

**CHUUK PUBLIC UTILITY CORPORATION**

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**FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITORS' REPORT**

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**YEARS ENDED SEPTEMBER 30, 2005 AND 2004**

## INDEPENDENT AUDITORS' REPORT

The Board of Directors  
Chuuk Public Utility Corporation:

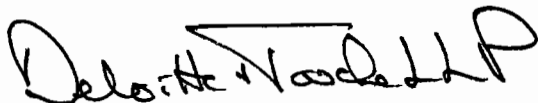
We were engaged to audit the accompanying statements of net assets of the Chuuk Public Utility Corporation (CPUC), a component unit of the Government of the State of Chuuk, as of September 30, 2005 and 2004, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the CPUC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

CPUC was unable to provide schedules, reconciliations and subsidiary ledgers to support 2004 cash in bank balances and receivables, utility plant, accounts payable and accrued expense account balances at both September 30, 2005 and 2004.

Because of the matters discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying financial statements.

The Management Discussion and Analysis on pages 2-3 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplemental information is the responsibility of CPUC's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 5, 2006, on our consideration of CPUC's internal control over financial reporting and 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



July 5, 2006

## CHUUK PUBLIC UTILITIES CORPORATION

### Management's Discussion and Analysis Year Ended September 30, 2005

The following Management Discussion and Analysis of the Chuuk Public Utility Corporation's (CPUC) activities and financial performance provides the reader with an introduction and overview to the financial statements for the fiscal year ended September 30, 2005.

U.S. Government Accounting Standards Board Statement No. 34 requires that published financial statements must contain a management discussion and analysis. This section of the CPUC's annual report presents management's discussion of CPUC's performance for years ended September 30, 2005 and 2004. It should be read in conjunction with the financial statements that follow this section.

The CPUC is a component unit of the Government of the State of Chuuk. Its primary objective is to provide electrical, water, and sewer service to the public.

The following table summarizes the financial position and results of operation of CPUC as of 2005 and 2004.

	<u>2005</u>	<u>2004</u>
<b>Assets:</b>		
Utility plant in service, net	\$6,105,721	\$7,689,874
Current assets	<u>654,280</u>	<u>1,248,221</u>
Total assets	<u>\$6,760,001</u>	<u>\$8,938,095</u>
<b>Net assets and liabilities:</b>		
Invested in capital assets, net of related debt	\$2,143,427	\$3,544,749
Unrestricted	<u>(734,473)</u>	<u>516,891</u>
Total net assets	<u>1,408,954</u>	<u>4,061,640</u>
Long-term debt	3,461,734	3,461,734
Current liabilities	<u>1,889,313</u>	<u>1,414,721</u>
Total liabilities	<u>5,351,047</u>	<u>4,876,455</u>
Total net assets and liabilities	<u>\$6,760,001</u>	<u>\$8,938,095</u>
<b>Revenue, expenses, and changes in net assets</b>		
Operating revenues	\$3,140,136	\$1,121,024
Operating expenses	<u>4,754,868</u>	<u>4,063,053</u>
Operating loss	<u>(1,614,732)</u>	<u>(2,942,029)</u>
Subsidies and other income	548,747	1,982,305
Interest expense	<u>(269,327)</u>	<u>(25,722)</u>
Total non operating revenue	<u>279,420</u>	<u>1,956,583</u>
Net loss	<u>(1,335,312)</u>	<u>(985,446)</u>
Net assets at beginning of year	4,061,640	5,047,086
Prior period adjustment	<u>(1,317,374)</u>	<u>-</u>
Net assets at end of year	<u>\$1,408,954</u>	<u>\$4,061,640</u>

# CHUUK PUBLIC UTILITIES CORPORATION

## Management's Discussion and Analysis Year Ended September 30, 2005

### FINANCIAL HIGHLIGHTS

CPUC's financial position as reflected on its statement of net assets, indicates a decrease in net utility plant assets of \$1.6 million (down 21%) in fiscal year 2005 compared to the prior year. As utility plant assets have steadily depreciated, and cash flows have not been sufficient to replace these assets, the book value of CPUC's capital assets has declined in each of the past five years.

Current assets of \$654,000 at September 30, 2005 also reflect a decline of 48% from the prior year's \$1.25 million. This decline reflects reductions in accounts receivable balances from management's decision to write-off or reserve old receivables of doubtful collectibility.

Total liabilities of \$5.35 million at September 30, 2005 increased \$475,000 from the prior year (up 9.7%). The increase in liabilities generally pertains to increases in unremitted social security taxes, wage tax withholdings, the current portion of notes payable on which CPUC is delinquent.

During fiscal year 2005, operating revenues of \$3.1 million increased by \$2.02 million (up 200%), from \$1.12 million recorded in fiscal year 2004. This increase denotes accounting anomalies in fiscal year 2004 where revenues were not properly recorded rather than significant gains in sales. Total expenditures of \$4.75 million were up 17% from the prior year, almost totally as the result of increases in the price of diesel fuel.

Net non-operating revenues of \$0.28 million in fiscal year 2005 declined \$1.7 million (or 86%) from the \$1.96 million recorded in the prior year as non-capital financing sources dried up. Most of the other income in fiscal year 2005 pertained to a FEMA Hazard Mitigation grant that was utilized for a pole hardening project.

CPUC's overall net loss in fiscal year 2005 of \$1.33 million was 36% higher than the \$0.98 million recorded in fiscal year 2004, virtually all attributable to increased fuel costs.

In fiscal year 2005, CPUC made major adjustments to its accounting records in order to rectify inaccurate balances and otherwise adjust accounts receivable and accounts payable balances to correctly reflect its true position with respect to amounts due from its customers and owed to its vendors. Most of these adjustments pertained to prior year balances, the aggregate amount of which (\$1.3 million) reduced net assets. Taking into account both CPUC's net loss and these prior period adjustments, net assets declined in fiscal year 2005 by \$2.65 million (or 65%) from the prior year.

CPUC's clean-up of its accounting records in fiscal year 2005 represents a concerted effort by CPUC board and management to increase the accountability and economic viability of CPUC's operations. Central to these efforts also was the increase of electric tariffs in October 2006 to at least a level whereby variable operating costs will be covered by cash flows. Additionally, in late 2006, the first deliveries of new generators under ADB loan and public infrastructure sector grant funding are expected. This new generating capacity is expected to improve operating efficiencies and thereby reduce the cost of operations.

## CHUUK PUBLIC UTILITY CORPORATION

Statements of Net Assets  
September 30, 2005 and 2004

<u>Assets</u>	<u>2005</u>	<u>2004</u>
Utility plant, at cost:		
Electric plant in service	\$ 15,663,420	\$ 15,136,112
Water and sewer plant in service	10,088,112	10,088,112
	<u>25,751,532</u>	<u>25,224,224</u>
Less accumulated depreciation	(19,645,811)	(17,534,350)
Total utility plant	<u>6,105,721</u>	<u>7,689,874</u>
Current assets:		
Cash	1,314	306,720
Accounts receivable, net	275,867	474,423
Other receivables	-	444,105
Inventory	195,861	22,973
Prepayments	181,238	-
Total current assets	<u>654,280</u>	<u>1,248,221</u>
	<u>\$ 6,760,001</u>	<u>\$ 8,938,095</u>
<u>Net Assets and Liabilities</u>		
Net assets:		
Invested in capital assets, net of related debt	\$ 2,143,427	\$ 3,544,749
Unrestricted (deficit)	(734,473)	516,891
Total net assets	<u>1,408,954</u>	<u>4,061,640</u>
Contingencies		
Current liabilities:		
Overdraft	124,513	-
Current portion of notes payable	681,255	618,244
Accounts payable:		
Fuel oil	199,519	73,638
Fixed assets	-	65,147
Operations	50,838	140,191
Accrued taxes and other liabilities	263,042	96,497
Accrued interest expense	269,327	292,551
Deferred income	230,695	50,000
Accrued annual leave	70,124	78,453
Total current liabilities	<u>1,889,313</u>	<u>1,414,721</u>
Noncurrent liabilities:		
Notes payable	<u>3,461,734</u>	<u>3,461,734</u>
Total liabilities	<u>5,351,047</u>	<u>4,876,455</u>
	<u>\$ 6,760,001</u>	<u>\$ 8,938,095</u>

See accompanying notes to financial statements.

## CHUUK PUBLIC UTILITY CORPORATION

### Statements of Changes in Net Assets Years Ended September 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating revenues:		
Electricity sales	\$ 3,126,580	\$ 1,104,999
Other sales	<u>13,556</u>	<u>16,025</u>
Total operating revenues	<u>3,140,136</u>	<u>1,121,024</u>
Operating and maintenance expenses:		
Production fuel	2,159,962	2,021,928
Administrative and general	1,293,824	744,950
Depreciation	<u>1,301,082</u>	<u>1,296,175</u>
Total operating and maintenance expenses	<u>4,754,868</u>	<u>4,063,053</u>
Operating loss	<u>(1,614,732)</u>	<u>(2,942,029)</u>
Nonoperating revenues:		
FSM and Chuuk State grants and subsidies	463,001	125,010
Other income	85,746	1,857,295
Interest expense	<u>(269,327)</u>	<u>(25,722)</u>
Total nonoperating revenues	<u>279,420</u>	<u>1,956,583</u>
Net loss	<u>(1,335,312)</u>	<u>(985,446)</u>
Net assets at beginning of year	4,061,640	5,047,086
Prior period adjustments	<u>(1,317,374)</u>	<u>-</u>
Net assets at end of year	<u>\$ 1,408,954</u>	<u>\$ 4,061,640</u>

See accompanying notes to financial statements.

## CHUUK PUBLIC UTILITY CORPORATION

Statements of Cash Flows  
Years Ended September 30, 2005 and 2004

	2005	2004
Cash flows from operating activities:		
Cash received from customers	\$ 2,560,725	\$ 1,598,045
Cash payments to suppliers and employees	<u>(2,989,149)</u>	<u>(2,899,205)</u>
Net cash used for operating activities	<u>(428,424)</u>	<u>(1,301,160)</u>
Cash flows from noncapital financing activities:		
Operating grants and other income	548,747	1,982,305
Increase (decrease) in overdraft	<u>124,513</u>	<u>(115,330)</u>
Net cash provided by noncapital financing activities	<u>673,260</u>	<u>1,866,975</u>
Cash flows from capital and related financing activities:		
Acquisition of utility plant	(613,253)	(213,736)
Proceeds from notes payable	63,011	-
Repayment of notes payable	-	(12,738)
Interest paid	<u>-</u>	<u>(32,773)</u>
Net cash used by capital and related financing activities	<u>(550,242)</u>	<u>(259,247)</u>
Net (decrease) increase in cash	(305,406)	306,568
Cash at beginning of year	<u>306,720</u>	<u>152</u>
Cash at end of year	<u>\$ 1,314</u>	<u>\$ 306,720</u>
<u>Reconciliation of operating loss to net cash used for operating activities:</u>		
Operating loss	\$ (1,614,732)	\$ (2,942,029)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Bad debt	808,949	-
Depreciation	1,301,082	1,296,175
Decrease (increase) in assets:		
Accounts receivable	(412,560)	477,021
Other receivables	(444,105)	-
Inventory	(172,888)	-
Prepayments	(181,238)	-
Increase (decrease) in liabilities:		
Accounts payable	(28,619)	(127,306)
Accrued liabilities	<u>315,687</u>	<u>(5,021)</u>
Net cash used for operating activities	<u>\$ (428,424)</u>	<u>\$ (1,301,160)</u>

See accompanying notes to financial statements.

# CHUUK PUBLIC UTILITY CORPORATION

Notes to Financial Statements  
September 30, 2005 and 2004

## (1) Summary of Significant Accounting Policies

### General

The Chuuk Public Utility Corporation (CPUC) is a component unit of the Government of the State of Chuuk. CPUC was created by Chuuk State Law 192-12. Its primary objective is to provide electrical, water and sewer services to the public. CPUC has adopted the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC).

### Utility Plant

Utility plant is stated at cost with the exception of certain utility plant assets transferred to CPUC at the carrying value of the Department of Public Works as of September 30, 2001. The net book value of electric plant assets and water and sewer plant assets so transferred to CPUC was \$3,241,375 and \$3,834,338, respectively, as of September 30, 2005 and 2004.

### Depreciation

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from 3 to 20 years.

### Capitalization of Interest

CPUC charges to construction in progress interest incurred during the period of construction. Interest capitalized is computed based on the interest expense incurred on loan proceeds restricted to construction. Interest capitalization ceases when constructed facilities are placed in service.

### Annual and Sick Leave

Earned but unused annual leave is paid to employees upon termination of their employment. Accordingly, CPUC accrues these benefits in the period earned. It is the policy of CPUC to record the cost of sick leave when leave is actually taken and a liability is actually incurred. The accumulated estimated amount of sick leave at September 30, 2005 was \$76,031.

### Revenues

Sales of electricity are recorded as billed to customers on a monthly billing cycle basis. At September 30, 2005 and 2004, unbilled revenues are accrued based on the most recent billing cycles.

### Allowance for Doubtful Accounts

CPUC establishes an allowance for doubtful accounts receivable based on the credit risk of specific customers, historical trends and other information.

### Federal Grants and Subsidies

CPUC periodically receives appropriated subsidies from the Chuuk State Legislature.



# CHUUK PUBLIC UTILITY CORPORATION

Notes to Financial Statements  
September 30, 2005 and 2004

## (1) Summary of Significant Accounting Policies, Continued

### Cash

For purposes of the statements of net assets and cash flows, cash is defined as cash on hand and cash held in demand accounts. As of September 30, 2005 and 2004, cash was \$1,314 and \$306,720, respectively, and the corresponding bank balances were \$6,962 and \$63,631, respectively, which are maintained in financial institutions subject to the Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2005 and 2004, bank deposits in the amount of \$6,962 and \$63,631, respectively, were FDIC insured. CPUC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Therefore, these deposits are exposed to custodial credit risk.

### Inventories

Inventories of materials and fuel are determined by physical count and are valued at the lower of cost (first in, first out method), or market value.

### 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.

### Risk Management

Chuuk Public Utility Corporation carries workmen's compensation liability insurance for all employees of the Corporation. Chuuk Public Utility Corporation is substantially self-insured for all other risks. Management is of the opinion that no material losses have been sustained as a result of this practice during the last three years.

### Accounting Standards

The financial statements of CPUC have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. Governmental Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting," requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. CPUC has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

# CHUUK PUBLIC UTILITY CORPORATION

Notes to Financial Statements  
September 30, 2005 and 2004

## (1) Summary of Significant Accounting Policies, Continued

### Accounting Standards, Continued

CPUC has adopted GASB Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments" (GASB 34) as amended by GASB Statement Nos. 37 and 38. GASB 34 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 net asset categories:

- Invested in capital assets, net of related debt:

Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

- Restricted:

- Nonexpendable – Net assets subject to externally imposed stipulations that require CPUC to maintain them permanently.
- Expendable – Net assets whose use by CPUC is subject to externally imposed stipulations that can be fulfilled by actions of CPUC pursuant to those stipulations or that expire by the passage of time.

- Unrestricted:

Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action by management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

CPUC has no nonexpendable restricted net assets at September 30, 2005 and 2004.

### New Accounting Standards

In fiscal year 2005, CPUC implemented GASB Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3)*, which addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest risk, GASB Statement No. 40 requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates.

In November 2003, GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. The provisions of the Statement are effective for periods beginning after December 15, 2004. CPUC does not believe that the implementation of this Statement will have a material effect on its financial statements.

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments. The provisions of this Statement are effective for periods beginning after December 15, 2007. CPUC does not believe that the implementation of this Statement will have a material effect on its financial statements.

# CHUUK PUBLIC UTILITY CORPORATION

Notes to Financial Statements  
September 30, 2005 and 2004

## (1) Summary of Significant Accounting Policies, Continued

### New Accounting Standards, Continued

In May 2004, GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section*, an amendment to NCGA Statement 1. GASB Statement No. 44 improves the understandability and usefulness of statistical section information and adds information from the new financial reporting model for state and local governments required by GASB Statement No. 34. The provisions of this Statement are effective for periods beginning after June 15, 2005. CPUC does not believe the implementation of this Statement will have a material effect on its financial statements.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other postemployment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2008. CPUC does not believe the implementation of this Statement will have a material effect on its financial statements.

In June 2005, GASB issued Statement No. 47, *Accounting for Termination Benefits*. GASB Statement No. 47 establishes guidance for state and local governmental employers on accounting and financial reporting for termination benefits. These benefits include incentives for voluntary terminations (e.g., early retirement window programs) and severance payments with respect to involuntary terminations. The provisions of this Statement are effective for periods beginning after June 15, 2005. CPUC does not believe that the implementation of this Statement will have a material effect on its financial statements.

## (2) Utility Plant

Utility plant movement for the years ended September 30, 2005 and 2004, is as follows:

	<u>2004</u>	<u>Additions</u>	<u>Reclassification/ Adjustments</u>	<u>2005</u>
General plant in service	\$ 310,360	\$ -	\$ (17,720)	\$ 292,640
Electric plant in service	14,825,752	613,253	(68,225)	15,370,780
Water and sewer plant in service	<u>10,088,112</u>	<u>-</u>	<u>-</u>	<u>10,088,112</u>
	<u>25,224,224</u>	<u>613,253</u>	<u>(85,945)</u>	<u>25,751,532</u>
Less accumulated depreciation	<u>(17,534,350)</u>	<u>(1,301,082)</u>	<u>(810,379)</u>	<u>(19,645,811)</u>
	<u>\$ 7,689,874</u>	<u>\$ (687,829)</u>	<u>\$ (896,324)</u>	<u>\$ 6,105,721</u>
	<u>2003</u>	<u>Additions</u>	<u>Deductions</u>	<u>2004</u>
General plant in service	\$ 310,360	\$ -	\$ -	\$ 310,360
Electric plant in service	14,612,016	213,736	-	14,825,752
Water and sewer plant in service	<u>10,088,112</u>	<u>-</u>	<u>-</u>	<u>10,088,112</u>
	25,010,488	213,736	-	25,224,224
Less accumulated depreciation	<u>(16,238,175)</u>	<u>(1,296,175)</u>	<u>-</u>	<u>(17,534,350)</u>
	<u>\$ 8,772,313</u>	<u>\$(1,082,439)</u>	<u>\$ -</u>	<u>\$ 7,689,874</u>

**CHUUK PUBLIC UTILITY CORPORATION**

Notes to Financial Statements  
September 30, 2005 and 2004

**(3) Accounts Receivable**

Bills are issued to customers near mid-month approximately one month subsequent to providing the service. Therefore, approximately forty-five days of service is accrued at September 30, 2005 and 2004, which is classified as accounts receivable - unbilled. Accounts receivable at September 30, 2005 and 2004, are summarized as follows:

	<u>2005</u>	<u>2004</u>
Residential	\$ 594,971	\$ 321,341
Commercial	478,545	435,446
Government	719,668	472,553
Unbilled	<u>78,213</u>	<u>229,497</u>
	1,871,397	1,458,837
Less allowance for doubtful receivables	<u>(1,595,530)</u>	<u>(984,414)</u>
	<u>\$ 275,867</u>	<u>\$ 474,423</u>

All of CPUC's accounts receivable are with customers and government agencies based in Chuuk.

**(4) Grants and Subsidies**

Chuuk State and Federal grants and subsidies are comprised of the following for the years ended September 30, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Hazard Mitigation Grant Program	\$ 463,001	\$ -
Chuuk State fuel subsidy	<u>-</u>	<u>125,010</u>
	<u>\$ 463,001</u>	<u>\$ 125,010</u>

The 2004 Chuuk State fuel subsidy derives from grants under Section 214(b) of the Compact of Free Association. There are no specific compliance terms associated with these funds other than they be utilized in the process of power generation or for purchases to generate power. The hazard mitigation grant program is received in a subrecipient capacity through the State of Chuuk.

**(5) Contingencies**

CPUC is party to various legal proceedings, the ultimate impact of which is not currently predictable. Therefore, no liability has been recorded in the accompanying financial statements due to management's inability to predict the ultimate outcome of these proceedings.

CPUC is a component unit of the State of Chuuk. The ability of CPUC to pay liabilities in the ordinary course of business is dependent on subsidies from the State and from providing power and water services at fair utility rates.

**(6) Contributed Assets**

During the fiscal year ended September 30, 1999, the State of Chuuk contributed various electric plant and water and sewer plant assets to the Corporation.

## CHUUK PUBLIC UTILITY CORPORATION

Notes to Financial Statements  
September 30, 2005 and 2004

### (6) Contributed Assets, Continued

The contributions from the FSM National Government result from compliance with Section 7.01 of the Financing Agreement between the National Government of the FSM (FSM), State of Chuuk and CPUC wherein the FSM is obligated to finance 10% (ceiling of \$186,900) of the actual costs of the civil and mechanical works of the FSM Water Supply and Sanitation Project. The remaining 90% is financed through a loan from the Asian Development Bank which is passed through the FSM National Government to Chuuk State and then to CPUC.

There are no net contributions for the years ended September 30, 2005 and 2004.

### (7) Notes Payable

	<u>2005</u>	<u>2004</u>
Notes payable to a commercial bank, ninety-day terms, interest at prime plus 2.00% on a \$150,000 line of credit. The loan is collateralized by a Bank of the FSM deposit and security interest in fixed assets, accounts receivable and inventories.	\$ 81,921	\$ 81,921
Amount drawn on a note payable with an available total of \$549,743, facilitated by Federated States of Micronesia Development Bank (FSMDB), interest at 9%, due in monthly installments of \$11,412. The loan is collateralized by major machinery, equipment and assignment of income.	599,334	536,323
Amount drawn on a note payable with an available total of \$2,795,540 to the State of Chuuk, facilitated by an Asian Development Bank loan to the FSM, interest at 6.82%, due in semi-annual principal installments commencing August 1, 2007. The loan is ultimately collateralized by a Chuuk State pledge of Compact of Free Association revenues to the FSM National Government. The State of Chuuk has not imposed collateralization on the Corporation.	<u>3,461,734</u>	<u>3,461,734</u>
	4,142,989	4,079,978
Less current maturities	<u>681,255</u>	<u>618,244</u>
Long-term portion of notes payable	\$ <u>3,461,734</u>	\$ <u>3,461,734</u>

The note to the commercial bank is due currently. Management has not paid off the line but has submitted a proposal to term the loan out over three years. Since this proposal has yet to be accepted by the bank, the entire loan balance is reflected as current.

The loan from the FSMDB requires that CPUC maintain hazard insurance. Hazard insurance has not been obtained and the ultimate impact of this matter is currently unknown.

**CHUUK PUBLIC UTILITY CORPORATION**

Notes to Financial Statements  
September 30, 2005 and 2004

**(7) Notes Payable, Continued**

Notes payable mature as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 681,255	\$ 269,327	\$ 950,582
2007	29,869	192,168	222,037
2008	59,737	189,113	248,850
2009	59,737	185,039	244,776
2010	59,737	180,965	240,702
2011-2015	298,685	843,711	1,142,396
2016-2020	647,222	706,204	1,353,426
2021-2025	796,595	444,753	1,241,348
2026-2030	796,595	173,114	969,709
2031	<u>713,557</u>	<u>4,823</u>	<u>718,380</u>
	<b>\$ <u>4,142,989</u></b>	<b>\$ <u>3,189,217</u></b>	<b>\$ <u>7,332,206</u></b>

**(8) Related Party Transactions**

At September 30, 2005, accounts receivable from the State of Chuuk amounted to \$743,708 (approximately \$444,000 as of September 30, 2004). Revenue received from the State of Chuuk for the year ended September 30, 2005 amounted to \$1,162,055. The amount of revenue derived from the State of Chuuk in 2004 is not currently determinable.

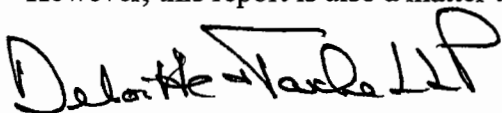
**(9) Prior Period Adjustments**

To correct various balance sheet assets as of September 30, 2005, management recorded unidentified offsets as prior period adjustments. The details of these adjustments is not known and accordingly, it is not possible to restate 2004 and prior fiscal years for these matters.

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether CPUC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our engagement to audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance that is required to be reported under *Government Auditing Standards*, which is described in the accompanying Schedule of Findings as item 2005-01.

This report is intended solely for the information and use of the Board of Directors and management of CPUC, federal awarding agencies, pass-through entities and the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than those specified parties. However, this report is also a matter to public record.

A handwritten signature in black ink, appearing to read "Deloitte & Touche LLP", is written over a faint, illegible printed name.

July 5, 2006

## CHUUK PUBLIC UTILITY CORPORATION

Schedule of Findings  
Year Ended September 30, 2005

### Finding 2005-01 - Reconciliation

Criteria: CPUC should maintain an adequate system of accounting and should be able to reconcile its general ledger with subsidiary ledgers. Additionally, bank reconciliations should be prepared monthly. Fixed asset ledgers should be constructed that detail CPUC's fixed assets and support depreciation calculations. Source documents (checks, invoices, cash receipts, etc.) should be on file to substantiate accounting transactions. Source documents are required to be on file through the audit and then for an additional three years.

Condition: CPUC did not maintain an adequate system of accounting during the year. Bank reconciliations were not prepared monthly and subsidiary ledgers were not reconciled with general ledger balances. In some cases, subsidiary ledgers were not maintained, such as for payables and fixed assets. Therefore, CPUC was not able to prepare financial statements that are supported by its books and records. Additionally, source documents were placed in a storage facility that was exposed to the elements and virtually no checks, invoices or cash receipts were available to support entries into the financial statements.

Cause: The cause of this condition is primarily due to inadequate accounting assistance, inadequate use and understanding of the CPUC accounting software, the absence of monthly closing procedures and the lack of adequate filing and document maintenance systems.

Effect: The effect of this condition is an inability to substantiate financial statement balances, financial statement transactions and compliance with laws and regulations.

Recommendation: CPUC must acquire adequate accounting assistance, must prepare monthly financial statements that are supported by its books and records, must maintain an adequate filing and retention system and must be able to demonstrate compliance with laws and regulations.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Management acknowledges that it has failed to provide an acceptable level of fiscal responsibility over CPUC operations during the last several years. As pointed out in the finding, and as reflected in the auditor's disclaimers of opinions on CPUC's financial statements, accountability and transparency have been significantly impaired.

The board and management of CPUC are committed to changing this state of affairs, but heretofore have had only limited success. A controller that came on board in July of 2005 left in May 2006. During this time, bank reconciliations were performed on a monthly basis and a fixed asset register was established that ties to the general ledger. Many reconciliation tasks, however, were not performed. The failure to maintain adequate accounts receivable and accounts payable subledgers required writing off \$3-4 million in bad debts and old balances as of September 30, 2005. Moreover, during the same period there was a steady depletion of cash flows to where only diesel fuel and essential personnel could be maintained and routine maintenance of the utility plant suffered accordingly. Necessary purchases of computer hardware to support the billing and accounting departments and software maintenance were also neglected during this period. Some of the cash flow problems have been alleviated by the completion of more cash power installations and by the new electric tariffs that became effective in October 2005 but funding accounting priorities continues to be a struggle.



## CHUUK PUBLIC UTILITY CORPORATION

Schedule of Findings, Continued  
Year Ended September 30, 2005

### Finding 2005-01 – Reconciliation, Continued

#### Auditee Response and Corrective Action Plan, Continued:

CPUC management will undertake the following corrective actions to improve its accountability:

- Hiring a new controller by August 2006.
- Determining whether to upgrade or scrap the existing accounting software and purchase a more user-friendly package, no later than September , 2006
- Development of accounting policies and procedures to ensure the monthly preparation of financial statements supported by the FMIS; monthly reconciliations of key control accounts with the subsidiary ledger balances; the printing and retention of monthly reports from the UtilStar billing system to adequately support and track accounts receivable balances; implementation of internal controls over cash and bank deposits to adequately protect cash assets; proper compliance with laws and regulations.
- Implementation of a new filing system to support access to accounting and billing information and a retention policy to ensure records are kept for suitable periods of time.

Management is committed to having these procedures in effect for all of fiscal year 2007 and will retroactively reconcile the 2006 accounts as time permits to prepare for the fiscal year 2006 audit.