

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

**INDEPENDENT AUDITORS' REPORTS ON
INTERNAL CONTROL AND ON COMPLIANCE**

YEAR ENDED SEPTEMBER 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) as of and for the year ended September 30, 2011, and have issued our report thereon dated June 15, 2012. 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

Management of CPUC is responsible for establishing and maintaining effective 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 and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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. However, we identified a deficiency in internal control over financial reporting, described in the accompanying Schedule of Findings and Questioned Costs as item 2011-1 that we consider to be significant deficiency in internal control over financial reporting. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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 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 certain matters that we reported to CPUC in a separate letter dated June 15, 2012.

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

This report is intended solely for the information and use of the Board of Directors, management of CPUC, others with the entity, the Office of 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 these specified parties. However, this report is also a matter of public record.

Deloitte & Touche LLP

June 15, 2012

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT
COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND
ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB
CIRCULAR A-133 AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

The Board of Directors
Chuuk Public Utility Corporation:

Compliance

We have audited the Chuuk Public Utility Corporation's (CPUC) compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on CPUC's major federal program for the year ended September 30, 2011. CPUC's major federal program is identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (page 8). Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of CPUC's management. Our responsibility is to express an opinion on CPUC's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about CPUC's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of CPUC's compliance with those requirements.

In our opinion, CPUC complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended September 30, 2011.

Internal Control Over Compliance

Management of CPUC is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered CPUC's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance, and to test and report on internal control over compliance in accordance with OMB Circular A-133 but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of CPUC's internal control over compliance.

Internal Control Over Compliance, Continued

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies in internal control over compliance, such that there is reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of CPUC as of and for the year ended September 30, 2011, and have issued our report thereon dated June 15, 2012. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards (page 6) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of CPUC. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the Board of Directors, management of CPUC, others with the entity, the Office of 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 these specified parties. However, this report is also a matter of public record.

Deloitte & Touche LLP

June 15, 2012

**CHUUK PUBLIC UTILITY CORPORATION
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Schedule of Expenditures of Federal Awards
Year Ended September 30, 2011

<u>CFDA#</u>	<u>Agency/Program</u>	<u>Federal Expenditures</u>
	<u>U.S. Department of the Interior</u>	
15.875	Pass through the Government of the Federated States of Micronesia: Economic, Social and Political Development of the Territories: FSM Public Sector Infrastructure - Fiscal Year 2011 (CPUC CRISP Capital Recovery)	\$ 1,232,035 *
15.875	Pass through the Government of the Federated States of Micronesia: Economic, Social and Political Development of the Territories: Compact Infrastructure Grant - Weno Power Emergency Grant	<u>139,912</u>
	Total U.S. Department of the Interior	<u>1,371,947</u>
	Total Federal Awards Expended	<u>\$ 1,371,947</u>
* Denotes a major program.		
	Reconciliation to the basic financial statements:	
	Capitalized as utility plant additions	\$ 118,234
	Capitalized as construction in progress	733,615
	Capitalized as materials inventory	194,438
	Advances	<u>325,660</u>
	Total Federal Awards Expended	<u>\$ 1,371,947</u>

See accompanying notes to schedule of expenditures of federal awards.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2011

(1) Scope of Audit

The Chuuk Public Utility Corporation (CPUC) is a component unit of the State of Chuuk. CPUC was created by Chuuk State Law 192-12. Only the federal expenditures of CPUC are included within the scope of the OMB Circular A-133 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as CPUC's cognizant agency for the Single Audit.

CFDA #15.875 represents the Office of Insular Affairs (OIA), U. S. Department of the Interior. Funding from this source is subject to varying rules and regulations since OIA administers the Compact of Free Association, which is a treaty, and is not a federal program. The Compact is comprised of various funded programs, each with separate compliance requirements. To maximize audit coverage of OIA funding, the OIG has recommended that programs administered under CFDA #15.875 be grouped by like compliance requirements and such groupings be separately evaluated as major programs.

(2) Summary of Significant Accounting Policies

Basis of Accounting

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of CPUC and is presented on the accrual basis of accounting, consistent with the manner in which CPUC maintains its accounting records. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133. All expenses and capital outlays are reported as expenditures.

**CHUUK PUBLIC UTILITY CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2011

Part I - Summary of Auditors' Results Section

Financial Statements

- | | |
|--|-------------|
| 1. Type of auditors' report issued: | Unqualified |
| Internal control over financial reporting: | |
| 2. Material weakness(es) identified? | No |
| 3. Significant deficiency(ies) identified? | Yes |
| 4. Noncompliance material to the financial statements noted? | No |

Federal Awards

- | | |
|---|---------------|
| Internal control over major programs: | |
| 5. Material weakness(es) identified? | No |
| 6. Significant deficiency(ies) identified? | None reported |
| 7. Type of auditors' report issued on compliance for major programs: | Unqualified |
| 8. Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? | No |
| 9. Identification of major program: | |

<u>CFDA Number</u>	<u>Name of Federal Program</u>
15.875	Economic, Social and Political Development of the Territories: FSM Public Sector Infrastructure – Fiscal Year 2011 CPUC CRISP Capital Recovery

- | | |
|--|-----------|
| 10. Dollar threshold used to distinguish between Type A and Type B programs: | \$300,000 |
| 11. Auditee qualified as low-risk auditee? | No |

Part II – Financial Statement Findings Section

<u>Finding Number</u>	<u>Finding</u>
2011-1	Inventory

Part III – Federal Award Findings and Questioned Costs Section

No items are reportable.

**CHUUK PUBLIC UTILITY CORPORATION
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2011

Finding No.: 2011-1
Area: Inventory

Criteria: Inventory count procedures should be established and applied to facilitate an accurate inventory count. Further, variances between the general ledger and inventory records should be timely investigated and reconciled.

Condition: Our observation of CPUC's inventory count noted the following:

- a. Of twenty-three inventory items tested during inventory observation, eight have differences between the inventory valuation report and physical counts, as follows:

<u>Product No./Description</u>	<u>Per Inventory Listing</u>	<u>Per Physical Count</u>	<u>Difference</u>	
			<u>(in units)</u>	<u>(in amount)</u>
1. P/N U7021-RL-TG Meter bases	170	156	14	\$ (337)
2. 9Y-5992 Core as-radiator	16	4	12	(282)
3. 116-9868 Elbow – EXH	1	2	(1)	1,501
4. 343-6811 – Kit gasket single cylinder head	-	32	(32)	5,870
5. PVC pipe 20' x 4" dia.	25	20	5	(91)
6. PVC Pipe - 20' x 3/4" dia.	150	127	23	(132)
7. PVC Pipe - 20' x 2" dia.	100	98	2	(41)
8. Secondary Poles	75	147	(72)	<u>18,304</u>
				\$ <u>24,792</u>

- b. Of seven inventory count sheets tested, evidence of counter signatures and dates of physical counts were not located for six. Further, for one item (Product No. 4P-0710), the number of items per the count sheet differs from the inventory listing.

Further, the result of the physical inventory count was reconciled to the general ledger four months after the physical count and resulted in an adjustment of \$194,438.

Cause: The cause of the above conditions is due to inadequate procedures related to physical inventory counts and reconciliation.

Effect: The effect of the above condition is a potential for inventory misstatements.

Recommendation: We recommend that inventory count guidelines be prepared, be discussed with affected personnel, and that personnel performing the counts be adequately supervised. We further recommend that inventories be properly valued, reconciled with physical counts, and reconciling items be timely adjusted.

Auditee Response and Corrective Action Plan: We concur to your finding. We are aware of our inventory management and recording problem and last month, we hired an Inventory Manager to look after it. Our plan, which also depends on our resources, is to manage our inventory through a perpetual and a job costing system. That and with someone looking after it will improve our financial reporting on inventory.

Name of Contact Person: Kelly Keller, Chief Financial Officer

Proposed Completion Date: December 31, 2012

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Schedule of Prior Audit Findings
Year Ended September 30, 2011

Unresolved Prior Audit Findings and Responses

There are no unresolved prior audit findings as of September 30, 2011.