

CHUUK PUBLIC UTILITY CORPORATION

**(A COMPONENT UNIT OF THE
STATE OF CHUUK)**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2009 AND 2008

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Chuuk Public Utility Corporation:

We have audited the accompanying statement of deficiency of the Chuuk Public Utility Corporation (CPUC), a component unit of the State of Chuuk, as of September 30, 2009, and were engaged to audit the statement of deficiency as of September 30, 2008, and the statements of revenue, expenses and changes in deficiency and cash flows for the years ended September 30, 2009 and 2008. These financial statements are the responsibility of CPUC's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, 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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of CPUC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The system of financial accounting and reporting in operation for CPUC for the year ended September 30, 2008 was inadequate. Because of inadequacies in CPUC's accounting records and internal control, we were unable to satisfy ourselves about the amounts at which inventories, utility plant, accounts payable, and accrued liabilities are recorded in the accompanying statement of deficiency at September 30, 2008, and the amounts at which revenues and expenses are recorded for the year then ended. Therefore we were not able to satisfy ourselves about the account balances presented within the statement of deficiency of CPUC as of September 30, 2008. The statement of deficiency enters materially into the determination of the results of operations and cash flows of CPUC for the year ended September 30, 2009.

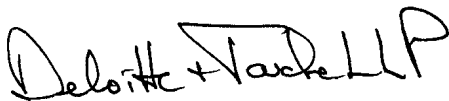
Because of the significance of the matters discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial position of CPUC as of September 30, 2008, and the changes in its net assets and its cash flows for the years ended September 30, 2009 and 2008.

In our opinion, the statement of deficiency as of September 30, 2009 presents fairly, in all material respects, the financial position of CPUC as of that date, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that CPUC will continue as a going concern. As discussed in Note 10 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 10. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The Management Discussion and Analysis on pages 3 through 9 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. 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 4, 2010, 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.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

June 4, 2010

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

Management's Discussion and Analysis
Years Ended September 30, 2009 and 2008

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, 2009.

GASB 34 of the U.S. Government Accounting Standards Board requires that 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, 2009 and 2008. 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 2009, 2008 and 2007. We also include a table for some financial ratios that tells us the financial health of CPUC and how CPUC performed in year 2009 in comparison with 2008 and 2007.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Assets:			
Utility plant in service, net	\$ 2,010,041	\$ 2,961,336	\$ 3,971,652
Current assets	<u>605,322</u>	<u>545,217</u>	<u>668,840</u>
Total assets	\$ <u>2,615,363</u>	\$ <u>3,506,553</u>	\$ <u>4,640,492</u>
Deficiency and Liabilities:			
Invested in capital assets, net of related debt	\$ (2,353,312)	\$ (1,500,636)	\$ (226,560)
Unrestricted deficit	<u>(2,630,054)</u>	<u>(2,258,321)</u>	<u>(1,636,203)</u>
Total deficiency	<u>(4,983,366)</u>	<u>(3,758,957)</u>	<u>(1,862,763)</u>
Long-term debt	3,370,961	3,522,834	3,318,811
Current and other liabilities	<u>4,227,768</u>	<u>3,742,676</u>	<u>3,184,444</u>
Total liabilities	<u>7,598,729</u>	<u>7,265,510</u>	<u>6,503,255</u>
Total deficiency and liabilities	\$ <u>2,615,363</u>	\$ <u>3,506,553</u>	\$ <u>4,640,492</u>
Revenue, Expenses, and Changes in Net Assets:			
Operating revenues	\$ 3,484,618	\$ 2,279,239	\$ 2,151,578
Operating expenses	<u>4,463,895</u>	<u>4,060,578</u>	<u>3,859,142</u>
Operating loss	<u>(979,277)</u>	<u>(1,781,339)</u>	<u>(1,707,564)</u>
Subsidies and other income	92,136	384,473	407,865
Interest expense	<u>(337,268)</u>	<u>(499,328)</u>	<u>(235,795)</u>
Total non-operating revenue	<u>(245,132)</u>	<u>(114,855)</u>	<u>172,070</u>
Net loss	(1,224,409)	(1,896,194)	(1,535,494)
Net deficiency at beginning of year	<u>(3,758,957)</u>	<u>(1,862,763)</u>	<u>(327,269)</u>
Net deficiency at end of year	\$ <u>(4,983,366)</u>	\$ <u>(3,758,957)</u>	\$ <u>(1,862,763)</u>

**CHUUK PUBLIC UTILITIES CORPORATION
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Management's Discussion and Analysis
Years Ended September 30, 2009 and 2008

Financial Ratios	<u>2009</u>	<u>2008</u>	<u>2007</u>
Financial Health:			
Unrestricted net assets	(75.48)%	(99.08)%	(76.0)%
Capital asset condition	7.78%	11.63%	15%
Assets to debt	(190.54)%	(107.20)%	(40.1)%
Current ratio	0.15	0.15	0.21
Quick ratio	0.00	0.00	0.00
Allowance for doubtful accounts	75.56%	81.18%	81.9%
Financial Performance:			
Change in net assets	(32.57)%	(101.79)%	(4692.00)%
Operating ratio	1.25	1.78	1.79
Debt service load	10.66%	10.48%	9.20%
Debt service coverage	10.33	4.56	8.97
Days in accounts receivable	46.11	52.07	46.69
Net income (loss) per revenue dollar	\$(0.35)	\$(0.83)	\$(0.71)
Total operations and maintenance expense per Kwh sold	\$0.66	\$0.63	\$0.47
Total fuel expense per Kwh sold	\$0.42	\$0.32	\$0.25
Total operations and maintenance expense (excluding fuel expense) per customer	\$896.29	\$974.93	\$994.53
Revenue per Kwh sold	\$0.53	\$0.34	\$0.26
Bad debt expense per revenue dollar	\$0.14	\$0.06	\$0.07

FINANCIAL HIGHLIGHTS

This year we are changing the way we report our financial highlight from the traditional report of changes between years to financial ratios that can inform the readers of the financial statements about the economic health of CPUC and how CPUC perform from year to year.

The change is necessary for couple of reasons.

Much attention has been given to CPUC in recent years because of poor performance and scrutiny of its financial statements is necessary. Also the audit indicates that the recurring losses from operations and net deficiency raise substantial doubt about CPUC's ability to continue as a going concern and because of CPUC's vital role in the well being and overall economic development of Chuuk State, presentation of vital information is necessary to guide its reform process.

In the meeting between the utility executives and the leaders of the Freely Associated States to the U.S. on the theme "Keeping the Light On", it was agreed by consensus that the reporting of the well being of the utilities needs be promulgated and made available. The Governments need to understand the financial performance of their utilities to ensure that they are operating as mandated.

CPUC through the Chuuk State Government and the FSM National Government has obtained a loan that is currently being matched with our Compact Infrastructure Fund to rehabilitate the power system of CPUC. The reporting of financial ratios will endorse CPUC's commitment over transparency and in meeting the financial performance criteria being set in the financing agreements.

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Although these financial ratios are not the only ways to measure the performance of CPUC, their reliability is an important issue. The numbers used in the calculation of the financial ratios can be verified by the audited financial statements.

Reporting of the Ratios:

- Unrestricted Net Assets (75.48)%

For the year ended September 2009, the Utility's total unrestricted net assets is approximately \$2.6 million deficit or negative 75.48% of annual revenue, an indication that CPUC does not have any resources in reserve, unexpended and or available for emergencies. Because there are deficit net assets, one may say that the CPUC is worth nothing, or to say it in other words, the government would have to pay to sell CPUC. How one reverses this negative trend in net assets is to start making a profit.

- Capital Asset Condition 7.78%

At September 30, 2009, the Utility's depreciable capital assets amounted to \$25.8 million and total accumulated depreciation is \$23.8 million indicating that only 7.78 % of the useful capital assets have remaining lives. This is a grave concern; the utility business relies heavily on its ability to generate power and produce water for the general public. Without this infrastructure capacity, it is no surprise that CPUC cannot provide these vital services and make money to pay its obligations. How does CPUC change this trend? CPUC is to seek financial assistance from ADB, U.S. DOI and Chuuk State Government to rebuild the needed infrastructure necessary to move forward. It is also necessary that CPUC management and the government revisit its tariff so that an acceptable level is reserved for capital replacement. Such policy on reserving a certain part of the tariff for replacement is needed to prevent management from running its productive assets into the ground again.

- Assets to Debt (190.54)%

At September 30, 2009, more than all of the Utility's remaining assets of \$3.5 million are funded with debt or other obligations, indicating that each dollar asset owned by CPUC, \$1.90 is owed to others. This indicates that should the issuers of the debt come after their money, they would only get half of what is being owed, even if CPUC liquidates all of its assets. How does CPUC get around this serious situation? CPUC can negotiate with the State government to assume the liabilities or negotiate with debtors for an extended grace period to give CPUC time to improve operations before it can have the ability to pay. This is an all win situation plan, since even liquidating all assets would not satisfy all existing debt.

- Current Ratio 0.15%

A more realistic indication of how much each issuer of the debt will obtain from a dollar owed from CPUC is the measurement of its current ratio. At September 30, 2009, the measurement indicates that CPUC can only pay 0.15 cents of a dollar owed, and this is only possible if CPUC collects all its accounts receivable before the payout.

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- Quick Ratio 0.00%

Even more realistic in the repayment of debt is whether CPUC can manage to pay its debt through operating cash flow. The answer to that question is answered by this ratio. At September 30, 2009, CPUC does not have the cash or cash equivalents to pay its current liabilities. The indicator also supports the fact that the current liabilities of CPUC are not decreasing as they should have been but are increasing from \$3.6 million in 2008 to \$4.1 million in 2009. CPUC is not paying its current debts because of cash flow. How can it start paying its current debt? CPUC should generate sufficient revenue to cover its costs and pay its debt. CPUC should vigorously collect its accounts receivable and improve its technical and non technical losses to reduce costs of operation so more money is saved to pay its current debt.

- Allowance for Doubtful Accounts 76.84%

At September 30, 2009, CPUC management believes that of the \$1.9 million in accounts receivable, only \$440 thousand is collectible or 76.84% of what is considered accounts receivable is uncollectible. This raises a question as to how CPUC manages its collection policy, the prepayment metering and the effectiveness of management in carrying out this function. It is a loss to the Corporation when CPUC cannot collect all that the customers owe.

- Change in Net Assets (32.57%)

At September 30, 2009, total net assets decreased by \$1.2 million or (32.57%) from prior year, an indication that the total financial condition declined during the fiscal year. However, it should be noted that any measure of favorable action on behalf of CPUC can change this performance indicator or vice versa. For example, this year's action through the emergency task force and Government's executive order to increase the tariff from the average of 34 cents per Kwh to 53 cents per Kwh improves this indicator from -101.8% last year to only (32.57%) this year or an improvement of \$700 thousand. How can CPUC further decrease its losses? The answer is by generating more revenues through line loss reduction, improvement in generating capacity, metering of all services and improvement in collection of accounts receivable.

- Operating Ratio 1.25%

At September 30, 2009, CPUC's operating ratio is 1.25, meaning that \$1.25 of CPUC current operating expenses exceeds \$1 of CPUC current operating revenue, a measure indicating that CPUC cannot cover its current cost from its current revenue without relying on subsidies and grants, a measurement of self-sufficiency.

- Debt Service Load 10.66%

At September 30, 2009, the total Utility's non-capital expenses amounted to \$3.2 million and of that \$337 thousand or (10.66%) is related to the cost of debt service. In proportion to the amount of non-capital expenses, this ratio seems small, but it is unfavorable to CPUC, because only when CPUC can meet all its expenses is it able to meet its debt service payments.

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Management's Discussion and Analysis
Years Ended September 30, 2009 and 2008

- Debt Service Coverage 10.33

For September 30, 2009, the Utility has 10.33 times more of annual revenue to the annual debt service payments. This may again look very favorable, but without meeting needed operational expenses first, the measurement becomes meaningless. The 10 times more revenue currently not available for servicing of the debt.

- Days in Accounts Receivable 46.11

For the year ending September 30, 2009, this measurement indicates that it would take an average of 46 days to collect its accounts receivable. The 46 days in respect to CPUC annual revenues is \$450 thousand in cash flow. This is an area management can look into to improve its cash flow, especially in areas like minimizing the billing cycle, converting all commercial and government customers to prepaid meters, etc.

- Net Income (loss) per Revenue Dollar \$(0.35)

For the year ended September 30, 2009, CPUC has a net loss of (\$0.35) per revenue dollar. This is a poor financial indicator which indicates that the CPUC's total expenses exceed its total revenue. Should this trend continue, CPUC will continue to go into more debt or go out of business? In short the CPUC should not be in business if it continues to incur losses after losses, year after year. The management can be made accountable since the law mandates CPUC to operate on a cost recovery basis.

- Total Ops & Maint. Expense per Kwh Sold \$0.66

For year ended September 30, 2009, CPUC has total operating and maintenance costs of 66 cents per Kwh. In other words, it is costing CPUC 66 cents to produce and sell a Kwh of electricity. Is this cost competitive? One way to find out is how much the customers can reasonably afford, and also by comparison to other similar utilities in the region. The balance should be struck between how much the CPUC can continue to raise its tariff after its operating and maintenance costs and how much the public can afford before they switch to self generation.

- Total Fuel Expense per Kwh Sold \$0.42

For year ending September 30, 2009, it is costing CPUC 42 cents in fuel to produce 1 Kwh of electricity. This tells us that the tariff cannot be set below 42 cents per Kwh; otherwise CPUC cannot afford the fuel it needs to run the generators. How CPUC manages this cost is very important because it comprises more than half of its operating and maintenance costs. Any saving of this cost will greatly impact the cost of CPUC operation. CPUC should improve the fuel efficiency of its generation production and also negotiate for discounts from the only supplier of diesel fuel. The governments can look into the possibility of relieving the supplier from the taxes being imposed on the fuel being consumed by CPUC so the supplier can pass the savings to CPUC.

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- Total Ops & Maint. Expense (excluding Fuel Expense) per Customer \$896.29

For year ended September 2009, it cost CPUC \$896.29 annually, not including fuel expense, to serve one customer. Whether the cost is reasonable should be determined by comparing it with other related and similar sized utilities in the region. This measurement can be used by CPUC to revisit its tariff structure for appropriate realignment of cross subsidies between classes of customers for promotion of attractive pricing strategies.

- Revenue per Kwh Sold \$0.53

In December 2008, CPUC increased its tariff from an average of 34 cents per Kwh to 53 cents per Kwh, the first time that the rate of CPUC ever surpassed the cost of fuel to produce that Kwh. The revenue of CPUC increased by \$700 thousand as a result of the increase in tariff; however it was still not enough to cover the cost of 66 cents to operate and maintain the utility. What's preventing CPUC from full cost recovery after raising a tariff to an all time high tariff of 53 cents Kwh this year? One is the cost to maintain and operate the water and sewer services is not been billed to customers and so the revenue from power is subsidizing the cost of these services to the people. Second, due to deteriorated generation capacities, production of power is not consistent, generating only half the demand of power in Chuuk. Because of limited generation, not enough money is available to cover the fixed cost needed to provide these utility services. There are also technical and non technical losses to the systems that contribute to monetary losses to CPUC; as an example, CPUC loses 40% of power it produces due to distribution loss, self use (pumps for water and sewer), power theft, un-metered services, billing anomalies, etc. CPUC can improve its operation to complement the new tariff by correcting these operational deficiencies.

- Bad Debt Expense per Revenue Dollar \$0.14

For September 30, 2009, CPUC loses 14 cents of its revenue dollar to bad debts. This is another concern because what's the good reason to increase the tariff when you cannot collect. This is another operation deficiency contributing to the recurring financial losses of CPUC. Improvement of this indicator will also improve customer relations, since bad debt can also mean that disconnection was consistently and uniformly applied to all customers.

Management's Discussion and Analysis for the years ended September 30, 2008 and 2007, is set forth in the report on the audit of CPUC's financial statements, which is dated June 15, 2009, and that Discussion and Analysis explains the major factors impacting the 2008 and 2007 financial statements and can be viewed at the Office of the Public Auditor's website at www.fsmpublicauditor.fm.

Capital Assets and Debt Administration

For additional information concerning capital assets, please refer to note 4 to the financial statements.

For additional information concerning debt, please refer to note 6 to the financial statements.

FISCAL YEAR 2010 OUTLOOK

CPUC will continue to incur losses in 2010, because many of the operational deficiencies reported above have not been corrected at the time of this writing due to lack of funds. CPUC has estimated in its operational budget for 2010 that it would require injections of more than \$3 million and new management and technical team to improve the system and get it back on track. This is in addition to the needed capitalization of a new power plant and money for rehabilitation of the water and sewer infrastructure.

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As of date of this writing CPUC through Chuuk State government is working with ADB and DOI to build a new power plant and to provide a new management team with injection of new money of \$2 million to fix the reported deficiencies in the CPUC operations. This work however is estimated to start in the fiscal year 2011, which will not have impact to the operation of CPUC in 2010.

The management has made some progress in refurbishing the idled generating units that were down due to overuse and poor maintenance. This has enabled the utility to keep moving forward despite the financial problems and limited technical resources needed to do the major changes.

The internal control and management of CPUC finances are also being monitored and managed accordingly and CPUC was able to provide auditable books to complete the audit this year. It is expected that the work will continue to improve as we move into 2010 and 2011.

In conclusion, it will take a lot of effort and money to turn around CPUC. Commitments from the Chuuk State government and other stakeholders need be reaffirmed because that is the only way to make CPUC work. Without such commitments, CPUC is history. Desolving CPUC is not an option for Chuuk because of the vital role the utility plays in the development of Chuuk. The lives, health, sanitation, and future well being of Chuuk State, is dependent upon the commitment that the State and National government will make now.

CHUUK PUBLIC UTILITY CORPORATION
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Statements of Deficiency
September 30, 2009 and 2008

<u>Assets</u>	<u>2009</u>	<u>2008</u>
Utility plant, at cost:		
Electric plant in service	\$ 15,708,109	\$ 15,708,109
Water and sewer plant in service	10,088,111	10,088,111
	<u>25,796,220</u>	<u>25,796,220</u>
Less accumulated depreciation	(23,786,179)	(22,834,884)
Total utility plant	<u>2,010,041</u>	<u>2,961,336</u>
Current assets:		
Cash	4,664	4,854
Accounts receivable, net	440,187	325,125
Other receivables	19,377	19,377
Inventory	141,094	195,861
Total current assets	<u>605,322</u>	<u>545,217</u>
	<u>\$ 2,615,363</u>	<u>\$ 3,506,553</u>
<u>Deficiency and Liabilities</u>		
Net deficiency:		
Invested in capital assets, net of related debt	\$ (2,353,312)	\$ (1,500,636)
Unrestricted deficit	(2,630,054)	(2,258,321)
Total deficiency	<u>(4,983,366)</u>	<u>(3,758,957)</u>
Commitment and contingencies		
Current liabilities:		
Bank overdraft	-	111,346
Current portion of notes payable	992,392	939,138
Accounts payable	84,211	-
Accrued taxes and other liabilities	1,187,554	1,277,583
Accrued interest expense	1,564,440	1,052,701
Advances from Chuuk State Government	58,000	-
Advances from Chuuk State Housing Authority	220,000	220,000
Deferred income	17,693	67,693
Accrued annual leave	3,739	1,559
Total current liabilities	<u>4,128,029</u>	<u>3,670,020</u>
Noncurrent liabilities:		
Accrued annual leave	99,739	72,656
Notes payable	3,370,961	3,522,834
Total liabilities	<u>7,598,729</u>	<u>7,265,510</u>
	<u>\$ 2,615,363</u>	<u>\$ 3,506,553</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, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Operating revenues:		
Electricity sales	\$ 4,020,000	\$ 2,399,490
Other sales	<u>39,093</u>	<u>21,896</u>
	4,059,093	2,421,386
Less uncollectable accounts	<u>(574,475)</u>	<u>(142,147)</u>
Total operating revenues	<u>3,484,618</u>	<u>2,279,239</u>
Operating and maintenance expenses:		
Production fuel	2,758,465	2,305,709
Administrative and general	754,135	742,626
Depreciation	<u>951,295</u>	<u>1,012,243</u>
Total operating and maintenance expenses	<u>4,463,895</u>	<u>4,060,578</u>
Operating loss	<u>(979,277)</u>	<u>(1,781,339)</u>
Nonoperating revenues (expense):		
Contribution from FSM National Government	-	150,000
Contribution from Chuuk State Government	92,136	192,146
OMIP grant	-	42,327
Interest expense	<u>(337,268)</u>	<u>(499,328)</u>
Total nonoperating revenues (expense), net	<u>(245,132)</u>	<u>(114,855)</u>
Change in deficiency	(1,224,409)	(1,896,194)
Deficiency at beginning of year	<u>(3,758,957)</u>	<u>(1,862,763)</u>
Deficiency at end of year	<u>\$ (4,983,366)</u>	<u>\$ (3,758,957)</u>

See accompanying notes to financial statements.

CHUUK PUBLIC UTILITY CORPORATION
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Statements of Cash Flows
Years Ended September 30, 2009 and 2008

	2009	2008
Cash flows from operating activities:		
Cash received from customers	\$ 3,319,556	\$ 2,055,362
Cash payments to suppliers for goods and services	(2,608,314)	(2,291,507)
Cash payments to employees	(651,603)	(573,412)
Net cash provided by (used in) operating activities	59,639	(809,557)
Cash flows from noncapital financing activities:		
Contributions from Chuuk State Government	58,000	192,146
Contributions from FSM National Government	-	150,000
Contributions from Chuuk State Housing Authority	-	110,000
Operating grants received	-	42,327
(Decrease) increase in bank overdraft	(111,346)	56,791
Net cash (used for) provided by noncapital financing activities	(53,346)	551,264
Cash flows from capital and related financing activities:		
Acquisition of utility plant	-	(1,927)
Principal payment on long-term debt	(6,483)	-
Proceeds from issuance of long-term debt	-	263,760
Net cash (used for) provided by capital and related financing activities	(6,483)	261,833
Net change in cash	(190)	3,540
Cash at beginning of year	4,854	1,314
Cash at end of year	\$ 4,664	\$ 4,854
<u>Reconciliation of operating loss to net cash provided by (used in)</u>		
<u>operating activities:</u>		
Operating loss	\$ (979,277)	\$ (1,781,339)
Adjustments to reconcile operating loss to net cash provided by (used in) operating activities:		
Depreciation	951,295	1,012,243
Bad debts	574,475	142,147
Decrease (increase) in assets:		
Accounts receivable	(689,537)	(192,022)
Other receivables	-	(11,000)
Inventory	54,767	-
Prepayments	-	188,038
Increase (decrease) in liabilities:		
Accounts payable	84,211	(232,782)
Accrued taxes and other liabilities	84,442	215,886
Deferred revenue	(50,000)	(163,002)
Accrued annual leave	29,263	12,274
Net cash provided by (used in) operating activities	\$ 59,639	\$ (809,557)

Supplemental schedule of noncash financing activities:

In 2009, Chuuk State Government paid \$92,136 on behalf of CPUC to pay outstanding debt.

See accompanying notes to financial statements.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2009 and 2008

(1) Organization

The Chuuk Public Utility Corporation (CPUC) is a component unit of the State of Chuuk. CPUC was created by Chuuk State Law 192-12. Its primary objective is to operate all public utilities within the State of Chuuk including providing, maintaining and improving the water, electric, and sewerage systems to the public.

CPUC is governed by a five-member Board of Directors, which comprises of one member from each of the five senatorial districts of the State appointed by the Governor with the advice and consent of the Chuuk State Legislature.

CPUC's financial statements are incorporated into the financial statements of the State of Chuuk as a component unit.

(2) Summary of Significant Accounting Policies

The accounting policies of CPUC conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. 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 Principles 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 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.

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 Statement No. 34, CPUC's equity is presented in the following net asset categories:

- Investment in capital assets net of related debt; capital assets, net of accumulated depreciation, plus construction or improvement of those assets, less related debt.

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

Notes to Financial Statements
September 30, 2009 and 2008

(2) Summary of Significant Accounting Policies, Continued

- 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 of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

CPUC has no restricted net assets at September 30, 2009 and 2008.

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statements of net assets. Proprietary fund operating statements present increases and decreases in net total assets. 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.

Cash

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.

For purposes of the statements of deficiency and cash flows, cash is defined as cash on hand and cash held in demand accounts. As of September 30, 2009 and 2008, the carrying amount of cash was \$4,664 and \$4,854, respectively, and the corresponding bank balances were \$11,026 and \$3,618, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2009 and 2008, bank deposits were fully FDIC insured.

Receivables

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

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

Notes to Financial Statements
September 30, 2009 and 2008

(2) 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.

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 \$1,332,381 and \$1,462,484, respectively, as of September 30, 2009 and 2008. Current policy is to capitalize items over \$200. Depreciation is calculated on the straight-line method based on the estimated useful lives of the assets, which range from 3 to 20 years.

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 CPUC 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. As of September 30, 2009 and 2008, the accumulated vacation leave liability totals \$103,478 and \$74,215, respectively.

Revenue Recognition

Sales of electricity are recorded as billed to customers on a monthly billing cycle basis. At September 30, 2009 and 2008, unbilled revenues are accrued based on the most recent billing cycles. Unbilled receivables at September 30, 2009 and 2008 are \$95,134 and \$19,207, respectively.

Grants and Subsidies

CPUC periodically receives appropriated subsidies from the Chuuk State Legislature.

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.

Taxation

CPUC exists and operates solely for the benefit of the public and shall be exempted from any State or Municipal taxes or assessments on any of its property, operations or activities. CPUC shall be liable for employees' contributions to the National Social Security System or other employees' benefits of the State or FSM National Government, if any, in such manner as provided by law.

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

Notes to Financial Statements
September 30, 2009 and 2008

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

During fiscal year 2009, CPUC implemented the following pronouncements:

- GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which 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.
- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation.
- GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, which improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income.
- GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which improves financial reporting by contributing to the GASB's efforts to codify all GAAP for state and local governments so that they derive from a single source.
- GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, which incorporates accounting and financial reporting guidance previously only contained in the American Institute of Certified Public Accountants (AICPA) auditing literature into the GASB's accounting and financial reporting literature for state and local governments, and addresses three issues from the AICPA's literature - related party transactions, going concern considerations, and subsequent events.

The implementation of these pronouncements did not have a material effect on the accompanying financial statements.

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which 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.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. 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.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2009 and 2008

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In December 2008, GASB issued Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*, which clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, for calculating the annual required contribution (ARC) adjustment. 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 March 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The provisions of this statement are effective for periods beginning after June 15, 2010. Management has not determined the effect that the implementation of this statement will have on the financial statements of CPUC.

Risk Management

CPUC carries workmen's compensation liability insurance for all employees of the Corporation; however, CPUC 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.

Reclassifications

Certain reclassifications have been made to the 2008 financial statements to conform to the 2009 presentation.

(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, 2009 and 2008, which is classified as accounts receivable - unbilled. Accounts receivable at September 30, 2009 and 2008, are summarized as follows:

	<u>2009</u>	<u>2008</u>
Residential	\$ 713,367	\$ 617,614
Commercial	728,559	681,998
Government	377,934	390,201
Unbilled	<u>95,134</u>	<u>19,207</u>
	1,914,994	1,709,020
Less allowance for doubtful receivables	<u>(1,474,807)</u>	<u>(1,383,895)</u>
	<u>\$ 440,187</u>	<u>\$ 325,125</u>

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2009 and 2008

(4) Utility Plant

Utility plant activity for the years ended September 30, 2009 and 2008 is as follows:

	<u>2008</u>	<u>Additions</u>	<u>Disposals/ Adjustments</u>	<u>2009</u>
General plant in service	\$ 321,314	\$ -	\$ -	\$ 321,314
Electric plant in service	15,386,795	-	-	15,386,795
Water and sewer plant in service	<u>10,088,111</u>	<u>-</u>	<u>-</u>	<u>10,088,111</u>
	25,796,220	-	-	25,796,220
Less accumulated depreciation	<u>(22,834,884)</u>	<u>(951,295)</u>	<u>-</u>	<u>(23,786,179)</u>
	<u>\$ 2,961,336</u>	<u>\$ (951,295)</u>	<u>\$ -</u>	<u>\$ 2,010,041</u>
	<u>2007</u>	<u>Additions</u>	<u>Disposals/ Adjustments</u>	<u>2008</u>
General plant in service	\$ 323,200	\$ 3,314	\$ (5,200)	\$ 321,314
Electric plant in service	15,386,795	-	-	15,386,795
Water and sewer plant in service	<u>10,088,111</u>	<u>-</u>	<u>-</u>	<u>10,088,111</u>
	<u>25,798,106</u>	<u>3,314</u>	<u>(5,200)</u>	<u>25,796,220</u>
Less accumulated depreciation	<u>(21,826,454)</u>	<u>(1,012,243)</u>	<u>3,813</u>	<u>(22,834,884)</u>
	<u>\$ 3,971,652</u>	<u>\$ (1,008,929)</u>	<u>\$ (1,387)</u>	<u>\$ 2,961,336</u>

(5) Grants and Subsidies

FSM National Government, Chuuk State, and other subsidies are comprised of the following for the years ended September 30, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
FSM National Government fuel subsidy	\$ -	\$ 150,000
Chuuk State fuel subsidy	92,136	192,146
OMIP Grants	<u>-</u>	<u>42,327</u>
	<u>\$ 92,136</u>	<u>\$ 384,473</u>

The Chuuk State fuel subsidy derives from the Declaration of a State of Emergency. There are no specific compliance terms associated with these funds other than that they be utilized for power generation. At September 30, 2009, Chuuk State contributed \$92,136 to pay for certain debt.

(6) Notes Payable

	<u>2009</u>	<u>2008</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

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

Notes to Financial Statements
September 30, 2009 and 2008

(6) Notes Payable, Continued

	<u>2009</u>	<u>2008</u>
Amount drawn on a note payable with an available total of \$737,743, for cash power meters and other equipment purchases, 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.	731,260	737,743
Amount drawn on a note payable with an available total of \$2,795,540 to the State of Chuuk, for water well and electric construction purposes, 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>3,550,172</u>	<u>3,642,308</u>
Less current maturities	<u>4,363,353</u> <u>992,392</u>	<u>4,461,972</u> <u>939,138</u>
Long-term portion of notes payable	\$ <u>3,370,961</u>	\$ <u>3,522,834</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. The 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. The loan payment was refinanced and was set at \$4,000 per month.

Notes payable mature as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2010	\$ 992,392	\$ 1,745,405	\$ 2,737,797
2011	59,737	176,891	236,628
2012	59,737	172,816	232,553
2013	59,737	168,742	228,479
2014	59,737	164,668	224,405
2015-2019	547,640	745,251	1,292,891
2020-2024	796,595	499,081	1,295,676
2025-2029	796,595	227,441	1,024,036
2030-2032	<u>991,183</u>	<u>17,715</u>	<u>1,008,898</u>
	<u>\$ 4,363,353</u>	<u>\$ 3,918,010</u>	<u>\$ 8,281,363</u>

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

Notes to Financial Statements
September 30, 2009 and 2008

(7) Noncurrent Liabilities

Noncurrent liability activities for the years ended September 30, 2009 and 2008, was as follows:

	Beginning Balance October 1, <u>2008</u>	<u>Addition</u>	<u>Reduction</u>	Ending Balance September <u>30, 2009</u>	Amount due Within <u>One Year</u>
Loans payable	\$ 4,461,972	\$ -	\$ (98,619)	\$ 4,363,353	\$ 992,392
Accrued annual leave	<u>74,215</u>	<u>33,142</u>	<u>(3,879)</u>	<u>103,478</u>	<u>3,739</u>
	<u>\$ 4,536,187</u>	<u>\$ 33,142</u>	<u>\$ (102,498)</u>	<u>\$ 4,466,831</u>	<u>\$ 996,131</u>
	Beginning Balance October 1, <u>2007</u>	<u>Addition</u>	<u>Reduction</u>	Ending Balance September <u>30, 2008</u>	Amount due Within <u>One Year</u>
Loans payable	\$ 4,198,212	\$ 263,760	\$ -	\$ 4,461,972	\$ 939,138
Accrued annual leave	<u>61,941</u>	<u>13,866</u>	<u>(1,592)</u>	<u>74,215</u>	<u>1,559</u>
	<u>\$ 4,260,153</u>	<u>\$ 277,626</u>	<u>\$ (1,592)</u>	<u>\$ 4,536,187</u>	<u>\$ 940,697</u>

(8) 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.

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, 2009 and 2008.

(9) Related Party Transactions

Accounts receivable from the State of Chuuk amounted to \$377,934 and \$390,201 as of September 30, 2009 and 2008, respectively. Revenue received from the State of Chuuk for the years ended September 30, 2009 and 2008 amounted to \$701,750 and \$782,559, respectively.

Advances from Chuuk State Housing Authority amounted to \$220,000 as of September 30, 2009 and 2008. The underlying agreement indicates that all parties will utilize their best efforts to obtain funding from external sources to repay the advances. There has been no subsequent payment made to Chuuk State Housing Authority.

Advances from Chuuk State Government amounted to \$58,000 as of September 30, 2009. The agreement indicates that all parties will utilize their best efforts to obtain funding from external sources to repay the advances. Subsequent payments of \$14,571 have been made.

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

Notes to Financial Statements
September 30, 2009 and 2008

(10) Contingencies

Going Concern

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, 2009, current liabilities exceeded current assets by \$3,522,707, and total liabilities exceed total assets by \$4,983,366. 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, 2009, 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.

Litigation

CPUC is party to various outstanding court judgments of in excess of \$1 million. CPUC has provided for an amount that it believes it will actually be responsible for. The ultimate impact of any remaining judgments is not currently predictable. Therefore, no liability has been recorded in the accompanying financial statements due to management's ability to predict the ultimate outcome. Any changes in this estimate will be resolved prospectively.

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.

Other

At September 30, 2009, CPUC wrote-off \$154,195 of deferred income and various other liability accounts. CPUC is uncertain if the amount will result in a liability in the near future but will address the matter prospectively.

(11) Commitment

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

<u>Year ending September 30,</u>	
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 have audited the financial statements of Chuuk Public Utility Corporation (CPUC) a component unit of the State of Chuuk, as of and for the year ended September 30, 2009, and have issued our report thereon dated June 4, 2010, which report disclaimed an opinion on the statements of revenues, expenses and changes in deficit and cash flows due to inadequacies of accounting records and internal control. Except as discussed in the preceding sentence, we conducted our audit 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.

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 24) to be a significant deficiency in internal control over financial reporting, which is described as item 2009-01.

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.

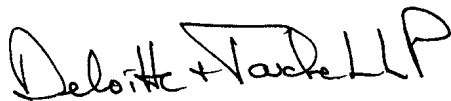
Compliance and Other Matters

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 2009-01.

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 4, 2010.

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 and use of the Board of Directors and management of CPUC, the Office of the Public Auditor of the FSM, 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 of public record.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

June 4, 2010

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

Schedule of Findings and Responses
Year Ended September 30, 2009

Finding 2009-01 - 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. Source documents voucher checks, invoices or cash receipts were not available to support entries into the financial statements.

Cause: The cause of this condition is primarily due to inadequate accounting assistance, 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: CPUC concurs with the finding and will implement the necessary changes to resolve the finding in FY2010.