

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

FINANCIAL STATEMENTS AND
ADDITIONAL INFORMATION AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2013 AND 2012

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

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Years Ended September 30, 2013 and 2012

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INDEPENDENT AUDITORS' REPORT

The Board of Directors
Pohnpei Utilities Corporation:

Report on the Financial Statements

We have audited the accompanying statements of net position of the Pohnpei Utilities Corporation (PUC), a component unit of the State of Pohnpei, which comprise the statements of net position as of September 30, 2013 and 2012, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 to 5 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise PUC's basic financial statements. The supplemental combining schedules on pages 23 to 25 are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The supplemental combining schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplemental combining schedules are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 20, 2014 on our consideration of PUC's internal control over financial reporting and on 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering PUC's internal control over financial reporting and compliance.

Deloitte & Touche LLP

June 20, 2014

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

Management's Discussion and Analysis
Years Ended September 30, 2013 and 2012

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, 2013 and 2012. 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.

With two units decommissioned in the last two years, PUC now has an installed generation capacity of 11.4 MW (10.67 MW from diesel engines and .725 MW from Nanpil Hydro power station) and with the aging condition of the units, the generation capacity is de-rated down to 6.8 MW while the power demand is 6.3MW in 2013 and 2012. PUC generated 34,286 MWh and 36,111 MWh and sold 28,130 and 28,418 MWh to customers in 2013 and 2012, respectively. This resulted in total power revenue of \$14.8 million and \$14.2 million to PUC in 2013 and 2012, respectively. Although, the number of kilowatt hours sold slightly decreased from 2012, sales revenue in 2013 still increased and this is mainly the result of a slightly higher fuel tariff as well as the .04 cents adjustment on the base tariff which took effect for the whole year in 2013 compared to only five months in fiscal year (FY) 2012. The number of households being serviced by the PUC is 6,543 (6,340 using cash power meters and 203 using conventional meters) in 2013 and 6,684 in 2012. The service coverage is about 96% of the 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 1.6 million gallons per day. PUC produced 803 million and 758 million gallons and sold 615 million and 607 million gallons to customers in 2013 and 2012, respectively, which resulted in total revenue to PUC of \$1.45 million and \$1.22 million, respectively. PUC services 3,540 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 years ended September 30, 2013, 2012 and 2011:

Assets:	<u>2013</u>	<u>2012</u>	<u>2011</u>
Utility plant, net	\$ 31,885,861	\$ 25,515,984	\$ 25,575,338
Current assets	3,673,516	3,333,433	3,679,558
Other non-current assets	<u>1,072,298</u>	<u>1,072,028</u>	<u>878,185</u>
	<u>\$ 36,631,675</u>	<u>\$ 29,921,445</u>	<u>\$ 30,133,081</u>
 Liabilities and Net Position:			
Notes payable	\$ 390,000	\$ 390,000	\$ 390,000
Current portion of long-term debt	376,519	850,835	217,015
Other current liabilities	2,042,594	1,487,644	1,366,505
Long-term debt, net of current portion	<u>10,001,159</u>	<u>8,601,488</u>	<u>8,417,394</u>
Total Liabilities	<u>12,810,272</u>	<u>11,329,967</u>	<u>10,390,914</u>

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Management's Discussion and Analysis
Years Ended September 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Net Position:			
Invested in capital assets, net of related debt	22,550,807	16,643,452	17,401,879
Restricted	721,325	721,325	528,685
Unrestricted	<u>549,271</u>	<u>1,226,701</u>	<u>1,811,603</u>
Total net position	<u>23,821,403</u>	<u>18,591,478</u>	<u>19,742,167</u>
	<u>\$ 36,631,675</u>	<u>\$ 29,921,445</u>	<u>\$ 30,133,081</u>
Revenues, Expenses and Changes in Net Position:			
Operating revenues	\$ 16,317,381	\$ 15,513,817	\$ 14,002,210
Bad debt expense	(234,520)	(732,513)	-
Operating expenses	<u>(17,654,086)</u>	<u>(16,672,725)</u>	<u>(16,211,625)</u>
Net operating loss	(1,571,225)	(1,891,421)	(2,209,415)
Non-operating revenues, net	<u>222,521</u>	<u>114,561</u>	<u>323,092</u>
Net loss before capital contributions	(1,348,704)	(1,776,860)	(1,886,323)
Capital contributions	<u>6,578,629</u>	<u>626,171</u>	<u>-</u>
Increase (decrease) in net position	5,229,925	(1,150,689)	(1,886,323)
Net position at beginning of year	<u>18,591,478</u>	<u>19,742,167</u>	<u>21,628,490</u>
Net position at end of year	<u>\$ 23,821,403</u>	<u>\$ 18,591,478</u>	<u>\$ 19,742,167</u>

Overall changes in the statements of net position components from September 30, 2012 to 2013 include an increase in utility plant of \$6,369,877, an increase in current assets of \$340,083 and an increase in current and long term liabilities of \$1,480,305.

Increase in utility plant is the net of capital acquisitions, asset disposition, depreciation, and construction work in process (ADB Sewer system rehabilitation loan and power generation project). Please see note 6 to the financial statements for additional information on PUC's utility plant.

Increase in current assets is attributable to increases in accounts receivable and materials inventory realized from engine parts salvaged from the decommissioning of Daihatsu Unit #7.

Increase in current liability is attributable to the impact of the tariff adjustment which put PUC in a better financial position to acquire desperately needed materials and consumable items for day to day operations. Increase in long term debt is mainly the result of the on-going Asian Development Bank loan funded project to rehabilitate the sewer system. Please see note 7 to the financial statements for additional information on PUC's debts.

The increase in operating revenues before bad debts is mainly due to a slight increase in average fuel tariff during the year plus the electricity base rate adjustment that was implemented for the whole year compared to the five months it took effect in FY 2012.

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Management's Discussion and Analysis
Years Ended September 30, 2013 and 2012

The increase in operating expenses is mainly the result of increased depreciation expense and other critical operational expenses needed for the daily upkeep of the system that was not manageable prior to the adjustment of the base tariff. Ex. Tree trimming project to clear vegetation from power distribution lines.

PUC incurred a loss (before capital contributions) of \$1,348,704, which is an improvement of \$428,156 from 2012. After capital contributions, PUC's net position improved by \$5.2 million made possible by the grant from the government of Japan for the solar system and Caroline Fisheries Corporation's (CFC) contributions for the acquisition of NPP4 (Two used Caterpillar generators).

Management's Discussion and Analysis for the year ended September 30, 2013 is set forth in PUC's report on the audit of financial statements, which is dated June 5, 2013. That Discussion and Analysis explains the major factors impacting the 2012 financial statements and can be viewed at the Office of the Public Auditor's website at www.fsmopa.fm.

For additional information about this report, please contact Marcelino Actouka, General Manager, P.O. Box C, Kolonia, Pohnpei.

Economic Outlook

The economic outlook for PUC in 2014 is projected to be slightly better than 2013. Fuel which comprises of 65% of PUC's total expenditures and 71% of the expenditures in the division of power, stayed constant in 2013 and there are no known indications of significant fluctuations in this area for PUC. With no major changes anticipated in the economy in 2014 that will affect the need for electricity and water, PUC does not expect significant differences in demand for the services it provides to its customers. In the electricity division, with the introduction of IPP in Pohnpei, customers realized noticeable differences in the reliability of power generation for the first half of 2014 and should only expect more improvements later in the year when all of the aging generators will be replaced by new units expected to come online in late FY 2014. PUC is also expecting to commission the Nanpil Hydro Plant in late June 2014. With new and more efficient generators, PUC will operate without the compressed demand that plagued the corporation caused by the unreliability of PUC's aging generators. With a reliable source of power, PUC anticipates an increase in its sale of electricity which will result from customers' electricity consumption patterns returning to normal. PUC is also expected to issue an RFP later in 2014 for the construction of solar farm to be operated under IPP/PPA arrangements. It is PUC's vision that, with enough production from renewable sources of energy, the tariff will drop off to a level that will be favorable for the current customer base and future customers to use more electricity as opposed to current conservation efforts that are adversely impacting PUC's non-fuel revenue.

This concludes the management discussion and analysis of the financial statements for the year ended September 30, 2013.

POHNPEI UTILITIES CORPORATION
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Statements of Net Position
September 30, 2013 and 2012

<u>ASSETS</u>	<u>2013</u>	<u>2012</u>
Current assets:		
Cash and cash equivalents	\$ 411,374	\$ 452,169
Investments	174,124	174,257
Time certificates of deposit	43,251	41,951
Accounts receivable, net	1,528,419	1,331,304
Prepayments	102,961	80,121
Materials and fuel inventory	1,413,387	1,253,631
Total current assets	<u>3,673,516</u>	<u>3,333,433</u>
Other noncurrent assets:		
Long-term deposit	576,213	576,213
Restricted - cash and cash equivalents	496,085	495,815
Total other noncurrent assets	<u>1,072,298</u>	<u>1,072,028</u>
Utility plant, at cost:		
Electric plant in service	40,273,615	36,437,645
Water and sewer plant in service	20,387,315	20,134,811
	<u>60,660,930</u>	<u>56,572,456</u>
Less accumulated depreciation	<u>(36,431,796)</u>	<u>(36,375,355)</u>
Depreciable assets	24,229,134	20,197,101
Construction work-in-process	7,656,727	5,318,883
Total utility plant	<u>31,885,861</u>	<u>25,515,984</u>
	<u>\$ 36,631,675</u>	<u>\$ 29,921,445</u>
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Notes payable	\$ 390,000	\$ 390,000
Current portion of long-term debt	376,519	850,835
Accounts payable:		
Operations	1,031,683	490,636
Fuel and lubricants	536,290	635,434
Unearned revenue	181,551	148,398
Accrued taxes and other liabilities	234,926	159,621
Employees' annual leave	58,144	53,555
Total current liabilities	<u>2,809,113</u>	<u>2,728,479</u>
Noncurrent liabilities:		
Long-term debt, net of current portion	<u>10,001,159</u>	<u>8,601,488</u>
Total liabilities	<u>12,810,272</u>	<u>11,329,967</u>
Commitments and contingencies		
Net position:		
Net investment in capital assets	22,550,807	16,643,452
Restricted	721,325	721,325
Unrestricted	549,271	1,226,701
Total net position	<u>23,821,403</u>	<u>18,591,478</u>
	<u>\$ 36,631,675</u>	<u>\$ 29,921,445</u>

See accompanying notes to financial statements.

POHNPEI UTILITIES CORPORATION
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Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2013 and 2012

	2013	2012
Operating revenues:		
Electricity sales	\$ 14,839,959	\$ 14,210,389
Water sales	1,450,370	1,221,151
Other sales	27,052	82,277
Total operating revenues before bad debts	16,317,381	15,513,817
Bad debts	(234,520)	(732,513)
Total operating revenues after bad debts	16,082,861	14,781,304
Operating and maintenance expenses:		
Production fuel	11,630,970	11,631,683
Depreciation	2,242,291	2,052,791
Administrative and general	1,229,434	1,049,009
Generation	905,654	736,434
Water and sewer	855,137	598,242
Distribution	790,600	604,566
Total operating and maintenance expenses	17,654,086	16,672,725
Operating loss	(1,571,225)	(1,891,421)
Nonoperating (expenses) revenues:		
Interest expense, net	(170,941)	(171,354)
Grants and subsidies	72,286	253,972
Gain on disposal of fixed assets	318,044	-
Other income	3,132	31,943
Total nonoperating revenues, net	222,521	114,561
Loss before capital contributions	(1,348,704)	(1,776,860)
Capital contributions:		
Grants from foreign government and others	6,578,629	626,171
Change in net position	5,229,925	(1,150,689)
Net position at beginning of year	18,591,478	19,742,167
Net position at end of year	\$ 23,821,403	\$ 18,591,478

See accompanying notes to financial statements.

POHNPEI UTILITIES CORPORATION
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Statements of Cash Flows
Years Ended September 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Cash received from customers	\$ 15,922,031	\$ 15,297,421
Cash payments to suppliers for goods and services	(13,213,041)	(12,462,694)
Cash paid to employees	(1,885,713)	(1,693,907)
Net cash provided by operating activities	823,277	1,140,820
Cash flows from investing activities:		
Interest and dividends on investments and bank account	1,467	61
Cash flows from noncapital financing activities:		
Advance from affiliate	325,813	-
Operating grants received	72,286	61,332
Interest paid	(11,820)	(28,027)
Net cash provided by noncapital financing activities	386,279	33,305
Cash flows from capital and related financing activities:		
Interest paid	(143,634)	(146,216)
Proceeds from long-term debt	-	187,315
Principal repayment of long-term debt	(673,293)	(211,679)
Acquisition of utility plant	(434,891)	(652,292)
Net cash used in capital and related financing activities	(1,251,818)	(822,872)
Net change in cash and cash equivalents	(40,795)	351,314
Cash and cash equivalents at beginning of year	452,169	100,855
Cash and cash equivalents at end of year	\$ 411,374	\$ 452,169
<u>Reconciliation of operating loss to net cash provided by operating activities:</u>		
Operating loss	\$ (1,571,225)	\$ (1,891,421)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation	2,242,291	2,052,791
Bad debts	234,520	732,513
Other income	3,132	31,943
Interest expense	(18,391)	-
Write off of plant and equipment	-	127,304
(Increase) decrease in assets:		
Accounts receivable	(431,635)	(215,906)
Prepayments	(22,840)	(8,699)
Materials and fuel inventory	158,288	191,156
Increase (decrease) in liabilities:		
Accounts payable	116,090	145,290
Unearned revenue	33,153	(32,433)
Accrued taxes and other liabilities	75,305	6,223
Employees' annual leave	4,589	2,059
Net cash provided by operating activities	\$ 823,277	\$ 1,140,820

See accompanying notes to financial statements.

POHNPEI UTILITIES CORPORATION
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Statements of Cash Flows, Continued
Years Ended September 30, 2013 and 2012

Supplemental information of noncash operating financing activities :

During the year ended September 30, 2012, PUC received a sub-grant of \$192,640 from the FSM National Government (FSMNG) through an increase in long-term deposit for its fuel purchase line.

Supplemental information of noncash capital and related financing activities :

During the years ended September 30, 2013 and 2012, PUC was allocated \$1,598,648 and \$842,278, respectively, relating to two projects funded by the Asian Development Bank master project funds through the FSMNG. As a result, PUC increased its capital assets and long-term debt each by the sum amounts.

During the year ended September 30, 2013, PUC decommissioned an generator. As a result, PUC decreased electric plant in service and accumulated depreciation by \$2,850,850 and a gain on disposal through salvaged materials inventory of \$311,802.

During the year ended September 30, 2013, PUC received electric plant asset of \$5,821,400 and construction work-in-progress of \$731,379 through capital contributions from the Japan Government and Caroline Fisheries Corporation, respectively.

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2013 and 2012

(1) Summary of Significant Accounting Policies

Organization: Pohnpei Utilities Corporation (PUC) is a component unit of the Government of the State of Pohnpei. PUC commenced operations on October 1, 1991, with assets and liabilities of the Division of Public Utilities of the Pohnpei State Department of Public Works transferred as of that date. PUC has adopted the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC). As of October 1, 1993, the assets, liabilities, and operations of the Division of Water and Sewer of the Pohnpei State Department of Public Works were also transferred to PUC as the result of Pohnpei State Law 3L-41-93.

Basis of Accounting: PUC utilizes the flow of economic resources measurement focus. Its financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units using the accrual basis of accounting. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended by GASB Statement No.'s 37 and 38, establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following three net position categories:

- Net investment in capital assets - capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets as well as deferred outflows of resources and deferred inflows of resources that are attributable to those assets or related debt.
- Restricted - restricted assets reduced by liabilities and deferred inflows of resources related to those assets that are subject to externally imposed stipulations.
- Unrestricted - the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

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.

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 or are restricted for use are separately classified on the statements of net position.

Investments: PUC values its investments based on fair values in accordance with GASB Statement No. 31. 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 and is primarily determined based on quoted market rates.

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

POHNPEI UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2013 and 2012

(1) Summary of Significant Accounting Policies, Continued

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.

Utility Plant: Utility plant assets were transferred to PUC at the carrying value of the Division of Public Utilities and Division of Water and Sewer of the Pohnpei State Department of Public Works as of October 1, 1991 and 1993, for the electric plant and water and sewer plants, respectively, except as to certain utility plant assets which are stated at estimated net book value in the absence of documents to support cost. The net book value of the electric plant assets transferred was \$17,191,311 as of October 1, 1991, and the net book value of the water and sewer plant assets transferred was \$6,708,112 as of October 1, 1993. PUC capitalizes plant acquisitions with original costs in excess of \$5,000.

Depreciation: Depreciation is computed using the straight-line method over the estimated useful lives of the assets. 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. Sick leave earned but not taken at September 30, 2013 and 2012, approximated \$281,000 and \$250,000, respectively, and have not been recorded in the accompanying financial statements.

Revenues and Unearned Revenues: Sales of electricity and water are recorded as billed to customers on a semi-monthly or 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 position.

Grants and Subsidies: PUC receives grants from the U.S Government or other foreign governments or entities either as a direct recipient or as a sub recipient from the Pohnpei State Government or the FSM National Government 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.

POHNPEI UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2013 and 2012

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards: During fiscal year 2013, PUC implemented the following pronouncements:

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addressed how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*, which improved financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which enhanced the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements issued on or before November 30, 1989, which does not conflict or contradict GASB pronouncements. GASB Statement no. 62 superseded GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which established guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position, and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. These Statements amend the net asset reporting requirements in Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. With the implementation of GASB Statement No. 63 and Statement No. 65, the Statement of Net Assets was renamed the Statement of Net Position. In addition, the Statement of Net Position includes two new classifications separate from assets and liabilities. Amounts reported as deferred outflows of resources are reported in a separate section following assets. Likewise, amounts reported as deferred inflows of resources are reported in a separate section following liabilities.

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of PUC.

POHNPEI UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2013 and 2012

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards:, Continued

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements on the financial statements of PUC.

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*, which improves accounting and financial reporting for state and local governments' combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. A disposal of government operations can occur through a transfer to another government or a sale. The provisions in Statement 69 are effective for fiscal years beginning after December 15, 2013. Management has not yet determined the effect of implementation of these statements on the financial statements of PUC.

In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The provisions in Statement 70 are effective for fiscal years beginning after June 15, 2013. Management has not yet determined the effect of implementation of these statements on the financial statements of PUC.

(2) Concentration of Credit Risk

Financial instruments which potentially subject PUC to concentrations of credit risk consist principally of cash and cash equivalents, investments and accounts receivable.

At September 30, 2013 and 2012, PUC has cash deposits in bank accounts that are not subject to or exceed federal depository insurance limits. PUC has not experienced any losses in such accounts.

Substantially all of PUC's customer accounts receivable are from individuals, companies and government agencies based in Pohnpei. Concentrations largely result from accounts receivable from Pohnpei State Government and various agencies. Management assesses the risk of loss and provides for an allowance for doubtful accounts to compensate for known credit risks. Additionally, PUC purchases virtually its entire fuel inventory from a single entity.

(3) Cash and Cash Equivalents and Investments

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.

POHNPEI UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2013 and 2012

(3) Cash and Cash Equivalents and Investments, Continued

A. Cash and Cash Equivalents:

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. PUC does not have a deposit policy for custodial credit risk.

As of September 30, 2013 and 2012, the carrying amount of PUC's total cash and cash equivalents and time certificates of deposit was \$950,710 and \$989,935, respectively, and the corresponding bank balances were \$1,128,045 and \$1,120,774, respectively. Of the bank balances, \$1,128,045 and \$989,163, respectively, are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2013 and 2012, bank deposits in the amount of \$500,000 were FDIC insured. PUC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk. PUC has not experienced any losses on such accounts and management believes it is not exposed to any significant credit risk on its deposits.

B. Investments:

As of September 30, 2013 and 2012, investments in mutual funds at fair value are \$174,124 and \$174,257, 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, 2013 and 2012.

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, 2013 and 2012.

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.

POHNPEI UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2013 and 2012

(4) 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. Funds were accumulated in a restricted investment fund, held by a trustee, in the name of PUC. During the year ended September 30, 2012, the trustee notified PUC that it can no longer service the account and as such, the balance of \$145,112 was transferred into a bank deposit account that is held as collateral for a new bank loan. The related balance continues to be shown as restricted in the accompanying statements of net position since restrictions have not been removed by the enabling body.

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.

(5) Accounts Receivable

Accounts receivable at September 30, 2013 and 2012, are summarized as follows:

	<u>2013</u>	<u>2012</u>
Accounts receivable - electrical:		
Residential	\$ 1,397,774	\$ 1,319,523
Commercial	558,455	405,572
Government	305,069	319,328
Unbilled	<u>1,566</u>	<u>7,006</u>
	<u>2,262,864</u>	<u>2,051,429</u>
Accounts receivable - water and sewer:		
Residential	2,829,763	2,533,247
Commercial and government	416,961	342,386
Unbilled	<u>65,448</u>	<u>209,048</u>
	<u>3,312,172</u>	<u>3,084,681</u>
Installment receivables	79,981	84,649
Other	<u>95,589</u>	<u>98,212</u>
	5,750,606	5,318,971
Less allowance for doubtful receivables	<u>(4,222,187)</u>	<u>(3,987,667)</u>
	<u>\$ 1,528,419</u>	<u>\$ 1,331,304</u>

PUC operates 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, 2013 and 2012, included in accounts receivable – electrical due from customers enrolled in the cash power meter system are \$812,863 and \$695,525, respectively.

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Notes to Financial Statements
September 30, 2013 and 2012

(6) Utility Plant

A summary of changes in capital assets for the years ended September 30, 2013 and 2012 is as follows:

	Beginning Balance <u>October 1, 2012</u>	Additions	Deletions	Transfers	Ending Balance <u>September 30, 2013</u>
<u>Depreciable assets:</u>					
Production plant	\$ 20,586,399	\$ 5,821,730	\$ (2,185,850)	\$ -	\$ 24,222,279
Distribution plant	14,410,917	66,687	-	2,373	14,479,977
General plant	<u>1,440,329</u>	<u>131,030</u>	-	-	<u>1,571,359</u>
Electric plant in service	<u>36,437,645</u>	<u>6,019,447</u>	<u>(2,185,850)</u>	<u>2,373</u>	<u>40,273,615</u>
Water production plant	6,725,203	37,682	-	-	6,762,885
Sewage collection and treatment plant	5,512,301	-	-	-	5,512,301
Water distribution plant	7,225,103	43,447	-	-	7,268,550
General plant	<u>672,204</u>	<u>171,375</u>	-	-	<u>843,579</u>
Water and sewer plant in service	<u>20,134,811</u>	<u>252,504</u>	-	-	<u>20,387,315</u>
Total utility plant in service	56,572,456	6,271,951	(2,185,850)	2,373	60,660,930
Less accumulated depreciation	<u>(36,375,355)</u>	<u>(2,242,291)</u>	<u>2,185,850</u>	-	<u>(36,431,796)</u>
	<u>20,197,101</u>	<u>4,029,660</u>	-	<u>2,373</u>	<u>24,229,134</u>
<u>Non-depreciable assets:</u>					
<u>Construction work-in-progress:</u>					
Electric plant	1,459	922,771	-	(2,373)	921,857
Water and sewer plant	<u>5,317,424</u>	<u>1,417,446</u>	-	-	<u>6,734,870</u>
	<u>5,318,883</u>	<u>2,340,217</u>	-	<u>(2,373)</u>	<u>7,656,727</u>
	<u>\$ 25,515,984</u>	<u>\$ 6,369,877</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 31,885,861</u>
	Beginning Balance <u>October 1, 2011</u>	Additions	Deletions	Transfers	Ending Balance <u>September 30, 2012</u>
<u>Depreciable assets:</u>					
Production plant	\$ 19,477,802	\$ 1,075,368	\$ -	\$ 33,229	\$ 20,586,399
Distribution plant	14,355,396	55,521	-	-	14,410,917
General plant	<u>1,366,789</u>	-	-	<u>73,540</u>	<u>1,440,329</u>
Electric plant in service	<u>35,199,987</u>	<u>1,130,889</u>	-	<u>106,769</u>	<u>36,437,645</u>
Water production plant	6,714,802	10,401	-	-	6,725,203
Sewage collection and treatment plant	5,512,301	-	-	-	5,512,301
Water distribution plant	7,225,103	-	-	-	7,225,103
General plant	<u>568,243</u>	<u>73,961</u>	-	<u>30,000</u>	<u>672,204</u>
Water and sewer plant in service	<u>20,020,449</u>	<u>84,362</u>	-	<u>30,000</u>	<u>20,134,811</u>
Total utility plant in service	55,220,436	1,215,251	-	136,769	56,572,456
Less accumulated depreciation	<u>(34,322,564)</u>	<u>(2,052,791)</u>	-	-	<u>(36,375,355)</u>
	<u>20,897,872</u>	<u>(837,540)</u>	-	<u>136,769</u>	<u>20,197,101</u>
<u>Non-depreciable assets:</u>					
<u>Construction work-in-progress:</u>					
Electric plant	116,220	115,501	(123,493)	(106,769)	1,459
Water and sewer plant	<u>4,561,246</u>	<u>789,989</u>	<u>(3,811)</u>	<u>(30,000)</u>	<u>5,317,424</u>
	<u>4,677,466</u>	<u>905,490</u>	<u>(127,304)</u>	<u>(136,769)</u>	<u>5,318,883</u>
	<u>\$ 25,575,338</u>	<u>\$ 67,950</u>	<u>\$ (127,304)</u>	<u>\$ -</u>	<u>\$ 25,515,984</u>

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Notes to Financial Statements
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(6) Utility Plant, Continued

The NanPil Hydropower Station has not been operational. At September 30, 2013 and 2012, cumulative costs of \$7.5 million are included in electric production plant with corresponding \$4.3 million and \$4.0 million in accumulated depreciation, respectively. In April 2012, the Secretariat of the Pacific Community (SPC) issued a Request for Proposal (RFP) for the rehabilitation of this asset, which is to be funded via a direct grant from SPC. The project started in March 2014 and is expected to be completed in June 2014.

At September 30, 2013 and 2012, water and sewer plant construction in progress represents infrastructure projects for overhauling sewage pumps, extension of sewage lines, and treatment plants funded by two Asian Development Bank (ADB) loans (ADB Loan No.s 2099 and 2100) administered by the FSM National Government (FSMNG) (see note 7). PUC has no related commitment for project funds through internal sources.

At September 30, 2013, of total project costs of \$926,900 for the purchase and installation of two generators, PUC funded \$195,521 and Caroline Fisheries Corporation contributed \$731,379. As of September 30, 2013, the generators have not been placed in service, and the amount has been recorded in construction work-in-progress in the accompanying statements of net position.

In January 2013, PUC received a solar power generation system valued at approximately \$5.8 million from the Japan Government via a sub-grant through the FSM National Government.

(7) Notes Payable and Long-Term Debt

Notes payable at September 30, 2013 and 2012 include \$200,000 due to Pohnpei State Government (PSG) that are non-interest bearing, uncollateralized and have no set repayment date.

Additionally, notes payable at September 30, 2013 and 2012 include borrowings of \$190,000 against a line of credit with the Bank of the Federated States of Micronesia (BFSM). The \$190,000 line is collateralized by a time certificate deposit (TCD) with the bank, bearing variable interest at 2.5% and 5% over the TCD rate (effective rate of 3.00% and 5.75% at September 30, 2013 and 2012, respectively) and currently expires in June 2014. The agreement restricts 105% of outstanding loan balance as such TCD in the amount of \$199,500 is reflected as restricted in the accompanying statements of net position as of September 30, 2013 and 2012.

Changes in notes payable during the years ended September 30, 2013 and 2012, are as follows:

	Outstanding October 1, <u>2012</u>	<u>Increases</u>	<u>Decreases</u>	Outstanding September 30, <u>2013</u>
Notes payable to PSG	\$ 200,000	\$ -	\$ -	\$ 200,000
Notes payable to BFSM	<u>190,000</u>	<u>-</u>	<u>-</u>	<u>190,000</u>
	\$ <u>390,000</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>390,000</u>
	Outstanding October 1, <u>2011</u>	<u>Increases</u>	<u>Decreases</u>	Outstanding September 30, <u>2012</u>
Notes payable to PSG	\$ 200,000	\$ -	\$ -	\$ 200,000
Notes payable to BFSM	<u>190,000</u>	<u>190,000</u>	<u>(190,000)</u>	<u>190,000</u>
	\$ <u>390,000</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>390,000</u>

POHNPEI UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2013 and 2012

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

Long-term debt consists of the following at September 30, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Payable on ADB loan no. 1459, administered by the FSMNG; original amount of \$2,118,767, due in semi-annual installments of \$33,500 from February 2007 to August 2044. The loan 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, 2013 and 2012. During 2011, an additional \$294,720 was allocated to PUC which extended the maturity date to February 2052.	\$ 2,431,000	\$ 2,487,450
Loan payable to United States Department of Agriculture, Rural Utilities Service (RUS), original amount of \$578,000, due in monthly installments of \$2,654 from October 2006 to July 2044. The loan is collateralized by a revenue pledge. The loan bears fixed interest of 4.5%.	529,360	535,507
Loan payable to BFSM, original amount of \$773,122, 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 from September 2008 with unpaid principal due in August 2013. Loan was subsequently refinanced for another 5-year term, now maturing on November 30, 2018, with essentially the same terms. Current and noncurrent portions have been presented based on the subsequent refinance.	470,065	542,757
Loan payable to FSM Development Bank (FSMDB), original amount of \$481,701, interest at 9% and monthly installment of \$10,379. In August 2011, the loan was refinanced to increase borrowing by \$310,950, which was used in operations. Interest remains fixed at 9%, with monthly principal and interest installments of \$9,807 beginning on December 25, 2011 and matures on November 25, 2016. The loan is also secured by PUC's TCD for \$150,000, which is reflected as restricted in the accompanying statements of net position. A member of the PUC Board is also a member of management of the FSMDB.	327,821	405,799
Payable on ADB loan no. 2099, administered by the FSMNG, drawn against the total Standard Drawing Rights (SDR) of \$9.868 million (PUC allocation of \$3.752 million), principal due in semi-annual installments of \$85,883 from January 15, 2013 to July 15, 2036. Interest is payable at 1.0% per annum during the grace period and at 1.5% thereafter. Proceeds are used for infrastructure projects to overhaul sewage pumps, extend sewage lines, and for treatment plants.	5,246,749	4,222,128
Payable on ADB loan no. 2100, administered by the FSMNG, drawn against the total SDR of \$4.8 million (PUC allocation of \$2 million), principal due in semi-annual installments of varying amounts as a percentage of total SDRs through January 15, 2029. Interest is payable at LIBOR plus 0.6% (effective of 2.1% at September 30, 2013 and 2012). Proceeds are used for infrastructure projects to overhaul sewage pumps, extend sewage lines, and for treatment plants.	1,277,944	1,129,730

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Notes to Financial Statements
September 30, 2013 and 2012

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

	<u>2013</u>	<u>2012</u>
Loan payable to Bank of Guam, original amount of \$140,000, due in monthly installments of \$3,039 from May 30, 2012 to April 30, 2016. The loan is secured by a \$140,000 saving account. The loan bears interest fixed at 2%.	<u>94,739</u>	<u>128,952</u>
Total long-term debt	10,377,678	9,452,323
Less: current portion of long-term debt	<u>376,519</u>	<u>850,835</u>
Long-term portion of long-term debt	\$ <u>10,001,159</u>	\$ <u>8,601,488</u>

The proceeds from long-term debt were used for various infrastructure upgrades and acquisitions except for the Bank of Guam loan, which was obtained for operation purposes.

Total interest capitalized in construction work-in progress and long-term debt (no. 2099 and no. 2100) approximated \$53,000 and \$38,000 during the years ended September 30, 2013 and 2012, respectively.

At September 30, 2013, PUC is not in compliance with several debt covenants contained in the loan agreement with the BFSM. 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>
2014	\$ 376,519	\$ 206,829	\$ 583,348
2015	405,313	197,565	602,878
2016	417,246	176,550	593,796
2017	313,083	157,726	470,809
2018	314,647	144,772	459,419
2019-2023	1,173,173	633,105	1,806,278
2024-2028	1,435,260	527,451	1,962,711
2029-2033	1,092,333	412,478	1,504,811
2034-2038	1,023,665	328,802	1,352,467
2039-2043	2,856,755	237,347	3,094,102
2044-2048	318,382	41,823	360,205
2049-2053	308,679	26,321	335,000
2054-2058	324,421	10,579	335,000
2059	<u>18,202</u>	<u>162</u>	<u>18,364</u>
	\$ <u>10,377,678</u>	\$ <u>3,101,510</u>	\$ <u>13,479,188</u>

POHNPEI UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2013 and 2012

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

Changes in long-term debt for the years ended September 30, 2013 and 2012, are as follows:

	Outstanding October 1, 2012	Increases	Decreases	Outstanding September 30, 2013	Current	Noncurrent
Loan payable to:						
ADB no. 1459	\$ 2,487,450	\$ -	\$ (56,450)	\$ 2,431,000	\$ 42,721	\$ 2,388,279
ADB no. 2099	4,222,128	1,445,274	(420,653)	5,246,749	93,293	5,153,456
ADB no. 2100	1,129,730	153,374	(5,160)	1,277,944	34,693	1,243,251
RUS	535,507	-	(6,147)	529,360	8,153	521,207
BFSM	542,757	-	(72,692)	470,065	62,076	407,989
BOG	128,952	-	(34,213)	94,739	35,150	59,589
FSMDB	<u>405,799</u>	<u>-</u>	<u>(77,978)</u>	<u>327,821</u>	<u>100,433</u>	<u>227,388</u>
	<u>\$ 9,452,323</u>	<u>\$ 1,598,648</u>	<u>\$ (673,293)</u>	<u>\$ 10,377,678</u>	<u>\$ 376,519</u>	<u>\$ 10,001,159</u>

	Outstanding October 1, 2011	Increases	Decreases	Outstanding September 30, 2012	Current	Noncurrent
Loan payable to:						
ADB no. 1459	\$ 2,541,872	\$ -	\$ (54,422)	\$ 2,487,450	\$ 42,298	\$ 2,445,152
ADB no. 2099	3,397,609	824,519	-	4,222,128	108,720	4,113,408
ADB no. 2100	1,121,773	17,759	(9,802)	1,129,730	27,178	1,102,552
RUS	543,396	-	(7,889)	535,507	7,795	527,712
BFSM	608,175	-	(65,418)	542,757	542,757	-
BOG	-	140,000	(11,048)	128,952	34,237	94,715
FSMDB	<u>421,584</u>	<u>47,315</u>	<u>(63,100)</u>	<u>405,799</u>	<u>87,850</u>	<u>317,949</u>
	<u>\$ 8,634,409</u>	<u>\$ 1,029,593</u>	<u>\$ (211,679)</u>	<u>\$ 9,452,323</u>	<u>\$ 850,835</u>	<u>\$ 8,601,488</u>

(8) Grants, Subsidies and Capital Contributions

Grants and subsidies comprise the following for the years ended September 30, 2013 and 2012:

	2013	2012
Other FSM or U.S grants and subsidies	\$ 72,286	\$ 38,832
Other foreign governments and organizations	<u>-</u>	<u>215,140</u>
Operating grants	<u>\$ 72,286</u>	<u>\$ 253,972</u>
Capital contributions from Japan Government:		
Repair of generator	\$ -	\$ 626,171
Solar power system	5,821,400	-
Capital contributions from Caroline Fisheries Corporation	731,379	-
SPC	<u>25,850</u>	<u>-</u>
Capital contributions	<u>\$ 6,578,629</u>	<u>\$ 626,171</u>

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(9) 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 (FSMNG) through the State of Pohnpei. These assets were donated to the FSMNG 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.

(10) 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 \$174,124 and \$174,257 at September 30, 2013 and 2012, respectively.

(11) Related Party Transactions

At September 30, 2013 and 2012, accounts receivable include amounts owed by the State of Pohnpei and its component units to PUC of \$309,299 and \$265,725, respectively.

At September 30, 2013 and 2012, PUC also has a non-interest bearing advance from the PUC Social Club of \$211,848 and \$164,165, respectively. Further, at September 30, 2013 and 2012, PUC has a non-interest bearing advance from the State of Pohnpei of \$368,129 and \$96,520, respectively. These advances have no set repayment terms, are classified as current due to the mutual consent of the parties and are included as accounts payable – operations in the accompanying statements of net position.

At September 30, 2013 and 2012, PUC has a non-interest bearing note payable to the State of Pohnpei of \$200,000 (note 7).

PUC purchased all of its production fuel during the years ended September 30, 2013 and 2012 from FSM Petroleum Corporation (FSMPC), a component unit of FSMNG. At September 30, 2013 and 2012, long-term deposits in the amount of \$576,213, through a sub-grant from the FSMNG, are held by FSMPC as collateral for a fuel and lubricant purchase line. At September 30, 2013 and 2012, payables to FSMPC were \$536,290 and \$635,434, respectively.

(12) Restricted Net Position

At September 30, 2013 and 2012, net position is restricted for the following purposes:

	<u>2013</u>	<u>2012</u>
Self-insurance fund	\$ 145,112	\$ 145,112
Fuel deposit from fuel operating grant	<u>576,213</u>	<u>576,213</u>
	\$ <u>721,325</u>	\$ <u>721,325</u>

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

Notes to Financial Statements
September 30, 2013 and 2012

(13) 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 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 the 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 Position
September 30, 2013
(With comparative totals as of September 30, 2012)

<u>Assets</u>	<u>Power and Utility</u>	<u>Water and Sewer</u>	<u>Totals</u>	
			<u>2013</u>	<u>2012</u>
Current assets:				
Cash and cash equivalents	\$ 344,131	\$ 67,243	\$ 411,374	\$ 452,169
Investments	174,124	-	174,124	174,257
Time certificates of deposit	43,251	-	43,251	41,951
Accounts receivable, net	1,097,411	431,008	1,528,419	1,331,304
Prepayments	102,961	-	102,961	80,121
Fuel and material inventory	1,179,143	234,244	1,413,387	1,253,631
Total current assets	2,941,021	732,495	3,673,516	3,333,433
Other noncurrent assets:				
Long-term deposit	576,213	-	576,213	576,213
Restricted - cash and cash equivalents	496,085	-	496,085	495,815
Total other noncurrent assets	1,072,298	-	1,072,298	1,072,028
Utility plant, at cost:				
Electric plant in service	40,273,615	-	40,273,615	36,437,645
Water and sewer plant in service	-	20,387,315	20,387,315	20,134,811
	40,273,615	20,387,315	60,660,930	56,572,456
Less accumulated depreciation	(26,119,268)	(10,312,528)	(36,431,796)	(36,375,355)
Depreciable assets	14,154,347	10,074,787	24,229,134	20,197,101
Construction work-in-process	921,857	6,734,870	7,656,727	5,318,883
Total utility plant	15,076,204	16,809,657	31,885,861	25,515,984
	\$ 19,089,523	\$ 17,542,152	\$ 36,631,675	\$ 29,921,445
<u>Liabilities and Net Position</u>				
Current liabilities:				
Notes payable	\$ 390,000	\$ -	\$ 390,000	\$ 390,000
Current portion of long-term debt	197,659	178,860	376,519	850,835
Accounts payable:				
Operations	1,031,683	-	1,031,683	490,636
Fuel and lubricants	536,290	-	536,290	635,434
Unearned revenue	181,551	-	181,551	148,398
Accrued taxes and other liabilities	234,926	-	234,926	159,621
Employees' annual leave	58,144	-	58,144	53,555
Total current liabilities	2,630,253	178,860	2,809,113	2,728,479
Noncurrent liabilities:				
FSM Development Bank loan	227,388	-	227,388	317,949
RUS Water extension loan	-	521,207	521,207	527,712
Bank of Guam	59,589	-	59,589	94,715
Bank of the FSM	407,989	-	407,989.00	-
ADB Water extension loan	-	8,784,986	8,784,986	7,661,112
Total liabilities	3,325,219	9,485,053	12,810,272	11,329,967
Net position:				
Net investment in capital assets	15,226,204	7,324,603	22,550,807	16,643,452
Restricted	721,325	-	721,325	721,325
Unrestricted	(183,225)	732,496	549,271	1,226,701
Total net position	15,764,304	8,057,099	23,821,403	18,591,478
	\$ 19,089,523	\$ 17,542,152	\$ 36,631,675	\$ 29,921,445

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 Position
Year Ended September 30, 2013
(With comparative totals for the year ended September 30, 2012)

	Power and Utility	Water and Sewer	Totals	
			2013	2012
Operating revenues:				
Residential	\$ 258,473	\$ 1,002,441	\$ 1,260,914	\$ 1,227,532
Cash power	8,031,845	-	8,031,845	7,775,831
Commercial	3,796,451	237,468	4,033,919	3,752,057
Government	2,753,190	210,461	2,963,651	2,676,120
Other sales	15,700	11,352	27,052	82,277
Total operating revenues before bad debts	14,855,659	1,461,722	16,317,381	15,513,817
Bad debt recovery (expense)	56,823	(291,343)	(234,520)	(732,513)
Total operating revenues after bad debts	14,912,482	1,170,379	16,082,861	14,781,304
Operating and maintenance expenses:				
Production fuel	11,630,970	-	11,630,970	11,631,683
Depreciation	1,731,760	510,531	2,242,291	2,052,791
Administrative and general:				
Salaries and wages	421,870	-	421,870	404,181
Employee benefits	284,734	-	284,734	269,130
Customer service and collection	131,747	-	131,747	78,396
Vehicle, POL	131,117	-	131,117	139,687
Consumables and supplies	52,203	-	52,203	23,123
Communications	47,523	-	47,523	36,111
Contractual services	36,764	-	36,764	12,500
Repairs and maintenance	32,218	-	32,218	15,180
Insurance	29,094	-	29,094	19,946
Travel	23,565	-	23,565	13,549
Other	38,599	-	38,599	37,206
	1,229,434	-	1,229,434	1,049,009
Generation:				
Repairs and maintenance	425,348	-	425,348	332,890
Salaries and wages	385,262	-	385,262	383,367
Other production	95,044	-	95,044	20,177
	905,654	-	905,654	736,434
Water and sewer:				
Salaries and wages	-	514,064	514,064	459,753
Consumables and supplies	-	154,874	154,874	19,127
Repairs and maintenance	-	63,611	63,611	16,622
Employee benefits	-	54,370	54,370	51,033
Chemicals	-	49,124	49,124	42,065
Other	-	19,094	19,094	9,642
	-	855,137	855,137	598,242
Distribution:				
Salaries and wages	588,940	-	588,940	379,896
Repairs and maintenance	83,382	-	83,382	159,782
Consumables and supplies	118,278	-	118,278	64,888
	790,600	-	790,600	604,566
Total operating and maintenance expenses	16,288,418	1,365,668	17,654,086	16,672,725
Operating loss	(1,375,936)	(195,289)	(1,571,225)	(1,891,421)

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 Position, Continued
Year Ended September 30, 2013
(With comparative totals for the year ended September 30, 2012)

	Power and Utility	Water and Sewer	Totals	
			2013	2012
Nonoperating revenues (expenses):				
Interest expense, net	(130,094)	(40,847)	(170,941)	(171,354)
Grants and subsidies	-	72,286	72,286	253,972
Gain on disposal of fixed assets	318,044	-	318,044	-
Other income	3,132	-	3,132	31,943
	191,082	31,439	222,521	114,561
Total nonoperating revenues, net				
Loss before capital contributions	(1,184,854)	(163,850)	(1,348,704)	(1,776,860)
Capital contributions:				
Grants from foreign government and others	6,578,629	-	6,578,629	626,171
Change in net position	5,393,775	(163,850)	5,229,925	(1,150,689)
Net position at beginning of year	10,370,529	8,220,949	18,591,478	19,742,167
Net position at end of year	\$ 15,764,304	\$ 8,057,099	\$ 23,821,403	\$ 18,591,478

See accompanying Independent Auditors' Report.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Board of Directors
Pohnpei Utilities Corporation:

We have audited, in accordance with the 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, the financial statements of Pohnpei Utilities Corporation (PUC), a component unit of the State of Pohnpei, which comprise the statement of net position as of September 30, 2013, and the related statements of revenues, expenses and changes in net position, and of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated June 20, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered PUC's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of PUC's internal control.

A *deficiency in internal control* 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 and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Deloitte & Touche LLP

June 20, 2014

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

Summary Schedule of Prior Year Findings
Year Ended September 30, 2013

There are no prior year findings unresolved as of September 30, 2013.