

April 11, 2011

The Board of Directors
Pohnpei Utilities Corporation

Dear Members of the Board:

We have performed an audit of the financial statements of Pohnpei Utilities Corporation (PUC) as of and for the year ended September 30, 2010, in accordance with auditing standards generally accepted in the United States of America (“generally accepted auditing standards”) and have issued our report thereon dated April 11, 2011.

We have prepared the following comments to assist you in fulfilling your obligation to oversee the financial reporting and disclosure process for which management of PUC is responsible.

OUR RESPONSIBILITY UNDER GENERALLY ACCEPTED AUDITING STANDARDS AND GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS

Our responsibility under generally accepted auditing standards and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, have been described in our engagement letter dated November 21, 2010. As described in that letter, the objective of a financial statement audit conducted in accordance with the aforementioned standards is:

- To express an opinion on the fairness of the presentation of PUC’s basic financial statements and to disclaim an opinion on the required supplementary information for the year ended September 30, 2010 in conformity with accounting principles generally accepted in the United States of America (“generally accepted accounting principles”), in all material respects;
- To express an opinion on whether the supplementary information that accompanies the basic financial statements is presented fairly, in all material respects, in relation to the basic financial statements taken as a whole; and
- To report on PUC’s internal control over financial reporting and on its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters for the year ended September 30, 2010 based on an audit of financial statements performed in accordance with the standards applicable to financial audits contained in *Government Auditing Standards*.

Our responsibilities under generally accepted auditing standards and *Government Auditing Standards* include forming and expressing an opinion about whether the financial statements that have been prepared with the oversight of management and the Board of Directors are presented fairly, in all material respects, in conformity with generally accepted accounting principles. The audit of the financial statements does not relieve management or the Board of Directors of their responsibilities.

We considered PUC's 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 do not express an opinion on the effectiveness of PUC's internal control over financial reporting. Our consideration of internal control over financial reporting would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses.

ACCOUNTING ESTIMATES

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and on assumptions about future events. Significant accounting estimates reflected in PUC's 2010 financial statements include management's estimate of the allowance for uncollectible accounts, which is determined based upon past collection experience and aging of the accounts; management's estimate of unearned cash power revenue, which is based on power consumption by cash power customers; and, management's estimate of depreciation expense, which is based on estimated useful lives of the respective capital assets. During the year ended September 30, 2010, we are not aware of any significant changes in accounting estimates or in management's judgments relating to such estimates.

AUDIT ADJUSTMENTS AND UNCORRECTED MISSTATEMENTS

As the result of our audit work, we identified matters that resulted in audit adjustments that we believe either individually or in the aggregate with others have had a significant effect on PUC's financial reporting process. Such adjustments, listed in Appendix A to Attachment II, have been recorded in the accounting records and are reflected in the 2010 financial statements.

In addition, attached to Attachment II as Appendices B and C, summaries of uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest and prior period presented that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

SIGNIFICANT ACCOUNTING POLICIES

PUC's significant accounting policies are set forth in Note 1 to PUC's 2010 financial statements. During the year ended September 30, 2010, there were no significant changes in previously adopted accounting policies or their application. New accounting policies adopted during the year ended September 30, 2010 are also set forth in Note 1 to PUC's 2010 financial statements.

OTHER INFORMATION IN THE ANNUAL REPORTS

When audited financial statements are included in documents containing other information, such as Annual Reports, we will read such other information and consider whether it, or the manner of its presentation, is materially inconsistent with the information, or the manner of its presentation, in the financial statements audited by us. In the event that PUC issues an Annual Report or other documentation that includes the audited financial statements, we will be required to read the other information in PUC's 2010 Annual Report and will inquire as to the methods of measurement and presentation of such information. If we note a material inconsistency or if we obtain any knowledge of a material misstatement of fact in the other information, we will discuss this matter with management and, if appropriate, with the Board of Directors.

DISAGREEMENTS WITH MANAGEMENT

We have not had any disagreements with management related to matters that are material to PUC's 2010 financial statements.

CONSULTATION WITH OTHER ACCOUNTANTS

We are not aware of any consultations that management may have had with other accountants about auditing and accounting matters during 2010.

MANAGEMENT'S REPRESENTATIONS

We have made specific inquiries of PUC's management about the representations embodied in the financial statements. Additionally, we have requested that management provide to us the written representations PUC is required to provide to its independent auditors under generally accepted auditing standards. We have attached to this letter, as Attachment II, a copy of the representation letter we obtained from management.

MAJOR ISSUES DISCUSSED WITH MANAGEMENT PRIOR TO OUR RETENTION

Throughout the year, routine discussions were held or were the subject of correspondence with management regarding the application of accounting principles or auditing in connection with transactions that have occurred, transactions that are contemplated, or reassessment of current circumstances. In our judgment, such discussions or correspondence were not held in connection with our retention as auditors.

SIGNIFICANT DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

In our judgment, we received the full cooperation of PUC's management and staff and had unrestricted access to PUC's senior management in the performance of our audit.

CONTROL-RELATED MATTERS

We have issued a separate report to you, dated April 11, 2011, on PUC's internal control over financial reporting and on its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters, which was based upon the audit performed in accordance with *Government Auditing Standards*. Within that report, we noted a certain matter that was considered to be a material weakness under standards established by the American Institute of Certified Public Accountants. Although we have included management's written response to our comment contained in the report, such response has not been subjected to the auditing procedures applied in our audit of the basic financial statements and, accordingly, we do not express an opinion or provide any form of assurance on the appropriateness of the response or the effectiveness of any corrective actions described therein.

We have identified, and included in the attached Attachment I, certain control deficiencies related to PUC's internal control over financial reporting and also other matters as of September 30, 2010 that we wish to bring to your attention.

The definition of a control deficiency is also set forth in Attachment I.

* * * * *

This report is intended solely for the information and use of the Board of Directors, management, others within PUC and the Office of the Public Auditor and is not intended to be and should not be used by anyone other than these specified parties.

We wish to thank the staff and management of PUC for their cooperation and assistance during the course of this engagement.

Very truly yours,

Deloitte & Touche LLP

SECTION I – CONTROL DEFICIENCIES

We identified, and have included below, control deficiencies involving PUC's internal control over financial reporting as of September 30, 2010 that we wish to bring to your attention:

1. Report Signoff

Condition: The bank reconciliation for June 2010, the aged payable report for March 2010 and the payroll posting audit report for the pay period ended November 7th 2010 were not signed by a preparer and a reviewer.

Recommendation: To establish accountability, preparers and reviewers should sign monthly bank reconciliations.

2. Missing Documents

Condition: PUC could not provide the request form completed by new customer for the new hook-up service. Also, PUC could not provide the read report on October 31, 2009 for route 46.

Recommendation: PUC should improve filing and retrieving procedures to ensure that supporting documents are retrievable.

3. Input Error of Re-read Meter Reading

Condition: Per the re-read report dated 10/21/09, the meter reading of account no. 220184000 is 474500 in the current period. Per Utility Star, the current period meter read of this account is 462500. Per the billing supervisor, this represents an input error.

Recommendation: Meter reading input to Utility Star should be reviewed for accuracy.

4. Input Error of Fuel Cost

Condition: PUC over-charged 0.050 of fuel cost per KWh in October 09. To resolve the issue, the billing supervisor under-charged 0.050 of fuel cost per KWh in November 09.

Recommendation: The fuel cost per KWh input to Utility Star should be reviewed.

5. Unearned Cash Power

Condition: The cash power sales by account summary report for the year ended September 30, 2010, which was the basis for the estimation of unearned cash power revenue at year-end, reflected total cash power KWh sales of approximately 17.8 million while total recorded sales based on the Peak and Loss Report approximated 17.4 million. The difference of approximately 400,000 KWh may be due to timing errors, adjustments, or theft of service. From the selection of 3 accounts from the sales report, we noted 1 account with a difference in KWh of 551.50 (total reported in the summary report was 28,881.70 and the total reported in the Suprema system is 29,433.20).

Recommendation: PUC should review the cash power sales report and consider selecting a sample of customers on a regular basis and compare the consumption reported therein with activities recorded in the Suprema system.

ATTACHMENT I, CONTINUED

6. Cash Power Adjustments

Condition: During the year, various fees and charges were directly recorded through cashpower arrears customer accounts (subledger), but were not recorded in the general ledger (GL). At the end of the year, a reconciling adjustment was made to correct the GL balances against the SL. This adjustment resulted in additional recorded revenues of approximately \$190K (mainly relating to cashpower revenues).

Recommendation: Fees and charges that are recorded directly to cashpower arrears accounts should be accumulated and journalized each month. Additionally, reconciliations between the Accounts Receivable SL and GL should be performed and resulting adjustments should be recorded monthly.

7. Disputed Invoices

Condition: During the audit process, a vendor confirmed additional amounts due from PUC of approximately \$131,000 which were not recorded by PUC. The amount mainly comprises various invoices in fiscal years 2006 to 2008, incurred for a capital project completed in 2007. PUC has not adjusted its records to reflect these disputed invoices pending further reconciliation with the vendor.

Recommendation: PUC should perform detail reconciliation with the vendor to establish the actual liability.

8. Analysis of Allowance for Doubtful Accounts

Condition: PUC does not perform a comprehensive analysis of the allowance for doubtful accounts. During the audit, we proposed to increase the allowance for doubtful accounts by \$370,000, of which \$300,000 was recorded in PUC's financial statements. Additionally, PUC does not enforce a disconnection policy for water accounts.

Prior Year Status: This condition is reiterative of conditions identified in our prior year audit of PUC.

Recommendation: PUC should perform a periodic review of the collectability of its receivables to determine an appropriate allowance. PUC should consider implementing a disconnect policy for past due water accounts.

SECTION II – OTHER MATTERS

Our observations concerning other matters related to operations and best practices involving internal control over financial reporting that we wish to bring to your attention are as follows:

1. Bank Reconciling Items

Condition: The September 2010 savings account reconciliation contains two credit card sales (\$2,199 and \$3,600) outstanding since September 2009 or prior. Management indicated that oral discussions had been held with bank personnel at various times; however, the informal follow-ups have not been documented. Additionally, the September 2010 checking account reconciliation contains some \$3,000 of carried over items identified as "bank errors" which may no longer be recoverable.

Prior Year Status: This condition is reiterative of conditions identified in our prior year audit of PUC.

Recommendation: An appropriate level of PUC management should perform follow-up with the bank in writing.

SECTION II – OTHER MATTERS, CONTINUED

2. Additional Allocated Loans from FSMNG

Condition: In 2010, PUC recorded an adjustment to increase its share of the Asian Development Bank loan through the FSM National Government in the amount of \$341,092, which represents cost sharing of consulting fees relating to a utility project closed in FY2004. PUC's in-house legal counsel noted that although PUC is apparently bound by the agreement, it should take certain actions to ascertain that these allocated charges are valid, paid for, and represent PUC's allocated share.

Recommendation: PUC should obtain detail documents to support this additional indebtedness as recommended by counsel.

3. Production Line Losses

Condition: For the year ended September 30, 2010, production and line losses remained significantly above industry standards at 2.3 million kWh and 6.0 million kWh, (or 5.1% and 15.0% of total production), respectively. Losses may be caused by equipment problems, inefficiencies at generation plants or in transmission and distribution, or by theft of service. Production and line losses for the year ended September 30, 2009 approximated 5.1% and 18.6%, respectively.

Prior Year Status: This condition is reiterative of conditions identified in our prior year audit of PUC.

Recommendation: PUC should determine the cause(s) of the production and line losses and take steps to reduce losses to a more acceptable level. This was also brought to management's attention in our previous management letter.

4. Long Outstanding Receivables from Employees

Condition: At September 30, 2010, \$89,737 of \$96,559 of accounts receivable – others are deemed uncollectible. These receivables are mainly from employees, former employees or former board members which have been outstanding for several years. These receivables have been fully provided for.

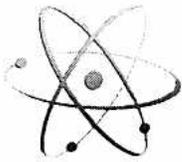
Prior Year Status: This condition is reiterative of conditions identified in our prior year audit of PUC.

Recommendation: Though fully provided with an allowance, management should strengthen its collection efforts to ensure that advances to employees are timely collected.

SECTION II – DEFINITION

The definition of a control deficiency that is established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, is as follows:

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 deficiency in *design* exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective is not always met. A deficiency in *operation* exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

**POHNPEI UTILITIES CORPORATION****“Dedicated to improving the Quality of Life on Pohnpei”**

April 11, 2011

**BOARD OF
DIRECTORS**Deloitte & Touche
P.O. Box 753
Kolonias, Pohnpei 96941*Johnny Hebel*
*Chairman**Francisco Mendiola*
*Vice Chairman**Anna Mendiola*
*Secretary**William Kostka*
*Director**Lucille Overhoff*
*Director**Wilbur Walter*
*Director**Heinrick Stevenson*
*Director**Feliciano M. Perman*
General Manager/CEO

We are providing this letter in connection with your audits of the financial statements of Pohnpei Utilities Corporation (PUC) as of September 30, 2010 and 2009 and for the years then ended, for the purpose of expressing an opinion as to whether the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of PUC in conformity with accounting principles generally accepted in the United States of America (GAAP). We confirm that we are responsible for the following:

- a. The fair presentation in the financial statements of PUC's net assets, related statements of revenues, expenses and change in net assets, and cash flows, in conformity with accounting principles generally accepted in the United States of America (GAAP).
- b. The fair presentation of the required supplementary information, including the Management's Discussion and Analysis, and the supplemental schedules accompanying the financial statements that are presented for the purpose of additional analysis of the financial statements.
- c. The design and implementation of programs and controls to prevent and detect fraud, including fraud related to federal awards.
- d. Establishing and maintaining effective internal control over financial reporting.
- e. Compliance with local and federal laws, rules and regulations, including compliance with the requirements of grants and contracts relating to PUC's operations. We are responsible for establishing and maintaining the components of internal control relating to our activities in order to achieve the objectives of providing reliable financial reports, effective and efficient operations, and compliance with laws and regulations.
- f. The review and approval of the financial statements, accompanying schedules and related notes and acknowledge your role in the preparation of this information. Specifically, we acknowledge that your role in the preparation of the financial statements was a matter of convenience rather than one of necessity. We have reviewed the financial statement preparation assistance provided by you and acknowledge that the financial statements are prepared in accordance with GAAP. Our review was based on the use of the stand-alone business-type activities checklist by the Government Finance Officers Association. Additionally, we agreed with the adjusting and reclassification entries included in Appendix A.

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Federated States of Micronesia 96941

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ATTACHMENT II, CONTINUED

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following representations made to you during your audits.

1. The financial statements referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America. In addition:
 - a. Net asset components (invested in capital assets, net of related debt; restricted; and unrestricted) are properly classified and, if applicable, approved.
 - b. Capital assets, including infrastructure assets, are properly capitalized, reported, and, if applicable, depreciated
 - c. Required supplementary information is measured and presented within prescribed guidelines.
 - d. Costs to federal awards have been charged in accordance with applicable cost principles.
 - e. Required supplementary information is measured and presented within prescribed guidelines.
2. PUC has made available to you all:
 - a. Financial records and related data for all financial transactions of the Corporation. The records, books, and accounts, as provided to you, record the financial and fiscal operations of PUC and provide the audit trail to be used in a review of accountability. Information presented in financial reports is supported by the books and records from which the financial statements have been prepared.
 - b. Minutes of the meetings of the Board of Directors or summaries of actions of recent meetings for which minutes have not yet been prepared.
3. There has been no:
 - a. Action taken by PUC's management that contravenes the provisions of federal and local laws and regulations, or of contracts and grants applicable to PUC.
 - b. Communication from other regulatory agencies concerning noncompliance with or deficiencies in financial reporting practices or other matters that could have a material effect on the financial statements.
4. We believe the effects of any uncorrected financial statement misstatements aggregated by you during the current audit engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. A summary of such uncorrected misstatements has been attached as Appendix B.
5. We believe the effects of the uncorrected financial statement misstatements detected in the current year that relate to the prior year presented, when combined with those

ATTACHMENT II, CONTINUED

misstatements aggregated by you during the prior-year audit engagement and pertaining to the prior year presented, are immaterial, both individually and in the aggregate, to the financial statements for September 30, 2009 taken as a whole. A summary of such uncorrected misstatements has been attached as Appendix C.

6. PUC has not performed a formal risk assessment, including the assessment of the risk that the financial statements may be materially misstated as a result of fraud. However, management has made available to you its understanding about the risks of fraud in PUC and does not believe that the financial statements are materially misstated as a result of fraud.
7. We have no knowledge of any fraud or suspected fraud affecting PUC involving
 - a. management
 - b. employees who have significant roles in internal control over financial reporting
 - c. others if the fraud could have a material effect on the financial statements.
8. We have no knowledge of any allegations of fraud or suspected fraud affecting PUC received in communications from employees, former employees, analysts, regulators, or others.
9. 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. This condition has been disclosed in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification (ASC) Topic No. 450 *Contingencies*.
10. We are responsible for compliance with local and state laws, rules and regulations, including compliance with the provisions of grants and contracts relating to PUC's operations. We are responsible for establishing and maintaining the components of internal control relating to our activities in order to achieve the objectives of providing reliable financial reports, effective and efficient operations, and compliance with laws and regulations. PUC is responsible for maintaining accounting and administrative control over revenues, obligations, expenditures, assets, and liabilities.
11. There are no reportable conditions, including significant deficiencies and material weaknesses, in the design or operation of internal control that could adversely affect PUC's ability to initiate, record, process, and report financial information.
12. Management has identified and disclosed to you all laws and regulations that have a direct and material effect on the determination of financial statement amounts.

Except where otherwise stated below, matters less than \$46,000 collectively are not considered to be exceptions that require disclosure for the purpose of the following representations. This amount is not necessarily indicative of amounts that would require adjustment to or disclosure in the financial statements.

13. There are no transactions that have been improperly recorded in the accounting records

ATTACHMENT II, CONTINUED

underlying the financial statements except for those listed in Appendices B and C.

14. PUC has no plans or intentions that may affect the carrying value or classification of assets and liabilities.
15. The following, to the extent applicable, have been appropriately identified and properly recorded and disclosed in the financial statements:
 - a. Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances and line-of-credit or similar arrangements.
 - b. Related-party transactions and associated amounts receivable or payable, including sales, purchases, loans, transfers, leasing arrangements, and guarantees (written or oral).
16. In preparing the financial statements in conformity with accounting principles generally accepted in the United States of America, management uses estimates. All estimates have been disclosed in the financial statements for which known information available prior to the issuance of the financial statements indicates that both of the following criteria are met:
 - a. It is at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events.
 - b. The effect of the change would be material to the financial statements.

We are not aware of any estimates at September 30, 2010 that may change and that the effect of the change would be material to the financial statements.
17. There are no:
 - a. Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.
 - b. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB ASC Topic No. 450, *Contingencies* other than that disclosed in the financial statements.
18. PUC has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral, except as disclosed in the financial statements.
19. PUC has complied with all aspects of contractual agreements that would have an effect on the financial statements in the event of noncompliance.
20. No events have occurred subsequent to September 30, 2010 to the dates of our signatures below that require consideration as adjustments to or disclosures in the financial statements.
21. We have disclosed to you that no change in PUC's internal control over financial reporting has occurred during PUC's most recent fiscal year that has materially affected,

ATTACHMENT II, CONTINUED

or is reasonably likely to materially affect, PUC's internal control over financial reporting.

22. No corporation or agency of the Federal Government, the Pohnpei State Government, or the FSM National Government has reported a material instance of noncompliance to us.
23. Provisions have been made to reduce accounts receivable to their estimated net realizable value.
24. PUC is responsible for determining and maintaining the adequacy of the allowance for doubtful accounts receivable, as well as estimates used to determine such amounts. Management believes the allowances are adequate to absorb currently estimated bad debts in the account balances.
25. We have identified to you all awards provided by federal agencies in the form of grants, contracts, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, or direct appropriations.
26. Provision has been made, when applicable, for any loss to be sustained as a result of purchase commitments for inventory quantities in excess of normal requirements or at prices in excess of the prevailing market prices.
27. PUC has established a self insurance fund in accordance with Pohnpei State Law to defray costs of any unforeseen accidents or disasters. PUC is substantially self-insured for all other risks. We are of the opinion that no material losses have been sustained as a result of this practice.
28. PUC is a party to several legal proceedings, the ultimate impact of which is not currently predictable. Management is of the opinion that the ultimate impact of these proceedings, though not predictable, will not be material and accordingly, no liability for such proceedings has been recorded in the financial statements.
29. PUC has obligated, expended, received, and used public funds of PUC in accordance with the purpose for which such funds have been appropriated or otherwise authorized by federal law. Such obligation, expenditure, receipt, or use of public funds was in accordance with any limitations, conditions, or mandatory directions imposed by federal law.
30. Money or similar assets handled by PUC on behalf of the Federal Government have been properly and legally administered and the accounting and recordkeeping related thereto is proper, accurate, and in accordance with law.
31. No evidence of fraud or dishonesty in fiscal operations of programs administered by PUC has been discovered.
32. During fiscal year 2010, PUC implemented the following pronouncements
 - GASB 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.
 - GASB 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

ATTACHMENT II, CONTINUED

governments to manage specific risks or make investments - in their financial statements.

- GASB 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.
- GASB Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*, which provides guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code, and establishes requirements for recognizing and measuring the effects of the bankruptcy process on assets and liabilities, and for classifying changes in those items and related costs.

The implementation of these pronouncements did not have a material effect on PUC's financial statements.

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 has not evaluated the effect that the implementation of this statement will have on the financial statements of the PUC.

In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to measurement of OPEB obligations by certain employers participating in agent multiple-employer OPEB plans. The provisions of Statement 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the PUC.

In June 2010, GASB issued Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. The provisions of this statement are effective for periods beginning after June 15, 2010. Management has not evaluated the effect that the implementation of this statement will have on the financial statements of the PUC.

33. 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.
34. The Corporation has not received written communication from its lenders regarding any loan covenant noncompliance and believes that the non-compliance with certain covenants associated with its loan with the Bank of the FSM will have no effect on the

financial statements.

35. PUC is responsible for establishing a provision to reduce excess or obsolete inventories to their estimated net realizable value. Management is of the opinion that no material provision is necessary to reduce inventories to their net realizable value at September 30, 2010.



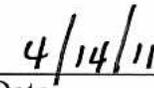
Feliciano M. Perman
General Manager



Date



Johnny Adolph
Acting Comptroller



Date

ATTACHMENT II, CONTINUED

POHNPEI UTILITIES CORPORATION
APPENDIX A - POSTED ADJUSTMENTS AND FINANCIAL STATEMENT RECLASSIFICATION ENTRIES
SEPTEMBER 30, 2010

#	Name	Debit	Credit
1 CJE To adjust unearned cash power			
235-00-00	CUSTOMER DEPOSITS	-	46,563.00
447-00-00	CASH POWER SALES	46,563.00	-
		46,563.00	46,563.00
	To adjust unearned cash power based on updated analysis.		
1 AJE To reconcile beginning net asset			
215-00-00	APPROPRIATED RETAINED EARNINGS	346.00	-
Blank (4687)	Miscellaneous - GL off	-	346.00
		346.00	346.00
	To reconcile beginning net assets to prior year audited FS.		
2 AJE To adjust AR - PUC internal accts			
142-01-01	A/R - RESIDENTIAL /WATER	-	7,525.00
142-02-00	A/R - COMMERCIAL & INDUSTRIAL	-	10,331.00
442-00-00	COMMERCIAL & INDUSTRIAL SALES	10,331.00	-
442-00-01	COMERCIAL SALES/WATER	7,525.00	-
		17,856.00	17,856.00
	To reverse additional PUC internal AR balances.		
3 AJE To reverse double recording of PPE 9/11/10			
242-01-00	ACCRUED WAGES & SALARIES	70,439.76	-
546-01-03	SAL & WAGES - STANDARD	-	15,042.41
580-01-05	SAL & WAGES - STANDARD	-	15,418.88
601-01-09	SAL & WAGES-STANDARD/WATER	-	20,333.43
920-01-07	SAL & WAGES - STANDARD	-	14,940.20
926-02-07	EE BENEFITS-GROUP HEALTH	-	2,442.21
926-04-07	EE BENEFITS-SOCIAL SECURITY	-	2,262.63
		70,439.76	70,439.76
	To reverse double recording of PPE 9/11/10 payroll.		
4 AJE To reverse incorrect inventory write off			
154-02-00	PARTS INVENTORY - GENERATION	6,441.43	-
154-03-00	PARTS INVENTORY-DISTRIBUTION	3,512.50	-
154-04-00	PARTS INVENTORY - WATER/SEWER	1,752.41	-
554-17-03	REPAIRS & MAINT. - PARTS	-	6,441.43
594-17-05	REPAIRS & MAINT. - PARTS	-	3,512.50
617-02-09	MAINTENANCE-PARTS/WATER	-	1,752.41
		11,706.34	11,706.34
	To reverse items incorrectly identified as obsolete inventory items.		

ATTACHMENT II, CONTINUED

APPENDIX A - POSTED ADJUSTMENTS AND FINANCIAL STATEMENT RECLASSIFICATION ENTRIES SEPTEMBER 30, 2010

#	Name	Debit	Credit
5 AJE To expense inactive WIPs			
107-05-06	W I P SEWER PH.2&3 (OMIP)	-	65.00
107-05-09	W I P - POHNITA PUMP PROJECT	-	42.00
107-05-21	W I P W/S OMIP YR2 SEWER IMPR.	-	241.00
107-10-00	W I P OMIP WATER/SEWER	-	3,213.00
554-17-03	REPAIRS & MAINT. - PARTS	13,472.00	-
107-05-13	W I P WATER/SEWER HOOK UP	-	1,242.00
107-05-22	W I P W/S OMIP YR2 TRAINING	-	28.00
107-04-10	W I P PRELIM. PINGELAP SOLAR	-	4,215.00
107-05-15	W I P DO NOT USE	75.00	-
107-03-01	W I P HOOK UP ELECTRICAL	-	4,501.00
		<u>13,547.00</u>	<u>13,547.00</u>

To clear out inactive WIPs no longer valid.

6 AJE To reverse Mitsu invoice #383			
232-00-00	ACCOUNTS PAYABLE	22,220.00	-
554-17-03	REPAIRS & MAINT. - PARTS	-	22,220.00
		<u>22,220.00</u>	<u>22,220.00</u>

To reverse Mitsui invoice #JA110383 (which was reversed in Oct 2010 by PUC).

7 AJE To adjust AR allowance			
144-00-01	ACCUM PROV-UNCOLLECT-WATER	-	300,000.00
904-00-06	UNCOLLECTIBLE ACCOUNTS	300,000.00	-
		<u>300,000.00</u>	<u>300,000.00</u>

To increase AR allowance based on updated analysis.

8 AJE To adjust CWIP			
101-03-00	DISTRIBUTION PLANT	726.40	-
107-09-00	W I P OMIP GRANTS POWER	-	39,804.25
554-17-03	REPAIRS & MAINT. - PARTS	9,663.92	-
594-17-05	REPAIRS & MAINT. - PARTS	9,837.73	-
903-00-06	CUST RECORDS & COLLECTION EXP.	14,492.47	-
921-15-07	MISC. - OTHER	5,083.73	-
		<u>39,804.25</u>	<u>39,804.25</u>

To adjust CWIP account.

9 AJE To capitalize Engine#8 repair			
101-01-00	PRODUCTION PLANT	582,833.18	-
554-17-03	REPAIRS & MAINT. - PARTS	-	582,833.18
		<u>582,833.18</u>	<u>582,833.18</u>

To capitalize total costs incurred for Engine#8 major repair (including \$137,972 net expense incurred in FY2009).

ATTACHMENT II, CONTINUED

APPENDIX A - POSTED ADJUSTMENTS AND FINANCIAL STATEMENT RECLASSIFICATION ENTRIES SEPTEMBER 30, 2010

#	Name	Debit	Credit
10 AJE To adjust FSMPC AP			
232-00-00	ACCOUNTS PAYABLE	-	34,003.20
547-01-03	POL - FUEL	34,003.20	-
		<u>34,003.20</u>	<u>34,003.20</u>
	To adjust AP to FSMPC on the 2 unrecorded June 2010 invoices.		
11 AJE To adjust ADB loan			
101-01-01	WATER PRODUCTION PLANT	341,092.12	-
108-00-01	ACCUM. DEPRECIATION - WAT/SEW	-	51,163.92
403-01-01	DEPRE - WATER PRODUCTION	51,163.92	-
224-01-01	ASIAN DEV. BANK LOAN	-	341,092.12
		<u>392,256.04</u>	<u>392,256.04</u>
	To increase ADB loan to pick up FMGNG allocated consulting fees relating to the 2004 project, to capitalize this cost to the ADB water project as original project costs, and to depreciate through 2010.		
1 RJE To reclassify due to affiliates			
232-00-00	ACCOUNTS PAYABLE	66,136.00	-
Blank (4719)	ACCOUNTS PAYABLE - AFFILIATES	-	66,136.00
		<u>66,136.00</u>	<u>66,136.00</u>
	To reclassify balances due to PSG and PUC Social Club as AP affiliates for FS presentation purposes.		
2 RJE To reclassify LTD			
224-01-01	ASIAN DEV. BANK LOAN	47,938.00	-
231-01-00	Notes Payable - current portion	-	225,884.00
224-01-00	RUS LOAN	7,128.00	-
224-00-00	OTHER LONG-TERM DEBT	170,818.00	-
		<u>225,884.00</u>	<u>225,884.00</u>
3 RJE To reclassify unreleased checks			
130-02-00	CASH AT BANK - BANK OF FSM	110,395.00	-
Blank (4719)	ACCOUNTS PAYABLE - AFFILIATES	-	91,857.00
Audit	Liability - unreleased checks	-	18,538.00
		<u>110,395.00</u>	<u>110,395.00</u>
	To reclassified unreleased checks (AP affilaite to PUC social club) and others.		

ATTACHMENT II, CONTINUED

**POHNPEI UTILITIES CORPORATION
APPENDIX B - PASSED ADJUSTMENTS
SEPTEMBER 30, 2010**

	Assets	Liabilities	Retained Earnings Beg of Year	Income Statement
	Dr (Cr)	Dr (Cr)	Dr (Cr)	Dr (Cr)
Current Year Known Misstatements				
(Dr) Cash (Cr) Liability <i>To reclassify stale checks to a liability account.</i>	7,211	(7,211)		
(Dr) Cash (Cr) Liability <i>To reclassify stale checks to a liability account.</i>	27,938	(27,938)		
(Dr) Cash (Cr) Expenditure <i>To void a unreleased check</i>	8,500			(8,500)
(Dr) Inventory in transit (Cr) Accounts Payable <i>To accrue liability for material/supplies FOB origin from ADR</i>	36,175	(36,175)		
Total Known Misstatements	79,824	(71,324)	0	(8,500)
Current Year Likely Misstatements				
(Dr) Bad debt expense (Cr) AR Allowance <i>To increase AR allowance after recording provision of \$300,000</i>	(77,000)			77,000
(Dr) Expenses (Cr) AP - Adams <i>To adjust for unrecorded invoices</i>		(131,487)		131,487
(Dr) LTD (Cr) Expenses <i>To adjust final difference in ADB loans</i>		25,093		(25,093)
Total Likely Misstatements	(77,000)	(106,394)	0	183,394
TOTAL	2,824	(177,718)	0	174,894

ATTACHMENT II, CONTINUED

POHNPEI UTILITIES CORPORATION
 APPENDIX C - PRIOR YEAR MISSTATEMENT
 SEPTEMBER 30, 2010

	Assets	Liabilities	Retained Earnings Beg of Year	Income Statement
	Dr (Cr)	Dr (Cr)	Dr (Cr)	Dr (Cr)
Prior Year Known Misstatements				
(Dr) CWIP (Cr) R&M Expense <i>To adjust R&M parts expense in FY09 for Engine #8</i>	137,972			(137,972)
(Dr) Expense (Cr) AP - Adam's <i>To adjust for unrecorded invoices (through FY2009)</i>		(131,417)		131,417
TOTAL	137,972	(131,417)	0	(6,555)

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