003.

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.

April 8, 2003



**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, 2002. 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, 2002.

Internal Control Over Compliance

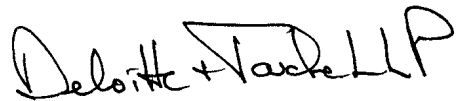
The management of PUC is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered PUC's internal control over compliance with 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, 2002, and have issued our report thereon dated April 8, 2003. 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.

April 8, 2003

POHNPEI UTILITIES CORPORATION

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2002

Grantor/Program Title	CFDA No.	Total Authorizations	Prior Years' Expenditures	Expenditures for the Year Ended Sept. 30, 2002	Total Program Expenditures
<u>U.S. Department of the Interior:</u>					
Office of Territorial and					
International Affairs:					
<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	653,274	11,729	665,003
Pohnpei Water, Sewage, and Solid Waste Utilities Development, Third-Year		443,500	368,949	74,564	443,513
Pohnpei Water, Sewage, and Solid Waste Utilities Development, Fourth-Year		285,000	279,498	5,502	285,000
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	456,000	-	456,000
Pohnpei Power Generation and Distribution Sixth-Year - Apprenticeship training		60,000	52,345	-	52,345
Continuation of Prepaid Meter Program		250,000	250,000	-	250,000
Utility Development 2001		117,668	13,412	36,981	50,393
OMIP Bench		71,000	71,000	-	71,000
OMIP Bench		562,500	-	234,826	234,826
		<u>\$ 5,259,884</u>	<u>\$ 4,501,264</u>	<u>\$ 363,602</u>	<u>\$ 4,864,866</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, 2002

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, 2002

There are no prior audit findings relative to Federal awards.