

**POHNPEI UTILITIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)**

**FINANCIAL STATEMENTS AND
ADDITIONAL INFORMATION AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2006 AND 2005

POHNPEI UTILITIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

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Years Ended September 30, 2006 and 2005

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INDEPENDENT AUDITORS' REPORT

The Board of Directors
Pohnpei Utilities Corporation:

We have audited the accompanying statements of net assets of the Pohnpei Utilities Corporation (PUC), a component unit of the State of Pohnpei, as of September 30, 2006 and 2005, and the related statements of revenues, expenses and changes in net assets 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of PUC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management Discussion and Analysis on pages 3-5 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This information is the responsibility of PUC's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit of the financial statements was made for the purpose of expressing our opinion on the basic financial statements taken as a whole. The additional information on pages 20-22 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 the audit of the basic financial statements 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 1, 2007, 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte & Touche LLP

February 1, 2007

POHNPEI UTILITIES CORPORATION
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Management Discussion and Analysis
Years Ended September 30, 2006 and 2005

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 years ended September 30, 2006 and 2005. 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 and approved by the Legislature of Pohnpei State, which has oversight over operation of the Power, Water and Sewer utility services. The General Manager who is hired by the Board of Directors oversees the daily operation of PUC.

The PUC has an installed generation capacity of 15.46 MW while the power demand is 6.5 MW in 2006 and 2005. The PUC generated 38,549 MWh and 39,412 MWh and sold 31,976 and 33,620 MWh to customers in 2006 and 2005, respectively. This resulted in total power revenue of \$8.6 million and \$7.7 million to PUC in 2006 and 2005, respectively. The increase in sales revenue in 2006 is mainly the result of increases in fuel tariff from an average of \$0.1501/kWhr in 2005 to \$0.1944/ kWhr in 2006. The number of households being serviced by the PUC actually decreased from 6,496 to 6,442 in 2006 due to termination of inactive accounts. The service coverage is about 96% of the population.

The PUC also provides clean 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 2 million gallons per day. PUC produced 1.4 billion gallons and sold 700 million and 660 million gallons to customers in 2006 and 2005, respectively, which resulted in total revenue to PUC of \$1.1 million and \$1.2 million, respectively. The PUC services 3,628 households, which covers about 1/3 of Pohnpei in area or 53% of the total population.

The following table summarizes the financial condition and operations of the PUC for FY 2006, 2005 and 2004:

Assets:	<u>2006</u>	<u>2005</u>	<u>2004</u>
Utility plant, net	\$ 29,912,393	\$ 28,719,385	\$ 28,453,386
Current assets	5,602,827	6,330,689	7,222,309
Other non-current assets	<u>487,516</u>	<u>482,832</u>	<u>329,448</u>
	<u>\$ 36,002,736</u>	<u>\$ 35,532,906</u>	<u>\$ 36,005,143</u>
 Liabilities and Net Assets:			
Notes payable	\$ 643,647	\$ 506,938	\$ 466,938
Current portion of long-term debt	118,536	129,918	104,635
Other current liabilities	1,286,008	1,581,671	833,180
Long-term debt, net	<u>2,645,682</u>	<u>2,747,515</u>	<u>2,296,089</u>
Total Liabilities	<u>\$ 4,693,873</u>	<u>\$ 4,966,042</u>	<u>\$ 3,700,842</u>

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Management Discussion and Analysis
Years Ended September 30, 2006 and 2005

Net Assets	<u>2006</u>	<u>2005</u>	<u>2004</u>
Invested in capital assets, net of related debt	26,694,528	25,435,014	25,645,724
Restricted	132,505	127,821	124,437
Unrestricted	<u>4,481,830</u>	<u>5,004,029</u>	<u>6,534,140</u>
 Total net assets	 <u>31,308,863</u>	 <u>30,566,864</u>	 <u>32,304,301</u>
	 \$ <u>36,002,736</u>	 \$ <u>35,532,906</u>	 \$ <u>36,005,143</u>
 Revenues, Expenses and Changes in Net Assets			
Operating revenues	\$ 10,071,600	\$ 9,042,447	\$ 8,232,181
Bad debt expense	(81,000)	(1,962,011)	(126,773)
Operating expenses	<u>(11,920,059)</u>	<u>(10,637,095)</u>	<u>(9,465,166)</u>
 Net operating loss	 (1,929,459)	 (3,556,659)	 (1,359,758)
 Non-operating revenues, net	 226,087	 271,426	 187,486
 Capital contributions	 <u>2,445,371</u>	 <u>1,547,796</u>	 <u>381,000</u>
 Increase (decrease) in net assets	 741,999	 (1,737,437)	 (791,272)
 Net assets at beginning of year	 <u>30,566,864</u>	 <u>32,304,301</u>	 <u>33,095,573</u>
 Net assets at end of year	 \$ <u>31,308,863</u>	 \$ <u>30,566,864</u>	 \$ <u>32,304,301</u>

Overall changes in the balance sheet components from September 30, 2005 to 2006 include an increase in net utility plant, a decrease in current assets, and a decrease in current and long term debt.

Additions to utility plant in 2006 are \$3,200,000, but with depreciation of \$2,000,000, the net increase to utility plant is \$1,200,000. There are three major projects worked on this year. One is the water extension project from Awak to Kinakapw Madolenimw also called RUS Phase I. This project started in June 2004 and was completed during the current year. The project is funded by the Government of the United States of America, Rural Utility Services, a total grant and loan of \$2,911,000. This year, the amount accrued for capitalization for this project is \$990,000. The other major project worked on this year is the Nett hydroelectric plant rehabilitation. The funding for the project comes from the United States Government DOI – Operations and Management Improvement Program of \$350,000, Compact of Free Association Infrastructure grant of \$350,000 and a PUC loan of \$350,000. The project started in August 2005 and is still in work in progress. The amount accrued so far on the project at September 30, 2006 is \$860,108. The other major project worked on also this year is the drilling of the deep water wells. The project is funded by United States Government, Compact II Infrastructure grant in the amount of \$1,069,000. The project is on-going and the amount accrued in work in progress at September 30, 2006 is \$1,054,000.

Changes in current and other assets from 2005 to 2006 are due to improvement of collection in trade and grants receivable.

Decreases in current and long term debt from 2005 to 2006 are due to payment of current debt and retirement of the FSM Development bank loan.

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Management Discussion and Analysis
Years Ended September 30, 2006 and 2005

The changes in revenue, expenses and changes in net assets statement between fiscal year 2005 and 2006 include an increase in operating revenue, a decrease in net, non-operating revenue, and a decrease in operating expenses (inclusive of bad debt expense).

The increase in operating revenue is 11% or \$1,029,153 compared to 2005. The increase is due to an increase in power sales of \$933,916 and an increase in water sales of \$72,950. The increase in power sales is mainly from increases in the fuel tariff, a factor of fuel cost increases passed on to customers. The water sale increase reflects the expanded area of service coverage made possible by the ADB and the RUS water expansion projects.

The increase in non-operating revenue and capital contributions is due to funds received from USDA RUS funding for the water extension, FSM Compact II Infrastructure grants for rehabilitation of the Hydroelectric plant in Nett and deep well drilling from the US military, and Department of the Interior OMIP grants.

There is a decrease in overall operating expense between 2005 and 2006 (inclusive of bad debt expense). Although fuel cost increased by 25% (or \$1,339,000) from last year, there is an improvement in collection which translates into less bad debt expense recorded this year, an improvement of about \$1,881,000. With less money available after fuel, the repair and maintenance expenses were greatly reduced, resulting in a short-term gain this year in net assets.

This concludes the management discussion and analysis of the financial statements for the year September 30, 2006.

Management's Discussion and Analysis for the year ended September 30, 2005 is set forth in PUC's report on the audit of financial statements, which is dated June 1, 2006. That Discussion and Analysis explains the major factors impacting the 2005 financial statements and can be viewed at the Office of the Public Auditor's website at www.fsmpublicauditor.fm

POHNPEI UTILITIES CORPORATION
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Statements of Net Assets
September 30, 2006 and 2005

<u>ASSETS</u>	<u>2006</u>	<u>2005</u>
Current assets:		
Cash and cash equivalents	\$ 521,763	\$ 333,314
Investments	637,506	601,000
Accounts receivable, net	2,605,737	3,048,181
Grants receivable	232,950	825,333
Materials and fuel inventory	1,604,871	1,522,861
Total current assets	5,602,827	6,330,689
Other noncurrent assets:		
Restricted:		
Cash and cash equivalents	3,881	3,881
Time certificates of deposit	350,000	350,000
Investments	132,505	127,821
Interest receivable	1,130	1,130
Total other noncurrent assets	487,516	482,832
Utility plant, at cost:		
Electric plant in service	36,122,868	36,013,176
Water and sewer plant in service	18,086,411	14,716,959
	54,209,279	50,730,135
Less accumulated depreciation	(26,554,184)	(24,544,850)
Depreciable assets	27,655,095	26,185,285
Construction work-in-process	2,257,298	2,534,100
Total utility plant	29,912,393	28,719,385
	\$ 36,002,736	\$ 35,532,906
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Notes payable	\$ 643,647	\$ 506,938
Current portion of long-term debt	118,536	129,918
Accounts payable:		
Fuel oil	451,635	482,734
Operations	261,414	745,570
Deferred revenue	318,636	149,417
Accrued taxes and other liabilities	177,610	157,625
Employees' annual leave	76,713	46,325
Total current liabilities	2,048,191	2,218,527
Noncurrent liabilities:		
Long-term debt, net of current portion	2,645,682	2,747,515
Total liabilities	4,693,873	4,966,042
Commitments and contingencies		
Net assets:		
Invested in capital assets, net of related debt	26,694,528	25,435,014
Restricted	132,505	127,821
Unrestricted	4,481,830	5,004,029
Total net assets	31,308,863	30,566,864
	\$ 36,002,736	\$ 35,532,906

See accompanying notes to financial statements.

POHNPEI UTILITIES CORPORATION
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Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2006 and 2005

	2006	2005
Operating revenues:		
Electricity sales	\$ 8,657,285	\$ 7,723,369
Water sales	1,091,223	1,177,684
Other sales	323,092	141,394
Total operating revenues before bad debts	10,071,600	9,042,447
Bad debts	(81,000)	(1,962,011)
Total operating revenues after bad debts	9,990,600	7,080,436
Operating and maintenance expenses:		
Production fuel	6,694,457	5,355,411
Depreciation	2,009,334	1,908,540
Administrative and general	1,514,636	1,462,987
Water and sewer	594,515	669,478
Generation	553,686	733,713
Distribution	553,431	506,966
Total operating expenses	11,920,059	10,637,095
Operating loss	(1,929,459)	(3,556,659)
Nonoperating revenues:		
Grants and subsidies	182,548	193,459
Spurline projects	96,465	22,930
Interest (expense) income, net	(57,926)	4,039
Other income	5,000	50,998
Total nonoperating revenues	226,087	271,426
Net loss before capital contributions	(1,703,372)	(3,285,233)
Capital contributions:		
Grants from United States Department of Agriculture, Rural Utility Service	603,987	1,547,796
Grants passed through from the United States Department of the Interior	1,841,384	-
Change in net assets	741,999	(1,737,437)
Net assets at beginning of year	30,566,864	32,304,301
Net assets at end of year	\$ 31,308,863	\$ 30,566,864

See accompanying notes to financial statements.

POHNPEI UTILITIES CORPORATION
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Statements of Cash Flows
Years Ended September 30, 2006 and 2005

	2006	2005
Cash flows from operating activities:		
Cash received from customers	\$ 10,602,263	\$ 8,988,958
Cash payments to suppliers for goods and services	(8,662,826)	(6,635,717)
Cash paid to employees	(1,852,717)	(1,701,877)
Net cash provided by operating activities	86,720	651,364
Cash flows from investing activities:		
Payments to self insurance fund	(4,684)	(3,384)
Increase in time certificates of deposit	-	(150,000)
Increase in internally restricted investments	(36,506)	(50,000)
Net cash used for investing activities	(41,190)	(203,384)
Cash flows from noncapital financing activities:		
Operating grants received	182,548	193,459
Proceeds from notes payable to bank	90,000	40,000
Spurline projects	96,465	22,930
Net cash provided by noncapital financing activities	369,013	256,389
Cash flows from capital and related financing activities:		
Proceeds from note payable to investment company	46,709	-
Repayments of long-term debt	(113,215)	(101,291)
Proceeds from long-term debt	-	578,000
Proceeds from sale of assets	5,000	50,998
Acquisition of utility plant	(2,627,858)	(1,948,757)
Capital contributions	2,463,270	722,756
Net cash used for capital and related financing activities	(226,094)	(698,294)
Net change in cash and cash equivalents	188,449	6,075
Cash and cash equivalents at beginning of year	333,314	327,239
Cash and cash equivalents at end of year	\$ 521,763	\$ 333,314
<u>Reconciliation of operating loss to net cash provided</u>		
<u>by operating activities:</u>		
Operating loss	\$ (1,929,459)	\$ (3,556,659)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation	2,009,334	1,908,540
Bad debts	81,000	1,962,011
Other income	(57,926)	4,039
(Increase) decrease in assets:		
Accounts receivable	361,444	(169,189)
Prepayments	-	46,551
Materials and fuel inventory	(82,010)	(292,420)
Increase (decrease) in liabilities:		
Accounts payable	(515,255)	618,472
Deferred revenue	169,219	115,700
Accrued taxes and other liabilities	19,985	9,020
Employees' annual leave	30,388	5,299
Net cash provided by operating activities	\$ 86,720	\$ 651,364

Supplemental disclosure of non-cash financing activity:

During the year ended September 30, 2006, PUC received a capital contribution of water wells valued at \$574,484 from the FSM National Government, which were originally funded by the United States Department of the Interior.

See accompanying notes to financial statements.

POHNPEI UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2006 and 2005

(1) Summary of Significant Accounting Policies

The accounting policies of Pohnpei Utilities Corporation (PUC) conform with accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. Governmental Accounting 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: 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.

Cash and Cash Equivalents: Cash and cash equivalents include cash on hand, demand deposits, and short-term investments with maturity dates within three months of the date acquired by PUC. Deposits maintained in time certificates of deposit with original maturity dates greater than three months are separately classified on the statement of net assets.

Investments: Investments and related investment earnings are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Accounts Receivable and Allowance for Doubtful Accounts: PUC grants credit to companies, individuals and government agencies on an unsecured basis, substantially all of whom are based in Pohnpei. The allowance for doubtful accounts is established through a provision charged to expense. Accounts are charged against the allowance when management believes that the collection of the balance is unlikely. The allowance is an amount that management believes will be adequate to absorb possible losses on existing balances that may be uncollectible, based on evaluations of collectibility and prior loss experience.

Inventory: Materials and fuel inventory are substantially carried at the lower of cost (weighted average) or market.

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.

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Notes to Financial Statements
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(1) Summary of Significant Accounting Policies, Continued

Depreciation: Depreciation is computed using the straight-line method over the estimated useful lives of the assets. 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. Accrued sick leave at September 30, 2006 approximates \$210,000.

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.

Revenues: Sales of electricity and water are recorded as billed to customers on a monthly billing cycle basis. At September 30, 2006 and 2005, unbilled revenues are accrued based on the most recent billing cycles.

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

Operating and Non-operating Revenues and Expenses: PUC considers revenues and costs that are directly related to utility operations to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

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.

Reclassification: Certain reclassifications have been made to the 2005 financial statements to correspond with the 2006 presentation.

New Accounting Standards

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes standards for impairment of capital assets when its service utility has declined significantly and unexpectedly.
- GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment to NCGA Statement 1*, which improves the understandability and usefulness of statistical section information and adds information from the new financial reporting model for state and local governments required by GASB Statement No. 34.
- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation (an amendment to GASB Statement No. 34)*, which requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets.

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Notes to Financial Statements
September 30, 2006 and 2005

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 47, *Accounting for Termination of Benefits*, which establishes guidance for state and local governmental employers on accounting and financial reporting for termination of benefits.
- GASB Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefits Expenditures/Expense and Liabilities by Cost-Sharing Employers*, which clarifies the requirements of GASB Statement Nos. 27 and 45 for recognition of pension and other postemployment benefit expenditures/expense and liabilities by cost-sharing employers.

The implementation of these pronouncements did not have a material impact on the accompanying financial statements.

In October 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. GASB Statement No. 48 establishes uniform financial reporting for these types of revenues. The provisions of this Statement are effective for periods beginning after December 15, 2006. In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments. The provisions of this Statement are effective for periods beginning after December 15, 2007. Additionally, in June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post Employment Benefits Other than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition and display of other postemployment benefit expenses and related liabilities, note disclosures, and, if applicable, required supplementary information in the reports of the state and local employers. The provisions of this Statement are effective for periods beginning after December 15, 2006.

Management does not believe that the implementation of these Statements will have a material effect on the financial statements of PUC.

(2) Deposits and Investments

GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

The deposit and investment policies of PUC are governed by its enabling legislation. The Board of Directors is required to engage one or more fund custodians to assume responsibility for the physical possession of the PUC's investments.

A. Deposits:

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

- Category 1 Deposits that are federally insured or collateralized with securities held by PUC or its agent in PUC's name;

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Notes to Financial Statements
September 30, 2006 and 2005

(2) Deposits and Investments, Continued

A. Deposits, Continued:

- Category 2 Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in PUC's name;
- Category 3 Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in PUC's name and non-collateralized deposits.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, PUC's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. The PUC does not have a deposit policy for custodial credit risk.

As of September 30, 2006 and 2005, the carrying amount of the PUC's total cash and cash equivalents and time certificates of deposit was \$875,644 and \$687,195, respectively, and the corresponding bank balances were \$981,749 and \$835,575, respectively. Of the bank balances, \$874,872 and \$685,823, respectively, are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2006 and 2005, bank deposits in the amount of \$200,000 were FDIC insured. PUC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk. PUC has not experienced any losses on such accounts and management believes it is not exposed to any significant credit risk on its deposits.

B. Investments:

GASB Statement No. 3 previously required government entities to present investment risks in terms of whether the investments fell into the following categories:

- Category 1 Investments that are insured or registered, or securities held by the PUC or its agent in PUC's name;
- Category 2 Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in PUC's name;
- Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in PUC's name.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for investments falling into categories 1 and 2, and provided for disclosure requirements addressing other common risks of investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. GASB Statement No. 40 did retain and expand the element of custodial credit risk in GASB Statement No. 3.

As of September 30, 2006 and 2005, investments in mutual funds at fair value are \$770,011 and \$728,821, respectively.

POHNPEI UTILITIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Notes to Financial Statements
September 30, 2006 and 2005

(2) Deposits and Investments, Continued

B. Investments, Continued:

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, PUC will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. PUC's investments are held and administered by trustees. Accordingly, these investments are exposed to custodial credit risk. Based on negotiated trust and custody contracts, all of these investments were held in PUC's name by PUC's custodial financial institutions at September 30, 2006 and 2005.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for PUC. There was no concentration of credit risk for investments as of September 30, 2006 and 2005.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. PUC does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

(3) Self Insurance Fund and Risk Management

In accordance with section 2(5) of State Law 3L-41-93, an amendment to the enabling legislation for 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 PUC. As of September 30, 2006 and 2005, the carrying amount of the fund was \$132,505 and \$127,821, respectively, which was presented as a restricted investment in the accompanying statements of net assets.

Additionally, PUC carries life insurance on behalf of its employees and maintains commercial coverage of a comprehensive business policy and workmen's compensation insurance. PUC 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. As of September 30, 2006 and 2005, the carrying amount of the fund was \$3,881, which is presented as restricted cash and cash equivalents in the accompanying statements of net assets.

(5) Accounts Receivable

Bills are issued to customers near mid-month approximately one month subsequent to providing utilities services. Therefore, approximately forty-five days of service is accrued at September 30, 2006 and 2005, which is classified as accounts receivable - unbilled. Accounts receivable at September 30, 2006 and 2005, are summarized as follows:

POHNPEI UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2006 and 2005

(5) Accounts Receivable, Continued

	<u>2006</u>	<u>2005</u>
Accounts receivable - electrical:		
Residential	\$ 2,005,876	\$ 1,919,369
Commercial	1,140,852	1,027,329
Government	504,744	763,866
Unbilled	<u>647,520</u>	<u>558,547</u>
	<u>4,298,992</u>	<u>4,269,111</u>
Accounts receivable - water and sewer:		
Residential	983,299	1,207,590
Commercial and government	226,462	223,261
Unbilled	<u>143,117</u>	<u>127,196</u>
	<u>1,352,878</u>	<u>1,558,047</u>
Installment receivables	<u>122,662</u>	<u>313,537</u>
	5,774,532	6,140,695
Other	<u>150,988</u>	<u>146,269</u>
	5,925,520	6,286,964
Less allowance for doubtful receivables	<u>(3,319,783)</u>	<u>(3,238,783)</u>
	<u>\$ 2,605,737</u>	<u>\$ 3,048,181</u>

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) through June 2006, at which time PUC changed its policy to apply 50% of collections to arrears. As of September 30, 2006 and 2005, gross receivables from customers enrolled in the cash power meter system are \$1,637,089 and \$1,558,652, respectively.

(6) Utility Plant

A summary of changes in capital assets for the years ended September 30, 2006 and 2005 is as follows:

	<u>Beginning Balance</u> <u>October 1, 2005</u>	<u>Transfers and</u> <u>Additions</u>	<u>Transfers and</u> <u>Deletions</u>	<u>Ending Balance</u> <u>September 30, 2006</u>
<u>Depreciable assets:</u>				
Production plant	\$ 20,743,497	\$ -	\$ -	\$ 20,743,497
Distribution plant	13,841,848	61,642	-	13,903,490
General plant	<u>1,427,831</u>	<u>48,050</u>	-	<u>1,475,881</u>
Electric plant in service	<u>36,013,176</u>	<u>109,692</u>	-	<u>36,122,868</u>
Water production plant	5,365,165	-	-	5,365,165
Sewage collection and treatment plant	5,448,827	63,474	-	5,512,301
Water distribution plant	3,372,026	3,280,031	-	6,652,057
General plant	<u>530,941</u>	<u>25,947</u>	-	<u>556,888</u>
Water and sewer plant in service	<u>14,716,959</u>	<u>3,369,452</u>	-	<u>18,086,411</u>

POHNPEI UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2006 and 2005

(6) Utility Plant, Continued

	<u>Beginning Balance</u> <u>October 1, 2005</u>	<u>Transfers and</u> <u>Additions</u>	<u>Transfers and</u> <u>Deletions</u>	<u>Ending Balance</u> <u>September 30, 2006</u>
Total utility plant in service	50,730,135	3,479,144	-	54,209,279
Less accumulated depreciation	(24,544,850)	(2,009,334)	-	(26,554,184)
	<u>26,185,285</u>	<u>1,469,810</u>	<u>-</u>	<u>27,655,095</u>
<u>Non-depreciable assets:</u>				
<u>Construction work-in-progress:</u>				
Electric plant	23,769	1,136,393	(61,642)	1,098,520
Water and sewer plant	<u>2,510,331</u>	<u>2,017,899</u>	<u>(3,369,452)</u>	<u>1,158,778</u>
	<u>2,534,100</u>	<u>3,154,292</u>	<u>(3,431,094)</u>	<u>2,257,298</u>
	\$ <u>28,719,385</u>	\$ <u>4,624,102</u>	\$ <u>(3,431,094)</u>	\$ <u>29,912,393</u>
	<u>Beginning Balance</u> <u>October 1, 2004</u>	<u>Transfers and</u> <u>Additions</u>	<u>Transfers and</u> <u>Deletions</u>	<u>Ending Balance</u> <u>September 30, 2005</u>
<u>Depreciable assets:</u>				
Production plant	\$ 22,081,519	\$ -	\$ (1,338,022)	\$ 20,743,497
Distribution plant	13,280,522	561,326	-	13,841,848
General plant	<u>1,848,975</u>	<u>23,585</u>	<u>(444,729)</u>	<u>1,427,831</u>
Electric plant in service	<u>37,211,016</u>	<u>584,911</u>	<u>(1,782,751)</u>	<u>36,013,176</u>
Water production plant	5,383,153	-	(17,988)	5,365,165
Sewage collection and treatment plant	5,400,421	48,406	-	5,448,827
Water distribution plant	3,243,801	128,225	-	3,372,026
General plant	<u>445,081</u>	<u>179,678</u>	<u>(93,818)</u>	<u>530,941</u>
Water and sewer plant in service	<u>14,472,456</u>	<u>356,309</u>	<u>(111,806)</u>	<u>14,716,959</u>
Total utility plant in service	51,683,472	941,220	(1,894,557)	50,730,135
Less accumulated depreciation	(24,530,867)	(1,908,540)	<u>1,894,557</u>	(24,544,850)
	<u>27,152,605</u>	<u>(967,320)</u>	<u>-</u>	<u>26,185,285</u>
<u>Non-depreciable assets:</u>				
<u>Construction work-in-progress:</u>				
Electric plant	266,190	421,127	(663,548)	23,769
Water and sewer plant	<u>1,034,591</u>	<u>1,961,571</u>	<u>(485,831)</u>	<u>2,510,331</u>
	<u>1,300,781</u>	<u>2,382,698</u>	<u>(1,149,379)</u>	<u>2,534,100</u>
	\$ <u>28,453,386</u>	\$ <u>1,415,378</u>	\$ <u>(1,149,379)</u>	\$ <u>28,719,385</u>

POHNPEI UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2006 and 2005

(7) Notes Payable and Long-Term Debt

Notes payable consist of the following at September 30, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Notes payable drawn on a bank line of credit of \$190,000 (line expiry March 24, 2007), interest at time certificate of deposit (TCD) rate plus 2% (4.5% and 3.3% at September 30, 2006 and 2005, respectively), collateralized by TCD, due on January 29, 2007.	\$190,000	\$ 100,000
Note payable to an investment company, interest at 9.25% and 6.75% at September 30, 2006 and 2005, respectively, collateralized by investments.	453,647	406,938
Total notes payable	\$ 643,647	\$ 506,938

Changes in notes payable for the years ended September 30, 2006 and 2005, are as follows:

	<u>Outstanding September 30, 2005</u>	<u>Increases</u>	<u>Decreases</u>	<u>Outstanding September 30, 2006</u>
Note payable to bank	\$ 100,000	\$ 90,000	\$ -	\$ 190,000
Note payable to investment company	406,938	46,709	-	453,647
	\$ 506,938	\$ 136,709	\$ -	\$ 643,647
	<u>Outstanding September 30, 2005</u>	<u>Increases</u>	<u>Decreases</u>	<u>Outstanding September 30, 2006</u>
Note payable to bank	\$ 60,000	\$ 360,000	\$ (320,000)	\$ 100,000
Note payable to investment company	406,938	-	-	406,938
	\$ 466,938	\$ 360,000	\$ (320,000)	\$ 506,938

Long-term debt consists of the following at September 30, 2006 and 2005:

	<u>2006</u>	<u>2005</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 State of Pohnpei has not imposed collateralization on PUC and has waived its rights to receive 6.82% in interest. The loan agreement includes a 1% service charge to be added to the principal until installment payments commence. This service charge may be paid by PUC or by the State of Pohnpei.	\$ 2,118,767	\$ 2,118,767

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Notes to Financial Statements
September 30, 2006 and 2005

(7) Notes Payable and Long-Term Debt, Continued

Loan payable to United States Department of Agriculture, Rural Utilities Service, due in monthly installments of \$2,654 commencing October 28, 2006. The loan is collateralized by a revenue bond. The loan bears a fixed interest rate of 4.5%.	578,000		578,000
Loan payable to FSM Development Bank, 5 year term, interest at 9%, collateralized by a \$150,000 time certificate of deposit. Pursuant to a loan agreement dated October 26, 2001, PUC is required to make monthly payments of both principal and interest in the amount \$10,379. A member of the PUC Board is also a member of management of the FSM Development Bank.	<u>67,451</u>		<u>180,666</u>
Total long-term debt	2,764,218		2,877,433
Less: current portion of long-term debt	<u>118,536</u>		<u>129,918</u>
Long-term portion of long-term debt	\$ <u>2,645,682</u>		\$ <u>2,747,515</u>

Future minimum principal and interest payments on all long-term debt for subsequent years ending September 30, are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 118,536	\$ 160,852	\$ 279,388
2008	51,810	47,038	98,848
2009	52,552	46,296	98,848
2010	53,312	45,536	98,848
2011	54,090	44,758	98,848
2012-2016	282,812	211,428	494,240
2017-2021	305,445	188,795	494,240
2022-2026	331,300	162,940	494,240
2027-2031	361,062	133,178	494,240
2032-2036	395,581	98,659	494,240
2037-2041	435,917	58,323	494,240
2042-2046	<u>321,801</u>	<u>14,383</u>	<u>336,184</u>
	\$ <u>2,764,218</u>	\$ <u>1,212,186</u>	\$ <u>3,976,404</u>

Changes in non-current liabilities for the years ended September 30, 2006 and 2005, are as follows:

	Outstanding September 30, <u>2005</u>	<u>Increases</u>	<u>Decreases</u>	Outstanding September 30, <u>2006</u>	<u>Current</u>	<u>Noncurrent</u>
Loan payable to FSM Development Bank	\$ 180,666	\$ -	\$ (113,215)	\$ 67,451	\$ 67,451	\$ -
Loan payable to Rural Utilities Service	578,000	-	-	578,000	5,960	572,040
Loan payable to Asian Development Bank	<u>2,118,767</u>	<u>-</u>	<u>-</u>	<u>2,118,767</u>	<u>45,125</u>	<u>2,073,642</u>
	\$ <u>2,877,433</u>	\$ <u>-</u>	\$ <u>(113,215)</u>	\$ <u>2,764,218</u>	\$ <u>118,536</u>	\$ <u>2,645,682</u>

POHNPEI UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2006 and 2005

(7) Notes Payable and Long-Term Debt, Continued

	Outstanding September 30, <u>2004</u>	<u>Increases</u>	<u>Decreases</u>	Outstanding September 30, <u>2005</u>	<u>Current</u>	<u>Noncurrent</u>
Loan payable to FSM Development Bank	\$ 281,957	\$ -	\$ (101,291)	\$ 180,666	\$ 129,918	\$ 50,748
Loan payable to Rural Utilities Service	-	578,000	-	578,000	-	578,000
Loan payable to Asian Development Bank	<u>2,118,767</u>	<u>-</u>	<u>-</u>	<u>2,118,767</u>	<u>-</u>	<u>2,118,767</u>
	<u>\$ 2,400,724</u>	<u>\$ 578,000</u>	<u>\$ (101,291)</u>	<u>\$ 2,877,433</u>	<u>\$ 129,918</u>	<u>\$ 2,747,515</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.

(9) Grants, Subsidies and Capital Contributions

Grants, subsidies and capital contributions comprise the following for the years ended September 30, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Grants and Subsidies:		
U.S. Department of the Interior:		
Operations and maintenance improvement program:		
OMIP single phase prepaid meter	\$ -	\$ 132,712
OMIP three phase prepaid meter	43,000	9,224
Utility development 2001	4,203	20,651
Utility development 2002	4,388	30,872
Training	10,812	-
Power study	23,835	-
Strategic plan	26,340	-
Tarriff study	50,000	-
Hydrologist for the Military wells	<u>10,000</u>	<u>-</u>
	172,578	193,459
South Pacific Applied Geoscience Commission:		
Tarriff study	<u>9,970</u>	<u>-</u>
Total grants and subsidies	182,548	193,459
Capital Contributions:		
Rural Utilities Service (RUS)	603,987	1,547,796
Department of the Interior (DOI)	<u>1,841,384</u>	<u>-</u>
	<u>\$ 2,627,919</u>	<u>\$ 1,741,255</u>

POHNPEI UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2006 and 2005

(9) Grants, Subsidies and Capital Contributions, Continued

During the year ended September 30, 2006, DOI approved \$1,074,484 under the FSM Public Infrastructure Sector Grant to be used for the Pohnpei Water Well Drilling project. \$574,484 of the project amount was paid to the US Department of Defense to cover mobilization cost of military personnel, who assisted in this project. The remaining \$500,000 was passed through to PUC in the form of a sub-grant.

(10) Commitments and Contingencies

In August 2005, PUC entered into a contract with an engineering firm to provide design, procurement, and construction management services relating to the Hydro Rehabilitation Project for a total cost of \$1,117,040. Outstanding commitments under this contract amounted to \$382,489 as of September 30, 2006.

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.

(11) Sinking Fund

During fiscal year 1998, PUC 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.

The sinking fund consists of investments in three mutual funds that have the following asset allocations at September 30, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Money market funds	\$ 16,050	\$ 20,000
U.S. Government obligations	143,642	121,000
Corporate bonds and others	146,856	154,000
Common stock	<u>330,958</u>	<u>306,000</u>
	<u>\$ 637,506</u>	<u>\$ 601,000</u>

(12) Retirement Plan

PUC'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 receive from the FSM Social Security System. The Plan is a contributory, defined contribution plan in which PUC contributes a matching percentage 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. PUC's comptroller is the designated Plan administrator. Contributions to the Plan during the years ended September 30, 2006 and 2005 were \$82,554 and \$78,657, respectively. Management is of the opinion that the plan does not represent an asset or liability of PUC. At September 30, 2006 and 2005, plan assets were \$899,691 and \$793,108, respectively.

POHNPEI UTILITIES CORPORATION
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Combining Statement of Net Assets
September 30, 2006
(With comparative totals as of September 30, 2005)

<u>Assets</u>	<u>Power and Utility</u>	<u>Water and Sewer</u>	<u>Eliminating Entries</u>	<u>Totals</u>	
				2006	2005
Current assets:					
Cash and cash equivalents	\$ 1,323,278	\$ (801,515)	\$ -	\$ 521,763	\$ 333,314
Investment	637,506	-	-	637,506	601,000
Accounts receivable, net	1,970,992	634,745	-	2,605,737	3,048,181
Grants receivable	53,302	179,648	-	232,950	825,333
Fuel and material inventory	998,272	606,599	-	1,604,871	1,522,861
Total current assets	<u>4,983,350</u>	<u>619,477</u>	<u>-</u>	<u>5,602,827</u>	<u>6,330,689</u>
Other noncurrent assets:					
Restricted:					
Cash and cash equivalents	3,881	-	-	3,881	3,881
Time certificates of deposit	350,000	-	-	350,000	350,000
Investments	132,505	-	-	132,505	127,821
Interest receivable	1,130	-	-	1,130	1,130
Total other noncurrent assets	<u>487,516</u>	<u>-</u>	<u>-</u>	<u>487,516</u>	<u>482,832</u>
Utility plant, at cost:					
Electric plant in service	36,122,868	-	-	36,122,868	36,013,176
Water and sewer plant in service	-	18,086,411	-	18,086,411	14,716,959
	36,122,868	18,086,411	-	54,209,279	50,730,135
Less accumulated depreciation	<u>(20,607,866)</u>	<u>(5,946,318)</u>	<u>-</u>	<u>(26,554,184)</u>	<u>(24,544,850)</u>
Depreciable assets	15,515,002	12,140,093	-	27,655,095	26,185,285
Construction work-in-process	1,098,520	1,158,778	-	2,257,298	2,534,100
Total utility plant	<u>16,613,522</u>	<u>13,298,871</u>	<u>-</u>	<u>29,912,393</u>	<u>28,719,385</u>
	<u>\$ 22,084,388</u>	<u>\$ 13,918,348</u>	<u>\$ -</u>	<u>\$ 36,002,736</u>	<u>\$ 35,532,906</u>
<u>Liabilities and Net Assets</u>					
Current liabilities:					
Notes payable to bank	\$ 190,000	\$ -	\$ -	\$ 190,000	\$ 100,000
Note payable to investment company	453,647	-	-	453,647	406,938
Current portion of long-term debt	67,451	51,085	-	118,536	129,918
Accounts payable:					
Fuel oil	451,635	-	-	451,635	482,734
Operations	168,502	92,912	-	261,414	745,570
Deferred revenue	318,636	-	-	318,636	149,417
Accrued taxes and other liabilities	177,610	-	-	177,610	157,625
Employees' annual leave	76,713	-	-	76,713	46,325
Total current liabilities	<u>1,904,194</u>	<u>143,997</u>	<u>-</u>	<u>2,048,191</u>	<u>2,218,527</u>
Noncurrent liabilities:					
FSM Development Bank loan	-	-	-	-	50,748
RUS Water Extension loan	-	572,040	-	572,040	578,000
ADB Water Extension loan	-	2,073,642	-	2,073,642	2,118,767
Total liabilities	<u>1,904,194</u>	<u>2,789,679</u>	<u>-</u>	<u>4,693,873</u>	<u>4,966,042</u>
Commitments and contingencies					
Net assets:					
Invested in capital assets, net of related debt	16,092,424	10,602,104	-	26,694,528	25,435,014
Restricted	132,505	-	-	132,505	127,821
Unrestricted	3,955,265	526,565	-	4,481,830	5,004,029
Total net assets	<u>20,180,194</u>	<u>11,128,669</u>	<u>-</u>	<u>31,308,863</u>	<u>30,566,864</u>
	<u>\$ 22,084,388</u>	<u>\$ 13,918,348</u>	<u>\$ -</u>	<u>\$ 36,002,736</u>	<u>\$ 35,532,906</u>

See accompanying Independent Auditors' Report.

POHNPEI UTILITIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Combining Statement of Revenues, Expenses and Changes in Net Assets
Year Ended September 30, 2006
(With comparative totals for the year ended September 30, 2005)

	Power and Utility	Water and Sewer	Eliminating Entries	Totals	
				2006	2005
Operating revenues:					
Residential	\$ 620,906	\$ 826,847	\$ -	\$ 1,447,753	\$ 1,728,579
Commercial	2,389,326	152,820	-	2,542,146	2,337,492
Government	1,976,834	111,556	-	2,088,390	1,919,028
Cash power	3,670,219	-	-	3,670,219	2,915,954
Intercompany sales	72,345	-	(72,345)	-	-
Other sales	153,933	169,159	-	323,092	141,394
Total operating revenues before bad debts	8,883,563	1,260,382	(72,345)	10,071,600	9,042,447
Bad debts	(81,000)	-	-	(81,000)	(1,962,011)
Total operating revenues after bad debts	8,802,563	1,260,382	(72,345)	9,990,600	7,080,436
Operating and maintenance expenses:					
Production fuel	6,694,457	-	-	6,694,457	5,355,411
Depreciation	1,422,711	586,623	-	2,009,334	1,908,540
Administrative and general:					
Employee benefits	404,477	-	-	404,477	345,939
Salaries and wages	377,438	-	-	377,438	398,621
Vehicle, POL	264,361	-	-	264,361	202,414
General repairs	102,472	-	-	102,472	116,274
Consumables	94,381	-	-	94,381	65,517
Travel	80,140	-	-	80,140	66,012
Communications	59,362	-	-	59,362	39,207
Insurance	57,319	-	-	57,319	60,308
Contractual services	40,000	-	-	40,000	60,455
Training and safety	23,212	-	-	23,212	56,370
Customer service and collection	8,721	-	-	8,721	39,870
Legal fees	2,753	-	-	2,753	12,000
Utility	14,773	-	(14,773)	-	-
	1,529,409	-	(14,773)	1,514,636	1,462,987
Generation:					
Salaries and wages	429,605	-	-	429,605	369,746
Repairs and maintenance	90,701	-	-	90,701	339,803
Other production	33,380	-	-	33,380	24,164
	553,686	-	-	553,686	733,713
Water and sewer:					
Salaries and wages	-	427,685	-	427,685	397,398
Repairs and maintenance	-	14,971	-	14,971	116,111
Chemicals	-	26,137	-	26,137	53,147
Employee benefits	-	59,541	-	59,541	52,125
Other production	-	48,038	-	48,038	33,420
Training and safety	-	18,143	-	18,143	17,277
Utility expense	-	57,572	(57,572)	-	-
	-	652,087	(57,572)	594,515	669,478
Distribution:					
Salaries and wages	381,849	-	-	381,849	354,864
Repairs and maintenance	171,582	-	-	171,582	152,102
	553,431	-	-	553,431	506,966
Total operating expenses	10,753,694	1,238,710	(72,345)	11,920,059	10,637,095
Operating loss	(1,951,131)	21,672	-	(1,929,459)	(3,556,659)

See accompanying Independent Auditors' Report.

POHNPEI UTILITIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Combining Statement of Revenues, Expenses and Changes in Net Assets, Continued
Year Ended September 30, 2006
(With comparative totals for the year ended September 30, 2005)

	Power and Utility	Water and Sewer	Eliminating Entries	Totals	
				2006	2005
Nonoperating revenues:					
Federal grants and subsidies	182,548	-	-	182,548	193,459
Spurline projects	96,465	-	-	96,465	22,930
Interest (expense) income, net	(57,926)	-	-	(57,926)	4,039
Other income	5,000	-	-	5,000	50,998
Total nonoperating revenues	<u>226,087</u>	<u>-</u>	<u>-</u>	<u>226,087</u>	<u>271,426</u>
Net earnings (loss) before capital contributions	(1,725,044)	21,672	-	(1,703,372)	(3,285,233)
Capital contributions:					
Grants from United States Department of Agriculture	-	603,987	-	603,987	1,547,796
Grants passed through from the United States Department of the Interior	811,139	1,030,245	-	1,841,384	-
Change in net assets	(913,905)	1,655,904	-	741,999	(1,737,437)
Net assets at beginning of year	<u>21,094,099</u>	<u>9,472,765</u>	<u>-</u>	<u>30,566,864</u>	<u>32,304,301</u>
Net assets at end of year	<u>\$ 20,180,194</u>	<u>\$ 11,128,669</u>	<u>\$ -</u>	<u>\$ 31,308,863</u>	<u>\$ 30,566,864</u>

See accompanying Independent Auditors' Report.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN 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, 2006, and have issued our report thereon dated February 1, 2007. 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.

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 an opinion on the internal control over financial reporting. However, we noted one matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect PUC's ability to record, process, summarize and report financial data consistent with assertions of management in the financial statements. The one reportable condition is described in the accompanying Schedule of Findings and Questioned Costs (page 28) as item number 2006-1.

A material weakness is a reportable 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 caused by error or fraud 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, the reportable condition described above, in our opinion, is not considered to be a material weakness.

Compliance and Other Matters

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 grant agreements, 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 did not disclose any noncompliance that is required to be reported under *Government Auditing Standards*.

However, we noted other matters involving the internal control over financial reporting or operations that we have reported to management of PUC in a separate letter dated February 1, 2007.

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

February 1, 2007

**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 each of its major federal programs for the year ended September 30, 2006. PUC's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs 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 major federal programs 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.

As described in items 2006-2 through 2006-4 in the accompanying Schedule of Findings and Questioned Costs, PUC did not comply with requirements regarding reporting and procurement for the U.S. Department of Agriculture Rural Utilities Service Program (CFDA 10.760). Compliance with such requirements is necessary, in our opinion, for PUC to comply with requirements applicable to each of its federal programs.

In our opinion, except for the noncompliance described in the preceding paragraph, PUC complied, in all material respects, with the requirements referred to above that are applicable to its major federal programs for the year ended September 30, 2006.

Internal Control Over Financial Reporting

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 the audit, we considered PUC's internal control over compliance with requirements that could have a direct and material effect on major federal programs 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 reportable 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 grant agreements caused by error or fraud that would be material in relation to the major federal programs 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 basic financial statements of Pohnpei Utilities Corporation (PUC), as of and for the year ended September 30, 2006, and have issued our report thereon dated February 1, 2007. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of PUC. Such information has been subjected to the auditing procedures applied in our audit of the basic 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, the Office of the Public Auditor of the Federated States of Micronesia, federal awarding agencies, pass-through entities and 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.

Deloitte & Touche LLP

February 1, 2007

POHNPEI UTILITIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2006

Grantor/Program Title	CFDA No.	Total Authorizations	Receivable at Beginning of Year	Expenditures for the Year Ended Sept. 30, 2006	Cash Receipts for the Year Ended Sept. 30, 2006	Receivable at End of Year
<u>U.S. Department of the Interior:</u>						
Office of Territorial and International Affairs:						
<u>Operations and Maintenance Improvement Programs (OMIP):</u>						
	15.875					
Utility Development 2001		\$ 117,668	\$ 292	\$ 4,203	\$ 4,495	\$ -
OMIP Bench		562,500	-	4,388	4,388	-
OMIP Three Phase Prepaid Meter		75,000	-	43,000	43,000	-
OMPI LT Training		25,000	-	10,812	7,500	3,312
OMIP Power Study		50,000	-	23,835	23,835	-
OMIP Strategic Plan		100,000	-	26,340	15,000	11,340
OMIP Tariff Study		50,000	-	50,000	11,350	38,650
OMIP Hydrologist for the Military wells		10,000	-	10,000	10,000	-
Nanpil Hydro Rehabilitation Project		350,000	-	350,000	350,000	-
		<u>1,340,168</u>	<u>292</u>	<u>522,578</u>	<u>469,568</u>	<u>53,302</u>
<u>Infrastructure Sector Grant:</u>						
	15.875					
Nanpil Hydro Rehabilitation Project		556,588	-	455,761	495,593	(39,832)
Pohnpei Water Well Drilling		500,000	-	461,139	556,588	(95,449)
		<u>1,056,588</u>	<u>-</u>	<u>916,900</u>	<u>1,052,181</u>	<u>(135,281)</u>
<u>U.S. Department of Agriculture</u>						
Rural Utilities Service						
<u>Water and Waste Disposal Systems for Rural Communities</u>						
	10.760					
Grant		2,761,000	825,041	603,987	1,249,380	179,648
		<u>\$ 5,157,756</u>	<u>\$ 825,333</u>	<u>\$ 2,043,465</u>	<u>\$ 2,771,129</u>	<u>\$ 97,669</u>

- Note 1: The grant from RUS includes loan portion of \$578,000 and grant portion of \$2,183,000. Expenditures are first applied to the loan.
- Note 2: The schedule of expenditures of federal awards is prepared on the accrual basis of accounting.
- Note 3: The grants from US DOI were received in a pass-through capacity. The grant from RUS was received in a direct recipient capacity.
- Note 4: During the year ended September 30, 2006, PUC received water wells valued at \$574,484 from the FSM National Government, which were originally funded by the U.S. Department of the Interior (15.875). These funds were audited for compliance at the FSM National Government level and are therefore not included as federal awards for purposes of this schedule.

POHNPEI UTILITIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Schedule of Findings and Questioned Costs
Year Ended September 30, 2006

Part I - Summary of Auditors' Results

1. The Independent Auditors' Report on the financial statements expressed an unqualified opinion.
2. One reportable condition in internal control over financial reporting was identified, which was not considered to be a material weakness.
3. No instances of noncompliance considered material to the financial statements were disclosed by the audit.
4. No reportable conditions in internal control over compliance with requirements applicable to major federal award programs were identified.
5. The Independent Auditors' Report on compliance with requirements applicable to the major federal awards programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. PUC's major federal programs are:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
U.S. Department of Agriculture – Rural Utilities Service	10.760
U.S. Department of the Interior	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 not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

Part II - Financial Statement Findings Section

<u>Reference Number</u>	<u>Finding</u>
2006-1	Internal Control over Inventory

Part III - Federal Award Findings and Questioned Cost Section

<u>Reference Number</u>	<u>Finding</u>	<u>Questioned Cost</u>
2006-2	Error in reimbursement request	\$ -
2006-3	Procurement	11,753
2006-4	Procurement documentation	-

POHNPEI UTILITIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-1
Area: Internal Control over Inventory

Criteria:

Inventory issuances, purchases and returns should be controlled and timely recorded. Year-end physical inventory counts should be accurately performed and verified by an independent team; all errors discovered should be properly reflected in the final inventory schedules. Additionally, inventory on hand should be periodically evaluated for potential obsolescence.

Conditions:

We noted the following conditions:

- A. We test counted 91 items during our observation of PUC's year-end inventory procedures and found errors in 29 of the items counted (or 32%). Furthermore, correction was not reflected in the final inventory schedule for 16 of these 29 items.
- B. During the inventory count, we observed that some items were not counted. We were informed that these were donated items and therefore, they were not assigned a value. However, these items were not segregated from purchased items and/or so labeled. Therefore, it was difficult for the audit team to corroborate this assertion.
- C. We noted several instances where the "unit of measurement" in the inventory valuation system differs from the unit of measurement utilized in performing the count. As a result, inventory was not correctly valued. Specifically:
 1. Inventory item #RUS4 was valued at 4,000 cubit feet. However, 98 bags were counted. Upon further investigation, it was determined that the original purchase amounted to 4,000 cubit feet and 135 bags. This resulted in an overstatement of value by 37 bags, or approximately \$25,000.
 2. Inventory item #RUS1 was valued at 1,800 feet. However, 141 pipes were counted. The pipes are measured at 10 feet per pipe. As a result, inventory was overstated by 37 pipes, or approximately \$7,600.
 3. Inventory item #RUS3 was valued at 4,800 feet; however, 403 pipes were counted. The pipes are also measured at 10 feet per pipe. As a result, inventory was overstated by 77 pipes, or approximately \$13,400.
 4. Inventory item # UK/18 was valued at 1 lot; however, 11 cases were counted. The inventory division was not able to provide documentation showing comparable values. As a result, we were unable to determine whether the recorded 1 lot (or approximately \$12,500) was overstated.
- D. We selected 32 items from the Final Inventory Valuation reports and attempted to validate quantities on hand by reviewing current year purchases and reports as of September 30, 2005. We noted the following discrepancies:

POHNPEI UTILITIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-1, Continued
Area: Internal Control over Inventory

Conditions, Continued:

Item No.	Quantity on Hand 9/30/05	Purchases during FY 2006	Available Quantity	Quantity on Hand 9/30/06
E325600070C	12	0	12	43
Y529000304Z	4	0	4	7
E325600030B	12	12	24	51
E325700010P	12	12	24	26
C036570230Z	7	8	15	32
E325800050K	10	12	22	40
W20196	0	0	0	10
W10128	30	30	60	522
SOM/10	6	0	6	16
AEI/3	32	0	32	135
W20257	4,173	0	4,173	24,882

E. The entity has not analyzed its inventory on hand for potential obsolescence.

Cause:

This condition is caused by ineffective internal controls over the inventory system. The entity keeps a separate perpetual inventory system; however, such is not reconciled or adjusted monthly. Based on our discussion with entity personnel, the perpetual system is not relied upon since there are ineffective controls over inventory issuances and/or returns. As a result, the entity has been performing a 100% physical count at year-end and adjusts its inventory balances accordingly.

Effect:

A known overstatement of inventory of approximately \$50,000 (based on sampled records) and an additional likely overstatement of approximately \$58,000 (based on statistical projections) exists. However, the exact extent of the misstatements is unknown. Additionally, an inventory valuation reserve may be necessary for potential obsolescence.

Recommendation:

We recommend that PUC reassess its current procedures relative to recording inventory and consider adjusting inventory balances monthly based on perpetual records. Additionally, donated items should be physically segregated from purchased items and receiving and issuances should be segregated. Lastly, appropriate training or supervision should be provided to personnel conducting physical inventory counts to improve accuracy.

POHNPEI UTILITIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-1, Continued
Area: Internal Control over Inventory

Auditee Response and Corrective Action Plan:

The Pohnpei Utility Corporation will start adjusting inventory balances monthly based on perpetual records. The target to implement the perpetual monthly inventory adjustments in June 30, 2007. Prior to the implementation, PUC will reassess the values of its existing inventory, physically and account separately the donated inventory from the purchased inventory. PUC will thoroughly examine the inventory to separate any obsolete parts. This exercise will begin March 1, 2007 and target completion, one month from the date. PUC will train the personnel responsible for the tasks and assign appropriate supervision during the organization, physical count and the recording. The objective is to make sure that internal control over inventory is improved this year and the inventory issue doesn't appear again in the audit.

POHNPEI UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-2
CFDA No.: 10.760
Program Name: U.S. Department of Agriculture – Rural Utilities Service
Area: Procurement, Suspension and Debarment
Questioned Costs: \$0

Criteria:

Costs included in the reimbursement request should be accurate.

Condition:

We noted errors in the reimbursement requests that were submitted to the RUS in January and April 2006. These errors related to items that were recorded twice or had incorrect amounts. The grant reimbursement was overstated by approximated \$2,400.

Additionally, we noted that an invoice in the amount of \$15,542, which was included in the reimbursement request in April 2006, was later voided and reversed. The entity filed an amended reimbursement request during the course of our fieldwork. Additionally, a related adjustment was made to the September 30, 2006 financial statements. As such, this condition did not result in questioned costs.

Cause:

This condition may be due to human errors not being timely detected.

Effect:

Immaterial overstatements of the grant receivable and grant revenue balances resulted from this condition.

Recommendation:

We recommend that PUC strictly follow its existing procedures to ensure that all federal grant reimbursement requests are accurate.

Auditee Response and Corrective Action Plan:

The Pohnpei Utility Corporation concurs with the finding and as an immediate remedy, will reimburse the grantor, \$2,400. PUC would like to report that this year marks the biggest in history the amount of federal funds received in a given year. The amount of federal funds received is \$2,771,129, which can be found on page 27 of this audit.

The PUC's corrective action will be to make sure that the existing procedures on federal reimbursement requests are strictly followed so that all future federal grant requests are implemented immediately, this year 2007.

POHNPEI UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-3
CFDA No.: 10.760
Program Name: U.S. Department of Agriculture – Rural Utilities Service
Area: Procurement, Suspension and Debarment
Questioned Costs: \$11,753

Criteria:

Use of sole source procurement should be properly justified and documented in writing.

Condition:

PUC leased a truck from a vendor who was neither the winner nor the runner-up in a bid solicitation. PUC noted that the bid winner was not able to meet PUC requirements, and the runner-up only offered used trucks. PUC ultimately selected the only vendor that offered new US standard trucks. However, this procurement was not supported by written justifications for use of this vendor. Total payments made under this lease amounted to \$11,753.

Cause:

This condition is due to deviation from established procurement policies and procedures.

Effect:

No effect on the financial statements occurs as a result of this condition; however, noncompliance with the procurement criteria resulted in potential questioned costs.

Recommendation:

We recommend that PUC strictly follow procurement policies and document the rationale for use of vendors not selected through approved procurement procedures.

Auditee Response and Corrective Action Plan:

The PUC concurs with the finding. Since the problem is documentation, training is required. The PUC will do training on the PUC and federal procurement policies and procedures. The outcome of the training will be to have a trained procurement staff who can handle all procurement issues, including importance of documentation. The training will be implemented this year 2007.

POHNPEI UTILITIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-4
CFDA No.: 10.760
Program Name: U.S. Department of Agriculture – Rural Utilities Service
Area: Procurement, Suspension and Debarment
Questioned Costs: \$0

Criteria:

Documentation to support purchasing decisions should be appropriate for the type of procurement selected.

Condition:

PUC utilized a vendor for parts and repair of heavy equipment used for project purposes. A single source justification was prepared to support the selection of this vendor. However, we were informed that although other vendors were also able to provide the parts and services, the parts would have to be ordered. The decision was made based on parts availability with the selected vendor. However, no written documentation other than the sole source certification was available to support the actual procurement process as described by PUC.

Cause:

This condition is due to deviation from established procurement policies and procedures.

Effect:

No effect on the financial statements occurs as a result of this condition; however, noncompliance with the procurement criteria may result in questioned costs.

Recommendation:

We recommend that PUC strictly follow procurement policies and maintain proper trails for all decisions made that may deviate from standard policies and procedures.

Auditee Response and Corrective Action Plan:

The PUC concurs with the finding. The problem is similar to the finding No. 2006-3, which is documentation. The corrective action will be also training on the procurement policies and procedures. The training will be implemented this year, 2007.