

CHUUK PUBLIC UTILITY CORPORATION

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

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2010 AND 2009

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Chuuk Public Utility Corporation:

We have audited the accompanying statements of deficiency of the Chuuk Public Utility Corporation (CPUC), a component unit of the State of Chuuk, as of September 30, 2010 and 2009, and the related statements of revenue, expenses and changes in deficiency and cash flows for the years then ended. These financial statements are the responsibility of CPUC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

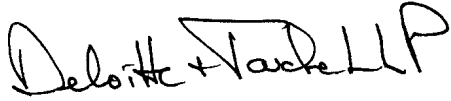
We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the accompanying statements of deficiency present fairly, in all material respects, the financial position of CPUC as of September 30, 2010 and 2009, and the results of operations and its cash flows for the years then ended 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's Discussion and Analysis on pages 1 through 5 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 11, 2011, 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 + Stach LLP". The signature is written in a cursive, stylized font.

June 11, 2011

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

Management's Discussion and Analysis
Year Ended September 30, 2010

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, 2010.

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, 2010, and 2009. 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 for fiscal years 2010, 2009 and 2008. We also include a table for some key financial ratios that can be useful in explaining the performance and financial health of CPUC over the three year period.

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Assets:			
Utility plant in service, net	\$ 1,373,956	\$ 2,010,041	\$ 2,961,336
Current assets	<u>259,583</u>	<u>605,322</u>	<u>545,217</u>
Total assets	\$ <u>1,633,539</u>	\$ <u>2,615,363</u>	\$ <u>3,506,553</u>
Deficiency and Liabilities:			
Invested in capital assets, net of related debt	\$ 565,038	\$(2,353,312)	\$(1,500,636)
Unrestricted deficit	<u>(1,661,965)</u>	<u>(2,630,054)</u>	<u>(2,258,321)</u>
Total deficiency	<u>(1,096,927)</u>	<u>(4,983,366)</u>	<u>(3,758,957)</u>
Long-term liabilities	147,012	3,470,700	3,595,490
Current liabilities	<u>2,583,454</u>	<u>4,128,029</u>	<u>3,670,020</u>
Total liabilities	<u>2,730,466</u>	<u>7,598,729</u>	<u>7,265,510</u>
Total deficiency and liabilities	\$ <u>1,633,539</u>	\$ <u>2,615,363</u>	\$ <u>3,506,553</u>
Revenue, Expenses, and Changes in Net Assets:			
Operating revenues	\$ 3,296,158	\$ 3,484,618	\$ 2,279,239
Operating expenses	<u>4,409,215</u>	<u>4,463,895</u>	<u>4,060,578</u>
Operating loss	<u>(1,113,057)</u>	<u>(979,277)</u>	<u>(1,781,339)</u>
Subsidies and other income	5,089,937	92,136	384,473
Interest expense	<u>(90,441)</u>	<u>(337,268)</u>	<u>(499,328)</u>
Total non-operating revenue (expense), net	<u>4,999,496</u>	<u>(245,132)</u>	<u>(114,855)</u>
Net income (loss)	3,886,439	(1,224,409)	(1,896,194)
Net deficiency at beginning of year	<u>(4,983,366)</u>	<u>(3,758,957)</u>	<u>(1,862,763)</u>
Net deficiency at end of year	\$ <u>(1,096,927)</u>	\$ <u>(4,983,366)</u>	\$ <u>(3,758,957)</u>

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

Management's Discussion and Analysis
Year Ended September 30, 2010

Financial Ratios	<u>2010</u>	<u>2009</u>	<u>2008</u>
Financial Health:			
Unrestricted net deficiency	(50.42)%	(75.48)%	(99.08)%
Capital asset condition	5.42%	7.78%	11.63%
Assets to debt	(167.15)%	(290.54)%	(207.20)%
Current ratio	0.10	0.15	0.15
Quick ratio	0.05	0.00	0.00
Allowance for doubtful accounts	93.81%	77.01%	81.18%
Financial Performance:			
Change in net deficiency	77.99%	(32.57)%	(101.79)%
Operating ratio	1.34	1.28	1.78
Debt service load	2.83%	10.66%	10.48%
Debt service coverage	36.45	10.33	4.56
Days in accounts receivable	10.19	46.11	52.07
Net income (loss) per revenue dollar	\$1.18	\$(0.35)	\$(0.83)
Total operations and maintenance expense per Kwh sold	\$0.69	\$0.66	\$0.63
Total fuel expense per Kwh sold	\$0.45	\$0.42	\$0.32
Total operations and maintenance expense (excluding fuel expense) per customer	\$826.10	\$896.29	\$974.93
Revenue per Kwh sold	\$0.54	\$0.53	\$0.34
Bad debt expense per revenue dollar	\$0.05	\$0.14	\$0.06

FINANCIAL HIGHLIGHTS

Fiscal year 2010 marked the beginning of good effort by the Chuuk State Government to reform the operation of CPUC, with first the nomination and confirmation of new Board members and then the hiring of a qualified accountant. This was made necessary to prepare the financial statements of CPUC and to transition the coming of the new management team, the Operations and Maintenance Management (OMM) team which commenced the later part of the year.

Additionally, in anticipation of the OMM and the Capital Recovery and Improvement Program (CRISP) funding, the Chuuk State Government also took over the responsibility of the ADB water loan. This clears up much of CPUC's liabilities and resulted in a much more positive financial outlook.

The statements of net deficiency, for example, was improved by \$3.9 million (or reduced from \$4,983,366 as of September 30, 2009 to \$1,096,927 as of September 30, 2010). Operating revenues earned during 2010 and 2009 was \$1 million higher than that earned during 2008 even when the generating facilities have been in their worst condition.

The operating expenses incurred during 2010 were \$54,680 (or 1%) less than 2009. This was a significant improvement, especially when the average price of fuel, which constituted the major portion of the operating expense, was 9% higher than 2009.

CHUUK PUBLIC UTILITIES CORPORATION
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Management's Discussion and Analysis
Year Ended September 30, 2010

Reporting of the Ratios:

- Unrestricted Net Deficiency (50.42)%

For the year ended September 2010, the utilities total unrestricted net deficiency is approximately \$1.66 million deficit or negative 50.42% of annual revenue, an indication that CPUC does not have any resources in reserve, unexpended and or available for emergencies.

- Capital Asset Condition 5.42%

At September 30, 2010, the Utility's depreciable capital assets amounted to \$25.4 million and total accumulated depreciation was \$24 million indicating that only 5.42 % of the useful capital assets have remaining financial lives.

- Assets to Debt (167.15)%

At September 30, 2010, more than all of the utilities remaining assets of \$1.6 million were funded with debts or other obligations.

- Current Ratio 0.10%

At September 30, 2010, the CPUC can only pay 0.10 cents of a dollar owed when liquidating all its current assets.

- Quick Ratio 0.05%

At September 30, 2010, CPUC has only 5 cent available to satisfy a dollar of its current obligations.

- Allowance for Doubtful Accounts 93.81%

At September 30, 2010, CPUC management believes that of the \$1.486 million in account receivable, only \$92 thousand was collectible or 93.81% of accounts receivable is uncollectible.

- Change in Net Deficiency 77.99%

At September 30, 2010, total net deficiency decreased by 3.9 million, a significant improvement from a deficiency of \$5.0 million last year to a low of \$1.0 million this year.

- Operating Ratio 1.34

At September 30, 2010, CPUC's operating ratio is 1.34, meaning that \$1.34 of CPUC current operating expenses exceed \$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 or grants, a measurement of self-sufficiency.

- Debt Service Load 2.83%

At September 30, 2010, the total utility's non-capital expenses amounted to \$3.2 million and of that \$90 thousand or (2.83%) was related to the cost of debts service.

**CHUUK PUBLIC UTILITIES CORPORATION
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Management's Discussion and Analysis
Year Ended September 30, 2010

- Debt Service Coverage 36.45
For September 30, 2010, the utility has 36.45 times more of annual revenue to the annual debt service costs.
- Days in Accounts Receivable 10.19
For the year ending September 30, 2010, this measurement indicates that it has taken on an average of 10 days to collect its accounts receivables.
- Net Income per Revenue Dollar \$1.18
For the year ended September 30, 2010, CPUC had a net income \$1.18 per revenue dollar, resulted from the \$4.9 million gain on transfer of liabilities between CPUC and the State Government.
- Total Ops & Maint. Expense per kWh Sold \$0.69
For year ended September 30, 2010, it cost CPUC 69 cents to produce one (1) kWh of electricity.
- Total Fuel Expense per kWh Sold \$0.42
For year ending September 30, 2010, it cost CPUC 42 cents in fuel to produce one (1) kWh of electricity.
- Total Ops & Maint. Expense (Excluding Fuel Expense) per Customer \$826.10
For year ended September 30, 2010, it cost CPUC \$759.61 per year to serve a customer. This excluded the cost of fuel.
- Revenue per Kwh Sold \$0.54
The average tariff per kWh sold for the year ended September 30, 2010 was \$0.54.
- Bad Debt Expense per Revenue Dollar \$0.05
For September 30, 2010, CPUC lost 5 cents of its revenue dollar to bad debts.

Management's Discussion and Analysis for the year ended September 30, 2009, is set forth in the report on the audit of CPUC's financial statements, which is dated June 4, 2010. That Discussion and Analysis explains the major factors impacting the 2009 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 and 7 to the financial statements.

**CHUUK PUBLIC UTILITIES CORPORATION
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Management's Discussion and Analysis
Year Ended September 30, 2010

FISCAL YEAR 2011 OUTLOOK

The future of CPUC looks promising as the team of experts (OMM team), which is funded by the Chuuk State Compact fund commences work October, 2010. The major tasks to be undertaken by the team are as follows:

1. Assessment and improvement of the legal, regulatory and institutional capacities of CPUC,
2. Human resource assessment and development of training plans,
3. Accounting and financial assessment and development,
4. Analysis of customer service and cash power metering,
5. Customer survey,
6. Technical survey of water and power supply networks and analysis of equipment needs,
7. Environmental assessment,
8. Inventory and assessment of equipment,
9. Define and prepare list of necessary materials and equipment,
10. Meeting all stakeholders involved in CPUC supervision,
11. Information system needs assessment and improvement, and
12. Preparation, presentation, and implementation of short-term and long-term repair and rehabilitation of CPUC.

It is the management's view that once these changes and reform plans are implemented in CPUC, it will have a major impact to the recovery of CPUC as a going concern and the presentation of its financial statements.

CHUUK PUBLIC UTILITY CORPORATION
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Statements of Deficiency
September 30, 2010 and 2009

<u>Assets</u>	<u>2010</u>	<u>2009</u>
Utility plant, at cost:		
Electric plant in service	\$ 15,379,986	\$ 15,708,109
Water and sewer plant in service	9,991,103	10,088,111
	<u>25,371,089</u>	<u>25,796,220</u>
Less accumulated depreciation	(23,997,133)	(23,786,179)
Total utility plant	<u>1,373,956</u>	<u>2,010,041</u>
Current assets:		
Cash	31,400	4,664
Accounts receivable, net	92,064	440,187
Other receivables	6,452	19,377
Inventory	129,667	141,094
Total current assets	<u>259,583</u>	<u>605,322</u>
	<u>\$ 1,633,539</u>	<u>\$ 2,615,363</u>
<u>Deficiency and Liabilities</u>		
Net deficiency:		
Invested in capital assets, net of related debt	\$ 565,038	\$ (2,353,312)
Unrestricted deficit	(1,661,965)	(2,630,054)
Total deficiency	<u>(1,096,927)</u>	<u>(4,983,366)</u>
Commitment and contingencies		
Current liabilities:		
Current portion of notes payable	808,918	992,392
Accounts payable	95,764	84,211
Accrued taxes and other liabilities	1,154,169	1,187,554
Accrued interest expense	473,223	1,564,440
Advances from Chuuk State Government	-	58,000
Advances from Chuuk State Housing Authority	-	220,000
Deferred income	17,693	17,693
Accrued annual leave	33,687	3,739
Total current liabilities	<u>2,583,454</u>	<u>4,128,029</u>
Noncurrent liabilities:		
Accrued annual leave	75,584	99,739
Other	71,428	-
Notes payable	-	3,370,961
Total liabilities	<u>2,730,466</u>	<u>7,598,729</u>
	<u>\$ 1,633,539</u>	<u>\$ 2,615,363</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, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Operating revenues:		
Electricity sales	\$ 3,384,406	\$ 4,020,000
Other sales	102,660	39,093
	<u>3,487,066</u>	<u>4,059,093</u>
Less uncollectable accounts	(190,908)	(574,475)
Total operating revenues	<u>3,296,158</u>	<u>3,484,618</u>
Operating and maintenance expenses:		
Production fuel	2,856,154	2,758,465
Administrative and general	918,889	754,135
Depreciation	634,172	951,295
Total operating and maintenance expenses	<u>4,409,215</u>	<u>4,463,895</u>
Operating loss	<u>(1,113,057)</u>	<u>(979,277)</u>
Nonoperating revenues (expense):		
Contribution from Chuuk State Government	-	92,136
Other income	126,766	-
Interest expense	(90,441)	(337,268)
Gain on transfer of liabilities	4,963,171	-
Total nonoperating revenues (expense), net	<u>4,999,496</u>	<u>(245,132)</u>
Change in deficiency	3,886,439	(1,224,409)
Deficiency at beginning of year	<u>(4,983,366)</u>	<u>(3,758,957)</u>
Deficiency at end of year	<u>\$ (1,096,927)</u>	<u>\$ (4,983,366)</u>

See accompanying notes to financial statements.

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

Statements of Cash Flows
Years Ended September 30, 2010 and 2009

	2010	2009
Cash flows from operating activities:		
Cash received from customers	\$ 3,612,143	\$ 3,319,556
Cash payments to suppliers for goods and services	(3,076,388)	(2,608,314)
Cash payments to employees	(529,685)	(651,603)
Net cash provided by operating activities	6,070	59,639
Cash flows from noncapital financing activities:		
Net gain on transfer of liabilities	46,000	-
Decrease in Chuuk State Government related advances	(6,071)	58,000
Decrease in bank overdraft	-	(111,346)
Net cash provided by (used in) noncapital financing activities	39,929	(53,346)
Cash flows from capital and related financing activities:		
Acquisition of utility plant	(5,000)	-
Reduction of long-term debt	(4,263)	(6,483)
Payment of interest	(10,000)	-
Net cash used in capital and related financing activities	(19,263)	(6,483)
Net change in cash	26,736	(190)
Cash at beginning of year	4,664	4,854
Cash at end of year	\$ 31,400	\$ 4,664
<u>Reconciliation of operating loss to net cash provided by operating activities:</u>		
Operating loss	\$ (1,113,057)	\$ (979,277)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Other income	126,766	-
Loss on disposal of assets	6,913	-
Depreciation	634,172	951,295
Bad debts	190,908	574,475
Decrease (increase) in assets:		
Accounts receivable	50,627	(689,537)
Other receivables	12,925	-
Inventory	11,427	54,767
Increase (decrease) in liabilities:		
Accounts payable	11,553	84,211
Accrued taxes and other liabilities	68,043	84,442
Deferred revenue	-	(50,000)
Accrued annual leave	5,793	29,263
Net cash provided by operating activities	\$ 6,070	\$ 59,639

See accompanying notes to financial statements.

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

Statements of Cash Flows, Continued
Years Ended September 30, 2010 and 2009

Supplemental schedule of noncash financing activities:

In December 2010, CPUC and Chuuk State agreed through a memorandum of understanding to offset claims and transfer certain debt between CPUC and Chuuk State. As a result, PCUC recorded the following noncash adjustments to its September 30, 2010 financial statements:

Decrease of accounts receivable	(106,588)
Decrease of accrued taxes and other liabilities	30,000
Decrease in accrued interest expense	1,171,658
Decrease in advances from Chuuk State Government	51,929
Decrease in advances from Chuuk State Housing Authority	220,000
Decrease in note payable	<u>3,550,172</u>
	\$ <u><u>4,917,171</u></u>

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

Notes to Financial Statements
September 30, 2010 and 2009

(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
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Notes to Financial Statements
September 30, 2010 and 2009

(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, 2010 and 2009.

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, 2010 and 2009, the carrying amount of cash was \$31,402 and \$4,664, respectively, and the corresponding bank balances were \$24,542 and \$11,026, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2010 and 2009, 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
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Notes to Financial Statements
September 30, 2010 and 2009

(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 \$777,752 and \$1,332,381, respectively, as of September 30, 2010 and 2009. 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, 2010 and 2009, the accumulated vacation leave liability totals \$109,271 and \$103,478, respectively.

Revenue Recognition

Sales of electricity are recorded as billed to customers on a monthly billing cycle basis. Customer accounts are read and billed on the 15th and 30th of the month, respectively, and are due and payable 15 days after billing. At September 30, 2010 and 2009, unbilled revenues are accrued based on the most recent billing cycles totaling \$46,000 and \$95,134, 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
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Notes to Financial Statements
September 30, 2010 and 2009

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

During fiscal year 2010, CPUC implemented the following pronouncements:

- GASB 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.
- GASB 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.
- GASB 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.
- GASB Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*, which provides guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code, and establishes requirements for recognizing and measuring the effects of the bankruptcy process on assets and liabilities, and for classifying changes in those items and related costs.

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

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 evaluated the effect that the implementation of this statement will have on the financial statements of the CPUC.

In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to measurement of OPEB obligations by certain employers participating in agent multiple-employer OPEB plans. The provisions of Statement 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the CPUC.

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

Notes to Financial Statements
September 30, 2010 and 2009

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2010, GASB issued Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. The provisions of this statement are effective for periods beginning after June 15, 2010. Management has not evaluated the effect that the implementation of this statement will have on the financial statements of the CPUC.

Risk Management

In 2009, CPUC carried workmen's compensation liability insurance for all employees of the Corporation. 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.

Subsequent Events

Management has considered subsequent events through June 11, 2011, upon which the financial statements were available to be issued. On December 21, 2010, CPUC and Chuuk State agreed through a memorandum of understanding to offset claims and transfer certain debt between CPUC and Chuuk State. The net impact of the transferred liability totaled \$4,963,171 which has been reflected in the accompanying financial statement. In February 2011, CPUC entered into a lease settlement agreement to cover period of May 11, 2007 to May 11, 2010 for a total amount of \$125,000, which has been accrued in the accompanying financial statements (see note 11).

(3) Utility Plant

Utility plant activity for the years ended September 30, 2010 and 2009 is as follows:

	<u>2009</u>	<u>Additions</u>	<u>Disposals/ Adjustments</u>	<u>2010</u>
General plant in service	\$ 321,314	\$ 5,000	\$ (126,861)	\$ 199,453
Electric plant in service	15,386,795	-	(206,261)	15,180,534
Water and sewer plant in service	<u>10,088,111</u>	<u>-</u>	<u>(97,009)</u>	<u>9,991,102</u>
	25,796,220	5,000	(430,131)	25,371,089
Less accumulated depreciation	<u>(23,786,179)</u>	<u>(634,172)</u>	<u>423,218</u>	<u>(23,997,133)</u>
	<u>\$ 2,010,041</u>	<u>\$ (629,172)</u>	<u>\$ (6,913)</u>	<u>\$ 1,373,956</u>
			<u>Disposals/ Adjustments</u>	
	<u>2008</u>	<u>Additions</u>	<u>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>

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
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(4) Accounts Receivable

Accounts receivable at September 30, 2010 and 2009, are summarized as follows:

	<u>2010</u>	<u>2009</u>
Residential	\$ 590,839	\$ 713,367
Commercial	845,336	728,559
Unbilled	46,000	95,134
Other	4,290	-
Government	<u>-</u>	<u>377,934</u>
	1,486,465	1,914,994
Less allowance for doubtful receivables	<u>(1,394,401)</u>	<u>(1,474,807)</u>
	<u>\$ 92,064</u>	<u>\$ 440,187</u>

(5) Grants and Subsidies

During the year ended September 30, 2009, CPUC received \$92,136 of fuel subsidy from the Chuuk State Government. 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 that they be utilized for power generation.

(6) Notes Payable

	<u>2010</u>	<u>2009</u>
Notes payable to a commercial bank, interest at 7.25, on an original \$150,000 line of credit that is due and payable. 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, 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.	726,997	731,260
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 was written off as of September 30, 2010 as part of the MOU with Chuuk State (see note 2).	<u>-</u>	<u>3,550,172</u>
	808,918	4,363,353
Less current maturities	<u>808,918</u>	<u>992,392</u>
Long-term portion of notes payable	<u>\$ -</u>	<u>\$ 3,370,961</u>

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Notes to Financial Statements
September 30, 2010 and 2009

(6) Notes Payable, Continued

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.

(7) Noncurrent Liabilities

Noncurrent liability activities for the years ended September 30, 2010 and 2009, was as follows:

	Beginning Balance October 1, <u>2009</u>	<u>Addition</u>	<u>Reduction</u>	Ending Balance September 30, 2010	Amount due Within <u>One Year</u>
Loans payable	\$ 4,363,353	\$ -	\$ (3,554,435)	\$ 808,918	\$ 808,918
Other (lease obligation)	-	125,000	-	125,000	53,572
Accrued annual leave	<u>103,478</u>	<u>54,493</u>	<u>(48,700)</u>	<u>109,271</u>	<u>33,687</u>
	<u>\$ 4,466,831</u>	<u>\$ 179,493</u>	<u>\$ (3,603,135)</u>	<u>\$ 1,043,189</u>	<u>\$ 896,177</u>
	Beginning Balance October 1, <u>2008</u>	<u>Addition</u>	<u>Reduction</u>	Ending Balance September 30, 2009	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>

(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, 2010 and 2009.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2010 and 2009

(9) Related Party Transactions

At September 30, 2009, trade accounts receivable from the State of Chuuk amounted \$377,934. Additionally, at September 30, 2009, non-interest bearing advances from Chuuk State Housing Authority and Chuuk State Government were \$220,000 and \$58,000. The outstanding balances of were fully written off as part of the MOU with the Chuuk State (see note 2).

Revenue received from the State of Chuuk for the years ended September 30, 2010 and 2009 amounted to \$497,371 and \$701,750, respectively.

(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, 2010, current liabilities exceed current assets by \$2,270,299, and total liabilities exceed total assets by \$971,926.

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 deficiency at September 30, 2010, 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. 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 additional 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.

Management Agreement

On August 23, 2010, CPUC entered into Operation and Maintenance Management contract for the management and maintenance of CPUC's operation. The contract is for a period of 2 years. However, the contract is federally funded through Chuuk State. CPUC does not record the transactions to its book. The transactions are performed and recorded by Chuuk State.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2010 and 2009

(10) Contingencies, Continued

Other

During the year ended 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

In November, 2010, CPUC terminated its lease agreement and entered into a new agreement expiring in December 31, 2012. Future minimum lease payments are as follow:

<u>Year ending September 30,</u>	
2011	\$ 35,000
2012	42,000
2013	10,500

In February 2011, CPUC entered into an agreement with the landowner to settle prior lease obligation covering the three-year period of May 11, 2007 to May 10, 2010 for an adjusted total of \$125,000. The amount is payable as follows: \$15,000 due in February 2011, \$10,000 due in March 2011, with the remainder balance of \$100,000 due in quarterly installments of \$14,286 beginning June 2011. As such, current and noncurrent liabilities of \$553,572 and \$71,428, respectively, have been reflected in the accompanying financial statements. The lease covering the 3-year period from May 11, 2010 is currently under negotiation and is expected to be finalized by June 30, 2011.

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, 2010, and have issued our report thereon dated June 11, 2011. 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.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

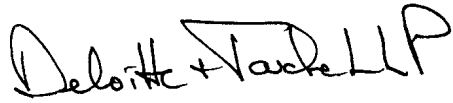
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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 11, 2011.

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 11, 2011

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

Summary Schedule of Prior Year Findings
Year Ended September 30, 2010

There are no prior year findings unresolved as of September 30, 2010.