

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

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

YEARS ENDED SEPTEMBER 30, 2015 AND 2014

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

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Years Ended September 30, 2015 and 2014

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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, 2015 and 2014, 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, 2015 and 2014, 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 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 17, 2016, 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 17, 2016

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

Management's Discussion and Analysis
Years Ended September 30, 2015 and 2014

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, 2015 and 2014. 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.

PUC is operating with three 3516C Caterpillar engines and two (2) 3512 Caterpillar engines. Of the five (5) gensets, unit #2 3512 is not operational due to generator failure. PUC has an installed diesel generation capacity of 8250 kW and has been de-rated to 5550 kW. A 2000kW diesel generation capacity under a Power Purchase Agreement with the FSM Petroleum Corporation has been de-rated to 990kW. Renewables include 725 kW from Nanpil Hydro Plant, 170kW from Palikir Solar Plant, and 200kW from Nett School Solar Plant. A total available diesel capacity of 5300 kW in 2014 has been increased to 6540 kW in 2015 with the peak demand of 6380kW recorded in December of 2014. Therefore in case one of the Power Modules stopped, PUC is under the condition to implement load shedding due to lack of supply. PUC produced 31,894,501 kWhr and 34,580,105 kWhr and sold 26,781,589 kWhr and 27,115,503 kWhr to customers in 2014 and 2015, respectively. The number of household being serviced by the PUC is 6,683 (6490 using cashpower meters and 193 using conventional meters) in 2015. The service coverage is 96% of the population.

PUC also provides potable water to the people of Pohnpei. PUC has the capacity to produce 5 million gallons per day. The daily water demand to existing customers varies from 1.5 to 2.0 million gallons per day. PUC produced 803 million gallons and 792 million gallons and sold 752 million gallons and 643 million gallons to customers in 2014 and 2015, respectively, which resulted in total revenue of \$2.05 million and \$1.64 million, respectively. PUC services the total of 3635 households, 3465 on conventional post paid meters and 170 prepaid meters (Cash Water) 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, 2015, 2014, and 2013:

Assets:	<u>2015</u>	<u>2014</u>	<u>2013</u>
Utility plant, net	\$ 32,487,525	\$ 30,632,819	\$ 31,885,861
Current assets	2,468,897	4,458,777	3,673,5163
Other noncurrent assets	<u>1,373,200</u>	<u>1,071,385</u>	<u>1,072,298</u>
	<u>\$ 36,329,622</u>	<u>\$ 36,162,981</u>	<u>\$ 36,631,675</u>
Liabilities and Net Position:			
Notes payable	\$ 389,131	\$ 389,131	\$ 390,000
Current portion of long-term debt	666,723	581,804	376,519
Other current liabilities	2,948,844	2,662,814	2,042,594
Long-term debt, net of current portion	<u>10,131,442</u>	<u>9,394,411</u>	<u>10,001,159</u>
Total liabilities	<u>14,136,140</u>	<u>13,028,160</u>	<u>12,810,272</u>

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Management's Discussion and Analysis
Years Ended September 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Net Position:			
Net investment in capital assets	22,171,629	21,490,412	22,550,807
Restricted	723,150	721,325	721,325
Unrestricted	<u>(701,297)</u>	<u>923,084</u>	<u>549,271</u>
Total net position	<u>22,193,482</u>	<u>23,134,821</u>	<u>23,821,403</u>
	<u>\$ 36,329,622</u>	<u>\$ 36,162,981</u>	<u>\$ 36,631,675</u>
Revenues, Expenses and Changes in Net Position:			
Operating revenues	\$ 13,874,094	\$ 16,738,234	\$ 16,317,381
Bad debts	(586,039)	(944,928)	(234,520)
Operating and maintenance expenses	<u>(15,495,837)</u>	<u>(17,530,542)</u>	<u>(17,654,086)</u>
Operating loss	(2,207,782)	(1,737,236)	(1,571,225)
Non-operating (expenses) revenues, net	<u>(150,057)</u>	<u>(1,104,106)</u>	<u>222,521</u>
Loss before capital contributions	(2,357,839)	(2,841,342)	(1,348,704)
Capital contributions	<u>1,416,500</u>	<u>2,154,760</u>	<u>6,578,629</u>
Change in net position	(941,339)	(686,582)	5,229,925
Net position at beginning of year	<u>23,134,821</u>	<u>23,821,403</u>	<u>18,591,478</u>
Net position at end of year	<u>\$ 22,193,492</u>	<u>\$ 23,134,821</u>	<u>\$ 23,821,403</u>

Overall changes in the statements of net position components from September 2014 to 2015 includes an increase of utility plant of \$1,854,706, net decrease of current and other noncurrent assets of \$1,688,065, and an increase in total liabilities of \$312,890.

Increase in utility plant is the net of capital acquisitions (6MW gensets, Dolapwail Spurline, Street lights, and vehicles) and current period depreciation. Please see note 5 to the financial statements for additional information on PUC's utility plant.

Decrease in current assets is attributable to a combination of a decrease in cash, decrease in inventory due to obsolescence, decrease in accounts receivable and an increase in the allowance for uncollectibles and a decrease in prepayments.

Increase in current liabilities is due to a combination of loans (6 MW genset Loan, BOG), an ongoing Asian Development Bank Loan funded project to rehabilitate the sewer system and payments. Please see note 6 to the financial statement for additional information on PUC's debts.

Decrease in operating revenue before bad debts is mainly due to the decrease in tariff for electricity and a decrease in water sales.

Decrease in operating expenses is mainly due to the decrease in fuel expense and inventory purchases due to less maintenance on new generators.

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Management's Discussion and Analysis
Years Ended September 30, 2015 and 2014

PUC incurred a loss before capital contribution in 2015. Capital contribution for 2015 is for the 6 MW generators contributed by the FSM National Government. Total amount of capital contribution decreased from 2014 by about 35%.

Management Discussion Analysis for the year ended September 30, 2014 is set forth in PUC's report on the audit of financial statement, which is dated June 20, 2015. That Discussion and Analysis explains the major factors impacting the 2014 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

By the end of June, with installation of a2-2MW CAT modules, the total firm power of the Nanponmal Power Plants will be 10 MW, the rehabilitated Nanpil Power Plant is 725kw. The Pohnlangas 600kw, the 200kw Nett Elementary School and COM 170 kw grid connected solar systems and the FSM Petroleum 2MW IPP/PPA have contributed to sustainable and reliable power that will finally end the crisis declared in 2009.

With world fuel price now at less than \$50 per barrel, renewable energy contributing close to 20% and the new CATs being fuel efficient, the tariff has gone from \$0.60cent/kwh in 2013, to \$0.34 cents/kwh, a 45% decrease. Other serious contribution in the reduction of loss, is the hiring of 48 tree trimmers in 2013/2014 that clear 100% of the circumferential three phase line off 13.8 kw power, trees and vines.

The PUC Board has approved on August 17, 2015, the new mission/vision and goals for the next five years that include zero CO2 emission in a Cooperative Utility as a result of 100% use of renewable energy of 10 MW Hydro, 10 MW of solar and the 10 MW of diesel to be used only as emergency back up.

The aggressive move of the installation of cash power and pre-paid meters will permanently reduce arrears and increase revenue. The introduction of sewer tariff and subsidies will contribute to improve financial status of PUC.

Finally the new goal of PUC includes becoming profitable in 5 years.

This concludes the management discussion and analysis of the financial statements for the year ended September 30, 2015.

POHNPEI UTILITIES CORPORATION
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Statements of Net Position
September 30, 2015 and 2014

<u>ASSETS</u>	<u>2015</u>	<u>2014</u>
Current assets:		
Cash and cash equivalents	\$ 395,370	\$ 763,949
Investments	173,860	174,124
Time certificates of deposit	54,731	45,379
Accounts receivable, net	1,595,754	1,627,574
Prepayments	27,192	601,226
Materials and fuel inventory, net of an allowance for obsolescence of \$1,013,943 at 2015	<u>221,990</u>	<u>1,246,525</u>
Total current assets	<u>2,468,897</u>	<u>4,458,777</u>
Other noncurrent assets:		
Long-term deposit	888,750	576,213
Restricted - cash and cash equivalents	<u>484,450</u>	<u>495,172</u>
Total other noncurrent assets	<u>1,373,200</u>	<u>1,071,385</u>
Utility plant, at cost:		
Electric plant in service	40,131,908	37,020,732
Water and sewer plant in service	<u>21,954,047</u>	<u>21,940,047</u>
	62,085,955	58,960,779
Less accumulated depreciation	<u>(37,381,441)</u>	<u>(35,353,059)</u>
Depreciable assets	24,704,514	23,607,720
Construction work-in-process	<u>7,783,011</u>	<u>7,025,099</u>
Total utility plant	<u>32,487,525</u>	<u>30,632,819</u>
	<u>\$ 36,329,622</u>	<u>\$ 36,162,981</u>
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Notes payable	\$ 389,131	\$ 389,131
Current portion of long-term debt	666,723	581,804
Accounts payable:		
Operations	1,758,275	1,162,735
Fuel, lubricants and kwh purchased	540,517	971,784
Unearned revenue	284,385	192,078
Accrued taxes and other liabilities	293,090	274,463
Employees' annual leave	<u>72,577</u>	<u>61,754</u>
Total current liabilities	4,004,698	3,633,749
Noncurrent liabilities:		
Long-term debt, net of current portion	<u>10,131,442</u>	<u>9,394,411</u>
Total liabilities	<u>14,136,140</u>	<u>13,028,160</u>
Commitments and contingencies		
Net position:		
Net investment in capital assets	22,171,629	21,490,412
Restricted	723,150	721,325
Unrestricted	<u>(701,297)</u>	<u>923,084</u>
Total net position	<u>22,193,482</u>	<u>23,134,821</u>
	<u>\$ 36,329,622</u>	<u>\$ 36,162,981</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, 2015 and 2014

	2015	2014
Operating revenues:		
Electricity sales	\$ 12,192,701	\$ 14,638,957
Water sales	1,636,527	2,047,746
Other sales	44,866	51,531
Total operating revenues before bad debts	13,874,094	16,738,234
Bad debts	(586,039)	(944,928)
Total operating revenues after bad debts	13,288,055	15,793,306
Operating and maintenance expenses:		
Production fuel	6,903,490	9,615,127
Depreciation	2,028,382	2,324,004
Administrative and general	1,843,633	1,657,879
Kwh purchased	1,292,751	1,533,341
Inventory stock obsolescence	1,013,943	-
Distribution	1,001,549	855,015
Water and sewer	859,651	826,223
Generation	552,438	718,953
Total operating and maintenance expenses	15,495,837	17,530,542
Operating loss	(2,207,782)	(1,737,236)
Nonoperating (expenses) revenues:		
Interest expense, net	(150,057)	(153,800)
Asset impairment	-	(1,030,306)
Grants and subsidies	-	80,000
Total nonoperating expenses, net	(150,057)	(1,104,106)
Loss before capital contributions	(2,357,839)	(2,841,342)
Capital contributions:		
Grants from foreign government and others	1,416,500	2,154,760
Change in net position	(941,339)	(686,582)
Net position at beginning of year	23,134,821	23,821,403
Net position at end of year	\$ 22,193,482	\$ 23,134,821

See accompanying notes to financial statements.

POHNPEI UTILITIES CORPORATION
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Statements of Cash Flows
Years Ended September 30, 2015 and 2014

	2015	2014
Cash flows from operating activities:		
Cash received from customers	\$ 13,412,182	\$ 15,779,678
Cash payments to suppliers for goods and services	(10,941,557)	(12,381,993)
Cash paid to employees	(2,220,751)	(2,465,286)
Net cash provided by operating activities	249,874	932,399
Cash flows from investing activities:		
Interest and dividends on investments and bank account	4,781	-
Cash flows from noncapital financing activities:		
Operating grants received	-	80,000
Interest paid	-	(11,970)
Net cash provided by noncapital financing activities	-	68,030
Cash flows from capital and related financing activities:		
Interest paid	(115,349)	(106,639)
Proceeds from long-term debt	830,000	-
Principal repayment of long-term debt	(235,605)	(263,068)
Acquisition of utility plant	(1,102,280)	(278,147)
Net cash used in capital and related financing activities	(623,234)	(647,854)
Net change in cash and cash equivalents	(368,579)	352,575
Cash and cash equivalents at beginning of year	763,949	411,374
Cash and cash equivalents at end of year	\$ 395,370	\$ 763,949
<u>Reconciliation of operating loss to net cash provided by operating activities:</u>		
Operating loss	\$ (2,207,782)	\$ (1,737,236)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation	2,028,382	2,324,004
Bad debts	586,039	944,928
Inventory stock obsolescence	1,013,943	-
Interest expense	(37,855)	(36,406)
(Increase) decrease in assets:		
Accounts receivable	(554,219)	(969,083)
Prepayments	(9,466)	10,235
Materials and fuel inventory	(168,040)	166,862
Long-term deposit	(312,537)	-
Increase (decrease) in liabilities:		
Accounts payable	(210,348)	175,421
Unearned revenue	92,307	10,527
Accrued taxes and other liabilities	18,627	39,537
Employees' annual leave	10,823	3,610
Net cash provided by operating activities	\$ 249,874	\$ 932,399

See accompanying notes to financial statements.

POHNPEI UTILITIES CORPORATION
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Statements of Cash Flows, Continued
Years Ended September 30, 2015 and 2014

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

During the years ended September 30, 2015 and 2014, PUC was allocated increases of \$1,195,974 and \$251,861, respectively, relating to two projects funded by the Asian Development Bank (ADB) master project funds through the FSM National Government (FSMNG). As a result, PUC increased its capital assets and its long-term debt by the same amounts.

During the years ended September 30, 2015 and 2014, loan payments of \$374,621 and \$391,125 were made by the Pohnpei State Government. As a result, PUC increased its accounts payable and reduced its long-term debt by the the same amount.

During the year ended September 30, 2015, PUC was allocated a decrease of \$593,798 of balance adjustments relating to currency re-evaluation changes associated with the ADB loans. As a result, PUC decreased its capital assets and its long-term debt by the same amount.

During the years ended September 30, 2015 and 2014, PUC recorded capital contributions from the FSMNG of \$1,416,500 and \$583,500, respectively, for acquisition of three generators. At September 30, 2014, the \$583,500 contribution was recorded in prepayments, which was transferred to capital assets during fiscal year 2015.

During the year ended September 30, 2014, PUC received water distribution assets of \$1,558,932 and construction work-in-progress of \$12,328 through capital contributions from the Pohnpei State Government and Caroline Fisheries Corporation, respectively.

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Notes to Financial Statements
September 30, 2015 and 2014

(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 and saving deposit accounts with banks, 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 and those deposit accounts that are restricted for use are separately classified in 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.

POHNPEI UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2015 and 2014

(1) Summary of Significant Accounting Policies, Continued

Inventory: Materials and fuel inventory are substantially carried at the lower of cost (weighted average) or market, net of an allowance for obsolescence relating to parts that have been specifically identified as likely not usable.

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, 2015 and 2014, approximated \$296,000 and \$277,000, 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
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Notes to Financial Statements
September 30, 2015 and 2014

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards: During fiscal year 2015, PUC implemented the following pronouncements:

- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.

In February 2015, GASB issued Statement No. 72, *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements and requires entities to expand their fair value disclosures by determining major categories of debt and equity securities within the fair value hierarchy on the basis of the nature and risk of the investment. The provisions in Statement 72 are effective for fiscal years beginning after June 15, 2015. Management believes that the implementation of this statement only requires additional disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques and will not have a material effect on PUC's financial statements.

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements 67 and 68 with the reporting requirements in Statement 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2015, with the exception of the provisions that address employers and governmental nonemployer contributing entities for pensions that are not within the scope of Statement 68, which are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on PUC's financial statements.

POHNPEI UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2015 and 2014

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB). The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on PUC's financial statements.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on PUC's financial statements.

In June 2015, GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which eliminates two of the four categories of authoritative GAAP that exist under the existing hierarchy prescribed by Statement 55. The two categories that will remain under the new standard are (1) GASB Statements and (2) GASB technical bulletins and implementation guides in addition to AICPA guidance that the GASB clears. The provisions in Statement No. 76 are effective for fiscal years beginning after June 15, 2015. Management does not believe that the implementation of this statement will have a material effect on PUC's financial statements.

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements. The provisions in Statement No. 77 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on PUU's financial statements.

POHNPEI UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2015 and 2014

(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, 2015 and 2014, 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, Time Certificates of Deposit 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 and Time Certificates of Deposit:

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, 2015 and 2014, the carrying amount of PUC's total cash and cash equivalents and time certificates of deposit was \$934,551 and \$1,304,500, respectively, (corresponding bank balances of \$1,002,759 and \$1,324,938, respectively), which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance with coverage of \$500,000 at September 30, 2015 and 2014. 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, 2015 and 2014, investments in mutual funds at fair value are \$173,860 and \$174,124, 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, 2015 and 2014.

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Notes to Financial Statements
September 30, 2015 and 2014

(3) Cash and Cash Equivalents, Time Certificates of Deposit 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, 2015 and 2014.

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, 2015 and 2014, are summarized as follows:

	<u>2015</u>	<u>2014</u>
Accounts receivable - electrical:		
Residential	\$ 1,509,404	\$ 1,402,933
Commercial	690,873	715,255
Government	<u>542,932</u>	<u>541,824</u>
	<u>2,743,209</u>	<u>2,660,012</u>
Accounts receivable - water and sewer:		
Residential	3,769,228	3,339,564
Commercial and government	511,159	466,909
Unbilled	<u>78,144</u>	<u>76,427</u>
	<u>4,358,531</u>	<u>3,882,900</u>
Installment receivables	75,710	77,505
Other	<u>96,458</u>	<u>99,272</u>
	7,273,908	6,719,689
Less allowance for doubtful receivables	<u>(5,678,154)</u>	<u>(5,092,115)</u>
	<u>\$ 1,595,754</u>	<u>\$ 1,627,574</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, 2015 and 2014, included in accounts receivable – electrical due from customers enrolled in the cash power meter system are \$881,455 and \$846,043, respectively.

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Notes to Financial Statements
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(5) Utility Plant

A summary of changes in capital assets for the years ended September 30, 2015 and 2014 is as follows:

	Beginning Balance <u>October 1, 2014</u>	Additions and <u>Transfers</u>	Deletions and <u>Transfers</u>	Ending Balance <u>September 30, 2015</u>
<u>Depreciable assets:</u>				
Production plant	\$ 20,756,331	\$ 2,826,752	\$ -	\$ 23,583,083
Distribution plant	14,612,657	178,632	-	14,791,289
General plant	<u>1,651,744</u>	<u>105,792</u>	-	<u>1,757,536</u>
Electric plant in service	<u>37,020,732</u>	<u>3,111,176</u>	-	<u>40,131,908</u>
Water production plant	6,762,885	-	-	6,762,885
Sewage collection and treatment plant	5,512,301	-	-	5,512,301
Water distribution plant	8,827,482	-	-	8,827,482
General plant	<u>837,379</u>	<u>14,000</u>	-	<u>851,379</u>
Water and sewer plant in service	<u>21,940,047</u>	<u>14,000</u>	-	<u>21,954,047</u>
Total utility plant in service	58,960,779	3,125,176	-	62,085,955
Less accumulated depreciation	<u>(35,353,059)</u>	<u>(2,028,382)</u>	-	<u>(37,381,441)</u>
	<u>23,607,720</u>	<u>1,096,794</u>	-	<u>24,704,514</u>
<u>Non-depreciable assets:</u>				
<u>Construction work-in-process:</u>				
Electric plant	7,280	2,848,634	(2,826,752)	29,162
Water and sewer plant	<u>7,017,819</u>	<u>1,523,043</u>	<u>(787,013)</u>	<u>7,753,849</u>
	<u>7,025,099</u>	<u>4,371,677</u>	<u>(3,613,765)</u>	<u>7,783,011</u>
	\$ <u>30,632,819</u>	\$ <u>5,468,471</u>	\$ <u>(3,613,765)</u>	\$ <u>32,487,525</u>
	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	<u>40,273,615</u>	<u>1,180,164</u>	<u>(4,433,047)</u>	<u>37,020,732</u>
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>	-	<u>(6,200)</u>	<u>837,379</u>
Water and sewer plant in service	<u>20,387,315</u>	<u>1,558,932</u>	<u>(6,200)</u>	<u>21,940,047</u>
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>

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(5) Utility Plant, Continued

At September 30, 2015 and 2014, 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 Nos. 2099 and 2100) administered by the FSM National Government (FSMNG) (see note 6). PUC has no related commitment for project funds through internal sources. At September 30, 2015, a substantial portion of the project has been completed and placed in service, with the final project close-out date anticipated for July 2016.

During the year ended September 30, 2015, PUC purchased and installed three generators with a total cost of approximately \$2.826 million of which \$2 million was funded by FSMNG appropriations (see note 7) and \$826,000 through a bank loan (see note 6).

A generator (Engine #8) with a total cost of \$2.77 million and fully depreciated as of September 30, 2015, became nonoperational in October 2015 and was subsequently decommissioned.

During the year ended September 30, 2014, one of the two generators placed in service during the year became nonoperational and beyond repair in that same year, and as such, the asset was written off resulting in an approximate \$457,000 impairment loss.

Additionally, a generator (Engine #9) became nonoperational in September 2014 and was decommissioned in October 2014. The asset cost and accumulated depreciation were written off as of September 30, 2014, resulting in an impairment loss of approximately \$572,000.

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, 2015 and 2014 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, 2015 and 2014 include an outstanding balance of \$189,131 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 5% and 2.5% over the TCD rate (effective rate of 5.25% and 3.00% at September 30, 2015 and 2014, respectively) and currently expires August 2016. The agreements restrict 100% of the line and 105% of the outstanding loan balance at September 30, 2015 and 2014, respectively, and as such, the related TCD balances of \$190,000 and \$199,500 are reflected as restricted in the accompanying statements of net position as of September 30, 2015 and 2014, respectively.

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

Changes in notes payable during the years ended September 30, 2015 and 2014, are as follows:

	Outstanding October 1, <u>2014</u>	<u>Increases</u>	<u>Decreases</u>	Outstanding September 30, <u>2015</u>
Notes payable to PSG	\$ 200,000	\$ -	\$ -	\$ 200,000
Notes payable to BFSM	<u>189,131</u>	<u>-</u>	<u>-</u>	<u>189,131</u>
	<u>\$ 390,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 389,131</u>
	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>

Long-term debt consists of the following at September 30, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
Payable on ADB loan no. 1459, administered by the FSMNG. 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%.	\$ 2,000,695	\$ 2,377,669
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.	4,955,287	5,114,941
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, 2015 and 2014, respectively). Proceeds are used for infrastructure projects to overhaul sewage pumps, extend sewage lines, and for treatment plants.	2,042,089	1,277,906
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%.	513,351	521,890

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

	<u>2015</u>	<u>2014</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.	313,618	390,186
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.	147,513	236,833
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%.	21,138	56,790
Loan payable to Bank of Guam, original amount of \$830,000, interest at 7% and monthly installments of \$7,529 from December 15, 2014 to November 15, 2029. The loan is collateralized by a certain chattel mortgage on the three generators purchased in 2015 (see note 5).	<u>804,474</u>	<u>-</u>
Total long-term debt	10,798,165	9,976,215
Less: current portion of long-term debt	<u>666,723</u>	<u>581,804</u>
Long-term portion of long-term debt	\$ <u>10,131,442</u>	\$ <u>9,394,411</u>

Total interest capitalized in construction work-in-process and long-term debt (no. 2099 and no. 2100) approximated \$42,300 and \$7,400 during the years ended September 30, 2015 and 2014, respectively.

At September 30, 2015, 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.

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Notes to Financial Statements
September 30, 2015 and 2014

(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>
2016	\$ 666,723	\$ 223,883	\$ 890,606
2017	601,453	200,630	802,083
2018	607,254	182,131	789,385
2019	521,570	166,528	688,098
2020	522,048	157,331	679,379
2021-2025	2,860,023	634,640	3,494,663
2026-2030	3,087,151	343,319	3,430,470
2031-2035	1,600,614	120,505	1,721,119
2036-2040	219,719	40,385	260,104
2041-2044	<u>111,610</u>	<u>10,073</u>	<u>121,683</u>
	<u>\$ 10,798,165</u>	<u>\$ 2,079,425</u>	<u>\$ 12,877,590</u>

Changes in long-term debt for the years ended September 30, 2015 and 2014, are as follows:

	<u>Outstanding October 1, 2014</u>	<u>Increases</u>	<u>Decreases</u>	<u>Outstanding September 30, 2015</u>	<u>Current</u>
Loan payable to:					
ADB no. 1459	\$ 2,377,669	\$ -	\$ (376,974)	\$ 2,000,695	\$ 48,703
ADB no. 2099	5,114,941	370,197	(529,851)	4,955,287	262,523
ADB no. 2100	1,277,906	825,777	(61,594)	2,042,089	71,739
RUS	521,890	-	(8,539)	513,351	8,594
BFSM	390,186	-	(76,568)	313,618	88,758
FSMDB	236,833	-	(89,320)	147,513	132,284
BOG	56,790	-	(35,652)	21,138	21,138
BOG	<u>-</u>	<u>830,000</u>	<u>(25,526)</u>	<u>804,474</u>	<u>32,984</u>
	<u>\$ 9,976,215</u>	<u>\$ 2,025,974</u>	<u>\$ (1,204,024)</u>	<u>\$ 10,798,165</u>	<u>\$ 666,723</u>

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

**POHNPEI UTILITIES CORPORATION
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(7) Grants, Subsidies and Capital Contributions

Grants and subsidies comprise the following for the years ended September 30, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
Operating Grants:		
Other FSM or U.S grants and subsidies	\$ <u> -</u>	\$ <u> 80,000</u>
Capital Contributions		
FSM National Government – generators	\$ 1,416,500	\$ 583,500
FSM National Government – water distribution	-	1,558,932
Caroline Fisheries Corporation – generator	<u> -</u>	<u> 12,328</u>
Capital contributions	\$ <u>1,416,500</u>	\$ <u>2,154,760</u>

(8) Contributions

During the year ended September 30, 1995, sole use rights for the Nanpohnmal Power Plant were contributed to PUC by the 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 FSMNG. 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 \$173,860 and \$174,124, respectively, at September 30, 2015 and 2014.

(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. At September 30, 2015 and 2014, balances of \$146,937 and \$145,112, respectively, are maintained in a bank deposit account that is held as collateral for a bank loan with an outstanding balance of \$21,138 and \$56,790, respectively. The deposit balances continued to be shown as restricted in the accompanying financial statements 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.

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(11) Related Party Transactions

At September 30, 2015 and 2014, accounts receivable include amounts owed by the State of Pohnpei and its component units to PUC of \$806,274 and \$826,832, respectively.

At September 30, 2015 and 2014, PUC has a non-interest bearing advance from the PUC Social Club of \$146,180 and \$132,820, respectively. Further, at September 30, 2015 and 2014, PUC has a non-interest bearing advance from the State of Pohnpei of \$1,041,354 and \$659,254, respectively, resulting from the ADB loan repayments made by the State of Pohnpei for PUC. 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, 2015 and 2014, 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, 2015 and 2014 from FSM Petroleum Corporation (FSMPC), a component unit of FSMNG. At September 30, 2015 and 2014, long-term deposits in the amount of \$888,750 and \$576,213, respectively, for which \$576,213 was received 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, 2015 and 2014, payables to FSMPC were \$540,517 and \$971,784, respectively.

(12) Retirement Plan

PUC's retirement plan (the Plan) is a self-administered program established to pay retirement, disability and survivor income to employees and their survivors to supplement similar benefits that employees receive from the FSM Social Security System. Starting August 2014, PUC matches a percentage of participants' contributions. Matching contributions to the Plan during the years ended September 30, 2015 and 2014 were \$89,780 and \$16,540 respectively. Management is of the opinion that the Plan does not represent an asset or a liability of PUC and as such no related assets or liabilities have been recorded in the accompanying statements of net assets.

(13) Restricted Net Position

At September 30, 2015 and 2014, net position is restricted for the following purposes:

	<u>2015</u>	<u>2014</u>
Self-insurance fund (note 10)	\$ 146,937	\$ 145,112
Fuel deposit from sub-grant (note 11)	<u>576,213</u>	<u>576,213</u>
	\$ <u>723,150</u>	\$ <u>721,325</u>

(14) 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, 2015
(With comparative totals as of September 30, 2014)

<u>Assets</u>	<u>Power and Utility</u>	<u>Water and Sewer</u>	<u>Totals</u>	
			2015	2014
Current assets:				
Cash and cash equivalents	\$ 395,370	\$ -	\$ 395,370	\$ 763,949
Investments	173,860	-	173,860	174,124
Time certificates of deposit	54,731	-	54,731	45,379
Accounts receivable, net	1,196,281	399,473	1,595,754	1,627,574
Divisional (payable) receivable	(1,140,896)	1,140,896	-	-
Prepayments	27,192	-	27,192	601,226
Fuel and material inventory, net	199,182	22,808	221,990	1,246,525
Total current assets	905,720	1,563,177	2,468,897	4,458,777
Other noncurrent assets:				
Long-term deposit	888,750	-	888,750	576,213
Restricted - cash and cash equivalents	484,450	-	484,450	495,172
Total other noncurrent assets	1,373,200	-	1,373,200	1,071,385
Utility plant, at cost:				
Electric plant in service	40,131,908	-	40,131,908	37,020,732
Water and sewer plant in service	-	21,954,047	21,954,047	21,940,047
	40,131,908	21,954,047	62,085,955	58,960,779
Less accumulated depreciation	(25,882,173)	(11,499,268)	(37,381,441)	(35,353,059)
Depreciable assets	14,249,735	10,454,779	24,704,514	23,607,720
Construction work-in-process	29,162	7,753,849	7,783,011	7,025,099
Total utility plant	14,278,897	18,208,628	32,487,525	30,632,819
	\$ 16,557,817	\$ 19,771,805	\$ 36,329,622	\$ 36,162,981
<u>Liabilities and Net Position</u>				
Current liabilities:				
Notes payable	\$ 389,131	\$ -	\$ 389,131	\$ 389,131
Current portion of long-term debt	275,164	391,559	666,723	581,804
Accounts payable:				
Operations	716,921	1,041,354	1,758,275	1,162,735
Fuel, lubricants and kwh purchased	540,517	-	540,517	971,784
Unearned revenue	284,385	-	284,385	192,078
Accrued taxes and other liabilities	293,090	-	293,090	274,463
Employees' annual leave	72,577	-	72,577	61,754
Total current liabilities	2,571,785	1,432,913	4,004,698	3,633,749
Noncurrent liabilities:				
Loan payable - FSM Development Bank	15,229	-	15,229	126,061
Loan payable - RUS	-	504,757	504,757	513,612
Loans payable - Bank of Guam	771,490	-	771,490	23,976
Loan payable - Bank of the FSM	224,860	-	224,860	317,115
Loans payable - ADB	-	8,615,106	8,615,106	8,413,647
Total liabilities	3,583,364	10,552,776	14,136,140	13,028,160
Net position:				
Net investment in capital assets	13,474,423	8,697,206	22,171,629	21,490,412
Restricted	723,150	-	723,150	721,325
Unrestricted	(1,223,120)	521,823	(701,297)	923,084
Total net position	12,974,453	9,219,029	22,193,482	23,134,821
	\$ 16,557,817	\$ 19,771,805	\$ 36,329,622	\$ 36,162,981

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, 2015
(With comparative totals for the year ended September 30, 2014)

	Power and Utility	Water and Sewer	Totals	
			2015	2014
Operating revenues:				
Residential	\$ 124,682	\$ 1,194,532	\$ 1,319,214	\$ 1,643,372
Cash power	7,015,789	-	7,015,789	8,296,570
Cash water	-	24,266	24,266	-
Commercial	3,009,193	200,827	3,210,020	3,704,450
Government	2,043,037	216,902	2,259,939	3,042,311
Other sales	33,103	11,763	44,866	51,531
Total operating revenues before bad debts	12,225,804	1,648,290	13,874,094	16,738,234
Bad debts	(111,890)	(474,149)	(586,039)	(944,928)
Total operating revenues after bad debts	12,113,914	1,174,141	13,288,055	15,793,306
Operating and maintenance expenses:				
Production fuel	6,903,490	-	6,903,490	9,615,127
Kwh purchased	1,292,751	-	1,292,751	1,657,879
Depreciation	1,404,508	623,874	2,028,382	2,324,004
Inventory stock obsolescence	869,367	144,576	1,013,943	-
Administrative and general:				
Salaries and wages	497,007	-	497,007	457,037
Employee benefits	456,107	-	456,107	335,785
Travel	113,011	-	113,011	56,772
Vehicle, POL	110,035	-	110,035	107,735
Insurance	102,953	-	102,953	64,496
Communications	95,358	-	95,358	55,606
Contractual services	92,077	-	92,077	175,920
Consumables and supplies	79,460	-	79,460	61,857
Customer service and collection	71,887	-	71,887	99,854
Repairs and maintenance	71,526	-	71,526	52,690
Other	154,212	-	154,212	65,589
	1,843,633	-	1,843,633	1,533,341
Distribution:				
Salaries and wages	764,379	-	764,379	717,576
Repairs and maintenance	146,367	-	146,367	59,886
Consumables and supplies	90,803	-	90,803	77,553
	1,001,549	-	1,001,549	855,015
Generation:				
Salaries and wages	451,750	-	451,750	366,730
Repairs and maintenance	49,060	-	49,060	299,200
Other	51,628	-	51,628	53,023
	552,438	-	552,438	718,953
Water and sewer:				
Salaries and wages	-	518,438	518,438	525,881
Chemicals	-	119,490	119,490	50,746
Consumables and supplies	-	75,202	75,202	113,121
Employee benefits	-	60,886	60,886	65,887
Repairs and maintenance	-	54,843	54,843	49,238
Other	-	30,792	30,792	21,350
	-	859,651	859,651	826,223
Total operating and maintenance expenses	13,867,736	1,628,101	15,495,837	17,530,542
Operating loss	(1,753,822)	(453,960)	(2,207,782)	(1,737,236)

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, 2015
(With comparative totals for the year ended September 30, 2014)

	Power and Utility	Water and Sewer	Totals	
			2015	2014
Nonoperating (expenses) revenues, net:				
Interest expense, net	(136,215)	(13,842)	(150,057)	(153,800)
Loss on asset impairment	-	-	-	(1,030,306)
Grants and subsidies	-	-	-	80,000
Total nonoperating expenses, net	<u>(136,215)</u>	<u>(13,842)</u>	<u>(150,057)</u>	<u>(1,104,106)</u>
Loss before capital contributions	(1,890,037)	(467,802)	(2,357,839)	(2,841,342)
Capital contributions:				
Grants from foreign government and others	<u>1,416,500</u>	<u>-</u>	<u>1,416,500</u>	<u>2,154,760</u>
Change in net position	(473,537)	(467,802)	(941,339)	(686,582)
Net position at beginning of year	<u>13,447,990</u>	<u>9,686,831</u>	<u>23,134,821</u>	<u>23,821,403</u>
Net position at end of year	<u>\$ 12,974,453</u>	<u>\$ 9,219,029</u>	<u>\$ 22,193,482</u>	<u>\$ 23,134,821</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, 2015, 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 17, 2016.

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. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings as items 2015-01 and 2015-02 that we consider to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether PUC's financial statements are free from 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*.

PUC's Response to Findings

PUC's responses to the findings identified in our audit are described in the accompanying Schedule of Findings. PUC's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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 17, 2016

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

Schedule of Findings
Year Ended September 30, 2015

Finding No.2015-01

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 \$188,000 during the year ended September 30, 2015 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 enforcement of the current procedures that are already in place. Physical counts will be more frequent throughout the Fiscal Year, quarterly, to ensure accuracy of inventory movement. This process will be prioritized until PUC achieve full compliance of the corrective action plan.

Personnel who will be responsible for the enforcement of this corrective plan are:

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

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

September 30, 2016 will be our target date.

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

Schedule of Findings
Year Ended September 30, 2015

Finding No.2015-02

Criteria: Monthly reconciliation of significant accounts should be performed and financial statements adjusted during the year to facilitate a timely year-end closing, as well as providing accurate interim financial statements for management and Board of Director reviews during the year.

Condition: Delays in performing monthly reconciliations resulted in a high number of post-closing adjustments that impacted all areas of PUC's internal financial statements. Additionally, this resulted in a delayed audit process.

Cause: The cause of this condition is due to insufficient accounting personnel and resources.

Effect: Inaccurate internal financial statements during the year and delay in the audit process resulted.

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

Recommendation: PUC should assess the resource needs of its accounting and finance function. A monthly reconciliation and closing checklist should be developed, with a target deadline be established for each significant areas.

Auditee Response and Corrective Action Plan:

We concur with the auditor's recommendation. PUC should assess the resource needs of its accounting and finance function. Currently, the accountant is picking up duties of a vacant position, which may contribute to the delay in meeting monthly reconciliations, therefore PUC shall hire personnel to fill up the vacancy. A monthly reconciliation and closing checklist will be developed with a target deadline to be established for each significant area.

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

Summary Schedule of Prior Year Findings
Year Ended September 30, 2015

There are no prior year findings unresolved as of September 30, 2015.