

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

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

YEARS ENDED SEPTEMBER 30, 2018 AND 2017

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

Table of Contents
Years Ended September 30, 2018 and 2017

	<u>Page No.</u>
I. Independent Auditors' Report	1
II. Management's Discussion and Analysis	3
III. Financial Statements:	
Statements of Net Position	7
Statements of Revenues, Expenses, and Changes in Net Position	8
Statements of Cash Flows	9
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 and Responses	27
Unresolved Prior Year Findings	29

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, 2018 and 2017, 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, 2018 and 2017, 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 6 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the 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 as a whole. The supplemental combining schedules on pages 22 to 24 are presented for purposes of additional analysis and are not a required part of the 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 financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the 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 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 July 1, 2019, 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 solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of PUC's 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

July 1, 2019

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

Management's Discussion and Analysis
Years Ended September 30, 2018 and 2017

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, 2018 and 2017. The discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

PUC is a public corporation of the Pohnpei State Government and is the primary provider of Power, Water and Sewer services for the island. It is under the governance of a seven-member Board of Directors that was appointed by the Governor and approved by the Legislature of Pohnpei State, which has oversight over operation of the Power, Water and Sewer utilities services. The General Manager who is hired by the Board of Directors oversees the daily operation of PUC.

PUC is operating with three (3) 3516C Caterpillar engines, two (2) 3516B Caterpillars engines, two (2) 3512 Caterpillar engines, and two (2) C18 Caterpillar engines. Of the nine (9) gensets, unit #1 3512 is not operational due to a generator failure, and unit #3 3516C due to a cracked engine block. PUC has an installed diesel generation capacity of 12,340 kW, and has been de-rated to 5800 kW. A 2,200kW diesel generation capacity under a Power Purchase Agreement with the FSM Petroleum Corporation has been de-rated to 1,050 kW. Renewables include 725 kW from Nanpil Hydro Plant, 180kW from Palikir Solar Plant, 200kW from Nett School Solar Plant, and 600 kW from Pohnlangas Solar Plant. A total available diesel capacity of 7,200 kW in 2017 has decreased to 5,800 kW during the latter part of fiscal year 2018, due to mechanical problems on Cat #1, with the peak demand of 6,178 kW recorded in May of 2018. PUC produced 36,947,906 kWhr and 36,882,381 kWhr, and sold 29,098,406 kWhr and 29,170,732 kWhr to customers in 2017 and 2018, respectively. The number of customers being serviced by the PUC is 7,315 (7,141 using cash power meters and 174 using conventional meters) in 2018. The service coverage is 96% of the population.

Presently, PUC is managing four separate water systems. The systems include the Central (Kolonia), Palikir, Lukop and Wapar Water Supply systems. The sources of water supply for these systems are both surface and ground water. The Central Water Supply depends on surface water and supplemented by ground water wells. Ground Water (Well) is the main water source for Palikir, Lukop and Wapar Water Supply system. Since then and up to the present, the central water system goes through a treatment process (rapid sand filter media's). Palikir, Lukop, and Wapar do not have a treatment process. All sources are being distributed to the general public for consumption. To ensure that quantity is met, the systems have several holding tanks for that purpose.

PUC has the aptitude to produce 5 million gallons per day. The daily water demand to existing customers varies from 1.8 to 2.8 million gallons per day. PUC sold 569 million gallons and 582 million gallons to customers in 2017 and 2018, respectively, which resulted in total revenue of \$1.39 million and \$1.56 million, respectively. PUC services the total of 3,934 households, 3,625 of which on conventional postpaid meters and 309 on prepaid meters (cash water) which covers about 2/3 of Pohnpei in area, or 61% of the population.

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

Management's Discussion and Analysis
Years Ended September 30, 2018 and 2017

The following table summarizes the financial condition and operations of the PUC for years ended September 30, 2018, 2017, and 2016:

Assets:	<u>2018</u>	<u>2017</u>	<u>2016</u>
Utility plant, net	\$ 30,406,316	\$ 32,438,233	\$ 34,500,711
Current assets	3,236,193	2,945,336	3,143,209
Other noncurrent assets	<u>1,774,385</u>	<u>1,773,849</u>	<u>1,665,374</u>
	<u>\$ 35,416,894</u>	<u>\$ 37,157,418</u>	<u>\$ 39,309,294</u>
Liabilities and Net Position:			
Notes payable	\$ 536,636	\$ 549,131	\$ 549,131
Current portion of long-term debt	475,070	577,064	623,694
Other current liabilities	4,627,941	4,321,891	3,821,612
Long-term debt, net of current portion	<u>7,927,544</u>	<u>8,484,337</u>	<u>9,132,336</u>
Total liabilities	<u>13,567,191</u>	<u>13,932,423</u>	<u>14,126,773</u>
Net Position:			
Net investment in capital assets	22,024,030	23,500,610	25,025,628
Restricted	723,686	723,150	723,150
Unrestricted	<u>(898,013)</u>	<u>(998,765)</u>	<u>(566,257)</u>
Total net position	<u>21,849,703</u>	<u>23,224,995</u>	<u>25,182,521</u>
	<u>\$ 35,416,894</u>	<u>\$ 37,157,418</u>	<u>\$ 39,309,294</u>
Revenues, Expenses and Changes in Net Position:			
Operating revenues	\$ 13,959,924	\$ 12,366,608	\$ 12,033,847
Bad debts	(506,464)	(775,031)	(150,534)
Operating and maintenance expenses	<u>(15,041,406)</u>	<u>(13,581,294)</u>	<u>(12,884,420)</u>
Operating loss	(1,587,946)	(1,989,717)	(1,001,107)
Non-operating (expenses) revenues, net	<u>(387,683)</u>	<u>(75,294)</u>	<u>161,840</u>
Loss before capital contributions	(1,975,629)	(2,065,011)	(839,267)
Capital contributions	<u>600,337</u>	<u>107,485</u>	<u>3,828,306</u>
Change in net position	(1,375,292)	(1,957,526)	2,989,039
Net position at beginning of year	<u>23,224,995</u>	<u>25,182,521</u>	<u>22,193,482</u>
Net position at end of year	<u>\$ 21,849,703</u>	<u>\$ 23,224,995</u>	<u>\$ 25,182,521</u>

Overall changes in the statements of net position components from September 2017 to 2018 include a decrease of utility plant of \$2,031,917, an increase of current and other noncurrent assets of \$291,393 and a decrease in total liabilities of \$365,232.

Decrease in utility plant are the result of depreciation, asset dispositions and transfers. Please see note 4 to the financial statements for additional information on PUC's utility plant.

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

Management's Discussion and Analysis
Years Ended September 30, 2018 and 2017

Our current assets (cash and cash equivalents, time certificates of deposit, net accounts receivable, and net material and fuel inventory) increased but prepayments decreased due to receipts of ordered items.

Decrease in liabilities is primarily due to a decrease in long-term debts. Please see note 5 to the financial statement for additional information on PUC's debts.

Increase in operating revenue before bad debts is mainly due to the increase in tariff for electricity and an increase in water sales due to additional hookups.

Increase in operating expenses is mainly due to the increase in fuel expense and inventory purchases and due to maintenance on generators.

PUC incurred a loss before capital contribution in 2018 and 2017. Capital contribution for 2018 is \$600,337 as compared to 2017 of \$107,485.

Management's Discussion and Analysis for the year ended September 30, 2017 is set forth in PUC's report on the audit of the financial statements, which is dated June 27, 2018. That Discussion and Analysis explains the major factors impacting our 2017 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 the General Manager at P.O. Box C, Kolonia, Pohnpei.

Economic Outlook

By the end June 2019, the major overhaul of CAT # 1 and # 2 will be completed and Cat # 3 engine will be replaced with a brand new unit. The installation of 2-545 diesel gensets has been completed and are pending completion of the monitoring screens. The available capacity will be 10,100 kW, inclusive of 1400 kW from IPP/PPA, and exclusive of the renewable plant. RE includes 725 kW, Nanpil Run of the river plant, 200 kW Nett Elementary School, 170 kW COM and Capital, and 600 kW Pohnlangas Solar farm and CFC Cat # 2.

With fuel cost creeping upward more renewable sources can offset the increase of fuel cost. A 275 kW Solar project has been funded by New Zealand Ministry of Foreign Affairs. PUC signed a PPA with Kepirohi Solar Energy Limited for a 3 MW solar plant and 1 MW Battery Storage System.

PUC is actively looking at ways to improve operational efficiencies by addressing station and distribution losses. Reform in collection has contributed to the improved collection for the interim as we seek funding to increase prepaid cash water to reduce AR.

PUC had engaged the services of the Graduate School USA to recommend a financial package for a supplemental management team and to invite donors to assist with the CRISP for PUC. By improving the financial health of PUC the OIDP Sewer Loan can receive repayment from savings.

A TA (9425) under the ADB has been awarded to Tetra Tech for Capacity Building and Sector reform for Renewable Energy Investments.

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

Management's Discussion and Analysis
Years Ended September 30, 2018 and 2017

With the TA (8565) from ADB for the hiring of a consultant to carry out the rate adjustment, PUC will be in a better position to maintain the assets of PUC. The Board has approved the recommendation of the consultant including the proposed amendment to PUC law to enable a smooth implementation of the tariff.

PUC's goal is to be able to stabilize the power situation on Pohnpei by the end of FY2019 and to maintain reliable utility service at an affordable rate to the general public by increasing of RE.

The Water system needs rehabilitation and PUC is actively seeking funding support from donor countries to fund the upgrades. Water extension from COM to Diadi Kitti has been contracted to ABCOR and call for RFP for the extension of water line from Kinakapw to Lehndiadi is in its final stages.

This concludes the management discussion and analysis of the financial statements for the year ended September 30, 2018.

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

Statements of Net Position
September 30, 2018 and 2017

<u>ASSETS</u>	<u>2018</u>	<u>2017</u>
Current assets:		
Cash and cash equivalents	\$ 1,388,441	\$ 1,011,846
Time certificates of deposit	228,788	227,524
Accounts receivable, net	1,373,374	1,291,850
Prepayments	58,974	274,847
Materials and fuel inventory, net	186,616	139,269
Total current assets	<u>3,236,193</u>	<u>2,945,336</u>
Other noncurrent assets:		
Long-term deposits	1,256,912	1,256,912
Restricted - cash and cash equivalents	517,473	516,937
Total other noncurrent assets	<u>1,774,385</u>	<u>1,773,849</u>
Utility plant, at cost:		
Electric plant in service	36,680,866	42,382,809
Water and sewer plant in service	29,933,322	30,818,426
	66,614,188	73,201,235
Less accumulated depreciation	<u>(37,057,939)</u>	<u>(41,195,846)</u>
Depreciable assets, net	29,556,249	32,005,389
Construction work-in-process	850,067	432,844
Total utility plant	<u>30,406,316</u>	<u>32,438,233</u>
	<u>\$ 35,416,894</u>	<u>\$ 37,157,418</u>
 <u>LIABILITIES AND NET POSITION</u> 		
Current liabilities:		
Notes payable	\$ 536,636	\$ 549,131
Current portion of long-term debt	475,070	577,064
Accounts payable:		
Operations	2,940,151	2,658,087
Fuel, lubricants and kwh purchased	603,096	911,000
Unearned revenue	627,100	391,989
Accrued taxes and other liabilities	334,462	233,389
Employees' annual leave	123,132	127,426
Total current liabilities	5,639,647	5,448,086
Noncurrent liabilities:		
Long-term debt, net of current portion	7,927,544	8,484,337
Total liabilities	<u>13,567,191</u>	<u>13,932,423</u>
Commitments and contingencies		
Net position:		
Net investment in capital assets	22,024,030	23,500,610
Restricted	723,686	723,150
Unrestricted	<u>(898,013)</u>	<u>(998,765)</u>
Total net position	<u>21,849,703</u>	<u>23,224,995</u>
	<u>\$ 35,416,894</u>	<u>\$ 37,157,418</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, 2018 and 2017

	2018	2017
Operating revenues:		
Electricity sales	\$ 12,191,748	\$ 10,928,691
Water sales	1,578,366	1,419,534
Other sales	189,810	18,383
Total operating revenues	13,959,924	12,366,608
Bad debts	(506,464)	(775,031)
Net operating revenues	13,453,460	11,591,577
Operating and maintenance expenses:		
Production fuel	6,390,446	5,869,428
Depreciation	2,109,349	2,218,758
Kwh purchased	2,106,591	1,384,348
Administrative and general	1,769,348	1,780,326
Generation	1,013,720	861,928
Water and sewer	917,516	705,809
Distribution	688,505	760,697
Provision for inventory obsolescence	45,931	-
Total operating and maintenance expenses	15,041,406	13,581,294
Operating loss	(1,587,946)	(1,989,717)
Nonoperating revenues (expenses), net:		
Interest expense, net	(199,977)	(193,315)
Grants and subsidies	100,000	-
Loss on disposal of utility assets	(420,031)	(939)
Other income	132,325	118,960
Total nonoperating (expenses) income, net	(387,683)	(75,294)
Loss before capital contributions	(1,975,629)	(2,065,011)
Capital contributions:		
Capital contributions	600,337	107,485
Total capital contributions	600,337	107,485
Change in net position	(1,375,292)	(1,957,526)
Net position at beginning of year	23,224,995	25,182,521
Net position at end of year	\$ 21,849,703	\$ 23,224,995

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, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Cash received from customers	\$ 13,504,262	\$ 12,427,884
Cash payments to suppliers for goods and services	(10,635,691)	(9,114,465)
Cash paid to employees	(2,543,164)	(2,066,647)
Net cash provided by operating activities	325,407	1,246,772
Cash flows from investing activities:		
Interest and dividends on investments and bank account	1,501	394
Net cash provided by investing activities	1,501	394
Cash flows from noncapital financing activities:		
Net decrease in note payable	(12,495)	-
Operating grants received	100,000	-
Net cash provided by noncapital financing activities	87,505	-
Cash flows from capital and related financing activities:		
Interest paid	(202,742)	(195,795)
Principal repayment of long-term debt	(160,567)	(444,977)
Cash receipts from grantor for capital projects	913,475	-
Acquisition of utility plant	(587,448)	(49,734)
Net cash used in capital and related financing activities	(37,282)	(690,506)
Net change in cash and cash equivalents	377,131	556,660
Cash and cash equivalents at beginning of year	1,528,783	972,123
Cash and cash equivalents at end of year	\$ 1,905,914	\$ 1,528,783
<u>Reconciliation of operating loss to net cash provided by operating activities:</u>		
Operating loss	\$ (1,587,946)	\$ (1,989,717)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation	2,109,349	2,218,758
Bad debts	506,464	775,031
Inventory obsolescence	45,931	-
Other income	132,325	118,960
(Increase) decrease in assets:		
Accounts receivable	(587,988)	(142,104)
Prepayments	215,873	96,907
Materials and fuel inventory	(93,278)	26,785
Long-term deposits	-	(108,475)
Increase (decrease) in liabilities:		
Accounts payable	(434,075)	162,521
Unearned revenue	(78,027)	84,420
Accrued taxes and other liabilities	101,073	(23,673)
Employees' annual leave	(4,294)	27,359
Net cash provided by operating activities	\$ 325,407	\$ 1,246,772

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

During the years ended September 30, 2018 and 2017, loan payments of \$408,235 and \$249,652, respectively, were made by Pohnpei State Government. As a result, PUC increased its accounts payable and reduced its long-term debt by the same amount.

During the year ended September 30, 2018, PUC was allocated a decrease of \$89,985 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 year ended September 30, 2018, PUC performed a physical inspection of all capital assets and wrote off a total of \$6,667,287 of capital assets not in existence, which resulted in recognition of loss of \$420,031.

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2018 and 2017

(1) 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.

PUC's financial statements are incorporated into the financial statements of the State of Pohnpei as a component unit.

(2) Summary of Significant Accounting Policies

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and modified by Statement No. 38, *Certain Financial Statement Note Disclosures*, establish financial reporting standards for governmental entities, which require that management's discussion and analysis of the financial activities be included with the basic financial statements and notes and modifies certain other financial statement disclosure requirements.

To conform to the requirements of GASB 34, equity is presented in the following net position categories:

- Net investment in capital assets - capital assets, net of accumulated depreciation, plus construction or improvement of those assets, net of related debts.
- Restricted: Nonexpendable - net position subject to externally imposed stipulations that requires PUC to maintain such permanently. At September 30, 2018 and 2017, PUC does not have nonexpendable net position. Expendable - net position whose use by PUC is subject to externally imposed stipulations that can be fulfilled by actions of PUC pursuant to those stipulations or that expire by the passage of time.
- Unrestricted - net position that is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and deferred outflows of resources, and liabilities and deferred inflows of resources associated with the operation of the fund are included in the statements of net position. Proprietary fund operating statements present increases and decreases in net position. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

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

Notes to Financial Statements
September 30, 2018 and 2017

(2) Summary of Significant Accounting Policies, Continued

Cash and Cash Equivalents and Time Certificates of Deposit

For purposes of the statements of net position and of cash flows, cash and cash equivalents are defined as cash on hand and cash held in bank deposit accounts. Time certificates of deposit with original maturity dates greater than three months and those deposits that are restricted for use are separately classified in the statements of net position.

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, 2018 and 2017, the carrying amount of cash and cash equivalents and time certificates of deposit was \$2,134,702 and \$1,756,307, respectively, and the corresponding bank balances were \$2,209,679 and \$1,849,854, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2018 and 2017, bank deposits of \$500,000 were FDIC insured. PUC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

Accounts Receivable and Allowance for Doubtful Accounts

All receivables are due from government agencies, businesses and individuals located within the State of Pohnpei and are interest free and uncollateralized. The allowance for uncollectable accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectable based on evaluations of the collectability of these accounts and prior collection experience. Management determines the adequacy of the allowance for uncollectable accounts based upon review of the aged accounts receivable. The allowance is established through a provision for bad debts charged to expense. Accounts deemed uncollectable are written off against the allowance based on the specific identification method.

Inventories

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. At September 30, 2018 and 2017, inventory is net of an allowance for obsolescence of \$1,034,114 and \$988,183, respectively.

Deferred Outflows of Resources

In addition to assets, the statements of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. As of September 30, 2018 and 2017, PUC has no items that qualify for reporting in this category.

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

Notes to Financial Statements
September 30, 2018 and 2017

(2) Summary of Significant Accounting Policies, Continued

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, with an estimated useful life in excess of one year.

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.

Deferred Inflows of Resources

In addition to liabilities, the statements of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. As of September 30, 2018 and 2017, PUC has no items that qualify for reporting in this category.

Compensated Absences

Earned but unused annual leave is paid to employees upon termination of their employment. Accordingly, vested or accumulated vacation leave is recorded as an expense and liability as the benefits accrue to employees. It is the policy of PUC to record the cost of sick leave when leave is actually taken and an expense is actually incurred. Accordingly, no liability is recorded for nonvesting accumulating rights to receive sick pay benefits.

Revenue Recognition

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 and water revenue is recognized as revenue upon point of sale; the estimated unearned portion is determined at the end of each year. At September 30, 2018 and 2017, the estimated unearned cash power revenue of \$189,000 and \$238,000, respectively, is included as part of unearned revenue in the accompanying statements of net position.

Operating and Nonoperating Revenues and Expenses

PUC considers utility 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.

Grants and Subsidies

PUC receives grants from the U.S Government and other foreign governments or entities either as a direct recipient or as a subrecipient from the Pohnpei State Government (PSG) or the FSM National Government (FSMNG) in addition to Pohnpei State Legislature appropriated subsidies and matching funds for federal programs as required.

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

Notes to Financial Statements
September 30, 2018 and 2017

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

During the year ended September 30, 2018, PUC implemented the following pronouncements:

- GASB 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.
- GASB Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement.
- GASB Statement No. 85, *Omnibus 2017*, which addresses practice issues that have been identified during implementation and application of certain GASB Statements including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits).
- GASB Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt.

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

In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) associated with the retirement of a tangible capital asset. The provisions in Statement No. 83 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments. The provisions in Statement No. 84 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

In April 2018, GASB issued Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, which improves the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. The provisions in Statement No. 88 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

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

Notes to Financial Statements
September 30, 2018 and 2017

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, which requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. The provisions in Statement No. 89 are effective for fiscal years beginning after December 15, 2019. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2018, GASB issued Statement No. 90, *Majority Equity Interests – an Amendment of GASB Statements No. 14 and No. 61*, which improves the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and the relevance of financial statement information for certain component units. The provisions in Statement No. 90 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

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 assets and 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.

(3) Accounts Receivable

Accounts receivable at September 30, 2018 and 2017, are summarized as follows:

	<u>2018</u>	<u>2017</u>
Accounts receivable - electrical:		
Residential	\$ 1,707,953	\$ 1,592,805
Commercial	770,516	758,393
Government	<u>616,749</u>	<u>526,527</u>
	<u>3,095,218</u>	<u>2,877,725</u>
Accounts receivable - water and sewer:		
Residential	4,467,706	4,151,920
Commercial and government	576,960	628,219
Unbilled	<u>63,867</u>	<u>72,475</u>
	<u>5,108,533</u>	<u>4,852,614</u>
Installment receivables	72,025	74,061
Other	<u>207,781</u>	<u>91,169</u>
	8,483,557	7,895,569
Less allowance for doubtful accounts	<u>(7,110,183)</u>	<u>(6,603,719)</u>
	<u>\$ 1,373,374</u>	<u>\$ 1,291,850</u>

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

Notes to Financial Statements
September 30, 2018 and 2017

(3) Accounts Receivable, Continued

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. As of September 30, 2018 and 2017, included in accounts receivable – electrical due from customers enrolled in the cash power meter system are \$1,033,402 and \$1,064,073, respectively.

(4) Utility Plant

A summary of changes in capital assets for the years ended September 30, 2018 and 2017 is as follows:

	Beginning Balance <u>October 1, 2017</u>	Additions and <u>Transfers</u>	Deletions and <u>Transfers</u>	Ending Balance <u>September 30, 2018</u>
<u>Depreciable assets:</u>				
Production plant	\$ 25,862,299	\$ -	\$ (4,797,069)	\$ 21,065,230
Distribution plant	14,919,872	91,861	(419,357)	14,592,376
General plant	<u>1,600,638</u>	<u>126,507</u>	<u>(703,885)</u>	<u>1,023,260</u>
Electric plant in service	<u>42,382,809</u>	<u>218,368</u>	<u>(5,920,311)</u>	<u>36,680,866</u>
Water production plant	6,762,885	-	(41,720)	6,721,165
Sewage collection and treatment plant	14,375,906	-	(768,045)	13,607,861
Water distribution plant	8,827,482	7,903	-	8,835,385
General plant	<u>852,153</u>	<u>32,201</u>	<u>(115,443)</u>	<u>768,911</u>
Water and sewer plant in service	<u>30,818,426</u>	<u>40,104</u>	<u>(925,208)</u>	<u>29,933,322</u>
Total utility plant in service	73,201,235	258,472	(6,845,519)	66,614,188
Less accumulated depreciation	<u>(41,195,846)</u>	<u>(2,109,349)</u>	<u>6,247,256</u>	<u>(37,057,939)</u>
	<u>32,005,389</u>	<u>(1,850,877)</u>	<u>(598,263)</u>	<u>29,556,249</u>
<u>Non-depreciable assets:</u>				
Construction work-in-process:				
Electric plant	124,133	556,542	(34,476)	646,199
Water and sewer plant	<u>308,711</u>	<u>126,063</u>	<u>(230,906)</u>	<u>203,868</u>
	<u>432,844</u>	<u>682,605</u>	<u>(265,382)</u>	<u>850,067</u>
	\$ <u>32,438,233</u>	\$ <u>(1,168,272)</u>	\$ <u>(863,645)</u>	\$ <u>30,406,316</u>

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

Notes to Financial Statements
September 30, 2018 and 2017

(4) Utility Plant, Continued

	Beginning Balance <u>October 1, 2016</u>	Additions and <u>Transfers</u>	Deletions and <u>Transfers</u>	Ending Balance <u>September 30, 2017</u>
<u>Depreciable assets:</u>				
Production plant	\$ 25,862,299	\$ -	\$ -	\$ 25,862,299
Distribution plant	14,919,872	-	-	14,919,872
General plant	<u>1,539,576</u>	<u>99,915</u>	<u>(38,853)</u>	<u>1,600,638</u>
Electric plant in service	<u>42,321,747</u>	<u>99,915</u>	<u>(38,853)</u>	<u>42,382,809</u>
Water production plant	6,762,885	-	-	6,762,885
Sewage collection and treatment plant	14,201,239	174,667	-	14,375,906
Water distribution plant	8,827,482	-	-	8,827,482
General plant	<u>843,116</u>	<u>15,501</u>	<u>(6,464)</u>	<u>852,153</u>
Water and sewer plant in service	<u>30,634,722</u>	<u>190,168</u>	<u>(6,464)</u>	<u>30,818,426</u>
Total utility plant in service	72,956,469	290,083	(45,317)	73,201,235
Less accumulated depreciation	<u>(39,021,466)</u>	<u>(2,218,758)</u>	<u>44,378</u>	<u>(41,195,846)</u>
	<u>33,935,003</u>	<u>(1,928,675)</u>	<u>(939)</u>	<u>32,005,389</u>
<u>Non-depreciable assets:</u>				
Construction work-in-process:				
Electric plant	118,614	5,519	-	124,133
Water and sewer plant	<u>447,094</u>	<u>36,284</u>	<u>(174,667)</u>	<u>308,711</u>
	<u>565,708</u>	<u>41,803</u>	<u>(174,667)</u>	<u>432,844</u>
	\$ <u>34,500,711</u>	\$ <u>(1,886,872)</u>	\$ <u>(175,606)</u>	\$ <u>32,438,233</u>

During the year ended September 30, 2018, PUC performed a physical inspection of all capital assets and wrote off a total of \$6,667,286 of capital assets not in existence, which resulted in a loss of \$420,031.

(5) Notes Payable and Long-Term Debt

Notes payable at September 30, 2018 and 2017 include \$200,000 due to Pohnpei State Government (PSG) that is non-interest bearing, uncollateralized and has no set repayment date.

Additionally, notes payable at September 30, 2018 and 2017 include an outstanding balance of \$336,636 and \$349,131, respectively, against a line of credit (LOC) with the Bank of the Federated States of Micronesia (BFSM) of \$370,000. The LOC is collateralized by time certificates of deposit (TCD) with the bank, bearing variable interest at 5% over the TCD rate (effective rate of 5.25% at September 30, 2018 and 2017) and currently expires December 2019. The agreements restrict 100% of the LOC at September 30, 2018 and 2017, respectively, and as such, the related TCD balances of \$370,000 are reflected as restricted cash and cash equivalents in the accompanying statements of net position as of September 30, 2018 and 2017.

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

Notes to Financial Statements
September 30, 2018 and 2017

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

Changes in notes payable during the years ended September 30, 2018 and 2017, are as follows:

	Outstanding October 1, <u>2017</u>	<u>Increases</u>	<u>Decreases</u>	Outstanding September 30, <u>2018</u>
Notes payable to PSG	\$ 200,000	\$ -	\$ -	\$ 200,000
Notes payable to BFSM	<u>349,131</u>	<u>-</u>	<u>(12,495)</u>	<u>336,636</u>
	<u>\$ 549,131</u>	<u>\$ -</u>	<u>\$ (12,495)</u>	<u>\$ 536,636</u>

	Outstanding October 1, <u>2016</u>	<u>Increases</u>	<u>Decreases</u>	Outstanding September 30, <u>2017</u>
Notes payable to PSG	\$ 200,000	\$ -	\$ -	\$ 200,000
Notes payable to BFSM	<u>349,131</u>	<u>-</u>	<u>-</u>	<u>349,131</u>
	<u>\$ 549,131</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 549,131</u>

Long-term debt consists of the following at September 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Payable on ADB loan no. 1459, administered by FSMNG. Repayments as allocated by FSMNG indicates annual principal payments of \$95,315 through FY2017 and \$98,297 for FY2018 through FY2036, plus interest at 1.0%.	\$ 1,747,110	\$ 1,867,901
Payable on ADB loan no. 2099, administered by FSMNG. Repayments as allocated by FSMNG indicates annual principal payments of \$252,109 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.	4,013,835	4,285,843
Payable on ADB loan no. 2100, administered by 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 rate of 0.88% at September 30, 2018 and 2017). Proceeds are used for infrastructure projects to overhaul sewage pumps, extend sewage lines, and for treatment plants.	1,453,577	1,558,998
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%.	482,442	493,246

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

Notes to Financial Statements
September 30, 2018 and 2017

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

	<u>2018</u>	<u>2017</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.	20,328	123,778
Loan payable to Bank of Guam (BOG), original amount of \$830,000, interest at 7% and monthly installments of \$7,529 from December 15, 2014 to November 15, 2019, upon which the unpaid principal is due and payable. The loan is collateralized by a certain chattel mortgage on the three generators purchased in 2015.	<u>685,322</u>	<u>731,635</u>
Total long-term debt	8,402,614	9,061,401
Less: current portion of long-term debt	<u>475,070</u>	<u>577,064</u>
Long-term portion of long-term debt	<u>\$ 7,927,544</u>	<u>\$ 8,484,337</u>

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>
2019	\$ 475,070	\$ 169,855	\$ 644,925
2020	1,062,432	127,711	1,190,143
2021	429,291	110,068	539,359
2022	439,476	103,491	542,967
2023	450,633	96,587	547,220
2024-2028	2,464,347	365,720	2,830,067
2029-2033	1,913,915	167,068	2,080,983
2034-2038	1,012,582	64,588	1,077,170
2039-2043	139,202	20,038	159,240
2044-2045	<u>15,666</u>	<u>206</u>	<u>15,872</u>
	<u>\$ 8,402,614</u>	<u>\$ 1,225,332</u>	<u>\$ 9,627,946</u>

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

Notes to Financial Statements
September 30, 2018 and 2017

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

Changes in long-term debt for the years ended September 30, 2018 and 2017, are as follows:

	Outstanding October 1, <u>2017</u>	<u>Increases</u>	<u>Decreases</u>	Outstanding September 30, <u>2018</u>	<u>Current</u>
Loan payable to:					
ADB no. 1459	\$ 1,867,901	\$ -	\$ (120,791)	\$ 1,747,110	\$ 97,069
ADB no. 2099	4,285,843	-	(272,008)	4,013,835	226,901
ADB no. 2100	1,558,998	-	(105,421)	1,453,577	77,322
BOG	731,635	-	(46,313)	685,322	43,099
RUS	493,246	-	(10,804)	482,442	10,351
BFSM	<u>123,778</u>	<u>-</u>	<u>(103,450)</u>	<u>20,328</u>	<u>20,328</u>
	<u>\$ 9,061,401</u>	<u>\$ -</u>	<u>\$ (658,787)</u>	<u>\$ 8,402,614</u>	<u>\$ 475,070</u>

During the year ended September 30, 2018, PUC was allocated a decrease of \$89,985 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.

	Outstanding October 1, <u>2016</u>	<u>Increases</u>	<u>Decreases</u>	Outstanding September 30, <u>2017</u>	<u>Current</u>
Loan payable to:					
ADB no. 1459	\$ 1,942,103	\$ -	\$ (74,202)	\$ 1,867,901	\$ 98,297
ADB no. 2099	4,611,038	-	(325,195)	4,285,843	252,109
ADB no. 2100	1,644,488	-	(85,490)	1,558,998	71,930
BOG	772,732	-	(41,097)	731,635	36,403
RUS	504,730	-	(11,484)	493,246	7,571
BFSM	230,776	-	(106,998)	123,778	110,754
FSMDB	<u>50,163</u>	<u>-</u>	<u>(50,163)</u>	<u>-</u>	<u>-</u>
	<u>\$ 9,756,030</u>	<u>\$ -</u>	<u>\$ (694,629)</u>	<u>\$ 9,061,401</u>	<u>\$ 577,064</u>

(6) Grants, Subsidies and Capital Contributions

Grants, subsidies and capital contributions comprise the following for the years ended September 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Operating Grants:		
FSMNG Congress appropriations	\$ <u>100,000</u>	\$ <u>-</u>
Capital Contributions:		
FSMNG – distribution	\$ 129,539	\$ 38,635
Foreign organization	-	10,000
Foreign government – generators	-	58,850
U.S. Government – generators	<u>470,798</u>	<u>-</u>
Total capital contributions	<u>\$ 600,337</u>	<u>\$ 107,485</u>

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

Notes to Financial Statements
September 30, 2018 and 2017

(7) 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.

(8) 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, a self-insurance fund was established to defray costs of any unforeseen accidents or disasters. At September 30, 2018 and 2017, balances of \$147,473 and \$146,937 respectively, are maintained in a bank deposit account that was held as collateral for a bank loan which was paid off during the year ended September 30, 2016. 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 purchases commercial insurance to cover its potential risks of loss from fire on its building and the contents and full coverage on property damages, but is self-insured for all other losses such as 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.

(9) Related Party Transactions

At September 30, 2018 and 2017, accounts receivable include amounts owed by the State of Pohnpei and its component units to PUC of \$933,366 and \$788,092, respectively.

At September 30, 2018 and 2017, PUC has a non-interest bearing advance from the PUC Social Club of \$123,206 and \$120,624, respectively. Further, at September 30, 2018 and 2017, PUC has a non-interest bearing advance from the State of Pohnpei of \$2,462,549 and \$2,041,154, 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, 2018 and 2017, PUC has a non-interest bearing note payable to the State of Pohnpei of \$200,000 (note 5).

PUC purchased all of its production fuel during the years ended September 30, 2018 and 2017 from FSM Petroleum Corporation (FSMPC), a component unit of FSMNG. At September 30, 2018 and 2017, long-term deposits in the amount of \$1,256,912, 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. PUC also purchases power generated by FSMPC under a Power Purchase Agreement (PPA). The PPA has an initial term of thirty-six months which expired in June 2017. Under the PPA, FSMPC is responsible to acquire, install and operate a 2.0 MW diesel generator, and PUC is committed to purchase available capacity up to the contract capacity, which means an average of 1,600 kW in any given month throughout the PPA term. The PPA is operating in the holdover status as the parties negotiated for renewal or termination. At September 30, 2018 and 2017, payables to FSMPC were \$603,096 and \$911,000, respectively.

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

Notes to Financial Statements
September 30, 2018 and 2017

(10) Retirement Plan

PUC's retirement plan (the Plan) is a self-administered program established to pay retirement, disability and survivor income to employees and their survivors to supplement similar benefits that employees receive from the FSM Social Security System. Starting August 2014, PUC matches a percentage of participants' contributions. Matching contributions to the Plan during the years ended September 30, 2018 and 2017 were \$69,760 and \$75,798, 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 position.

(11) Restricted Net Position

At September 30, 2018 and 2017, net position is restricted for the following purposes:

	<u>2018</u>	<u>2017</u>
Self-insurance fund (note 8)	\$ 147,473	\$ 146,937
Fuel deposit from sub-grant (note 9)	<u>576,213</u>	<u>576,213</u>
	\$ <u>723,686</u>	\$ <u>723,150</u>

(12) 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, 2018 and 2017, 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.

(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. For one case, the Court has ruled in favor of the plaintiff and awarded maximum damage in the amount of \$100,000. PUC is appealing the decision and as such no amount has been recorded in the accompanying financial statements. 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 a future period.

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

Combining Statement of Net Position
September 30, 2018
(With comparative totals as of September 30, 2017)

<u>Assets</u>	Power and Utility	Water and Sewer	Totals	
			2018	2017
Current assets:				
Cash and cash equivalents	\$ 1,388,441	\$ -	\$ 1,388,441	\$ 1,011,846
Time certificates of deposit	228,788	-	228,788	227,524
Accounts receivable, net	1,316,142	57,232	1,373,374	1,291,850
Divisional (payable) receivable	(1,385,819)	1,385,819	0	-
Prepayments	58,974	-	58,974	274,847
Materials and fuel inventory, net	151,593	35,023	186,616	139,269
Total current assets	<u>1,758,119</u>	<u>1,478,074</u>	<u>3,236,193</u>	<u>2,945,336</u>
Other noncurrent assets:				
Long-term deposits	1,256,912	-	1,256,912	1,256,912
Restricted - cash and cash equivalents	517,473	-	517,473	516,937
Total other noncurrent assets	<u>1,774,385</u>	<u>-</u>	<u>1,774,385</u>	<u>1,773,849</u>
Utility plant, at cost:				
Electric plant in service	36,680,866	-	36,680,866	42,382,809
Water and sewer plant in service	-	29,933,322	29,933,322	30,818,426
	<u>36,680,866</u>	<u>29,933,322</u>	<u>66,614,188</u>	<u>73,201,235</u>
Less accumulated depreciation	(23,825,917)	(13,232,022)	(37,057,939)	(41,195,846)
Depreciable assets	12,854,949	16,701,300	29,556,249	32,005,389
Construction work-in-process	646,199	203,868	850,067	432,844
Total utility plant	<u>13,501,148</u>	<u>16,905,168</u>	<u>30,406,316</u>	<u>32,438,233</u>
	<u>\$ 17,033,652</u>	<u>\$ 18,383,242</u>	<u>\$ 35,416,894</u>	<u>\$ 37,157,418</u>
<u>Liabilities and Net Position</u>				
Current liabilities:				
Notes payable	\$ 536,636	\$ -	\$ 536,636	\$ 549,131
Current portion of long-term debt	63,427	411,643	475,070	577,064
Accounts payable:				
Operations	677,602	2,262,549	2,940,151	2,658,087
Fuel, lubricants and kwh purchased	603,096	-	603,096	911,000
Unearned revenue	627,100	-	627,100	391,989
Accrued taxes and other liabilities	334,462	-	334,462	233,389
Employees' annual leave	123,132	-	123,132	127,426
Total current liabilities	<u>2,965,455</u>	<u>2,674,192</u>	<u>5,639,647</u>	<u>5,448,086</u>
Noncurrent liabilities:				
Loan payable - RUS	-	472,091	472,091	485,675
Loan payable - BOG	642,223	-	642,223	695,232
Loan payable - BFSM	-	-	0	13,024
Loans payable - ADB	-	6,813,230	6,813,230	7,290,406
Total liabilities	<u>3,607,678</u>	<u>9,959,513</u>	<u>13,567,191</u>	<u>13,932,423</u>
Net position:				
Net investment in capital assets	12,815,824	9,208,206	22,024,030	23,500,610
Restricted	723,686	-	723,686	723,150
Unrestricted	(113,536)	(784,477)	(898,013)	(998,765)
Total net position	<u>13,425,974</u>	<u>8,423,729</u>	<u>21,849,703</u>	<u>23,224,995</u>
	<u>\$ 17,033,652</u>	<u>\$ 18,383,242</u>	<u>\$ 35,416,894</u>	<u>\$ 37,157,418</u>

See accompanying Independent Auditors' Report.

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

Combining Statement of Revenues, Expenses and Changes in Net Position
Year Ended September 30, 2018
(With comparative totals for the year ended September 30, 2017)

	Power and Utility	Water and Sewer	Totals	
			2018	2017
Operating revenues:				
Residential	\$ 74,550	\$ 1,118,525	\$ 1,193,075	\$ 1,186,298
Cash power	7,457,504	-	7,457,504	6,745,002
Cash water	-	12,315	12,315	28,573
Commercial	2,778,641	216,222	2,994,863	2,585,325
Government	1,881,053	231,304	2,112,357	1,803,027
Other sales	172,985	16,825	189,810	18,383
	<u>12,364,733</u>	<u>1,595,191</u>	<u>13,959,924</u>	<u>12,366,608</u>
Total operating revenues				
Bad debts	(34,424)	(472,040)	(506,464)	(775,031)
	<u>12,330,309</u>	<u>1,123,151</u>	<u>13,453,460</u>	<u>11,591,577</u>
Net operating revenues				
Operating and maintenance expenses:				
Production fuel	6,390,446	-	6,390,446	5,869,428
Depreciation	1,319,389	789,960	2,109,349	2,218,758
Administrative and general:				
Salaries and wages	416,747	-	416,747	442,877
Employee benefits	444,603	-	444,603	470,979
Travel	153,961	-	153,961	136,759
Vehicle, POL	87,026	-	87,026	96,605
Insurance	61,263	-	61,263	68,668
Communications	60,032	-	60,032	64,969
Contractual services	50,140	-	50,140	73,240
Consumables and supplies	26,876	-	26,876	33,349
Customer service and collection	81,851	-	81,851	89,664
Repairs and maintenance	56,124	-	56,124	50,343
Other	330,725	-	330,725	252,873
	<u>1,769,348</u>	<u>-</u>	<u>1,769,348</u>	<u>1,780,326</u>
Kwh purchased	2,106,591	-	2,106,591	1,384,348
Generation:				
Salaries and wages	440,191	-	440,191	451,035
Repairs and maintenance	508,480	-	508,480	381,739
Other	65,049	-	65,049	29,154
	<u>1,013,720</u>	<u>-</u>	<u>1,013,720</u>	<u>861,928</u>
Distribution:				
Salaries and wages	644,739	-	644,739	693,726
Repairs and maintenance	5,974	-	5,974	8,897
Consumables and supplies	37,792	-	37,792	58,074
	<u>688,505</u>	<u>-</u>	<u>688,505</u>	<u>760,697</u>
Water and sewer:				
Salaries and wages	-	499,846	499,846	506,368
Chemicals	-	-	-	7,400
Consumables and supplies	-	-	-	61,678
Employee benefits	-	61,922	61,922	65,705
Repairs and maintenance	-	261,856	261,856	50,486
Other	-	93,892	93,892	14,172
	<u>-</u>	<u>917,516</u>	<u>917,516</u>	<u>705,809</u>
Provision for inventory obsolescence	44,246	1,685	45,931	-
Total operating and maintenance expenses	<u>13,332,245</u>	<u>1,709,161</u>	<u>15,041,406</u>	<u>13,581,294</u>
Operating loss	<u>(1,001,936)</u>	<u>(586,010)</u>	<u>(1,587,946)</u>	<u>(1,989,717)</u>

See accompanying Independent Auditors' Report.

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

Combining Statement of Revenues, Expenses and Changes in Net Position, Continued
Year Ended September 30, 2018
(With comparative totals for the year ended September 30, 2017)

	Power and Utility	Water and Sewer	Totals	
			2018	2017
Nonoperating revenues (expenses), net:				
Interest expense, net	-	(199,977)	(199,977)	(193,315)
Grants and subsidies	100,000	-	100,000	-
Loss on disposal of utility assets	(10,280)	(409,751)	(420,031)	(939)
Other income	-	132,325	132,325	118,960
	<u>89,720</u>	<u>(477,403)</u>	<u>(387,683)</u>	<u>(75,294)</u>
Total nonoperating revenues (expenses), net				
Loss before capital contributions	<u>(912,216)</u>	<u>(1,063,413)</u>	<u>(1,975,629)</u>	<u>(2,065,011)</u>
Capital contributions:				
Capital contributions	600,337	-	600,337	107,485
Total capital contributions	<u>600,337</u>	<u>-</u>	<u>600,337</u>	<u>107,485</u>
Change in net position	(311,879)	(1,063,413)	(1,375,292)	(1,957,526)
Net position at beginning of year	<u>13,737,853</u>	<u>9,487,142</u>	<u>23,224,995</u>	<u>25,182,521</u>
Net position at end of year	<u>\$ 13,425,974</u>	<u>\$ 8,423,729</u>	<u>\$ 21,849,703</u>	<u>\$ 23,224,995</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, 2018, 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 July 1, 2019.

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 and Responses as items 2018-01 and 2018-02 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 and Responses. 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

July 1, 2019

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

Schedule of Findings and Responses
Year Ended September 30, 2018

Finding No.2018-01

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 repairs and maintenance or construction work-in-process 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 \$59,000 during the year ended September 30, 2018 were recorded only as post-closing adjustments in June 2019.

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, 2019 will be our target date.

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

Schedule of Findings and Responses, Continued
Year Ended September 30, 2018

Finding No.2018-02

Criteria: Monthly reconciliations 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 established for each significant area.

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)**

Unresolved Prior Year Findings
Year Ended September 30, 2018

Summary Schedule of Prior Audit Findings

<u>Finding Number</u>	<u>Status</u>
2017-001	Not Corrected or Resolved
2017-002	Not Corrected or Resolved