

**CHUUK PUBLIC UTILITY CORPORATION  
(A COMPONENT UNIT OF THE GOVERNMENT  
OF THE STATE OF CHUUK)**

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**FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITORS' REPORT**

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**YEARS ENDED SEPTEMBER 30, 2007 AND 2006**

## INDEPENDENT AUDITORS' REPORT

The Board of Directors  
Chuuk Public Utility Corporation:

We were engaged to audit the accompanying statements of deficiency of the Chuuk Public Utility Corporation (CPUC), a component unit of the Government of the State of Chuuk, as of September 30, 2007 and 2006, and the related statements of revenues, expenses and changes in deficiency 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.

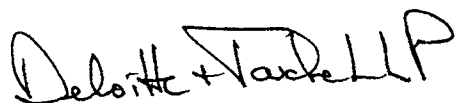
CPUC was unable to provide schedules and subsidiary ledgers to support inventory, utility plant, accounts payable and accrued expense account balances as of September 30, 2007 and 2006.

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 accompanying financial statements have been prepared assuming that CPUC will continue as a going concern. As discussed in Note 5 to the financial statements, CPUC's recurring losses from operations and net deficiency raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also described in Note 5. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

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 (GASB). This 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 June 30, 2008, 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.



June 30, 2008

**CHUUK PUBLIC UTILITIES CORPORATION**  
**(A COMPONENT UNIT OF THE GOVERNMENT OF THE STATE OF CHUUK)**

Management's Discussion and Analysis  
Year Ended September 30, 2007

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 fiscal year ended September 30, 2007.

GASB 34 of the U.S. Government Accounting Standards Board 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, 2007, 2006 and 2005. It should be read in conjunction with the financial statements that follow this section.

The following table summarizes the financial position and results of operations of CPUC as of 2007, 2006 and 2005.

|   | <u>2007</u>           | <u>2006</u>         | <u>2005</u>         |
|---|-----------------------|---------------------|---------------------|
| Assets:   |                       |                     |                     |
| Utility plant in service, net                   | \$ 3,971,652          | \$ 4,967,361        | \$ 6,105,721        |
| Current assets                                  | <u>668,840</u>        | <u>632,560</u>      | <u>654,280</u>      |
| Total assets                                    | <u>\$ 4,640,492</u>   | <u>\$ 5,599,921</u> | <u>\$ 6,760,001</u> |
| Net assets and liabilities                      |                       |                     |                     |
| Invested in capital assets, net of related debt | \$ (226,560)          | \$ 824,372          | \$ 2,143,427        |
| Unrestricted deficit                            | <u>(1,636,203)</u>    | <u>(1,515,641)</u>  | <u>(734,473)</u>    |
| Total net assets (deficiency)                   | <u>(1,862,763)</u>    | <u>(327,269)</u>    | <u>1,408,954</u>    |
| Current liabilities                             | 3,184,444             | 2,495,325           | 1,889,313           |
| Long-term debt                                  | <u>3,318,811</u>      | <u>3,431,865</u>    | <u>3,461,734</u>    |
| Total liabilities                               | <u>6,503,255</u>      | <u>5,927,190</u>    | <u>5,351,047</u>    |
| Total net assets and liabilities                | <u>\$ 4,640,492</u>   | <u>\$ 5,599,921</u> | <u>\$ 6,760,001</u> |
| Revenue, expenses and changes in net assets     |                       |                     |                     |
| Operating revenue                               | \$ 2,151,578          | \$ 2,363,191        | \$ 3,140,136        |
| Operating expenses                              | <u>3,859,142</u>      | <u>4,296,149</u>    | <u>4,754,868</u>    |
| Operating loss                                  | <u>(1,707,564)</u>    | <u>(1,932,958)</u>  | <u>(1,614,732)</u>  |
| Subsidies and other income                      | 407,865               | 492,110             | 548,747             |
| Interest expense                                | <u>(235,795)</u>      | <u>(295,375)</u>    | <u>(269,327)</u>    |
| Total non-operating revenue                     | <u>172,070</u>        | <u>196,735</u>      | <u>279,420</u>      |
| Net loss  | <u>(1,535,494)</u>    | <u>(1,736,223)</u>  | <u>(1,335,312)</u>  |
| Net assets (deficiency) at beginning of year    | <u>(327,269)</u>      | 1,408,954           | 4,061,640           |
| Prior Period Adjustment                         | <u>-</u>              | <u>-</u>            | <u>(1,317,374)</u>  |
| Net assets (deficiency) at end of year          | <u>\$ (1,862,763)</u> | <u>\$ (327,269)</u> | <u>\$ 1,408,954</u> |

**FINANCIAL HIGHLIGHTS**

During fiscal year 2007, operating revenues of \$2.15 million declined by \$0.21 million (down by 9%) from \$2.36 million in the prior year. This decrease reflects many causes. First of all, regular monthly meter readings for some customers have not been done. Secondly, CPUC was forced to implement power rationing because of generator problems and an inability to afford the fuel necessary for full-time power. Total expenses in fiscal year 2007 of \$3.86 million decreased by \$0.44 million (or 10%) from the \$4.30 expenditures recorded in fiscal year 2006 as management cut all expenditures except for fuel. The net operating loss of \$1.71 million compares to an operating loss of \$1.93 million in the prior year (down by 12%).

**CHUUK PUBLIC UTILITIES CORPORATION**  
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Management's Discussion and Analysis  
Year Ended September 30, 2007

The operating loss in fiscal year 2007 was partially off-set by the \$0.41 million in subsidies and other income. The total non-operating revenue for fiscal year 2007 is \$0.17 million as compared to \$0.20 million in the previous year. Reflecting this net loss, net assets of (\$1.86 million) at September 30, 2007 had declined \$1.54 million (down by 475%) from (\$0.32 million) recorded at September 30, 2006.

The accumulated effect of net losses for the previous years is steadily taking its toll on CPUC's deteriorating balance sheet, particularly in its utility plant. Mounting net losses year after year means that CPUC does not have the cash to replace aging assets. CPUC's balance sheet at September 30, 2007, shows net utility plant of \$3.97 million, a decrease of \$0.99 million (or 20%) from the \$4.96 million from the prior year.

Fixed additions during fiscal year 2007 were quite minor. Please see Note 2 to the financial statements for additional information on fixed assets.

There were no significant changes in long-term debt during fiscal year 2007. Please refer to Note 7 to the financial statements for additional information on debt.

#### **FISCAL YEAR 2008 OUTLOOK**

Due to the skyrocketing increase in fuel, the central task confronting the management team will be to adjust the electric tariff to cover such increases as they occur. It is also important that the disconnection or transferring of cash power of landlord accounts is to be made as soon as possible to have the needed funds from DOI. It is necessary to replace some of CPUC's generating capacity with new engines. In this way, repairs and maintenance expense will be reduced and likewise an increase in the power production is expected also. In this regard, loan negotiations with Asian Development Bank and other financial institutions will need to be actively pursued.

Management's Discussion and Analysis for the years ended September 30, 2006 and 2005, is set forth in the report on the audit of CPUC's financial statements, which is dated January 28, 2008, and that Discussion and Analysis explains the major factors impacting the 2006 and 2005 financial statements and can be viewed at the Office of the Public Auditor's website at [www.fsmpublicauditor.fm](http://www.fsmpublicauditor.fm)

**CHUUK PUBLIC UTILITY CORPORATION**  
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Statements of Deficiency  
Years Ended September 30, 2007 and 2006

| <u>Assets</u>                                   | <u>2007</u>         | <u>2006</u>         |
|---|---------------------|---------------------|
| Utility plant, at cost:                         |                     |                     |
| Electric plant in service                       | \$ 15,709,995       | \$ 15,679,519       |
| Water and sewer plant in service                | <u>10,088,111</u>   | <u>10,088,112</u>   |
|   | 25,798,106          | 25,767,631          |
| Less accumulated depreciation                   | <u>(21,826,454)</u> | <u>(20,800,270)</u> |
| Total utility plant                             | <u>3,971,652</u>    | <u>4,967,361</u>    |
| Current assets:                                 |                     |                     |
| Cash  | 1,314               | 1,314               |
| Accounts receivable, net                        | 275,250             | 246,031             |
| Other receivables                               | 8,377               | 1,316               |
| Inventory                                       | 195,861             | 195,861             |
| Prepayments                                     | <u>188,038</u>      | <u>188,038</u>      |
| Total current assets                            | <u>668,840</u>      | <u>632,560</u>      |
|   | <u>\$ 4,640,492</u> | <u>\$ 5,599,921</u> |
| <u>Deficiency and Liabilities</u>               |                     |                     |
| Net assets (deficiency):                        |                     |                     |
| Invested in capital assets, net of related debt | \$ (226,560)        | \$ 824,372          |
| Unrestricted deficit                            | <u>(1,636,203)</u>  | <u>(1,151,641)</u>  |
| Total deficiency                                | <u>(1,862,763)</u>  | <u>(327,269)</u>    |
| Commitment and contingencies                    |                     |                     |
| Current liabilities:                            |                     |                     |
| Overdraft                                       | 54,555              | 34,682              |
| Current portion of notes payable                | 879,401             | 711,124             |
| Accounts payable:                               |                     |                     |
| Fuel oil  | 162,402             | 155,831             |
| Operations                                      | 70,380              | 57,996              |
| Accrued taxes and other liabilities             | 887,206             | 678,354             |
| Accrued interest expense                        | 727,864             | 564,702             |
| Advances from Chuuk State Housing Authority     | 110,000             | -                   |
| Deferred income                                 | 230,695             | 230,695             |
| Accrued annual leave                            | <u>61,941</u>       | <u>61,941</u>       |
| Total current liabilities                       | 3,184,444           | 2,495,325           |
| Noncurrent liabilities:                         |                     |                     |
| Notes payable                                   | <u>3,318,811</u>    | <u>3,431,865</u>    |
| Total liabilities                               | <u>6,503,255</u>    | <u>5,927,190</u>    |
|   | <u>\$ 4,640,492</u> | <u>\$ 5,599,921</u> |

See accompanying notes to financial statements.

**CHUUK PUBLIC UTILITY CORPORATION**  
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Statements of Revenues, Expenses and Changes in Deficiency  
Years Ended September 30, 2007 and 2006

|  | <u>2007</u>           | <u>2006</u>         |
|--|-----------------------|---------------------|
| Operating revenues:  |                       |                     |
| Electricity sales  | \$ 2,131,785          | \$ 2,356,011        |
| Other sales  | <u>19,793</u>         | <u>7,180</u>        |
| Total operating revenues   | <u>2,151,578</u>      | <u>2,363,191</u>    |
| Operating and maintenance expenses:                                |                       |                     |
| Production fuel  | 2,068,993             | 1,999,642           |
| Administrative and general   | 764,586               | 1,142,048           |
| Depreciation   | <u>1,025,563</u>      | <u>1,154,459</u>    |
| Total operating and maintenance expenses                           | <u>3,859,142</u>      | <u>4,296,149</u>    |
| Operating loss   | <u>(1,707,564)</u>    | <u>(1,932,958)</u>  |
| Nonoperating (expense) revenues:                                   |                       |                     |
| FSM National Government Chuuk State grants,<br>and other subsidies | 398,640               | 480,000             |
| Other income   | 9,225                 | 12,110              |
| Interest expense   | <u>(235,795)</u>      | <u>(295,375)</u>    |
| Total nonoperating revenues  | <u>172,070</u>        | <u>196,735</u>      |
| Net loss   | <u>(1,535,494)</u>    | <u>(1,736,223)</u>  |
| Net assets (deficiency) at beginning of year                       | <u>(327,269)</u>      | <u>1,408,954</u>    |
| Net deficiency at end of year                                      | <u>\$ (1,862,763)</u> | <u>\$ (327,269)</u> |

See accompanying notes to financial statements.

**CHUUK PUBLIC UTILITY CORPORATION**  
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Statements of Cash Flows  
Years Ended September 30, 2007 and 2006

|  | <u>2007</u>         | <u>2006</u>         |
|--|---------------------|---------------------|
| Cash flows from operating activities:  |                     |                     |
| Cash received from customers   | \$ 2,115,298        | \$ 2,391,711        |
| Cash payments to suppliers and employees   | <u>(2,568,405)</u>  | <u>(2,777,891)</u>  |
| Net cash used in operating activities  | <u>(453,107)</u>    | <u>(386,180)</u>    |
| Cash flows from noncapital financing activities:                                   |                     |                     |
| Operating grants and other income  | 407,865             | 492,110             |
| Increase (decrease) in overdraft   | <u>19,873</u>       | <u>(89,831)</u>     |
| Net cash provided by noncapital financing activities                               | <u>427,738</u>      | <u>402,279</u>      |
| Cash flows from capital and related financing activities:                          |                     |                     |
| Acquisition of utility plant   | (29,854)            | (16,099)            |
| Payments of notes payable  | <u>55,223</u>       | <u>-</u>            |
| Net cash provided by (used in) capital and related financing activities            | <u>25,369</u>       | <u>(16,099)</u>     |
| Net change in cash   | -                   | -                   |
| Cash at beginning of year  | <u>1,314</u>        | <u>1,314</u>        |
| Cash at end of year  | <u>\$ 1,314</u>     | <u>\$ 1,314</u>     |
| <u>Reconciliation of operating loss to net cash used in operating activities:</u>  |                     |                     |
| Operating loss   | \$ (1,707,564)      | \$ (1,932,958)      |
| Adjustments to reconcile operating loss to net cash used for operating activities: |                     |                     |
| Depreciation   | 1,025,563           | 1,154,459           |
| Other income   | <u>(353,783)</u>    | <u>-</u>            |
| Decrease (increase) in assets:   |                     |                     |
| Accounts receivable  | 324,564             | 29,836              |
| Other receivables  | (7,061)             | (1,316)             |
| Prepayments  | -                   | (6,800)             |
| Increase (decrease) in liabilities:  |                     |                     |
| Accounts payable   | 18,955              | (36,530)            |
| Accrued liabilities  | 136,219             | 407,129             |
| Advances from Chuuk State Housing Authority  | <u>110,000</u>      | <u>-</u>            |
| Net cash used in operating activities  | <u>\$ (453,107)</u> | <u>\$ (386,180)</u> |

See accompanying notes to financial statements.

**CHUUK PUBLIC UTILITY CORPORATION**  
**(A COMPONENT UNIT OF THE GOVERNMENT OF THE STATE OF CHUUK)**

Notes to Financial Statements  
September 30, 2007 and 2006

(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.

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 \$2,055,448 and \$2,648,411, respectively, as of September 30, 2007 and 2006. Current policy is to capitalize items over \$200.

Depreciation

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

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 an expense is actually incurred. The accumulated estimated amount of sick leave at September 30, 2007 was \$56,054.

Revenues

Sales of electricity are recorded as billed to customers on a monthly billing cycle basis. At September 30, 2007 and 2006, unbilled revenues are accrued based on the most recent billing cycles. Unbilled receivables at September 30, 2007 and 2006 are \$78,582 and \$140,725, respectively.

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.

Grants and Subsidies

CPUC periodically receives appropriated subsidies from the Chuuk State Legislature.

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.



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Notes to Financial Statements  
September 30, 2007 and 2006

(1) Summary of Significant Accounting Policies, Continued

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.

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.

**CHUUK PUBLIC UTILITY CORPORATION**  
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Notes to Financial Statements  
September 30, 2007 and 2006

(1) Summary of Significant Accounting Policies, Continued

Accounting Standards, Continued

- 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, 2007 and 2006.

Operating and Non-Operating Revenue and Expenses

Operating revenues and expenses generally result directly from the operation and maintenance of CPUC. Non-operating revenues and expenses result from capital and financing activities, costs and related recoveries from natural disasters, surcharge and certain other non-recurring income and costs.

New Accounting Standards

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. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CPUC.

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 benefit 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. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CPUC.

In September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*. GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. The statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. The provisions of this statement are effective for periods beginning after December 15, 2006. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CPUC.

In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CPUC.

**CHUUK PUBLIC UTILITY CORPORATION**  
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Notes to Financial Statements  
September 30, 2007 and 2006

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In May 2007, GASB issued Statement No. 50, *Pension Disclosures an Amendment of GASB Statements No. 25 and 27*. GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits. The provisions of this statement are effective for periods beginning after June 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CPUC.

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CPUC.

Cash

GASB Statement No. 40 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 rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

- Category 1 Deposits that are federally insured or collateralized with securities held by CPUC or its agent in CPUC's name;
- Category 2 Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in CPUC's name; or
- Category 3 Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in CPUC's name and non-collateralized deposits.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, CPUC'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. CPUC does not have a deposit policy for custodial credit risk.

As of September 30, 2007 and 2006, cash was \$1,314 and the corresponding bank balances were \$6,913 and \$21,953, respectively, which are maintained in financial institutions subject to the Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2007 and 2006, bank deposits in the amount of \$6,913 and \$21,953, 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.

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Notes to Financial Statements  
September 30, 2007 and 2006

**(2) Utility Plant**

Utility plant movement for the years ended September 30, 2007 and 2006, is as follows:

|                                  | <u>2006</u>         | <u>Additions</u>    | <u>Disposals/<br/>Adjustments</u> | <u>2007</u>         |
|----------------------------------|---------------------|---------------------|-----------------------------------|---------------------|
| General plant in service         | \$ 302,840          | \$ 20,360           | \$ -                              | \$ 323,200          |
| Electric plant in service        | 15,376,679          | 9,494               | 621                               | 15,386,794          |
| Water and sewer plant in service | <u>10,088,112</u>   | <u>-</u>            | <u>-</u>                          | <u>10,088,112</u>   |
|                                  | <u>25,767,631</u>   | <u>29,854</u>       | <u>621</u>                        | <u>25,798,106</u>   |
| Less accumulated depreciation    | <u>(20,800,270)</u> | <u>(1,025,563)</u>  | <u>(621)</u>                      | <u>(21,826,454)</u> |
|                                  | <u>\$ 4,967,361</u> | <u>\$ (995,709)</u> | <u>\$ -</u>                       | <u>\$ 3,971,652</u> |

|                                  | <u>2005</u>         | <u>Additions</u>      | <u>Disposals/<br/>Adjustments</u> | <u>2006</u>         |
|----------------------------------|---------------------|-----------------------|-----------------------------------|---------------------|
| General plant in service         | \$ 292,640          | \$ 10,200             | \$ -                              | \$ 302,840          |
| Electric plant in service        | 15,370,780          | 5,899                 | -                                 | 15,376,679          |
| Water and sewer plant in service | <u>10,088,112</u>   | <u>-</u>              | <u>-</u>                          | <u>10,088,112</u>   |
|                                  | <u>25,751,532</u>   | <u>16,099</u>         | <u>-</u>                          | <u>25,767,631</u>   |
| Less accumulated depreciation    | <u>(19,645,811)</u> | <u>(1,154,459)</u>    | <u>-</u>                          | <u>(20,800,270)</u> |
|                                  | <u>\$ 6,105,721</u> | <u>\$ (1,138,360)</u> | <u>\$ -</u>                       | <u>\$ 4,967,361</u> |

**(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, 2007 and 2006, which is classified as accounts receivable - unbilled. Accounts receivable at September 30, 2007 and 2006, are summarized as follows:

|   | <u>2007</u>        | <u>2006</u>        |
|---|--------------------|--------------------|
| Residential                             | \$ 532,287         | \$ 622,803         |
| Commercial                              | 479,115            | 459,600            |
| Government                              | 427,014            | 618,433            |
| Unbilled                                | <u>78,582</u>      | <u>140,725</u>     |
|   | 1,516,998          | 1,841,561          |
| Less allowance for doubtful receivables | <u>(1,241,748)</u> | <u>(1,595,530)</u> |
|   | <u>\$ 275,250</u>  | <u>\$ 246,031</u>  |

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

**CHUUK PUBLIC UTILITY CORPORATION**  
**(A COMPONENT UNIT OF THE GOVERNMENT OF THE STATE OF CHUUK)**

Notes to Financial Statements  
September 30, 2007 and 2006

**(4) Grants and Subsidies**

FSM National Government, Chuuk State, and other subsidies are comprised of the following for the years ended September 30, 2007 and 2006:

|                                      | <u>2007</u>       | <u>2006</u>       |
|--------------------------------------|-------------------|-------------------|
| FSM National Government fuel subsidy | \$ 232,053        | \$ -              |
| Chuuk State fuel subsidy             | 125,600           | 440,000           |
| Other subsidy                        | <u>40,987</u>     | <u>40,000</u>     |
|                                      | <u>\$ 398,640</u> | <u>\$ 480,000</u> |

The Chuuk State fuel subsidy derives from the Declaration of a State of Emergency and Administrative Directive 06-2006. There are no specific compliance terms associated with these funds other than that they be utilized in the process of power generation or for purchases to generate power.

**(5) Contingencies**

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplates the continuation of CPUC as a going concern. However, CPUC has sustained substantial operating losses in recent years. In addition, CPUC has used a substantial amount of working capital in its operations. Further, at September 30, 2007, current liabilities exceeded current assets by \$2,515,604, and total liabilities exceed total assets by \$1,862,763. Management acknowledges that it is currently dependent on the State of Chuuk to pay for actual services rendered in order to maintain CPUC as a going concern. Should the State of Chuuk choose to discontinue payment for services rendered, CPUC management may have to consider alternative measures including, among other possibilities, the State of Chuuk maintaining CPUC as a going concern.

In view of these matters, realization of a major portion of the assets in the accompanying statement of net assets at September 30, 2007, is dependent upon continued operations of CPUC, which in turn is dependent upon CPUC's ability to meet its future debt service requirements, and the success of future operations. Management believes that actions presently being taken to revise CPUC's operating requirements, which include exerting more effort in collecting, provide the opportunity for CPUC to continue as a going concern.

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**  
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Notes to Financial Statements  
September 30, 2007 and 2006

(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, 2007 and 2006.

(7) Notes Payable

|   | <u>2007</u>         | <u>2006</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 security interest in fixed assets, accounts receivable and inventories.   | \$ 81,921           | \$ 81,921           |
| Amount drawn on a note payable with an available total of \$737,743, facilitated by Federated States of Micronesia Development Bank (FSMDB), interest at 9%, due in monthly installments of \$4,000. The loan is collateralized by major machinery, equipment and assignment of income.   | 737,743             | 599,334             |
| 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>3,378,548</u>    | <u>3,461,734</u>    |
|   | 4,198,212           | 4,142,989           |
| Less current maturities   | <u>879,401</u>      | <u>711,124</u>      |
| Long-term portion of notes payable  | \$ <u>3,318,811</u> | \$ <u>3,431,865</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. In June 2007, the loan payment was refinanced and was set at \$4,000 per month.

**CHUUK PUBLIC UTILITY CORPORATION**  
**(A COMPONENT UNIT OF THE GOVERNMENT OF THE STATE OF CHUUK)**

Notes to Financial Statements  
September 30, 2007 and 2006

(7) Notes Payable, Continued

Notes payable mature as follows:

| <u>Year ending<br/>September 30,</u> | <u>Principal</u>    | <u>Interest</u>     | <u>Total</u>        |
|--------------------------------------|---------------------|---------------------|---------------------|
| 2008                                 | \$ 879,401          | \$ 189,113          | \$ 1,068,514        |
| 2009                                 | 59,737              | 185,019             | 244,776             |
| 2010                                 | 59,737              | 180,965             | 240,702             |
| 2011                                 | 59,737              | 176,891             | 236,628             |
| 2012                                 | 59,737              | 172,816             | 232,553             |
| 2013-2017                            | 348,476             | 802,970             | 1,151,446           |
| 2018-2022                            | 796,595             | 607,736             | 1,404,331           |
| 2023-2027                            | 796,595             | 336,097             | 1,132,692           |
| 2028-2031                            | <u>1,138,197</u>    | <u>76,095</u>       | <u>1,214,292</u>    |
|                                      | <u>\$ 4,198,212</u> | <u>\$ 2,727,722</u> | <u>\$ 6,925,934</u> |

(8) Related Party Transactions

Accounts receivable from the State of Chuuk amounted to \$427,014 and \$618,433 as of September 30, 2007 and 2006, respectively. Revenue received from the State of Chuuk for the years ended September 30, 2007 and 2006 amounted to \$417,560 and \$727,352, respectively.

Advances from Chuuk State Housing Authority amounted to \$110,000 as of September 30, 2007. These advances were formalized in an agreement entered into in October 2007. The agreement indicates that all parties will utilize their best efforts to obtain funding from external sources to repay the advances. After September 30, 2007, an additional \$100,000 of advances were received from the Housing Authority.

(9) Commitment

CPUC leases a building office space expiring in 2011. Future minimum lease payments are as follows:

| <u>Year ending<br/>September 30,</u> |           |
|--------------------------------------|-----------|
| 2008                                 | \$ 38,400 |
| 2009                                 | 38,400    |
| 2010                                 | 38,400    |
| 2011                                 | 38,400    |

**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**

The Board of Directors  
Chuuk Public Utility Corporation:

We were engaged to audit the financial statements of Chuuk Public Utility Corporation (CPUC) a component unit of the Government of the State of Chuuk, as of and for the year ended September 30, 2007. Our report dated June 30, 2008, stated that the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the financial statements because CPUC was unable to provide schedules and subsidiary ledgers to support inventory, utility plant, accounts payable and accrued expense account balances.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered CPUC's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of CPUC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of CPUC's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control deficiency* 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 misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency described in the accompanying Schedule of Findings and Responses (page 17) to be a significant deficiency in internal control over financial reporting, which is described as item 2007-01.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.



Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is a material weakness.

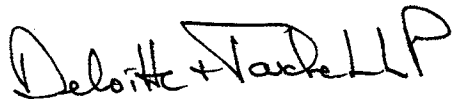
#### Compliance and Other Matters

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 and Responses as item 2007-01.

We noted other matters involving the internal control over financial reporting that we have reported to management of CPUC in a separate letter dated June 30, 2008.

CPUC's response to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. We did not audit CPUC's response and, accordingly, we express no opinion on it.

This report is intended for the information the Board of Directors and management of CPUC, the Office of the Public Auditor of FSM, federal awarding agencies, pass-through entities and the cognizant audit and others within the entity, 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 that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

June 30, 2008

**CHUUK PUBLIC UTILITY CORPORATION**  
**(A COMPONENT UNIT OF THE GOVERNMENT OF THE STATE OF CHUUK)**

Schedule of Findings and Responses  
Year Ended September 30, 2007

Finding 2007-01 - 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.

Prior Year Status: The above condition is reiterative of conditions identified in the prior year audit of the Chuuk Public Utilities Corporation.

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 recognizes the need to improve its accounting, filing and retention system.

During FY 2007, MAS 90 system has crashed a few times so there was a need to re input some transactions to come up with an accurate financial statement. Due to financial constraints, necessary purchases of computer hardware and software maintenance were not given priority.

The storage of documents also imposes a problem because of lack of filing cabinets and storing materials to safe keep the documents from elements and not enough to retain the files for a period of three years which is required in the audit.

CPUC Management will carry out the following corrective measures to improve its accountability:

- Hiring of new controller since the present controller is resigning effective July 2008
- Determining to upgrade the existing accounting software.

**CHUUK PUBLIC UTILITY CORPORATION**  
**(A COMPONENT UNIT OF THE GOVERNMENT OF THE STATE OF CHUUK)**

Schedule of Findings and Responses, Continued  
Year Ended September 30, 2007

Finding 2007-01 – Reconciliation, Continued

- Development of accounting policies and procedures to ensure the monthly preparation of financial statements; monthly reconciliations of key control accounts with the subsidiary ledger balances; the printing and retention of monthly reports from the Utilstar billing systems 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 dedicated to apply these measures in effect for all of fiscal year 2008 and will retroactively reconcile the 2007 accounts as time permits to prepare for the fiscal year 2008 audit.