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June 2, 2008

CONFIDENTIAL

The Board of Directors
Pohnpei Utilities Corporation:

Dear Board Members:

In planning and performing our audit of the financial statements of the Pohnpei Utilities Corporation (PUC) as of September 30, 2007, on which we have issued our report dated June 2, 2008, we considered PUC's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purposes of expressing an opinion on the effectiveness of PUC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of PUC's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

We developed the following recommendations concerning control deficiencies and other matters related to its internal control.

Control Deficiency:

(1) Independent Review of Adjustments to Customer Accounts

Criteria: Credit notes or other adjustments made to customer accounts should be reviewed by a party independent from the initiation and recording of such adjustments, preferably on a daily basis.

Condition: Currently, the billing department is the only department with system access to post adjustments to customer accounts. A daily *Adjustment Posting Audit Report* is printed and reviewed by the billing department to verify that all adjustments requested by the Customer Service Department have been posted. However, no procedure is in place to ensure that all adjustments made have been properly authorized.

Cause: Internal controls over adjustments are not comprehensive.

Effect: There is a risk of unauthorized adjustments to customer accounts.

Prior Year Status: This finding was also brought to management's attention in our previous management letter.

Recommendation: We recommend that the daily report accompanied with supporting documents be reviewed by a party external to the billing department.

Other Internal Control Matters:

(2) Cash Power Revenue Recognition

Criteria: Revenue should be recognized when earned, not when received.

Condition: PUC recognizes cash power revenue on a cash basis. Cash power payments are prepayments from customers for future power to be consumed. At any point in time, power for a portion of cash power payments received has not been provided to customers and revenue associated with this power has not been earned. Management estimates that approximately two weeks of cash power revenue has not been earned (consumed). Accordingly, it has estimated that approximately $270,000 of collected cash power revenue is unearned at September 30, 2007.

Cause: The cash power system is incapable of tracking information as there is no line of connection between the customer meter and the main hardware, so there is no way for the system to recall how much is remaining on individual vouchers sold.

Effect: Revenue may be immaterially misstated.

Prior Year Status: This finding was also brought to management's attention in our previous management letters.

Recommendation: The use of cash power is steadily increasing so the amount of unearned revenue from cash power will continue to increase. We recommend that the Corporation continue to accumulating historical data to develop a methodology for estimating the amount of unearned revenue from cash power.

(3) Unbilled Revenue Recognition Policy

Criteria: Unbilled revenue should be calculated based on actual number of unbilled days for each route.

Condition: Due to a lack of a summarized billing schedule by route/meter reading date, management estimated that 15 days are unbilled for all customers as of September 30, 2007 for the October 2007 billing cycle. Management was unable to re-generate this summary information during fieldwork as the information has been purged.

Cause: The billing system has an inherent limitation to provide reports after a certain cut-off date.

Effect: Unbilled revenue may be immaterially misstated.

Prior Year Status: This finding was also brought to management's attention in our previous management letter.

Recommendation: We recommend that a summary billing by route/meter reading date be maintained and unbilled revenue be properly calculated on a prospective basis.

(4) Travel Claims

Criteria: In accordance with PUC policy, all travel claims should be filed within 10 working days of traveler's return.

Condition: We noted that one traveler (TA #07-007) returned on 03/12/07, but the travel voucher had not been submitted to the Finance Office as of 06/22/07, significantly after the 10-day requirement period.

Cause: The condition appears to result from a lack of enforcement of existing policies and procedures.

Effect: No material impact on the financial statements results from this condition; however, the lack of enforcement of existing policies and procedures may result in uncollectible advances.

Recommendation: We recommend that travel advances be closely monitored to ensure compliance with PUC policy.

(5) Recording of Expenses

Criteria: Expenses should be recorded in the appropriate accounting period.

Condition: An invoice in the amount of $1,392, dated September 17, 2003 and received by PUC on November 20, 2003, was paid on January 29, 2007 and recorded in the general ledger on February 28, 2007.

Cause: The cause of this condition is that the transaction was not recorded in the appropriate accounting period.

Effect: There is no material impact on the financial statements; however, this condition results in an understatement of expense in the fiscal year ended September 30, 2003 and an overstatement of expense for the fiscal year ended September 30, 2007.

Recommendation: We recommend that PUC timely record and process invoices received.

(6) Returned Checks

Criteria: Deposits that are returned unpaid due to non-sufficient funds (NSF) should be separated from the cash account and be recorded as a receivable.

Condition: Collection items totaling $8,724 were included as bank reconciling items at September 30, 2007. These checks have not been redeposited and appear uncollectible.

Cause: PUC's reporting policy is incorrect.

Effect: There is an immaterial overstatement and understatement of cash in bank and other receivables, respectively. Additionally, as some of the balances may not be collectible, bad debt expense may be immaterially understated.

Recommendation: We recommend that returned items be removed from cash in bank and be separately recorded as a receivable. A list of unpaid collection items should be provided to the cashiers so that future payments from the same source are rejected until the balance has been cleared.

(6) Returned Checks, Continued

Prior Year Status: This finding was also reported in the audit of PUC for the year ended September 30, 2006.

(7) Production Losses

Criteria: Levels of unbilled power should be closely monitored and increases in station and line losses should be researched.

Condition: Station and line losses increased from 6,573 MWH (17.1% of production) in 2006 to 7,005 MWH (18.1% of production) in 2007.

Cause: Losses can be caused by equipment problems, inefficiencies at generation plants or at transmission and distribution, or by theft of service.

Effect: This condition may have resulted in the loss of revenue and /or increases in generation costs.

Recommendation: The Corporation should determine the cause(s) of the increases in losses and take steps to reduce losses to a more acceptable level.

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This report is intended solely for the information and use of the Board of Directors and management of Pohnpei Utilities Corporation.

We wish to express our appreciation for the cooperation of the staff and management of the Corporation during the course of our audit. We would be available to discuss any questions that you may have concerning the above comments at your convenience.

Very truly yours,

Deloitte + Touche LLP