

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

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

YEARS ENDED SEPTEMBER 30, 2014 AND 2013

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

Table of Contents
Years Ended September 30, 2014 and 2013

| | <u>Page No.</u> |
|--|-----------------|
| I. Independent Auditors' Report | 1 |
| II. Management's Discussion and Analysis | 3 |
| III. Basic Financial Statements: | |
| Statements of Net Position | 6 |
| Statements of Revenue, Expenses, and Changes in Net Position | 7 |
| Statements of Cash Flows | 8 |
| Notes to Financial Statements | 10 |
| IV. Other Supplementary Information | |
| Combining Statement of Net Position | 22 |
| Combining Statement of Revenues, Expenses and Changes in Net Position | 23 |
| V. 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 <i>Government Auditing Standards</i> | 25 |
| Schedule of Findings | 27 |
| Summary Schedule of Prior Year Findings | 28 |

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Pohnpei Utilities Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements 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, 2014 and 2013, 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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, 2014 and 2013, 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 Supplementary 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 22 to 24 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, 2015, 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, 2015

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

Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

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, 2014 and 2013. 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 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 utilities services. The General Manager who is hired by the Board of Directors oversees the daily operation of PUC.

In addition to units decommissioned earlier (#7 & #10), unit #9 was also put out of service due to a crankshaft failure. PUC now has an installed diesel generation capacity of 4.8 MW, 2 MW is available under a Power Purchase Agreement with the FSM Petroleum Corporation, .725 MW from Nanpil Hydro Plant, .170 MW from Palikir Solar Plant. A total of 6.8 MW from diesel generation in 2013 has been de-rated to 5.3 MW 2014 while the power demand is 6.0 MW in 2014. PUC generated 31,894 MWh and 34,286 MWh and sold 27,205 MWh and 28,450 MWh to customer in 2014 and 2013 respectively. This resulted in total power revenue of \$14.6 million and \$14.8 million to PUC in 2014 and 2013, respectively. The number of household being serviced by the PUC is 6,535 (6,333 using cash power meters and 202 using conventional meter) in 2014 and 6,543 in 2013. The service coverage remains at 96% of the population.

PUC also provides clean water to the people of Pohnpei. PUC has the capacity to produce 5 million gallons per day as we have 4 additional wells in service in 2014 while the daily water demand to existing customers amounts to approximately 1.8 million gallons per day. PUC produced 837 million gallons and 803 million gallons and sold 752 million gallons and 615 million gallons to customers in 2014 and 2013, respectively, which resulted in total revenue of \$2.05 million and \$1.45 million, respectively. PUC services 3,533 households, which covers about 2/3 of Pohnpei in area or 61% of the population.

The following table summarizes the financial condition and operations of the PUC for years ended September 30, 2014, 2013, and 2012:

| Assets: | <u>2014</u> | <u>2013</u> | <u>2012</u> |
|--|----------------------|----------------------|----------------------|
| Utility plant, net | \$ 30,632,819 | \$ 31,885,861 | \$ 25,515,984 |
| Current assets | 4,458,777 | 3,673,516 | 3,333,433 |
| Other noncurrent assets | <u>1,071,385</u> | <u>1,072,298</u> | <u>1,072,028</u> |
| | <u>\$ 36,162,981</u> | <u>\$ 36,631,675</u> | <u>\$ 29,921,445</u> |
| | | | |
| Liabilities and Net Position: | | | |
| Notes payable | \$ 389,131 | \$ 390,000 | \$ 390,000 |
| Current portion of long-term debt | 581,804 | 376,519 | 850,835 |
| Other current liabilities | 2,662,814 | 2,042,594 | 1,487,644 |
| Long-term debt, net of current portion | <u>9,394,411</u> | <u>10,001,159</u> | <u>8,601,488</u> |
| Total liabilities | <u>13,028,160</u> | <u>12,810,272</u> | <u>11,329,967</u> |

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

Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

| | <u>2014</u> | <u>2013</u> | <u>2012</u> |
|---|----------------------|----------------------|----------------------|
| Net Position: | | | |
| Net investment in capital assets | 21,490,412 | 22,550,807 | 16,643,452 |
| Restricted | 721,325 | 721,325 | 721,325 |
| Unrestricted | <u>923,084</u> | <u>549,271</u> | <u>1,226,701</u> |
| Total net position | <u>23,134,821</u> | <u>23,821,403</u> | <u>18,591,478</u> |
| | <u>\$ 36,162,981</u> | <u>\$ 36,631,675</u> | <u>\$ 29,921,445</u> |
| Revenues, Expenses and Changes in Net Position: | | | |
| Operating revenues | \$ 16,738,234 | \$ 16,317,381 | \$ 15,513,817 |
| Bad debts | (944,928) | (234,520) | (732,513) |
| Operating and maintenance expenses | <u>(17,530,542)</u> | <u>(17,654,086)</u> | <u>(16,672,725)</u> |
| Operating loss | (1,737,236) | (1,571,225) | (1,891,421) |
| Non-operating (expenses) revenues, net | <u>(1,104,106)</u> | <u>222,521</u> | <u>114,561</u> |
| Loss before capital contributions | (2,841,342) | (1,348,704) | (1,776,860) |
| Capital contributions | <u>2,154,760</u> | <u>6,578,629</u> | <u>626,171</u> |
| Change in net position | (686,582) | 5,229,925 | (1,150,689) |
| Net position at beginning of year | <u>23,821,403</u> | <u>18,591,478</u> | <u>19,742,167</u> |
| Net position at end of year | <u>\$ 23,134,821</u> | <u>\$ 23,821,403</u> | <u>\$ 18,591,478</u> |

Overall changes in the statements of net position components from September 2013 to 2014 include a decrease of utility plant of \$1,253,042, net increase of current and other noncurrent assets of \$784,348, and increase in total liabilities of \$217,888.

Decrease in utility plant is a result of loss on impairment of Generation #9 and NPP4 (CFC Generators) unit #1, recording of the extension of water line from Sekere to Nanpei Memorial School from the FSM National Government, and current period depreciation.. Please see note 5 to the financial statements for additional information on PUC's utility plant.

Increase in current assets is attributable to a combination of increases in cash, accounts receivable and prepayments.

Increase in current liability is due to a combination of advances from affiliates, ongoing Asian Development Bank loan funded project to rehabilitate the sewer system and payments. Please see note 6 to the financial statements for additional information on PUC's debts.

The increase in operating revenue before bad debts is mainly due to an increase in water sales and other sales.

The decrease in the operating expense is mainly due to the slight decrease in fuel expense and other related issues such as unexpected overtime expenses and inventory purchases relating to emergency work situations.

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

Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

PUC incurred a loss before capital contributions of \$2,841,342 in 2014. This is mainly due to operating loss and loss on impairment of Generator #9 and NPP generator unit #1. Capital contribution for 2014 is mainly for the extension of water line from Sekere to Nanpei Memorial School and prepayment from the FSM National Government for generators. Total amount of capital contributions decreased from 2013 by more than 50%.

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 20, 2014. That Discussion and Analysis explains the major factors impacting the 2013 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 2009 power crises declaration has been a major catalyst in the PUC amended Law which allows for the establishment of a cost recovery tariff and the push for new capital infusion from grants and other sources such as IPP/PPA and JV. The crisis also propelled PUC rapidly toward renewable energy projects. The initiation of a 2 MW IPP/PPA with FSM Petroleum Corporation, the National Government and PUC joint funding and installation in November 2014 of a 6 MW CAT modules, the World Bank grant of 4 MW to be installed in July, the EU funded 725 kW nanpil hydro now in operation, the JICA 200 kW solar (PV) installed at Nett Elementary School and the 600 kW solar PV grant from UAE Pacific partnership Fund to be commissioned in first calendar year of 2016 provided a large capital infusion of over \$10 million worth of grant that will certainly ease the power crises and reduce tariff. The number of large power customers are slowly increasing with the anticipation of up to 5 new large commercial and government facilities coming on line in 2016 and the continues increase, fuel cost will come down with more renewable projects on line. All these will ensure better economic outlook for the next fiscal year. With prepaid water meters being installed even though water and sewer contribute small revenue to the PUC operations budget, more revenue can be collected now. Finally, it is PUC's priority program for next fiscal year to establish sewer tariff or secure subsidy to ensure the cost recovery program for all the PUC divisions.

This concludes the management discussion an analysis of the financial statements for the year ended September 30, 2014.

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

Statements of Net Position
September 30, 2014 and 2013

| <u>ASSETS</u> | <u>2014</u> | <u>2013</u> |
|--|----------------------|----------------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 763,949 | \$ 411,374 |
| Investments | 174,124 | 174,124 |
| Time certificates of deposit | 45,379 | 43,251 |
| Accounts receivable, net | 1,627,574 | 1,528,419 |
| Prepayments | 601,226 | 102,961 |
| Materials and fuel inventory | <u>1,246,525</u> | <u>1,413,387</u> |
| Total current assets | <u>4,458,777</u> | <u>3,673,516</u> |
| Other noncurrent assets: | | |
| Long-term deposit | 576,213 | 576,213 |
| Restricted - cash and cash equivalents | <u>495,172</u> | <u>496,085</u> |
| Total other noncurrent assets | <u>1,071,385</u> | <u>1,072,298</u> |
| Utility plant, at cost: | | |
| Electric plant in service | 37,020,732 | 40,273,615 |
| Water and sewer plant in service | <u>21,940,047</u> | <u>20,387,315</u> |
| | 58,960,779 | 60,660,930 |
| Less accumulated depreciation | <u>(35,353,059)</u> | <u>(36,431,796)</u> |
| Depreciable assets | 23,607,720 | 24,229,134 |
| Construction work-in-process | <u>7,025,099</u> | <u>7,656,727</u> |
| Total utility plant | <u>30,632,819</u> | <u>31,885,861</u> |
| | <u>\$ 36,162,981</u> | <u>\$ 36,631,675</u> |
| <u>LIABILITIES AND NET POSITION</u> | | |
| Current liabilities: | | |
| Notes payable | \$ 389,131 | \$ 390,000 |
| Current portion of long-term debt | 581,804 | 376,519 |
| Accounts payable: | | |
| Operations | 1,162,735 | 1,031,683 |
| Fuel, lubricants and kwh purchased | 971,784 | 536,290 |
| Unearned revenue | 192,078 | 181,551 |
| Accrued taxes and other liabilities | 274,463 | 234,926 |
| Employees' annual leave | <u>61,754</u> | <u>58,144</u> |
| Total current liabilities | 3,633,749 | 2,809,113 |
| Noncurrent liabilities: | | |
| Long-term debt, net of current portion | <u>9,394,411</u> | <u>10,001,159</u> |
| Total liabilities | <u>13,028,160</u> | <u>12,810,272</u> |
| Commitments and contingencies | | |
| Net position: | | |
| Net investment in capital assets | 21,490,412 | 22,550,807 |
| Restricted | 721,325 | 721,325 |
| Unrestricted | <u>923,084</u> | <u>549,271</u> |
| Total net position | <u>23,134,821</u> | <u>23,821,403</u> |
| | <u>\$ 36,162,981</u> | <u>\$ 36,631,675</u> |

See accompanying notes to financial statements.

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

Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2014 and 2013

| | 2014 | 2013 |
|---|---------------|---------------|
| Operating revenues: | | |
| Electricity sales | \$ 14,638,957 | \$ 14,839,959 |
| Water sales | 2,047,746 | 1,450,370 |
| Other sales | 51,531 | 27,052 |
| Total operating revenues before bad debts | 16,738,234 | 16,317,381 |
| Bad debts | (944,928) | (234,520) |
| Total operating revenues after bad debts | 15,793,306 | 16,082,861 |
| Operating and maintenance expenses: | | |
| Production fuel | 9,615,127 | 11,630,970 |
| Depreciation | 2,324,004 | 2,242,291 |
| Kwh purchased | 1,657,879 | - |
| Administrative and general | 1,533,341 | 1,229,434 |
| Distribution | 855,015 | 790,600 |
| Water and sewer | 826,223 | 855,137 |
| Generation | 718,953 | 905,654 |
| Total operating and maintenance expenses | 17,530,542 | 17,654,086 |
| Operating loss | (1,737,236) | (1,571,225) |
| Nonoperating (expenses) revenues, net: | | |
| Loss on asset impairment | (1,030,306) | - |
| Interest expense, net | (153,800) | (170,941) |
| Grants and subsidies | 80,000 | 72,286 |
| Gain on disposal of fixed assets | - | 318,044 |
| Other income | - | 3,132 |
| Total nonoperating (expenses) revenues, net | (1,104,106) | 222,521 |
| Loss before capital contributions | (2,841,342) | (1,348,704) |
| Capital contributions: | | |
| Grants from foreign government and others | 2,154,760 | 6,578,629 |
| Change in net position | (686,582) | 5,229,925 |
| Net position at beginning of year | 23,821,403 | 18,591,478 |
| Net position at end of year | \$ 23,134,821 | \$ 23,821,403 |

See accompanying notes to financial statements.

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

Statements of Cash Flows
Years Ended September 30, 2014 and 2013

| | 2014 | 2013 |
|---|----------------|----------------|
| Cash flows from operating activities: | | |
| Cash received from customers | \$ 15,779,678 | \$ 15,922,031 |
| Cash payments to suppliers for goods and services | (12,381,993) | (13,213,041) |
| Cash paid to employees | (2,465,286) | (1,885,713) |
| Net cash provided by operating activities | 932,399 | 823,277 |
| Cash flows from investing activities: | | |
| Interest and dividends on investments and bank account | - | 1,467 |
| Cash flows from noncapital financing activities: | | |
| Operating grants received | 80,000 | 72,286 |
| Interest paid | (11,970) | (11,820) |
| Net cash provided by noncapital financing activities | 68,030 | 60,466 |
| Cash flows from capital and related financing activities: | | |
| Interest paid | (106,639) | (143,634) |
| Principal repayment of long-term debt | (263,068) | (347,480) |
| Acquisition of utility plant | (278,147) | (434,891) |
| Net cash used in capital and related financing activities | (647,854) | (926,005) |
| Net change in cash and cash equivalents | 352,575 | (40,795) |
| Cash and cash equivalents at beginning of year | 411,374 | 452,169 |
| Cash and cash equivalents at end of year | \$ 763,949 | \$ 411,374 |
| <u>Reconciliation of operating loss to net cash provided by operating activities:</u> | | |
| Operating loss | \$ (1,737,236) | \$ (1,571,225) |
| Adjustments to reconcile operating loss to net cash provided by operating activities: | | |
| Depreciation | 2,324,004 | 2,242,291 |
| Bad debts | 944,928 | 234,520 |
| Other income | - | 3,132 |
| Interest expense | (36,406) | (18,391) |
| (Increase) decrease in assets: | | |
| Accounts receivable | (969,083) | (431,635) |
| Prepayments | 10,235 | (22,840) |
| Materials and fuel inventory | 166,862 | 158,288 |
| Increase (decrease) in liabilities: | | |
| Accounts payable | 175,421 | 116,090 |
| Unearned revenue | 10,527 | 33,153 |
| Accrued taxes and other liabilities | 39,537 | 75,305 |
| Employees' annual leave | 3,610 | 4,589 |
| Net cash provided by operating activities | \$ 932,399 | \$ 823,277 |

See accompanying notes to financial statements.

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

Statements of Cash Flows, Continued
Years Ended September 30, 2014 and 2013

Supplemental information of noncash operating, capital and related financing activities :

During the years ended September 30, 2014 and 2013, PUC was allocated \$251,861 and \$1,598,648, respectively, relating to two projects funded by the Asian Development Bank master project funds through the FSM National Government (FSMNG). As a result, PUC increased its capital assets and long-term debt each by the same amounts.

During the years ended September 30, 2014 and 2013, loan repayments totaling \$391,125 and \$325,813 were made by the Pohnpei State Government (PSG). As a result, PUC increased its accounts payable and reduced long-term debt each by the same amounts.

During the year ended September 30, 2014, PUC recorded \$583,500 prepayment on acquisition of generators through capital contributions from FSMNG.

During the year ended September 30, 2014, PUC received water distribution assets of \$1,558,932 and construction work-in-process of \$12,328 through capital contributions from FSMNG and Caroline Fisheries Corporation (CFC), respectively.

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

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2014 and 2013

(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 are restricted for use and 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
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Notes to Financial Statements
September 30, 2014 and 2013

(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: Initial 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 subsequent 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, 2014 and 2013, approximated \$277,000 and \$281,000, 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 included as part of unearned 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 subrecipient 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 Nonoperating 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
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Notes to Financial Statements
September 30, 2014 and 2013

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards: During fiscal year 2014, PUC implemented the following pronouncements:

- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.

In June 2012, GASB issued 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 68 are effective for fiscal years beginning after June 15, 2014. Management does not believe that the implementation of this statement will have a material effect on PUC's financial statements.

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 this statement on PUC's financial statements.

In November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*, which addresses an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. The provisions in Statement 71 are effective for fiscal years beginning after June 15, 2014. Management does not believe that the implementation of this statement will have a material effect on PUC's financial statements.

Reclassification: Certain 2013 balances have been reclassified to correspond with the 2014 financial statement presentation.

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

Notes to Financial Statements
September 30, 2014 and 2013

(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, 2014 and 2013, 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.

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, 2014 and 2013, the carrying amount of PUC's total cash and cash equivalents and time certificates of deposit was \$1,304,500 and \$950,710, respectively, and the corresponding bank balances were \$1,324,938 and \$1,128,045, respectively. Of the bank balances, \$1,304,501 and \$1,128,045, respectively, are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2014 and 2013, 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, 2014 and 2013, investments in mutual funds at fair value are \$174,124.

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, 2014 and 2013.

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

Notes to Financial Statements
September 30, 2014 and 2013

(3) Cash and Cash Equivalents and Investments, Continued

B. Investments, Continued:

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, 2014 and 2013.

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.

(4) Accounts Receivable

Accounts receivable at September 30, 2014 and 2013, are summarized as follows:

| | <u>2014</u> | <u>2013</u> |
|---|---------------------|---------------------|
| Accounts receivable - electrical: | | |
| Residential | \$ 1,402,933 | \$ 1,397,774 |
| Commercial | 715,255 | 558,455 |
| Government | 541,824 | 305,069 |
| Unbilled | <u>-</u> | <u>1,566</u> |
| | <u>2,660,012</u> | <u>2,262,864</u> |
| Accounts receivable - water and sewer: | | |
| Residential | 3,339,564 | 2,829,763 |
| Commercial and government | 466,909 | 416,961 |
| Unbilled | <u>76,427</u> | <u>65,448</u> |
| | <u>3,882,900</u> | <u>3,312,172</u> |
| Installment receivables | 77,505 | 79,981 |
| Other | <u>99,272</u> | <u>95,589</u> |
| | 6,719,689 | 5,750,606 |
| Less allowance for doubtful receivables | <u>(5,092,115)</u> | <u>(4,222,187)</u> |
| | <u>\$ 1,627,574</u> | <u>\$ 1,528,419</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, 2014 and 2013, included in accounts receivable – electrical due from customers enrolled in the cash power meter system are \$846,043 and \$812,863, respectively.

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

Notes to Financial Statements
September 30, 2014 and 2013

(5) Utility Plant

A summary of changes in capital assets for the years ended September 30, 2014 and 2013 is as follows:

| | Beginning Balance <u>October 1, 2013</u> | Additions and <u>Transfers</u> | Deletions and <u>Transfers</u> | Ending Balance <u>September 30, 2014</u> |
|---------------------------------------|---|-----------------------------------|-----------------------------------|---|
| <u>Depreciable assets:</u> | | | | |
| Production plant | \$ 24,222,279 | \$ 967,099 | \$ (4,433,047) | \$ 20,756,331 |
| Distribution plant | 14,479,977 | 132,680 | - | 14,612,657 |
| General plant | <u>1,571,359</u> | <u>80,385</u> | - | <u>1,651,744</u> |
| Electric plant in service | 40,273,615 | 1,180,164 | (4,433,047) | 37,020,732 |
| Water production plant | 6,762,885 | - | - | 6,762,885 |
| Sewage collection and treatment plant | 5,512,301 | - | - | 5,512,301 |
| Water distribution plant | 7,268,550 | 1,558,932 | - | 8,827,482 |
| General plant | <u>843,579</u> | - | (6,200) | <u>837,379</u> |
| Water and sewer plant in service | 20,387,315 | 1,558,932 | (6,200) | 21,940,047 |
| Total utility plant in service | 60,660,930 | 2,739,096 | (4,439,247) | 58,960,779 |
| Less accumulated depreciation | <u>(36,431,796)</u> | <u>(2,324,004)</u> | <u>3,402,741</u> | <u>(35,353,059)</u> |
| | <u>24,229,134</u> | <u>415,092</u> | <u>(1,036,506)</u> | <u>23,607,720</u> |
| <u>Non-depreciable assets:</u> | | | | |
| <u>Construction work-in-process:</u> | | | | |
| Electric plant | 921,857 | 57,518 | (972,095) | 7,280 |
| Water and sewer plant | <u>6,734,870</u> | <u>329,712</u> | <u>(46,763)</u> | <u>7,017,819</u> |
| | <u>7,656,727</u> | <u>387,230</u> | <u>(1,018,858)</u> | <u>7,025,099</u> |
| | \$ <u>31,885,861</u> | \$ <u>802,322</u> | \$ <u>(2,055,364)</u> | \$ <u>30,632,819</u> |
| | Beginning Balance <u>October 1, 2012</u> | Additions and <u>Transfers</u> | Deletions and <u>Transfers</u> | 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 | 69,060 | - | 14,479,977 |
| General plant | <u>1,440,329</u> | <u>131,030</u> | - | <u>1,571,359</u> |
| Electric plant in service | 36,437,645 | 6,021,820 | (2,185,850) | 40,273,615 |
| 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 | 20,134,811 | 252,504 | - | 20,387,315 |
| Total utility plant in service | 56,572,456 | 6,274,324 | (2,185,850) | 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>4,032,033</u> | - | <u>24,229,134</u> |
| <u>Non-depreciable assets:</u> | | | | |
| <u>Construction work-in-process:</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>6,372,250</u> | \$ <u>(2,373)</u> | \$ <u>31,885,861</u> |

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

Notes to Financial Statements
September 30, 2014 and 2013

(5) Utility Plant, Continued

At September 30, 2014 and 2013, 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 6). PUC has no related commitment for project funds through internal sources. The projects are anticipated to be completed by July 2015.

At September 30, 2013, of total project costs of \$926,900 for the purchase and installation of two generators, PUC funded \$195,521 and a private corporation contributed \$731,379. The generators, which were part of construction work-in-process as of September 30, 2013, were placed in service during the year ended September 30, 2014. As of September 30, 2014, one of the generators is out of service and will likely be abandoned due to anticipated repair cost. As such, the asset cost and accumulated depreciation have been written-off as of September 30, 2014, resulting in an approximate \$457,000 impairment loss. In March 2015, the remaining unit also became nonoperational. No adjustment has been reflected in the accompanying financial statements for this matter.

Additionally, a generator became nonoperational in September 2014 and was subsequently decommissioned in October 2014. As such, the asset cost and accumulated depreciation have been written off as of September 30, 2014, resulting in an approximately \$572,000 impairment loss.

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 FSMNG.

In February 2014, PUC received a water distribution line valued at approximately \$1.559 million from the FSMNG.

(6) Notes Payable and Long-Term Debt

Notes payable at September 30, 2014 and 2013 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, 2014 and 2013 include outstanding balances of \$189,131 and \$190,000, respectively, 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, 2014 and 2013, respectively) and currently expires in June 2015. The agreement restricts 105% of the outstanding loan balance. The related \$199,500 TCD is reflected as restricted in the accompanying statements of net position as of September 30, 2014 and 2013.

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

Notes to Financial Statements
September 30, 2014 and 2013

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

Changes in notes payable during the years ended September 30, 2014 and 2013, are as follows:

| | Outstanding October 1, <u>2013</u> | <u>Increases</u> | <u>Decreases</u> | Outstanding September 30, <u>2014</u> |
|-----------------------|--|------------------|------------------|---|
| Notes payable to PSG | \$ 200,000 | \$ - | \$ - | \$ 200,000 |
| Notes payable to BFSM | <u>190,000</u> | <u>-</u> | <u>(869)</u> | <u>189,131</u> |
| | <u>\$ 390,000</u> | <u>\$ -</u> | <u>\$ (869)</u> | <u>\$ 389,131</u> |
| | | | | |
| | 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> |

Long-term debt consists of the following at September 30, 2014 and 2013:

| | <u>2014</u> | <u>2013</u> |
|---|--------------|--------------|
| Payable on ADB loan no. 1459, administered by the FSMNG; original amount of \$2,118,767. During 2011, an additional \$294,720 was allocated to PUC. Repayments as allocated by FSMNG indicates annual principal payments of \$56,498 through FY2016 and \$113,083 for FY2017 through FY2036, including interest at 1.0%. | \$ 2,377,669 | \$ 2,431,000 |
| Payable on ADB loan no. 2099, administered by the FSMNG. Repayments as allocated by FSMNG indicate annual principal payments of \$255,678 through FY2035, with interest 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. | 5,114,941 | 5,246,749 |
| Payable on ADB loan no. 2100, administered by the FSMNG, principal due in semi-annual installments of varying amounts as a percentage of total drawings through 2029. Interest is payable at LIBOR plus 0.6% (effective of 0.88% and 2.1% at September 30, 2014 and 2013, respectively). Proceeds are used for infrastructure projects to overhaul sewage pumps, extend sewage lines, and for treatment plants. | 1,277,906 | 1,277,944 |
| 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 bears fixed interest of 4.5%. | 521,890 | 529,360 |

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

Notes to Financial Statements
September 30, 2014 and 2013

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

| | <u>2014</u> | <u>2013</u> |
|--|---------------------|----------------------|
| 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, upon which the loan was refinanced for another 5 years maturing on November 30, 2018, with essentially the same terms. | 390,186 | 470,065 |
| 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 December 25, 2011 and maturing November 25, 2016. The loan is also collateralized by PUC's TCD of \$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. | 236,833 | 327,821 |
| 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 collateralized by a \$140,000 saving account. The loan bears interest fixed at 2%. | <u>56,790</u> | <u>94,739</u> |
| Total long-term debt | 9,976,215 | 10,377,678 |
| Less: current portion of long-term debt | <u>581,804</u> | <u>376,519</u> |
| Long-term portion of long-term debt | \$ <u>9,394,411</u> | \$ <u>10,001,159</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-process and long-term debt (no. 2099 and no. 2100) approximated \$7,400 and \$53,000 during the years ended September 30, 2014 and 2013, respectively.

At September 30, 2014, PUC is not in compliance with several debt covenants contained in the BFSM loan agreement. 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.

In October 2014, PUC entered into a \$830,000 loan with BOG, interest at 2% over bank reference rate (minimum rate of 7%), payable in monthly principal and interest installments of \$7,505 over 60 months, with the remaining balance due and payable in November 2019.

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

Notes to Financial Statements
September 30, 2014 and 2013

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

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> |
|-------------|---------------------|---------------------|----------------------|
| 2015 | \$ 581,804 | \$ 97,602 | \$ 679,406 |
| 2016 | 597,306 | 159,008 | 756,314 |
| 2017 | 548,612 | 138,441 | 687,053 |
| 2018 | 549,130 | 123,220 | 672,350 |
| 2019 | 457,819 | 111,156 | 568,975 |
| 2020-2024 | 2,347,983 | 473,317 | 2,821,300 |
| 2025-2029 | 2,475,222 | 334,393 | 2,809,615 |
| 2030-2034 | 1,935,365 | 191,820 | 2,127,185 |
| 2035-2039 | 345,193 | 48,002 | 393,195 |
| 2040-2044 | <u>137,781</u> | <u>15,752</u> | <u>153,533</u> |
| | <u>\$ 9,976,215</u> | <u>\$ 1,692,711</u> | <u>\$ 11,668,926</u> |

Changes in long-term debt for the years ended September 30, 2014 and 2013, are as follows:

| | <u>Outstanding October 1, 2013</u> | <u>Increases</u> | <u>Decreases</u> | <u>Outstanding September 30, 2014</u> | <u>Current</u> | <u>Noncurrent</u> |
|------------------|--|---------------------|---------------------|---|-------------------|----------------------|
| Loan payable to: | | | | | | |
| ADB no. 1459 | \$ 2,431,000 | \$ - | \$ (53,331) | \$ 2,377,669 | \$ 56,497 | \$ 2,321,172 |
| ADB no. 2099 | 5,246,749 | 223,575 | (355,383) | 5,114,941 | 255,678 | 4,859,263 |
| ADB no. 2100 | 1,277,944 | 28,286 | (28,324) | 1,277,906 | 44,694 | 1,233,212 |
| RUS | 529,360 | - | (7,470) | 521,890 | 8,278 | 513,612 |
| BFSM | 470,065 | - | (79,879) | 390,186 | 73,071 | 317,115 |
| BOG | 94,739 | - | (37,949) | 56,790 | 32,814 | 23,976 |
| FSMDB | <u>327,821</u> | <u>-</u> | <u>(90,988)</u> | <u>236,833</u> | <u>110,772</u> | <u>126,061</u> |
| | <u>\$ 10,377,678</u> | <u>\$ 251,861</u> | <u>\$ (653,324)</u> | <u>\$ 9,976,215</u> | <u>\$ 581,804</u> | <u>\$ 9,394,411</u> |
| | | | | | | |
| | <u>Outstanding October 1, 2012</u> | <u>Increases</u> | <u>Decreases</u> | <u>Outstanding September 30, 2013</u> | <u>Current</u> | <u>Noncurrent</u> |
| 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> |

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

Notes to Financial Statements
September 30, 2014 and 2013

(7) Grants, Subsidies and Capital Contributions

Grants and subsidies comprise the following for the years ended September 30, 2014 and 2013:

| | <u>2014</u> | <u>2013</u> |
|--|---------------------|---------------------|
| Operating Grants: | | |
| Other FSM or U.S grants and subsidies | \$ <u>80,000</u> | \$ <u>72,286</u> |
| Capital Contributions | | |
| FSM National Government – water distribution | \$ 1,558,932 | - |
| FSM National Government – generator* | 583,500 | - |
| Caroline Fisheries Corporation – generator | 12,328 | 731,379 |
| Japan Government – solar power system | - | 5,821,400 |
| SPC | <u>-</u> | <u>25,850</u> |
| Capital contributions | \$ <u>2,154,760</u> | \$ <u>6,578,629</u> |

(8) Contributions

During the year ended September 30, 1995, sole use rights for the Nanpohnmal Power Plant were contributed to PUC by the FSM National Government (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.

(9) Sinking Fund

During fiscal year 1998, PUC management established a sinking fund to finance future expansion and upgrade 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 at September 30, 2014 and 2013.

(10) Self Insurance Fund and Risk Management

In accordance with section 2(5) of State Law 3L-41-93, an amendment to the PUC 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.

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

Notes to Financial Statements
September 30, 2014 and 2013

(10) Self Insurance Fund and Risk Management, Continued

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.

(11) Related Party Transactions

At September 30, 2014 and 2013, accounts receivable include amounts owed by the State of Pohnpei and its component units to PUC of \$826,832 and \$309,299, respectively.

At September 30, 2014 and 2013, PUC also has a non-interest bearing advance from the PUC Social Club of \$132,820 and \$211,848, respectively. Further, at September 30, 2014 and 2013, PUC has a non-interest bearing advance from the State of Pohnpei of \$659,254 and \$368,129, 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, 2014 and 2013, PUC has a non-interest bearing note payable to the State of Pohnpei of \$200,000 (note 6).

PUC purchased all of its production fuel during the years ended September 30, 2014 and 2013 from FSM Petroleum Corporation (FSMPC), a component unit of FSMNG. At September 30, 2014 and 2013, 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. Starting November 2013, PUC also purchases power generated by FSMPC. At September 30, 2014 and 2013, payables to FSMPC were \$971,784 and \$536,290, respectively.

(12) Restricted Net Position

At September 30, 2014 and 2013, net position is restricted for the following purposes:

| | <u>2014</u> | <u>2013</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> |

(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, 2014
(With comparative totals as of September 30, 2013)

| <u>Assets</u> | <u>Power and Utility</u> | <u>Water and Sewer</u> | <u>Totals</u> | |
|--|------------------------------|----------------------------|---------------|---------------|
| | | | <u>2014</u> | <u>2013</u> |
| Current assets: | | | | |
| Cash and cash equivalents | \$ 403,652 | \$ 360,297 | \$ 763,949 | \$ 411,374 |
| Investments | 174,124 | - | 174,124 | 174,124 |
| Time certificates of deposit | 45,379 | - | 45,379 | 43,251 |
| Accounts receivable, net | 1,229,582 | 397,992 | 1,627,574 | 1,528,419 |
| Prepayments | 601,226 | - | 601,226 | 102,961 |
| Fuel and material inventory | 1,058,755 | 187,770 | 1,246,525 | 1,413,387 |
| Total current assets | 3,512,718 | 946,059 | 4,458,777 | 3,673,516 |
| Other noncurrent assets: | | | | |
| Long-term deposit | 576,213 | - | 576,213 | 576,213 |
| Restricted - cash and cash equivalents | 495,172 | - | 495,172 | 496,085 |
| Total other noncurrent assets | 1,071,385 | - | 1,071,385 | 1,072,298 |
| Utility plant, at cost: | | | | |
| Electric plant in service | 37,020,732 | - | 37,020,732 | 40,273,615 |
| Water and sewer plant in service | - | 21,940,047 | 21,940,047 | 20,387,315 |
| | 37,020,732 | 21,940,047 | 58,960,779 | 60,660,930 |
| Less accumulated depreciation | (24,477,666) | (10,875,393) | (35,353,059) | (36,431,796) |
| Depreciable assets | 12,543,066 | 11,064,654 | 23,607,720 | 24,229,134 |
| Construction work-in-process | 7,280 | 7,017,819 | 7,025,099 | 7,656,727 |
| Total utility plant | 12,550,346 | 18,082,473 | 30,632,819 | 31,885,861 |
| | \$ 17,134,449 | \$ 19,028,532 | \$ 36,162,981 | \$ 36,631,675 |
| <u>Liabilities and Net Position</u> | | | | |
| Current liabilities: | | | | |
| Notes payable | \$ 389,131 | \$ - | \$ 389,131 | \$ 390,000 |
| Current portion of long-term debt | 216,657 | 365,147 | 581,804 | 376,519 |
| Accounts payable: | | | | |
| Operations | 503,481 | 659,254 | 1,162,735 | 1,031,683 |
| Fuel, lubricants and kwh purchased | 971,784 | - | 971,784 | 536,290 |
| Unearned revenue | 192,078 | - | 192,078 | 181,551 |
| Accrued taxes and other liabilities | 274,463 | - | 274,463 | 234,926 |
| Employees' annual leave | 61,754 | - | 61,754 | 58,144 |
| Total current liabilities | 2,609,348 | 1,024,401 | 3,633,749 | 2,809,113 |
| Noncurrent liabilities: | | | | |
| FSM Development Bank loan | 126,061 | - | 126,061 | 227,388 |
| RUS Water extension loan | - | 513,612 | 513,612 | 521,207 |
| Bank of Guam | 23,976 | - | 23,976 | 59,589 |
| Bank of the FSM | 317,115 | - | 317,115 | 407,989 |
| ADB Water extension loan | - | 8,413,647 | 8,413,647 | 8,784,986 |
| Total liabilities | 3,076,500 | 9,951,660 | 13,028,160 | 12,810,272 |
| Net position: | | | | |
| Net investment in capital assets | 12,700,345 | 8,790,067 | 21,490,412 | 22,550,807 |
| Restricted | 721,325 | - | 721,325 | 721,325 |
| Unrestricted | 26,320 | 896,764 | 923,084 | 549,271 |
| Total net position | 13,447,990 | 9,686,831 | 23,134,821 | 23,821,403 |
| | \$ 16,524,490 | \$ 19,638,491 | \$ 36,162,981 | \$ 36,631,675 |

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, 2014
(With comparative totals for the year ended September 30, 2013)

| | Power and Utility | Water and Sewer | Totals | |
|---|----------------------|--------------------|--------------|--------------|
| | | | 2014 | 2013 |
| Operating revenues: | | | | |
| Residential | \$ 167,055 | \$ 1,476,317 | \$ 1,643,372 | \$ 1,260,914 |
| Cash power | 8,296,570 | - | 8,296,570 | 8,031,845 |
| Commercial | 3,467,138 | 237,312 | 3,704,450 | 4,033,919 |
| Government | 2,750,244 | 292,067 | 3,042,311 | 2,963,651 |
| Other sales | 40,437 | 11,094 | 51,531 | 27,052 |
| Total operating revenues before bad debts | 14,721,444 | 2,016,790 | 16,738,234 | 16,317,381 |
| Bad debts | (341,182) | (603,746) | (944,928) | (234,520) |
| Total operating revenues after bad debts | 14,380,262 | 1,413,044 | 15,793,306 | 16,082,861 |
| Operating and maintenance expenses: | | | | |
| Production fuel | 9,615,127 | - | 9,615,127 | 11,630,970 |
| Kwh purchased | 1,657,879 | - | 1,657,879 | - |
| | 11,273,006 | - | 11,273,006 | 11,630,970 |
| Depreciation | 1,761,139 | 562,865 | 2,324,004 | 2,242,291 |
| Administrative and general: | | | | |
| Salaries and wages | 457,037 | - | 457,037 | 421,870 |
| Employee benefits | 335,785 | - | 335,785 | 284,734 |
| Contractual services | 175,920 | - | 175,920 | 36,764 |
| Vehicle, POL | 107,735 | - | 107,735 | 131,117 |
| Customer service and collection | 99,854 | - | 99,854 | 131,747 |
| Insurance | 64,496 | - | 64,496 | 29,094 |
| Consumables and supplies | 61,857 | - | 61,857 | 52,203 |
| Travel | 56,772 | - | 56,772 | 23,565 |
| Communications | 55,606 | - | 55,606 | 47,523 |
| Repairs and maintenance | 52,690 | - | 52,690 | 32,218 |
| Other | 65,589 | - | 65,589 | 38,599 |
| | 1,533,341 | - | 1,533,341 | 1,229,434 |
| Generation: | | | | |
| Salaries and wages | 366,730 | - | 366,730 | 385,262 |
| Repairs and maintenance | 299,200 | - | 299,200 | 425,348 |
| Other | 53,023 | - | 53,023 | 95,044 |
| | 718,953 | - | 718,953 | 905,654 |
| Water and sewer: | | | | |
| Salaries and wages | - | 525,881 | 525,881 | 514,064 |
| Consumables and supplies | - | 113,121 | 113,121 | 154,874 |
| Employee benefits | - | 65,887 | 65,887 | 54,370 |
| Chemicals | - | 50,746 | 50,746 | 49,124 |
| Repairs and maintenance | - | 49,238 | 49,238 | 63,611 |
| Other | - | 21,350 | 21,350 | 19,094 |
| | - | 826,223 | 826,223 | 855,137 |
| Distribution: | | | | |
| Salaries and wages | 717,576 | - | 717,576 | 588,940 |
| Consumables and supplies | 77,553 | - | 77,553 | 118,278 |
| Repairs and maintenance | 59,886 | - | 59,886 | 83,382 |
| | 855,015 | - | 855,015 | 790,600 |
| Total operating and maintenance expenses | 16,141,454 | 1,389,088 | 17,530,542 | 17,654,086 |
| Operating (loss) income | (1,761,192) | 23,956 | (1,737,236) | (1,571,225) |

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, 2014
(With comparative totals for the year ended September 30, 2013)

| | Power and Utility | Water and Sewer | Totals | |
|---|----------------------|---------------------|----------------------|----------------------|
| | | | 2014 | 2013 |
| Nonoperating (expenses) revenues, net: | | | | |
| Loss on asset impairment | (1,030,306) | - | (1,030,306) | - |
| Interest expense, net | (120,644) | (33,156) | (153,800) | (170,941) |
| Grants and subsidies | - | 80,000 | 80,000 | 72,286 |
| Gain on disposal of fixed assets | - | - | - | 318,044 |
| Other income | - | - | - | 3,132 |
| | <u>(1,150,950)</u> | <u>46,844</u> | <u>(1,104,106)</u> | <u>222,521</u> |
| Total nonoperating (expenses) revenues, net | | | | |
| Loss before capital contributions | (2,912,142) | 70,800 | (2,841,342) | (1,348,704) |
| Capital contributions: | | | | |
| Grants from foreign government and others | <u>595,828</u> | <u>1,558,932</u> | <u>2,154,760</u> | <u>6,578,629</u> |
| Change in net position | (2,316,314) | 1,629,732 | (686,582) | 5,229,925 |
| Net position at beginning of year | <u>15,764,304</u> | <u>8,057,099</u> | <u>23,821,403</u> | <u>18,591,478</u> |
| Net position at end of year | <u>\$ 13,447,990</u> | <u>\$ 9,686,831</u> | <u>\$ 23,134,821</u> | <u>\$ 23,821,403</u> |

See accompanying Independent Auditors' Report.

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT 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, 2014, 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, 2015.

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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings as item 2014-001.

We noted certain matters that we reported to management of PUC in a separate letter dated June 20, 2015.

PUC's response to the finding identified in our audit is described in the accompanying Schedule of Findings. We did not audit PUC's response and, accordingly we express no opinion on it.

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, 2015

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

Schedule of Findings
Year Ended September 30, 2014

Finding No.2014-01

Criteria: Perpetual inventory records should reflect inventory quantities on hand, with inventory receipts and issuances properly recorded in the related inventory general ledger accounts. Furthermore, underlying records should reconcile to the general ledger and differences should be timely investigated and reconciled.

Condition: During the year ended September 30, 2012, PUC implemented a system requiring all inventory movements to be recorded through inventory accounts. Previously, PUC did not properly account for materials inventory. Inventory purchases and uses were directly recorded in the repair and maintenance or construction-in-progress accounts. At the end of each year, inventory accounts were adjusted based on results of physical counts. The differences therefore cannot be investigated due to lack of controls over inventory receipts and issuances. It appears that full compliance has not been achieved as inventory uses and adjustments of approximately \$67,000 during the year ended September 30, 2014 were not supported by issuance slips. Additionally, significant year-end adjustments were required to reconcile general ledger balances to physical count balances.

Cause: PUC has not fully implemented a perpetual inventory system.

Effect: The potential for misappropriation of assets exists and it appears that such would not be prevented or detected in a timely manner.

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

Recommendation: PUC should continue to enforce and train its users on the procedures implemented over inventory receipts and issuances. Also, in addition to the year-end physical count of all inventory items, PUC may consider performing cycle counts of its inventory. This process will assist in timely identification of variances and discrepancies.

Auditee Response and Corrective Action Plan:

We concur and would implement auditor's recommendation by ensuring that the staff is properly trained on the procedures already in place. Enforcement of the current process will be prioritized until PUC achieve full compliance of the corrective action plan.

Those personnel who will be responsible for the implementation of the corrective action plan are:

1. Inventory Technician
2. Accounting Division Manager
3. AGMs for Power and Water & Sewer
4. Stockman for each Division/Department Stockroom

Upon receipt of purchases, all receiving reports and invoices are to be prepared and submitted to the Accounting division (Inventory Technician) who will enter data in the inventory system. Storage will be in the respective warehouses of each Division/Department. Usage of inventory items will be documented by each division using issue slips that will be submitted to Accounting (Inventory Technician) at the end of the month for entry in the inventory system. Finance/Inventory record will then be reconciled against what is in stock.

September 30, 2015 is the target date.

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

Summary Schedule of Prior Year Findings
Year Ended September 30, 2014

There are no prior year findings unresolved as of September 30, 2014.