

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

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

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**YEARS ENDED SEPTEMBER 30, 2009 AND 2008**

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

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Years Ended September 30, 2009 and 2008

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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, 2009 and 2008, 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 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, the financial statements referred to above present fairly, in all material respects, the financial position of the Pohnpei Utilities Corporation as of September 30, 2009 and 2008, 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 through 6 is not a required part of the basic financial statements but is supplementary information required by the *Governmental Accounting Standards Board*. This supplementary information is the responsibility of PUC's management. We have applied certain limited procedures to such information, 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 was conducted for the purpose of forming an opinion on the basic financial statements of PUC taken as a whole. The additional information on pages 21 through 23 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 for the year ended September 30, 2009 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 April 14, 2010, 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.

The image shows a handwritten signature in cursive script that reads "Deloitte + Touche LLP". The signature is written in black ink on a white background.

April 14, 2010

**POHNPEI UTILITIES CORPORATION**  
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Management Discussion and Analysis  
Years Ended September 30, 2009 and 2008

The following discussion and analysis of the financial performance and activities 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, 2009 and 2008. 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.

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.

PUC has an installed generation capacity of 15.46 MW while the power demand was approximately 6.2 MW in 2009 and 2008. PUC generated 36,003 MWh and 36,106 MWh and sold 29,797 and 28,935 MWh to customers in 2009 and 2008, respectively. This resulted in total power revenue of \$10.3 million and \$12.6 million to PUC in 2009 and 2008, respectively. The decrease in sales revenue in 2009 is mainly the result of decreases in fuel tariff from an average of \$0.3426/kWhr in 2008 to \$0.2971/kWhr in 2009. The number of households being serviced by the PUC is 6,526 (6,139 using cash power meters and 387 using conventional meters) in 2009, slightly increased from a total of 6,363 in 2008. The service coverage is about 96% of the island's population.

PUC also provides clean water to the people of Pohnpei. PUC has the capacity to produce 4.72 million gallons per day while the daily water demand to existing customers amounts to 2.3 million gallons per day. PUC produced 770 million and 779 million gallons and sold 609 million and 590 million gallons to customers in 2009 and 2008, respectively, which resulted in total revenue to PUC of \$1.14 million and \$1.09 million, respectively. The PUC services 3,441 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 fiscal years 2009, 2008 and 2007:

Assets:	<u>2009</u>	<u>2008</u>	<u>2007</u>
Utility plant, net	\$ 24,380,722	\$ 26,257,924	\$ 28,391,763
Current assets	3,517,604	3,480,902	4,521,252
Other non-current assets	<u>295,082</u>	<u>516,621</u>	<u>494,401</u>
	<u>\$ 28,193,408</u>	<u>\$ 30,255,447</u>	<u>\$ 33,407,416</u>
 Liabilities and Net Assets:			
Notes payable	\$ -	\$ 100,000	\$ 874,825
Current portion of long-term debt	210,385	199,694	134,922
Other current liabilities	703,259	900,258	1,111,791
Long-term debt, net	<u>3,338,166</u>	<u>3,550,597</u>	<u>3,010,853</u>
Total Liabilities	<u>4,251,810</u>	<u>4,750,549</u>	<u>5,132,391</u>

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	<u>2009</u>	<u>2008</u>	<u>2007</u>
Net Assets:			
Invested in capital assets, net of related debt	20,982,171	22,879,154	24,769,163
Restricted	145,082	143,970	139,390
Unrestricted	<u>2,814,345</u>	<u>2,481,774</u>	<u>3,366,472</u>
Total net assets	<u>23,941,598</u>	<u>25,504,898</u>	<u>28,275,025</u>
	<u>\$ 28,193,408</u>	<u>\$ 30,255,447</u>	<u>\$ 33,407,416</u>
Revenues, Expenses and Changes in Net Assets:			
Operating revenues	\$ 11,537,213	\$ 13,799,835	\$ 11,369,043
Bad debt expense	(530,500)	(202,600)	-
Operating expenses	<u>(12,911,198)</u>	<u>(16,238,431)</u>	<u>(14,585,306)</u>
Net operating loss	(1,904,485)	(2,641,196)	(3,216,263)
Non-operating (expenses) revenues, net	341,185	(128,931)	57,672
Capital contributions	-	-	<u>124,753</u>
Decrease in net assets	(1,563,300)	(2,770,127)	(3,033,838)
Net assets at beginning of year	<u>25,504,898</u>	<u>28,275,025</u>	<u>31,308,863</u>
Net assets at end of year	<u>\$ 23,941,598</u>	<u>\$ 25,504,898</u>	<u>\$ 28,275,025</u>

Overall changes in the balance sheet components from September 30, 2008 to 2009 include a decrease in utility plant, net (\$1,877,202), a decrease in current assets (\$194,339) and a decrease in current and long term liabilities (\$498,739).

Decreases in utility plant are the result of depreciation, asset dispositions and transfers totaling \$1,877,202. There are no material additions to utility plant in 2009 so the carrying value of utility plant assets is reduced by approximately the same amount as total depreciation, and the direct expensing of 8 items in the fixed asset register under the \$5,000 capitalization threshold. **Please see note 5 of the financial statements for additional information on PUC's utility plant.**

Decreases in current assets are the net effect of minor decreases in accounts receivable and cash and an increase in inventory. Parts for Generator #8 make up the increase in inventory. PUC's inability to collect from its water customers make up the decrease in accounts receivable as PUC incurred \$500,000 in bad debt expense.

Decrease in current and long term debt from 2008 to 2009 is due to PUC's scheduled loan repayments to FSM Development Bank, U.S. Rural Utility Services, Asian Development Bank and the Bank of the FSM. The current portion of long-term debt increased due to the addition of the Bank of the FSM loan. A more favorable cash-flow in 2009 allowed PUC to decrease its accounts payable. Reduction of employees' annual leave also contributed to the decrease in current liabilities. **Please see note 6 of the financial statements for additional information on PUC's current and long-term debt.**

The changes in revenue, expenses and changes in net assets statement between fiscal year 2008 and 2009 include a decrease in operating revenues before bad debts (\$2,262,622), a decrease in operating expenses (\$3,327,233), and a decrease in net operating loss of \$736,711.

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Years Ended September 30, 2009 and 2008

The decrease in operating revenues before bad debts is due to decrease in average fuel tariff from \$0.3426 per kWh in 2008 to \$0.2971/kWh in 2009 or \$2,339,215, plus the increase in water sales of \$48,886 and other sales of \$27,707.

The decrease in operating expenses is mainly the result of fuel cost decreases. The fuel expense in 2009 alone is \$8,136,318, a decrease of \$3,378,697 from 2008. PUC cut costs in all areas in 2009 except in the Generation department where overdue repairs to the engines took place.

PUC incurred a loss of \$1,563,300 in 2009, an improvement of \$1,206,827 from 2008. It cost PUC \$0.43 to produce and sell one unit of power (kWh) in 2009; however, PUC charged an average of \$0.3971 per unit of power or (kWh) in 2009. It also cost PUC \$2.20 to produce and sell one thousand gallons of clean water (1,000 gallons), but PUC charged an average of \$1.80 per the thousand gallons of water sold.

Some of the factors affecting the disparity between actual production cost and the tariff are:

1. PUC does not charge depreciation expense to customers. In 2009, the cost of depreciation expense per unit of power is \$0.05 and the cost of depreciation per thousand gallons of water is \$1.05.
2. It should also be noted that the existing tariff was approved in 1996, 12 years ago using the revenue requirements and service levels of those years. Tariff reform is overdue for PUC because of inflation. To illustrate, based on the U.S. consumer price index inflation calculator, a \$1.00 in 2009 had about the same buying power as \$0.73 in 1996. In addition, freight and insurance costs have more than doubled because of the worldwide increase in fuel prices. PUC's costs are greatly impacted by freight because PUC relies heavily on imports of its engine parts and distribution, water and sewer supplies and materials.
3. PUC is paying for import taxes which it did not pay in 1996.
4. PUC is supposed to recover the actual cost of fuel by the tariff. However, based on the revenue analysis this year, PUC recovered from customers approximately \$7,224,689 in fuel charges, but spent \$8,136,318 on fuel, a shortfall of \$911,629. There was an improvement in this area as compared to 2008 because of the declining fuel price PUC enjoyed in 2009 (see item c below). PUC diverted funds intended for maintenance and operations to cover the shortfall in fuel revenue in 2009. The reasons for the fuel revenue shortfall are as follows:
  - a. The cost of lubrication oil and solvents has increased significantly and PUC does not include this cost in its fuel-pass-through tariff structure that changes when the cost of fuel changes. PUC spent about \$445,000 in lubrication oil and solvents in 2009.
  - b. The technical and line loss for PUC this year is 18.6 percent. The fuel used to produce the power that is lost is not recovered by the tariff.
  - c. Although there are 387 customers using conventional meters among the total 6,523 power customers, their power consumption averages about 46% of the total annual sales. These customers mainly comprise large commercial customers and government customers. The billing cycle for these customers is 45 days. The fuel price is not charged to these customers until 45 days later and so in times of decreasing fuel prices, these customers are charged a higher fuel price than the actual cost of fuel, creating a mismatch of current revenue and fuel expense which explains the improvement in fuel revenue recovery in 2009.

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Years Ended September 30, 2009 and 2008

**Economic Outlook**

The economic outlook for PUC operation next year is not as promising as 2009. PUC is likely to see an increase in fuel costs as world oil prices are starting to go up again. With fuel cost increasing, it will be tough for PUC to repeat 2009 results. When cost of power goes up, energy consumption will decrease along with non-fuel revenue which is bad because this is what funds PUC operations including its maintenance program. It should be noted that because PUC had delayed much needed maintenance to its utility plant due to financial constraints, it is estimated today that \$7.8 million is needed for the upgrade of the existing utility plant.

This concludes the management discussion and analysis of the financial statements for the year ended September 30, 2009.

Management's Discussion and Analysis for the year ended September 30, 2008 is set forth in PUC's report on the audit of financial statements, which is dated January 8, 2009. That Discussion and Analysis explains the major factors impacting the 2008 financial statements and can be viewed at the Office of the Public Auditor's website at [www.fsmopa.fm](http://www.fsmopa.fm)



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Statements of Net Assets  
September 30, 2009 and 2008

<u>ASSETS</u>	<u>2009</u>	<u>2008</u>
Current assets:		
Cash and cash equivalents	\$ 131,558	\$ 198,407
Investments	174,186	173,030
Time certificates of deposit	231,041	-
Accounts receivable, net	1,521,270	1,866,390
Grants receivable	-	23,698
Prepayments	12,309	-
Materials and fuel inventory	1,447,240	1,219,377
Total current assets	<u>3,517,604</u>	<u>3,480,902</u>
Other noncurrent assets:		
Restricted:		
Cash and cash equivalents	150,000	150,000
Time certificates of deposit	-	221,521
Investments	145,082	143,970
Interest receivable	-	1,130
Total other noncurrent assets	<u>295,082</u>	<u>516,621</u>
Utility plant, at cost:		
Electric plant in service	37,555,697	37,585,666
Water and sewer plant in service	19,353,434	19,357,434
	56,909,131	56,943,100
Less accumulated depreciation	(32,778,209)	(30,743,463)
Depreciable assets	24,130,922	26,199,637
Construction work-in-process	249,800	58,287
Total utility plant	<u>24,380,722</u>	<u>26,257,924</u>
	<u>\$ 28,193,408</u>	<u>\$ 30,255,447</u>
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Notes payable	\$ -	\$ 100,000
Current portion of long-term debt	210,385	199,694
Accounts payable:		
Operations	287,239	357,598
Affiliate	99,023	78,317
Deferred revenue	136,528	190,074
Accrued taxes and other liabilities	158,543	183,134
Employees' annual leave	21,926	91,135
Total current liabilities	913,644	1,199,952
Noncurrent liabilities:		
Long-term debt, net of current portion	3,338,166	3,550,597
Total liabilities	<u>4,251,810</u>	<u>4,750,549</u>
Contingencies		
Net assets:		
Invested in capital assets, net of related debt	20,982,171	22,879,154
Restricted	145,082	143,970
Unrestricted	2,814,345	2,481,774
Total net assets	<u>23,941,598</u>	<u>25,504,898</u>
	<u>\$ 28,193,408</u>	<u>\$ 30,255,447</u>

See accompanying notes to financial statements.

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Statements of Revenues, Expenses and Changes in Net Assets  
Years Ended September 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Operating revenues:		
Electricity sales	\$ 10,299,229	\$ 12,638,444
Water sales	1,138,576	1,089,691
Other sales	<u>99,408</u>	<u>71,700</u>
Total operating revenues before bad debts	11,537,213	13,799,835
Bad debts	<u>(530,500)</u>	<u>(202,600)</u>
Total operating revenues after bad debts	<u>11,006,713</u>	<u>13,597,235</u>
Operating and maintenance expenses:		
Production fuel	8,136,318	11,515,015
Depreciation	2,053,801	2,104,930
Administrative and general	934,799	1,089,952
Water and sewer	717,842	723,005
Generation	713,317	450,447
Distribution	<u>355,121</u>	<u>355,082</u>
Total operating expenses	<u>12,911,198</u>	<u>16,238,431</u>
Operating loss	<u>(1,904,485)</u>	<u>(2,641,196)</u>
Nonoperating (expenses) revenues:		
Interest expense, net	(176,887)	(128,931)
Grants and subsidies	479,969	-
Spurline projects	<u>38,103</u>	<u>-</u>
Total nonoperating (expenses) revenues	<u>341,185</u>	<u>(128,931)</u>
Change in net assets	(1,563,300)	(2,770,127)
Net assets at beginning of year	<u>25,504,898</u>	<u>28,275,025</u>
Net assets at end of year	<u>\$ 23,941,598</u>	<u>\$ 25,504,898</u>

See accompanying notes to financial statements.

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Statements of Cash Flows  
Years Ended September 30, 2009 and 2008

	2009	2008
Cash flows from operating activities:		
Cash received from customers	\$ 11,298,287	\$ 13,775,606
Cash payments to suppliers for goods and services	(9,543,864)	(12,430,488)
Cash paid to employees	(1,717,864)	(1,697,207)
Net cash provided by (used for) operating activities	36,559	(352,089)
Cash flows from investing activities:		
Payments to self insurance fund	-	(4,580)
Retirement of scholarship fund	-	3,881
Interest and dividends on investments and bank account	5,477	13,624
Net cash provided by investing activities	5,477	12,925
Cash flows from noncapital financing activities:		
(Payments for) proceeds from notes payable to bank	(100,000)	475,122
Advance from affiliate	20,706	38,317
Operating grants received	503,667	-
Interest expense	(193,022)	(128,931)
Spurline projects	38,103	-
Net cash provided by noncapital financing activities	269,454	384,508
Cash flows from capital and related financing activities:		
Repayments of long-term debt	(201,740)	(168,606)
Acquisition of utility plant	(176,599)	(35,387)
Net cash used for capital and related financing activities	(378,339)	(203,993)
Net change in cash and cash equivalents	(66,849)	(158,649)
Cash and cash equivalents at beginning of year	198,407	357,056
Cash and cash equivalents at end of year	\$ 131,558	\$ 198,407
<u>Reconciliation of operating loss to net cash provided by</u>		
<u>(used for) operating activities:</u>		
Operating loss	\$ (1,904,485)	\$ (2,641,196)
Adjustments to reconcile operating loss to net cash provided by		
(used for) operating activities:		
Depreciation	2,053,801	2,104,930
Bad debts	530,500	202,600
Write off of construction work-in-progress	-	64,296
(Increase) decrease in assets:		
Accounts receivable	(185,380)	98,449
Prepayments	(12,309)	10,186
Materials and fuel inventory	(227,863)	58,496
Increase (decrease) in liabilities:		
Accounts payable	(70,359)	(106,314)
Deferred revenue	(53,546)	(122,678)
Accrued taxes and other liabilities	(24,591)	(19,560)
Employees' annual leave	(69,209)	(1,298)
Net cash provided by (used for) operating activities	\$ 36,559	\$ (352,089)

Supplemental information of noncash investing and financing activities:

During the year ended September 30, 2008, notes payable of \$773,122 were converted to long-term debt in the same amount. Additionally, investments of \$476,825 were used to pay off an outstanding note to the investment company.

See accompanying notes to financial statements.

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Notes to Financial Statements  
September 30, 2009 and 2008

(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, Interpretations and Accounting Standards Updates 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. The allowance is established through a provision for bad debts charged against earnings.

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  
September 30, 2009 and 2008

(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, 2009 approximates \$231,214.

Net Assets: Net assets represent the residual interest in PUC's assets after liabilities are deducted and consist of three 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. Unbilled revenues are accrued based on the most recent billing cycles. Cash power revenue is recognized as revenue upon point of sale; the estimated unearned portion is determined at year end and recorded as deferred revenue in the accompanying statements of net assets.

Federal Grants and Subsidies: PUC receives federal grants either as a direct recipient or as 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 2008 financial statements to correspond with the 2009 presentation.

New Accounting Standards: During fiscal year 2009, PUC implemented the following pronouncements:

- GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which establishes standards for the measurement, recognition, and display of other postemployment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers.

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Notes to Financial Statements  
September 30, 2009 and 2008

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation.
- GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, which improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income.
- GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which improves financial reporting by contributing to the GASB's efforts to codify all GAAP for state and local governments so that they derive from a single source.
- GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, which incorporates accounting and financial reporting guidance previously only contained in the American Institute of Certified Public Accountants (AICPA) auditing literature into the GASB's accounting and financial reporting literature for state and local governments, and addresses three issues from the AICPA's literature - related party transactions, going concern considerations, and subsequent events.

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

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. The effect of the implementation of this statement on the financial statements of PUC has not been determined.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of PUC.

In December 2008, GASB issued Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*, which clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, for calculating the annual required contribution (ARC) adjustment. The provisions of this statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of PUC.

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

Notes to Financial Statements  
September 30, 2009 and 2008

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In March 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The provisions of this statement are effective for periods beginning after June 15, 2010. Management does not believe that the implementation of this statement 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;  |
| 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 in 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.

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

Notes to Financial Statements  
September 30, 2009 and 2008

(2) Deposits and Investments, Continued

A. Deposits, Continued:

As of September 30, 2009 and 2008, the carrying amount of PUC's total cash and cash equivalents and time certificates of deposit was \$512,599 and \$569,928, respectively, and the corresponding bank balances were \$608,200 and \$709,860, respectively. Of the bank balances, \$511,827 and \$569,156, respectively, are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2009 and 2008, bank deposits in the amount of \$500,000 and \$200,000, respectively, 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, 2009 and 2008, investments in mutual funds at fair value are \$319,268 and \$317,000, respectively.

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, 2009 and 2008.

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, 2009 and 2008.



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

Notes to Financial Statements  
September 30, 2009 and 2008

(2) Deposits and Investments, Continued

B. Investments, Continued:

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, 2009 and 2008, the carrying amount of the fund is \$145,082 and \$143,970, respectively, which is presented as a restricted investment in the accompanying statements of net assets.

Additionally, PUC is self-insured for all losses such as torts; theft or damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Management is of the opinion that no material losses have been sustained as a result of this practice during the past three years.

(4) Accounts Receivable

Effective July 1, 2008, PUC changed its policy and reads meters on the last day of the month and processes bills on the first of the following month. Therefore, approximately thirty days of service is accrued at September 30, 2009 and 2008, which is classified as accounts receivable - unbilled. Accounts receivable at September 30, 2009 and 2008, are summarized as follows:

	<u>2009</u>	<u>2008</u>
Accounts receivable - electrical:		
Residential	\$ 1,274,578	\$ 1,259,841
Commercial	620,537	547,457
Government	177,480	167,377
Unbilled	<u>358,995</u>	<u>523,921</u>
	<u>2,431,590</u>	<u>2,498,596</u>
Accounts receivable - water and sewer:		
Residential	1,651,653	1,455,065
Commercial and government	175,937	126,826
Unbilled	<u>125,711</u>	<u>111,991</u>
	<u>1,953,301</u>	<u>1,693,882</u>
Installment receivables	91,748	91,604
Other	<u>98,874</u>	<u>106,051</u>
	4,575,513	4,390,133
Less allowance for doubtful receivables	<u>(3,054,243)</u>	<u>(2,523,743)</u>
	<u>\$ 1,521,270</u>	<u>\$ 1,866,390</u>

PUC commenced a prepaid cash power meter system in which a portion of customer payments are used to satisfy balances in arrears. 50% of collections are applied to arrears at the time of purchase, starting October 2007. As of September 30, 2009 and 2008, gross receivables from customers enrolled in the cash power meter system are \$824,260 and \$879,178, respectively.

**POHNPEI UTILITIES CORPORATION**  
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Notes to Financial Statements  
September 30, 2009 and 2008

**(5) Utility Plant**

A summary of changes in capital assets for the years ended September 30, 2009 and 2008 is as follows:

	Beginning Balance <u>October 1, 2008</u>	<u>Additions</u>	<u>Deletions</u>	<u>Transfers</u>	Ending Balance <u>September 30, 2008</u>
<u>Depreciable assets:</u>					
Production plant	\$ 21,750,155	\$ -	\$ -	\$ -	\$ 21,750,155
Distribution plant	14,221,240	-	(9,111)	-	14,212,129
General plant	<u>1,614,271</u>	<u>-</u>	<u>(20,858)</u>	<u>-</u>	<u>1,593,413</u>
Electric plant in service	<u>37,585,666</u>	<u>-</u>	<u>(29,969)</u>	<u>-</u>	<u>37,555,697</u>
Water production plant	6,357,862	-	(4,000)	-	6,353,862
Sewage collection and treatment plant	5,512,301	-	-	-	5,512,301
Water distribution plant	6,930,383	-	-	-	6,930,383
General plant	<u>556,888</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>556,888</u>
Water and sewer plant in service	<u>19,357,434</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>19,353,434</u>
Total utility plant in service	56,943,100	-	(33,969)	-	56,909,131
Less accumulated depreciation	<u>(30,743,463)</u>	<u>(2,053,801)</u>	<u>19,055</u>	<u>-</u>	<u>(32,778,209)</u>
	<u>26,199,637</u>	<u>(2,053,801)</u>	<u>(14,914)</u>	<u>-</u>	<u>24,130,922</u>
<u>Non-depreciable assets:</u>					
<u>Construction work-in-progress:</u>					
Electric plant	13,800	170,185	-	-	183,985
Water and sewer plant	<u>44,487</u>	<u>21,328</u>	<u>-</u>	<u>-</u>	<u>65,815</u>
	<u>58,287</u>	<u>191,513</u>	<u>-</u>	<u>-</u>	<u>249,800</u>
	\$ <u>26,257,924</u>	\$ <u>(1,862,288)</u>	\$ <u>(14,914)</u>	\$ <u>-</u>	\$ <u>24,380,722</u>
	Beginning Balance <u>October 1, 2007</u>	<u>Additions</u>	<u>Deletions</u>	<u>Transfers</u>	Ending Balance <u>September 30, 2008</u>
<u>Depreciable assets:</u>					
Production plant	\$ 21,750,155	\$ -	\$ -	\$ -	\$ 21,750,155
Distribution plant	14,195,705	25,535	-	-	14,221,240
General plant	<u>1,614,271</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,614,271</u>
Electric plant in service	<u>37,560,131</u>	<u>25,535</u>	<u>-</u>	<u>-</u>	<u>37,585,666</u>
Water production plant	6,357,862	-	-	-	6,357,862
Sewage collection and treatment plant	5,512,301	-	-	-	5,512,301
Water distribution plant	6,879,995	-	-	50,388	6,930,383
General plant	<u>556,888</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>556,888</u>
Water and sewer plant in service	<u>19,307,046</u>	<u>-</u>	<u>-</u>	<u>50,388</u>	<u>19,357,434</u>
Total utility plant in service	56,867,177	25,535	-	50,388	56,943,100
Less accumulated depreciation	<u>(28,638,532)</u>	<u>(2,104,930)</u>	<u>-</u>	<u>(1)</u>	<u>(30,743,463)</u>
	<u>28,228,645</u>	<u>(2,079,395)</u>	<u>-</u>	<u>50,387</u>	<u>26,199,637</u>
<u>Non-depreciable assets:</u>					
<u>Construction work-in-progress:</u>					
Electric plant	32,706	3,205	-	(22,111)	13,800
Water and sewer plant	<u>130,412</u>	<u>6,648</u>	<u>-</u>	<u>(92,573)</u>	<u>44,487</u>
	<u>163,118</u>	<u>9,853</u>	<u>-</u>	<u>(114,684)</u>	<u>58,287</u>
	\$ <u>28,391,763</u>	\$ <u>(2,069,542)</u>	\$ <u>-</u>	\$ <u>(64,297)</u>	\$ <u>26,257,924</u>

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

Notes to Financial Statements  
September 30, 2009 and 2008

**(6) Notes Payable and Long-Term Debt**

Notes payable as of September 30, 2008 of \$100,000 were drawn on a bank line of credit, bore interest at the time certificate of deposit (TCD) rate plus 2% (6.1%) and were collateralized by the TCD. The credit line expired on December 7, 2008 and the note was repaid.

Changes in notes payable for the year ended September 30, 2009 and 2008, are as follows:

	Outstanding October 1, <u>2008</u>	<u>Increases</u>	<u>Decreases</u>	Outstanding September 30, <u>2009</u>
Notes to a bank	\$ <u>100,000</u>	\$ <u>-</u>	\$ <u>(100,000)</u>	\$ <u>-</u>
	Outstanding October 1, <u>2007</u>	<u>Increases</u>	<u>Decreases</u>	Outstanding September 30, <u>2008</u>
Notes to a bank	\$ 398,000	\$ 475,122	\$ (773,122)	\$ 100,000
Note to an investment company	<u>476,825</u>	<u>-</u>	<u>(476,825)</u>	<u>-</u>
	\$ <u>874,825</u>	\$ <u>475,122</u>	\$ <u>(1,249,947)</u>	\$ <u>100,000</u>

The proceeds from the notes payable were used to finance PUC's operating activities.

Long-term debt consists of the following at September 30, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Amount drawn on a note payable to the State of Pohnpei, facilitated by an Asian Development Bank (ADB) 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 was paid by the State of Pohnpei during the years ended September 30, 2009 and 2008.	\$ 1,972,270	\$ 2,022,848
Loan payable to United States Department of Agriculture, Rural Utilities Service (RUS), 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%.	559,418	565,803
Loan payable to Bank of the Federated States of Micronesia (BFSM), 5 year term, interest at 9%, collateralized by a diesel power comprehensive generator plant, two Daihatsu model 12D532 engines, building and materials, and existing and future receivables. Monthly principal and interest installments of \$9,794 commencing September 15, 2008.	722,055	773,122
Loan payable to FSM Development Bank (FSMDB), 5 year term, interest at 9%, collateralized by a \$150,000 time certificate of deposit, receivables, inventory and property, plant and equipment. Monthly principal and interest installments of \$10,379 commencing July 2007. A member of the PUC Board is also a member of management of the FSM Development Bank.	<u>294,808</u>	<u>388,518</u>

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

Notes to Financial Statements  
September 30, 2009 and 2008

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

Total long-term debt	3,548,551	3,750,291
Less: current portion of long-term debt	<u>210,385</u>	<u>199,694</u>
Long-term portion of long-term debt	\$ <u>3,338,166</u>	\$ <u>3,550,597</u>

The proceeds from long-term debt were previously used to acquire utility plant.

At September 30, 2009, PUC is not in compliance with several debt covenants contained in the loan agreement with the Bank of the FSM. PUC is in the process of obtaining a waiver from the Bank and is of the opinion that no impact on the accompanying financial statements would result from resolution of this matter.

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>
2010	\$ 210,385	\$ 130,541	\$ 340,926
2011	225,884	115,042	340,926
2012	201,235	98,813	300,048
2013	601,201	85,146	686,347
2014	57,543	41,305	98,848
2015-2019	301,121	193,119	494,240
2020-2024	325,797	168,443	494,240
2025-2029	354,208	140,032	494,240
2030-2034	386,965	107,275	494,240
2035-2039	425,094	69,146	494,240
2040-2044	<u>459,118</u>	<u>24,452</u>	<u>483,570</u>
	\$ <u>3,548,551</u>	\$ <u>1,173,314</u>	\$ <u>4,721,865</u>

Changes in non-current liabilities for the years ended September 30, 2009 and 2008, are as follows:

	<u>Outstanding October 1, 2008</u>	<u>Increases</u>	<u>Decreases</u>	<u>Outstanding September 30, 2009</u>	<u>Current</u>	<u>Noncurrent</u>
Loan payable to:						
ADB	\$ 2,022,848	\$ -	\$ (50,578)	\$ 1,972,270	\$ 48,829	\$ 1,923,441
RUS	565,803	-	(6,385)	559,418	6,815	552,603
BFSM	773,122	-	(51,067)	722,055	52,578	669,477
FSMDB	<u>388,518</u>	<u>-</u>	<u>(93,710)</u>	<u>294,808</u>	<u>102,163</u>	<u>192,645</u>
	\$ <u>3,750,291</u>	\$ <u>-</u>	\$ <u>(201,740)</u>	\$ <u>3,548,551</u>	\$ <u>210,385</u>	\$ <u>3,338,166</u>
	<u>Outstanding October 1, 2007</u>	<u>Increases</u>	<u>Decreases</u>	<u>Outstanding September 30, 2008</u>	<u>Current</u>	<u>Noncurrent</u>
Loan payable to:						
ADB	\$ 2,096,260	\$ -	\$ (73,412)	\$ 2,022,848	\$ 47,060	\$ 1,975,788
RUS	569,552	-	(3,749)	565,803	6,520	559,283
BFSM	-	773,122	-	773,122	52,741	720,381
FSMDB	<u>479,963</u>	<u>-</u>	<u>(91,445)</u>	<u>388,518</u>	<u>93,373</u>	<u>295,145</u>
	\$ <u>3,145,775</u>	\$ <u>773,122</u>	\$ <u>(168,606)</u>	\$ <u>3,750,291</u>	\$ <u>199,694</u>	\$ <u>3,550,597</u>

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

Notes to Financial Statements  
September 30, 2009 and 2008

(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 their operation.

(8) Grants, Subsidies and Capital Contributions

Grants and subsidies comprise the following for the year ended September 30, 2009:

U.S. Department of the Interior:

Operations and maintenance improvement program:

Cash power meters program	\$ 129,969
Repair of power plant engine #8	<u>350,000</u>
	\$ <u>479,969</u>

(9) Sinking Fund

During fiscal year 1998, PUC management established a sinking fund 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 mutual funds of \$174,186 and \$173,030 at September 30, 2009 and 2008, respectively.

(10) 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. In June 2008, PUC discontinued future employer contributions to the Plan until such time that PUC's financial standing improves.

Contributions to the Plan during the year ended September 30, 2008 were \$46,292. At September 30, 2008, plan assets were \$196,274. During the year ended September 30, 2009, PUC did not make any contribution to the Plan and additionally, all Plan participants withdrew remaining balances, resulting in a zero plan asset balance as of September 30, 2009.

**POHNPEI UTILITIES CORPORATION**  
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Notes to Financial Statements  
September 30, 2009 and 2008

(11) Related Party

At September 30, 2009 and 2008, accounts receivable include amounts owed by the State of Pohnpei and its component units to PUC of \$242,050 and \$159,070, respectively. At September 30, 2009 and 2008, PUC also has a non-interest bearing advance from the PUC Social Club of \$44,817. Further, at September 30, 2009 and 2008, PUC has a non-interest bearing advance from the State of Pohnpei of \$ 54,206 and \$33,500, respectively. These advances have no set repayment terms and are classified as current due to the mutual consent of the parties.

(12) Contingencies

PUC is involved in various legal actions in the normal course of business, including a variety of legal actions and claims that seek monetary damages or punitive damages. Based on current information, including legal consultation, management believes any ultimate liability that may arise from these actions would not materially affect PUC's financial position, results of operations or cash flows. However, management's evaluation of likely impact of these actions could change in the future and an unfavorable outcome, depending upon the amount and timing, could have a material effect on PUC's results of operations or cash flows in the future period.

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

Combining Statement of Net Assets  
September 30, 2009  
(With comparative totals as of September 30, 2008)

<u>Assets</u>	Power and Utility	Water and Sewer	Eliminating Entries	Totals	
				2009	2008
<b>Current assets:</b>					
Cash and cash equivalents	\$ 371,612	\$ (240,054)	\$ -	\$ 131,558	\$ 198,407
Investments	174,186	-	-	174,186	173,030
Time certificates of deposit	231,041	-	-	231,041	-
Accounts receivable, net	912,876	608,394	-	1,521,270	1,866,390
Grants receivable	-	-	-	-	23,698
Prepayments	12,309	-	-	12,309	-
Fuel and material inventory	1,103,334	343,906	-	1,447,240	1,219,377
Total current assets	<u>2,805,358</u>	<u>712,246</u>	<u>-</u>	<u>3,517,604</u>	<u>3,480,902</u>
<b>Other noncurrent assets:</b>					
Restricted:					
Cash and cash equivalents	150,000	-	-	150,000	150,000
Time certificates of deposit	-	-	-	-	221,521
Investments	145,082	-	-	145,082	143,970
Interest receivable	-	-	-	-	1,130
Total other noncurrent assets	<u>295,082</u>	<u>-</u>	<u>-</u>	<u>295,082</u>	<u>516,621</u>
<b>Utility plant, at cost:</b>					
Electric plant in service	37,555,697	-	-	37,555,697	37,585,666
Water and sewer plant in service	-	19,353,434	-	19,353,434	19,357,434
	37,555,697	19,353,434	-	56,909,131	56,943,100
Less accumulated depreciation	<u>(24,917,941)</u>	<u>(7,860,268)</u>	<u>-</u>	<u>(32,778,209)</u>	<u>(30,743,463)</u>
Depreciable assets	12,637,756	11,493,166	-	24,130,922	26,199,637
Construction work-in-process	216,065	33,735	-	249,800	58,287
Total utility plant	<u>12,853,821</u>	<u>11,526,901</u>	<u>-</u>	<u>24,380,722</u>	<u>26,257,924</u>
	<u>\$ 15,954,261</u>	<u>\$ 12,239,147</u>	<u>\$ -</u>	<u>\$ 28,193,408</u>	<u>\$ 30,255,447</u>
<u>Liabilities and Net Assets</u>					
<b>Current liabilities:</b>					
Notes payable to bank	\$ -	\$ -	\$ -	\$ -	\$ 100,000
Current portion of long-term debt	156,107	54,278	-	210,385	199,694
Accounts payable:					
Operations	287,239	-	-	287,239	357,598
Affiliate	44,818	54,205	-	99,023	78,317
Deferred revenue	136,528	-	-	136,528	190,074
Accrued taxes and other liabilities	158,543	-	-	158,543	183,134
Employees' annual leave	21,926	-	-	21,926	91,135
Total current liabilities	<u>805,161</u>	<u>108,483</u>	<u>-</u>	<u>913,644</u>	<u>1,199,952</u>
<b>Noncurrent liabilities:</b>					
FSM Development Bank loan	192,645	-	-	192,645	295,145
RUS Water extension loan	-	552,603	-	552,603	559,283
Bank of the FSM	669,477	-	-	669,477	720,381
ADB Water extension loan	-	1,923,441	-	1,923,441	1,975,788
Total liabilities	<u>1,667,283</u>	<u>2,584,527</u>	<u>-</u>	<u>4,251,810</u>	<u>4,750,549</u>
<b>Net assets:</b>					
Invested in capital assets, net of related debt	11,985,592	8,996,579	-	20,982,171	22,879,154
Restricted	145,082	-	-	145,082	143,970
Unrestricted	2,156,304	658,041	-	2,814,345	2,481,774
Total net assets	<u>14,286,978</u>	<u>9,654,620</u>	<u>-</u>	<u>23,941,598</u>	<u>25,504,898</u>
	<u>\$ 15,954,261</u>	<u>\$ 12,239,147</u>	<u>\$ -</u>	<u>\$ 28,193,408</u>	<u>\$ 30,255,447</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, 2009  
(With comparative totals for the year ended September 30, 2008)

	Power and Utility	Water and Sewer	Eliminating Entries	Totals	
				2009	2008
Operating revenues:					
Residential	\$ 223,560	\$ 908,860	\$ -	\$ 1,132,420	\$ 1,023,479
Commercial	2,487,270	132,062	-	2,619,332	3,234,714
Government	1,875,425	97,654	-	1,973,079	2,661,465
Cash power	5,712,974	-	-	5,712,974	6,808,477
Intercompany sales	55,902	-	(55,902)	-	-
Other sales	27,090	72,318	-	99,408	71,700
Total operating revenues before bad debts	10,382,221	1,210,894	(55,902)	11,537,213	13,799,835
Bad debts	(26,388)	(504,112)	-	(530,500)	(202,600)
Total operating revenues after bad debts	10,355,833	706,782	(55,902)	11,006,713	13,597,235
Operating and maintenance expenses:					
Production fuel	8,136,318	-	-	8,136,318	11,515,015
Depreciation	1,430,600	623,201	-	2,053,801	2,104,930
Administrative and general:					
Employee benefits	220,068	-	-	220,068	323,680
Salaries and wages	415,662	-	-	415,662	368,058
Vehicle, POL	91,768	-	-	91,768	127,839
General repairs	43,616	-	-	43,616	50,788
Consumables	54,848	-	-	54,848	48,093
Travel	19,323	-	-	19,323	13,394
Communications	30,508	-	-	30,508	58,521
Contractual services	25,000	-	-	25,000	40,000
Training and safety	2,074	-	-	2,074	9,985
Customer service and collection	31,432	-	-	31,432	49,594
Legal fees	500	-	-	500	-
Utility	55,902	-	(55,902)	-	-
	990,701	-	(55,902)	934,799	1,089,952
Generation:					
Salaries and wages	357,035	-	-	357,035	314,720
Repairs and maintenance	328,132	-	-	328,132	129,907
Other production	28,150	-	-	28,150	5,820
	713,317	-	-	713,317	450,447
Water and sewer:					
Salaries and wages	-	511,773	-	511,773	527,586
Repairs and maintenance	-	102,924	-	102,924	75,718
Chemicals	-	33,205	-	33,205	30,661
Employee benefits	-	41,131	-	41,131	58,553
Other production	-	19,378	-	19,378	13,984
Training and safety	-	9,431	-	9,431	16,503
	-	717,842	-	717,842	723,005
Distribution:					
Salaries and wages	315,065	-	-	315,065	314,796
Repairs and maintenance	40,056	-	-	40,056	40,286
	355,121	-	-	355,121	355,082
Total operating expenses	11,626,057	1,341,043	(55,902)	12,911,198	16,238,431
Operating loss	(1,270,224)	(634,261)	-	(1,904,485)	(2,641,196)

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, 2009  
(With comparative totals for the year ended September 30, 2008)

	<u>Power and Utility</u>	<u>Water and Sewer</u>	<u>Eliminating Entries</u>	<u>Totals</u>	
				<u>2009</u>	<u>2008</u>
Nonoperating revenues:					
Interest (expense) income, net	(131,628)	(45,259)	-	(176,887)	(128,931)
Federal grants and subsidies	479,969	-	-	479,969	-
Spurline projects	38,103	-	-	38,103	-
	<u>386,444</u>	<u>(45,259)</u>	<u>-</u>	<u>341,185</u>	<u>(128,931)</u>
Change in net assets	(883,780)	(679,520)	-	(1,563,300)	(2,770,127)
Net assets at beginning of year	<u>15,170,758</u>	<u>10,334,140</u>	<u>-</u>	<u>25,504,898</u>	<u>28,275,025</u>
Net assets at end of year	\$ <u>14,286,978</u>	\$ <u>9,654,620</u>	\$ <u>-</u>	\$ <u>23,941,598</u>	\$ <u>25,504,898</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**

Board of Directors  
Pohnpei Utilities Corporation:

We have audited the financial statements of Pohnpei Utilities Corporation (PUC) as of and for the year ended September 30, 2009 and have issued our report thereon dated April 14, 2010. 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 as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose 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. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A *material weakness* is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

### 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 disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of PUC in a separate letter dated April 14, 2010.

This report is intended solely for the information and use of the Board of Directors and management of Pohnpei Utilities Corporation, the Office of the Public Auditor, federal awarding agencies, pass-through entities, the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than those specified parties. However, this report is also a matter of public record.

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

April 14, 2010