

**POHNPEI UTILITIES CORPORATION**

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**FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITORS' REPORT**

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**YEARS ENDED SEPTEMBER 30, 2003 AND 2002**



## **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, 2003 and 2002, 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.

Except as discussed in the following paragraph, 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.

Because we were not engaged as auditors until after September 30, 2003, we were not present to observe the physical inventory at that date. We have not been able to satisfy ourselves by means of other auditing procedures concerning inventory quantities at September 30, 2003.

In our opinion, except for the effects, if any, of adjustments that may have resulted had we observed the physical inventory at September 30, 2003 as discussed in the previous paragraph, such financial statements present fairly, in all material respects, the financial position of the Pohnpei Utilities Corporation as of September 30, 2003 and 2002, 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 16-19 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, 2003, 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 1 to the financial statements, PUC adopted the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments, as amended by GASB Statement No. 37, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments, and GASB Statement No. 38, Certain Financial Statements Note Disclosures, as of October 1, 2002. The accompanying 2002 financial statements have been restated to reflect the changes required by GASB 34.

The Management Discussion and Analysis on pages 3 and 4 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurements and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 18, 2004, 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 cursive script that reads "Deloitte + Touche LLP".

March 18, 2004

## POHNPEI UTILITIES CORPORATION

### Management Discussion and Analysis Year Ended September 30, 2003

The following discussion and analysis of the financial performance and activity of the Pohnpei Utilities Corporation (PUC) is to provide an introduction and understanding of the basic financial statements of the PUC for the year ended September 30, 2003. The discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

The PUC is a public corporation of the Pohnpei State Government and is the primary provider of Power, Water and Sewer services for the island. It is under the governance of a seven-member Board of Directors that was appointed by the Governor of Pohnpei State, which has policy oversight over the corporation. The General Manager, who is hired by the Board of Directors, manages the daily operation of the corporation.

The PUC has an installed generation capacity of 15.46 MW while the power demand is 6.6 MW. The PUC generated 39,766 MWh and sold 34,448 MWh to customers this year. This brings in the total power revenue of \$6.8 million to the corporation. The number of households being serviced by PUC is 5,567, which is equivalent to the coverage of 90% of Pohnpei.

The PUC also provides treated water to the people of Pohnpei. The PUC has the capacity to produce 4.72 million gallons per day while the daily water demand to existing customers amounts to 1.59 million gallons per day. In FY 2003, PUC produced 950 million gallons and sold 581 million gallons to customers, which brings in the total revenue to PUC of \$1.0 million. The PUC services 3,449 households, which covers about 1/3 of the area in Pohnpei or an equivalent of 53% of the total population.

This year, the PUC extended approximately 11 miles of pipelines and installed (10) additional new wells, which could pump into the system an additional 1.2 million gallons of water per day. The extension provided services to 311 households, which brings annual revenue of \$72,000 to the corporation.

The following table summarizes the financial condition and operations of the PUC for FY 2003 and 2002:

	<u>2003</u>	<u>2002</u>
Assets:		
Utility plant, net	\$ 29,450,475	\$ 30,201,208
Current assets	6,203,297	6,107,014
Total other assets	<u>479,448</u>	<u>301,827</u>
	\$ <u>36,133,220</u>	\$ <u>36,610,049</u>
Liabilities and Net Assets:		
Long-term debt, net	\$ 2,407,268	\$ 2,027,640
Current portion of long-term debt	94,486	86,462
Other current liabilities	<u>535,893</u>	<u>651,470</u>
	<u>3,037,647</u>	<u>2,765,572</u>
Net assets:		
Invested in capital assets, net of related debt	26,948,721	28,087,106
Restricted	274,437	123,390
Unrestricted	<u>5,872,415</u>	<u>5,633,981</u>
	<u>33,095,573</u>	<u>33,844,477</u>
	\$ <u>36,133,220</u>	\$ <u>36,610,049</u>

## POHNPEI UTILITIES CORPORATION

### Management Discussion and Analysis, Continued Year Ended September 30, 2003

	<u>2003</u>	<u>2002</u>
Revenue, Expenses and Changes in Net Assets		
Operating revenues	\$ 8,087,222	\$ 7,120,770
Operating expenses	<u>9,378,216</u>	<u>8,269,766</u>
Net operating loss	(1,290,994)	(1,148,996)
Non-operating revenues, net	<u>542,090</u>	<u>1,927,077</u>
Increase (decrease) in net assets	\$ <u>(748,904)</u>	\$ <u>778,081</u>

Overall, the changes in the balance sheet components include a decrease in net utility plant, an increase in current assets, an increase in total other assets, an increase in long-term debt, and an increase in current liabilities.

Decreases in utility plant are attributable to insufficient replacement of capital assets that are depreciated over the year. The total depreciation for the year is \$2,105,605, while the Corporation re-invested only \$1,354,871 in capital assets.

Increases in current assets are due to increases in accounts receivable. Although prepaid meters have improved collection of residential and small commercial customers, the government, which once was current on its accounts, has become a delinquent customer. As of September 30, 2003, the amount owed by the government and its agencies, particularly PFC and EDA, is \$1.1 million. There is also a corresponding increase in water accounts receivable as water sales increased during the year.

Increases in total other assets are attributable to the creation of TCDs to secure PUC's loans.

Increases in long-term debt are due to the Asian Development Bank loan. The amount borrowed from ADB is \$2,118,267, of which \$1,590,073 is used for the pipeline extension and \$528,693 is used for the development of 10 wells.

Increases in other current liabilities are due to increases in PUC's general obligations.

There is a 12% increase in sales this year, an equivalent of \$900,000. The increases are due to increased power sales (2% or \$170,000) and a 7% increase in water sales due to ADB pipeline extension (\$72,000). The rest of the revenue comes from fuel-past-through tariff adjustments (see increases in fuel expenses), and other sales.

There is also a 13% or \$1,108,000 increase in total operating expenses from last year. The increases are due to a 13% increase in fuel prices, an equivalent of a \$475,000 increase. There is an increase in generation repairs and maintenance of approximately \$220,000. The Corporation also recorded an additional allowance for doubtful accounts of \$364,013. The rest of the increase is a result of increases in general and administration expenses.

This concludes the management discussion and analysis of the financial statements for the year ended September 30, 2003.

**POHNPEI UTILITIES CORPORATION**

Balance Sheets  
September 30, 2003 and 2002

<u>ASSETS</u>	<u>2003</u>	<u>2002</u>
Current assets:		
Cash	\$ 384,911	\$ 626,421
Internally restricted investments	524,000	474,511
Accounts receivable, net	4,263,322	3,894,333
Grants receivable	48,375	292
Prepayments	42,375	36,563
Materials and fuel inventory	940,314	1,074,894
Total current assets	<u>6,203,297</u>	<u>6,107,014</u>
Other noncurrent assets:		
Self insurance fund	124,437	123,390
Scholarship fund	3,881	3,881
Time certificates of deposit	350,000	100,000
Interest receivable	1,130	1,130
Inventory parts-water/sewer	-	73,426
Total other noncurrent assets	<u>479,448</u>	<u>301,827</u>
Utility plant, at cost:		
Electric plant in service	36,395,324	36,231,424
Water and sewer plant in service	11,894,096	11,779,097
Construction work-in-process	3,715,324	2,639,351
	52,004,744	50,649,872
Less accumulated depreciation	<u>(22,554,269)</u>	<u>(20,448,664)</u>
Total utility plant	<u>29,450,475</u>	<u>30,201,208</u>
	<u>\$ 36,133,220</u>	<u>\$ 36,610,049</u>
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Current portion of notes payable	\$ 94,486	\$ 86,462
Accounts payable:		
Fuel oil	142,134	51,615
Operations	123,131	202,514
Deferred revenue	79,362	88,035
Accrued taxes and other liabilities	139,255	185,125
Employees' annual leave	52,011	124,181
Total current liabilities	<u>630,379</u>	<u>737,932</u>
Noncurrent liabilities:		
Notes payable	<u>2,407,268</u>	<u>2,027,640</u>
Total liabilities	<u>3,037,647</u>	<u>2,765,572</u>
Contingencies		
Net assets:		
Invested in capital assets, net of related debt	26,948,721	28,087,106
Restricted	274,437	123,390
Unrestricted	5,872,415	5,633,981
Total net assets	<u>33,095,573</u>	<u>33,844,477</u>
	<u>\$ 36,133,220</u>	<u>\$ 36,610,049</u>

See accompanying notes to financial statements.

**POHNPEI UTILITIES CORPORATION**

Statements of Revenues, Expenses and Changes in Net Assets  
Years Ended September 30, 2003 and 2002

	2003	2002
Operating revenues:		
Electricity sales	\$ 6,841,665	\$ 6,001,949
Water sales	1,073,760	934,265
Other sales	171,797	184,556
Total operating revenues	8,087,222	7,120,770
Operating and maintenance expenses:		
Production fuel	3,678,145	3,202,041
Administrative and general	1,666,977	1,219,826
Depreciation	2,105,605	2,086,994
Generation	862,886	642,028
Water and sewer	621,243	621,445
Distribution	443,360	497,432
Total operating expenses	9,378,216	8,269,766
Operating loss	(1,290,994)	(1,148,996)
Nonoperating revenues:		
Grants and subsidies	263,352	363,602
Spurline projects	81,811	29,569
Loss on investments	-	(67,918)
Interest (expense) income, net	(3,421)	(46,122)
Recovery of bad debts	-	1,647,946
Other income	10,164	-
Total nonoperating revenues	351,906	1,927,077
Net (loss) income before capital contributions	(939,088)	778,081
Capital contributions:		
Grants from Pohnpei State	190,184	-
Change in net assets	(748,904)	778,081
Net assets at beginning of year	33,844,477	33,066,396
Net assets at end of year	\$ 33,095,573	\$ 33,844,477

See accompanying notes to financial statements.

**POHNPEI UTILITIES CORPORATION**

Statements of Cash Flows  
Years Ended September 30, 2003 and 2002

	2003	2002
Cash flows from operating activities:		
Cash received from customers	\$ 7,355,711	\$ 7,380,906
Cash payments to suppliers for goods and services	(5,092,418)	(4,497,521)
Cash paid to employees	(1,724,311)	(1,583,073)
Net cash provided by operating activities	538,982	1,300,312
Cash flows from investing activities:		
Payments to self insurance fund	(1,047)	(2,059)
Increase in time certificate of deposit	(250,000)	(100,000)
Increase in internally restricted investments	(49,489)	-
Net cash used for investing activities	(300,536)	(102,059)
Cash flows from noncapital financing activities:		
Operating grants received	215,269	404,846
Spurline projects	81,811	29,569
Net cash provided by noncapital financing activities	297,080	434,415
Cash flows from capital and related financing activities:		
Proceeds from notes payable	467,091	639,322
Repayments of notes payable	(79,439)	-
Acquisition of utility plant	(1,354,872)	(2,007,962)
Capital contributions	190,184	-
Net cash used for capital and related financing activities	(777,036)	(1,368,640)
Net change in cash	(241,510)	264,028
Cash at beginning of year	626,421	362,393
Cash at end of year	\$ 384,911	\$ 626,421
<u>Reconciliation of operating loss to net cash provided by</u>		
<u>by operating activities:</u>		
Operating loss	\$ (1,290,994)	\$ (1,148,996)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation	2,105,605	2,086,994
Provision for bad debts	364,013	-
Other income (expense)	6,743	1,601,824
(Increase) decrease in assets:		
Accounts receivable	(733,002)	(1,387,810)
Prepayments	(5,812)	(1,717)
Inventory	208,006	79,473
Increase (decrease) in liabilities:		
Accounts payable	11,136	108,672
Deferred revenue	(8,673)	24,822
Accrued taxes and other liabilities	(45,870)	3,147
Employees' annual leave	(72,170)	(66,097)
Net cash provided by operating activities	\$ 538,982	\$ 1,300,312

See accompanying notes to financial statements.

# POHNPEI UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2003 and 2002

## (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. 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. PUC capitalizes plant acquisitions with original costs in excess of \$5,000.

Depreciation: Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Depreciation expense for 2003 and 2002 is approximately 4.3% of the cost of depreciable properties. Estimated useful lives for utility plant assets are 5-40 years for production plant, 5-30 years for distribution plant and 3-20 years for general plant.

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, 2003 was \$115,967.

Revenues: Sales of electricity and water are recorded as billed to customers on a monthly billing cycle basis. At September 30, 2003 and 2002, 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, 2003 and 2002

## (1) Summary of Significant Accounting Policies, Continued

Net Assets: Net assets represent the residual interest in PUC's assets after liabilities are deducted and consist of four sections: invested in capital assets, net of related debt; restricted expendable and nonexpendable, and unrestricted. Net assets invested in capital assets, net of related debt include capital assets, restricted and unrestricted, net of accumulated depreciation, reduced by outstanding debt net of debt service reserve. Net assets are reported as restricted when constraints are imposed by third parties or enabling legislation. All of PUC's restricted net assets are expendable. All other net assets are unrestricted.

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.

Adoption of New Accounting Principle: For the year ended September 30, 2003, PUC adopted GASB Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments" (GASB 34) as amended by GASB Statement Nos. 37 and 38 and applied those standards on a retroactive basis. GASB 34 establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following net asset categories:

- Invested in capital assets, net of related debt:  
Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- Restricted:
  - Nonexpendable – Net assets subject to externally imposed stipulations that require PUC to maintain them permanently.
  - Expendable – Net assets whose use by PUC is subject to externally imposed stipulations that can be fulfilled by actions of PUC pursuant to those stipulations or that expire by the passage of time.
- Unrestricted:  
Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action by management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

The provisions of GASB 34 have been applied to all years presented.

**POHNPEI UTILITIES CORPORATION**

Notes to Financial Statements  
September 30, 2003 and 2002

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards: For fiscal year 2004, PUC will be implementing GASB Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3)*. For fiscal year 2005, PUC will be implementing GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. As of the date of the opinion, PUC has not evaluated the financial statement impact of GASB Statement Nos. 40 and 42.

Reclassifications: Certain reclassifications have been made to the 2002 financial statements to correspond with the 2003 presentation.

(2) Utility Plant

A summary of changes in capital assets for the years ended September 30, 2003 and 2002 is as follows:

<u>2003</u>	<u>Beginning Balance October 1, 2002</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Ending Balance September 30, 2003</u>
<u>Depreciable assets:</u>				
Production plant	\$ 22,081,519	\$ -	\$ -	\$ 22,081,519
Distribution plant	12,332,738	163,900	-	12,496,638
General plant	<u>1,817,167</u>	<u>-</u>	<u>-</u>	<u>1,817,167</u>
Electric plant in service	<u>36,231,424</u>	<u>163,900</u>	<u>-</u>	<u>36,395,324</u>
Water production plant	4,725,907	-	-	4,725,907
Sewage collection and treatment plant	5,317,499	-	-	5,317,499
Water distribution plant	1,290,610	114,999	-	1,405,609
General plant	<u>445,081</u>	<u>-</u>	<u>-</u>	<u>445,081</u>
Water and sewer plant in service	<u>11,779,097</u>	<u>114,999</u>	<u>-</u>	<u>11,894,096</u>
Total utility plant in service	48,010,521	278,899	-	48,289,420
Less accumulated depreciation	<u>(20,448,664)</u>	<u>(2,105,605)</u>	<u>-</u>	<u>(22,554,269)</u>
	<u>27,561,857</u>	<u>(1,826,706)</u>	<u>-</u>	<u>25,735,151</u>
<u>Non-depreciable assets:</u>				
Construction work-in-progress:				
Electric plant	283,657	423,751	-	707,408
Water and sewer plant	<u>2,355,694</u>	<u>652,222</u>	<u>-</u>	<u>3,007,916</u>
	\$ <u>30,201,208</u>	\$ <u>(750,733)</u>	\$ <u>-</u>	\$ <u>29,450,475</u>

**POHNPEI UTILITIES CORPORATION**

Notes to Financial Statements  
September 30, 2003 and 2002

(2) Utility Plant, Continued

<u>2002</u>	<u>Beginning Balance October 1, 2001</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Ending Balance September 30, 2002</u>
<u>Depreciable assets:</u>				
Production plant	\$ 22,081,519	\$ -	\$ -	\$ 22,081,519
Distribution plant	11,019,040	1,313,698	-	12,332,738
General plant	<u>1,817,167</u>	<u>-</u>	<u>-</u>	<u>1,817,167</u>
Electric plant in service	<u>34,917,726</u>	<u>1,313,698</u>	<u>-</u>	<u>36,231,424</u>
Water production plant	4,710,528	15,379	-	4,725,907
Sewage collection and treatment plant	4,617,568	699,931	-	5,317,499
Water distribution plant	1,124,567	166,043	-	1,290,610
General plant	<u>445,080</u>	<u>1</u>	<u>-</u>	<u>445,081</u>
Water and sewer plant in service	<u>10,897,743</u>	<u>881,354</u>	<u>-</u>	<u>11,779,097</u>
Total utility plant in service	45,815,469	2,195,052	-	48,010,521
Less accumulated depreciation	<u>(18,358,782)</u>	<u>(2,089,882)</u>	<u>-</u>	<u>(20,448,664)</u>
	<u>27,456,687</u>	<u>105,170</u>	<u>-</u>	<u>27,561,857</u>
<u>Non-depreciable assets:</u>				
Construction work-in-progress:				
Electric plant	1,050,388	-	(766,731)	283,657
Water and sewer plant	<u>1,773,165</u>	<u>582,529</u>	<u>-</u>	<u>2,355,694</u>
	\$ <u>30,280,240</u>	\$ <u>687,699</u>	\$ <u>(766,731)</u>	\$ <u>30,201,208</u>

(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, 2003 and 2002, which is classified as accounts receivable - unbilled. Accounts receivable at September 30, 2003 and 2002, are summarized as follows:

**POHNPEI UTILITIES CORPORATION**

Notes to Financial Statements  
September 30, 2003 and 2002

(5) Accounts Receivable, Continued

	<u>2003</u>	<u>2002</u>
Accounts receivable - electrical:		
Residential	\$ 1,759,296	\$ 1,342,647
Commercial	737,169	974,014
Government	468,949	403,489
Unbilled	<u>562,128</u>	<u>616,054</u>
	<u>3,527,542</u>	<u>3,336,204</u>
Accounts receivable - water and sewer:		
Residential	717,236	977,477
Commercial and government	179,913	206,001
Unbilled	<u>153,111</u>	<u>129,333</u>
	<u>1,050,260</u>	<u>1,312,811</u>
Installment receivables	<u>734,074</u>	<u>-</u>
Other	5,311,876	4,649,015
	<u>101,446</u>	<u>31,305</u>
	5,413,322	4,680,320
Less allowance for doubtful receivables	<u>(1,150,000)</u>	<u>(785,987)</u>
	<u>\$ 4,263,322</u>	<u>\$ 3,894,333</u>

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

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, 2003 and 2002, gross receivables from customers enrolled in the cash power meter system are \$1,369,611 and \$784,308, respectively.

(6) Notes Payable

Notes payable consist of the following at September 30, 2003 and 2002:

	<u>2003</u>	<u>2002</u>
Amount drawn on a note payable to the State of Pohnpei, facilitated by an Asian Development Bank loan to the FSM, due in semi-annual installments of \$33,500 commencing February 28, 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 6.82% in interest. PUC is instead paying 1% interest on the principal sum of the loan withdrawn and outstanding.	\$ 2,118,767	\$ 1,651,676

**POHNPEI UTILITIES CORPORATION**

Notes to Financial Statements  
September 30, 2003 and 2002

(6) Notes Payable, Continued

	<u>2003</u>	<u>2002</u>
Loan payable to FSM Development Bank, with a 5 year term, interest at 9%, collateralized by a time certificate of deposit of \$150,000. 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.	382,987	462,426
Total notes payable	2,501,754	2,114,102
Less: current portion	94,486	86,462
Long-term portion of notes payable	\$ 2,407,268	\$ 2,027,640

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>
2004	\$ 94,486	\$ 52,111	\$ 146,597
2005	103,437	43,160	146,597
2006	113,140	33,457	146,597
2007	117,049	23,664	140,713
2008	45,576	21,424	67,000
2009-2013	234,807	100,193	335,000
2014-2018	246,781	88,219	335,000
2019-2023	259,366	75,634	335,000
2024-2028	272,593	62,407	335,000
2029-2033	286,495	48,505	335,000
2034-2038	301,105	33,895	335,000
2039-2043	316,461	18,539	335,000
2044-2046	110,458	3,429	113,887
	\$ 2,501,754	\$ 604,637	\$ 3,106,391

Changes in non-current liabilities for the year ended September 30, 2003, are as follows:

	Outstanding September 30, <u>2002</u>	<u>Increases</u>	<u>Decreases</u>	Outstanding September 30, <u>2003</u>	<u>Current</u>	<u>Noncurrent</u>
Loan payable to FSM Development Bank	\$ 462,426	\$ -	\$ 79,439	\$ 382,987	\$ 94,486	\$ 288,501
Loan payable to Asian Development Bank	1,651,676	467,091	-	2,118,767	-	2,118,767
	\$ 2,114,102	\$ 467,091	\$ 79,439	\$ 2,501,754	\$ 94,486	\$ 2,407,268

## POHNPEI UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2003 and 2002

### (7) 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.

### (8) Grants, Subsidies and Capital Contributions

Grants, subsidies and capital contributions comprise the following for the years ended September 30, 2003 and 2002:

	<u>2003</u>	<u>2002</u>
Grants and Subsidies:		
U.S. Department of the Interior:		
Operations and maintenance improvement program - electrical year six - apprentice training	\$ 7,655	\$ -
OMIP - water year two	-	11,729
OMIP - water year three	-	74,564
OMIP - water year four	-	5,502
Utility development 2001	42,420	36,981
Utility development 2002	205,897	234,826
Human resources development 2003	<u>7,380</u>	<u>-</u>
Total grants and subsidies	263,352	363,602
Capital Contributions:		
Pohnpei State grants	<u>190,184</u>	<u>-</u>
	\$ <u>453,536</u>	\$ <u>363,602</u>

### (9) 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, 2003 or 2002.

### (10) 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 in anticipation of certain equipment purchases and upgrades.

## POHNPEI UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 2003 and 2002

### (10) Sinking Fund, Continued

The sinking fund is comprised of the following at September 30, 2003 and 2002:

	<u>2003</u>	<u>2002</u>
Money market funds	\$ 22,000	\$ 10,897
U.S. Government obligations	106,000	112,513
Corporate bonds and others	180,000	172,005
Common stock	<u>216,000</u>	<u>179,096</u>
	<u>\$ 524,000</u>	<u>\$ 474,511</u>

### (11) 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 three 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, 2003 and 2002 were \$80,827 and \$90,177, 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, 2003 and 2002, plan assets were \$445,161 and \$273,998, respectively.

**POHNPEI UTILITIES CORPORATION**

Combining Balance Sheet  
September 30, 2003

(With comparative totals as of September 30, 2002)

<u>Assets</u>	Power and Utility	Water and Sewer	Eliminating Entries	Totals	
				2003	2002
<b>Current assets:</b>					
Cash	\$ 992,878	\$ (607,967)	\$ -	\$ 384,911	\$ 626,421
Internally restricted investments	524,000	-	-	524,000	474,511
Accounts receivable, net	3,390,235	873,087	-	4,263,322	3,894,333
Grants receivable	48,096	279	-	48,375	292
Prepayments	42,375	-	-	42,375	36,563
Fuel and material inventory	796,498	143,816	-	940,314	1,074,894
Total current assets	5,794,082	409,215	-	6,203,297	6,107,014
<b>Other noncurrent assets:</b>					
Self insurance fund	124,437	-	-	124,437	123,390
Scholarship fund	3,881	-	-	3,881	3,881
Time deposit	350,000	-	-	350,000	100,000
Interest receivable	1,130	-	-	1,130	1,130
Inventory parts-water/sewer	-	-	-	-	73,426
Total other noncurrent assets	479,448	-	-	479,448	301,827
<b>Utility plant, at cost:</b>					
Electric plant in service	36,395,324	-	-	36,395,324	36,231,424
Water and sewer plant in service	-	11,894,096	-	11,894,096	11,779,097
Construction work-in-process	707,407	3,007,917	-	3,715,324	2,639,351
	37,102,731	14,902,013	-	52,004,744	50,649,872
Less accumulated depreciation	(18,128,505)	(4,425,764)	-	(22,554,269)	(20,448,664)
Total utility plant	18,974,226	10,476,249	-	29,450,475	30,201,208
	\$ 25,247,756	\$ 10,885,464	\$ -	\$ 36,133,220	\$ 36,610,049
<u>Net Assets and Liabilities</u>					
<b>Current liabilities:</b>					
Accounts payable:					
Fuel oil	\$ 142,134	\$ -	\$ -	\$ 142,134	\$ 51,615
Operations	52,878	70,253	-	123,131	202,514
Current portion of notes payable	94,486	-	-	94,486	86,462
Deferred revenue	79,362	-	-	79,362	88,035
Accrued taxes and other liabilities	98,500	40,755	-	139,255	185,125
Employees' annual leave	39,000	13,011	-	52,011	124,181
Total current liabilities	506,360	124,019	-	630,379	737,932
<b>Noncurrent liabilities:</b>					
FSM Development Bank Loan	106,881	181,620	-	288,501	375,964
ADB Water Extension Loan	-	2,118,767	-	2,118,767	1,651,676
Total liabilities	613,241	2,424,406	-	3,037,647	2,765,572
<b>Net assets:</b>					
Invested in capital assets, net of related deb	18,772,859	8,175,862	-	26,948,721	28,087,106
Restricted	274,437	-	-	274,437	123,390
Unrestricted	5,587,219	285,196	-	5,872,415	5,633,981
Total net assets	24,634,515	8,461,058	-	33,095,573	33,844,477
	\$ 25,247,756	\$ 10,885,464	\$ -	\$ 36,133,220	\$ 36,610,049

See accompanying Independent Auditors' Report

**POHNPEI UTILITIES CORPORATION**

Combining Statement of Operations and Net Assets  
Year Ended September 30, 2003  
(With comparative totals for the year ended September 30, 2002)

	Power and Utility	Water and Sewer	Eliminating Entries	Totals	
				2003	2002
Operating revenues:					
Residential	\$ 902,593	\$ 795,900	\$ -	\$ 1,698,493	\$ 1,399,177
Commercial	2,289,992	141,272	-	2,431,264	2,247,592
Government	1,936,440	136,588	-	2,073,028	1,895,249
Cash power	1,712,640	-	-	1,712,640	1,394,196
Intercompany sales	59,743	-	(59,743)	-	-
Other sales	42,305	129,492	-	171,797	184,556
Total operating revenues:	<u>6,943,713</u>	<u>1,203,252</u>	<u>(59,743)</u>	<u>8,087,222</u>	<u>7,120,770</u>
Operating and maintenance expenses:					
Production fuel	3,678,145	-	-	3,678,145	3,202,041
Depreciation	1,607,943	497,662	-	2,105,605	2,086,994
Administrative and general:					
Employee benefits	362,196	-	-	362,196	368,267
Salaries and wages	390,096	-	-	390,096	311,921
Consumables	91,136	-	-	91,136	139,896
General repairs	106,411	-	-	106,411	102,081
Training and safety	39,190	-	-	39,190	44,073
Customer service and collector	44,528	-	-	44,528	37,357
Vehicle, POL	120,014	-	-	120,014	108,875
Legal fees	16,176	-	-	16,176	35,000
Communications	49,024	-	-	49,024	41,687
Travel	79,042	-	-	79,042	30,669
Contractual services	2,904	-	-	2,904	-
Insurance	2,247	-	-	2,247	-
Bad debts	364,013	-	-	364,013	-
Total administrative and general:	<u>1,666,977</u>	<u>-</u>	<u>-</u>	<u>1,666,977</u>	<u>1,219,826</u>
Generation:					
Salaries and wages	432,630	-	-	432,630	447,786
Repairs and maintenance	392,187	-	-	392,187	157,619
Other production	38,069	-	-	38,069	36,623
Total generation:	<u>862,886</u>	<u>-</u>	<u>-</u>	<u>862,886</u>	<u>642,028</u>
Water and sewer:					
Salaries and wages	-	414,832	-	414,832	377,285
Employee benefits	-	54,859	-	54,859	63,094
Repairs and maintenance	-	43,390	-	43,390	71,199
Training and safety	-	66,864	-	66,864	11,972
Chemicals	-	14,943	-	14,943	77,035
Utility expense	-	43,359	(43,359)	-	-
Other production	-	26,355	-	26,355	20,860
Total water and sewer:	<u>-</u>	<u>664,602</u>	<u>(43,359)</u>	<u>621,243</u>	<u>621,445</u>
Distribution:					
Salaries and wages	344,632	-	-	344,632	358,287
Repairs and maintenance	115,112	-	(16,384)	98,728	139,145
Total distribution:	<u>459,744</u>	<u>-</u>	<u>(16,384)</u>	<u>443,360</u>	<u>497,432</u>
Total operating expenses:	<u>8,275,695</u>	<u>1,162,264</u>	<u>(59,743)</u>	<u>9,378,216</u>	<u>8,269,766</u>
Operating loss	<u>(1,331,982)</u>	<u>40,988</u>	<u>-</u>	<u>(1,290,994)</u>	<u>(1,148,996)</u>

See accompanying Independent Auditors' Report

**POHNPEI UTILITIES CORPORATION**

Combining Statement of Operations and Net Assets, Continued  
 Year Ended September 30, 2003  
 (With comparative totals for the year ended September 30, 2002)

	Power and Utility	Water and Sewer	Eliminating Entries	Totals	
				2003	2002
Nonoperating revenues:					
Federal grants and subsidies	220,932	42,420	-	263,352	363,602
Spurline projects	81,811	-	-	81,811	29,569
Loss on investments	-	-	-	-	(67,918)
Interest (expense) income, net	(3,421)	-	-	(3,421)	(46,122)
Recovery of bad debts	-	-	-	-	1,647,946
Other income	10,158	6	-	10,164	-
Total nonoperating revenues	309,480	42,426	-	351,906	1,927,077
Net income (loss) before capital contributions	(1,022,502)	83,414	-	(939,088)	778,081
Capital contributions	190,184	-	-	190,184	-
Change in net assets	(832,318)	83,414	-	(748,904)	778,081
Net assets at beginning of year	25,466,833	8,377,644	-	33,844,477	33,066,396
Net assets at end of year	\$ 24,634,515	\$ 8,461,058	\$ -	\$ 33,095,573	\$ 33,844,477

See accompanying Independent Auditors' Report

**POHNPEI UTILITIES CORPORATION**

Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2003

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 Programs (OMIP):</u>					
	15.875				
Pohnpei Power Generation and Distribution Sixth-Year - Apprenticeship training		\$ 60,000	\$ 52,345	\$ 7,655	\$ 60,000
Continuation of Prepaid Meter Program		250,000	250,000	-	250,000
Utility Development 2001		117,668	50,393	42,420	92,813
OMIP Bench		562,500	234,826	205,897	440,723
HR Development 2003		12,500	-	7,380	7,380
		<u>\$ 1,002,668</u>	<u>\$ 587,564</u>	<u>\$ 263,352</u>	<u>\$ 850,916</u>

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



**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, 2003, and have issued our report thereon dated March 18, 2004, which report was qualified because we were not able to satisfy ourselves concerning inventory quantities at September 30, 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 March 18, 2004.

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.

*Deloitte + Touche LLP*

March 18, 2004