

CHUUK PUBLIC UTILITY CORPORATION

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

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2011 AND 2010

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, 2011 and 2010, and the related statements of revenue, expenses and changes in deficiency and of 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, 2011 and 2010, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 15, 2012, 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 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.

The Management's Discussion and Analysis on pages 1 through 4 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.

Deloitte & Touche LLP

June 15, 2012

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

Management's Discussion and Analysis
Years Ended September 30, 2011 and 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, 2011.

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, 2011 and 2010. It should be read in conjunction with the financial statements that follow this section.

CPUC is a component unit of the Government of the State of Chuuk. Its primary objective is to provide electrical, water, and sewer services to the public. The following table summarizes the financial position and results of operation of CPUC for fiscal years 2011, 2010 and 2009. 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.

FINANCIAL HIGHLIGHTS

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Assets:			
Utility plant in service, net	\$ 2,093,080	\$ 1,373,956	\$ 2,010,041
Current assets	759,583	259,586	605,322
Non-current assets	<u>346,262</u>	<u>-</u>	<u>-</u>
Total assets	<u>\$ 3,199,095</u>	<u>\$ 1,633,539</u>	<u>\$ 2,615,363</u>
Deficiency and Liabilities:			
Invested in capital assets, net of related debt	\$ 855,398	\$ 565,038	\$(2,353,312)
Restricted for capital improvements	175,555	-	-
Unrestricted deficit	<u>(1,713,174)</u>	<u>(1,661,965)</u>	<u>(2,630,054)</u>
Total deficiency	<u>(682,221)</u>	<u>(1,096,927)</u>	<u>(4,983,366)</u>
Long-term liabilities	514,379	147,012	3,470,700
Current liabilities	<u>3,366,937</u>	<u>2,583,454</u>	<u>4,128,029</u>
Total liabilities	<u>3,881,316</u>	<u>2,730,466</u>	<u>7,598,729</u>
Total deficiency and liabilities	<u>\$ 3,199,095</u>	<u>\$ 1,633,539</u>	<u>\$ 2,615,363</u>
Revenues, Expenses, and Changes in Net Assets:			
Operating revenues	\$ 2,983,031	\$ 3,296,158	\$ 3,484,618
Operating expenses	<u>4,024,299</u>	<u>4,409,215</u>	<u>4,463,895</u>
Operating loss	<u>(1,041,268)</u>	<u>(1,113,057)</u>	<u>(979,277)</u>
Grants, subsidies and other income	1,531,754	5,089,937	92,136
Interest expense	<u>(75,780)</u>	<u>(90,441)</u>	<u>(337,268)</u>
Total non-operating revenue (expense), net	<u>1,455,974</u>	<u>4,999,496</u>	<u>(245,132)</u>
Change in deficiency	414,706	3,886,439	(1,224,409)
Deficiency at beginning of year	<u>(1,096,927)</u>	<u>(4,983,366)</u>	<u>(3,758,957)</u>
Deficiency at end of year	<u>\$ (682,221)</u>	<u>\$ (1,096,927)</u>	<u>\$ (4,983,366)</u>

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

Management's Discussion and Analysis
Years Ended September 30, 2011 and 2010

There was an increase to CPUC's assets in 2011 by \$1.6 million. CPUC added power, water and sewer materials, tools, and equipment all made possible through the Chuuk State Compact Capital Infrastructure Recovery (CRISP) grant.

Deficiency was down from \$1.1 million in 2010 to \$0.7 million in 2011; this is from improvement through contribution of CRISP grant and Japan Non-Project Grant Aid in 2011.

Revenues in 2011 decreased by 9% from 2010 mainly because of less generation output in 2011. Although power losses was reduced by 12% in 2011, there were only two generators operating both of which were only running for 70% to 80% of their time, because of engine failures and cash flow difficulties.

Expenses in 2011 also decreased by 9% because less fuel was used; 606,000 gallons used in 2011 compared to 825,000 gallons used in 2010.

The Statement of Revenues, Expenses and Changes in Deficiency resulted in an operating loss of \$1 million. With the nonoperating revenue that came from the CRISP grant and the Japan Non-Project Grant Aid, CPUC ended the year with a change in deficiency of \$0.4 million.

Reporting of the Ratios:

Financial Ratios	<u>2011</u>	<u>2010</u>	<u>2009</u>
Financial Health:			
Unrestricted net deficiency	(57.43)%	(50.42)%	(75.48)%
Capital asset condition	2.54%	4.43%	7.79%
Assets to debt	(121.33)%	(167.15)%	(290.54)%
Current ratio	0.23	0.10	0.15
Quick ratio	0.13	0.05	0.00
Allowance for doubtful accounts	77.75%	93.81%	77.01%
Financial Performance:			
Change in net deficiency	37.81%	77.99%	(32.57)%
Operating ratio	1.35	1.34	1.28
Debt service coverage	(0.75)	(0.61)	(0.05)
Days in accounts receivable	176	178	163
Net nonoperating income per revenue dollar	\$0.49	\$1.52	(\$0.0)
Total operations and maintenance expense (excluding fuel expense) per customer			
	\$909.09	\$896.10	\$896.29
Total fuel expense per Kwh sold			
	\$0.50	\$0.45	\$0.42
Revenue per Kwh sold			
	\$0.58	\$0.54	\$0.53
Bad debt expense per revenue dollar			
	\$0.00	\$0.05	\$0.14

CHUUK PUBLIC UTILITIES CORPORATION
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Management's Discussion and Analysis
Years Ended September 30, 2011 and 2010

Some of the key point ratios that needed attention are explained below.

- Capital asset condition 2.54%

At September 30, 2011, CPUC's depreciable capital assets amounted to \$25.2 million and total accumulated depreciation is \$24.5 million indicating that only 2.54% of the useful capital assets have remaining financial lives.

- Quick ratio 0.13

At September 30, 2011, CPUC has only 13 cents available to satisfy a dollar of its current obligations.

- Allowance for doubtful accounts 77.75%

At September 30, 2011, CPUC management believes that of the \$1.1 million in account receivable, only \$255 thousand was collectible or 77.75% of accounts receivable is uncollectible.

- Change in net deficiency 37.81%

At September 30, 2011, deficiency was \$0.6 million, an improvement of 37.81% from previous year or an improvement of \$415,000.

- Operating ratio 1.35

At September 30, 2011, CPUC's operating ratio was 1.35, meaning that for \$1 of operating revenues, CPUC's costs were \$1.35 (i.e. costs exceeded revenues by 35 cents/\$revenue). This indicates that CPUC could not operate without relying on subsidies and or grants.

- Net nonoperating income per revenue dollar \$0.49

For the year ended September 30, 2011, the net nonoperating income for CPUC dropped from \$1.52 per revenue dollar to a \$0.49 per revenue dollar.

- Total operating and maintenance expense per kWh sold \$0.79

For the year ended September 30, 2011, it cost CPUC 79 cents to produce one (1) kWh of electricity sold. There was 5,103,786 kWh sold in 2011.

- Total fuel expense per kWh sold \$0.50

For the year ended September 30, 2011, it cost CPUC 50 cents in fuel to produce one (1) kWh of electricity sold.

- Total operating and maintenance expense (excluding fuel expense) per customer \$909.09

For the year ended September 30, 2011, it cost CPUC \$909.09 per year to serve a customer excluding the cost of fuel. There were 1,637 customers being served.

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Years Ended September 30, 2011 and 2010

- Revenue per Kwh sold \$0.58

The average tariff per kWh sold for the year ended September 30, 2011 was \$0.58 based on 5,103,786 kWh sold in 2011.

Capital Assets and Debts

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

For additional information concerning debt, please refer to note 7 to the financial statements.

FISCAL YEAR 2012 OUTLOOK

CPUC anticipates a return to operating profit in 2012 (before depreciation and interest). There are six implemented actions that will bring about this positive change in CPUC's financial outlook.

1. CPUC has purchased three generators (two new 1.15 megawatt (MW) engines and one reconditioned 1.7MW engine). These were progressively installed and commissioned between December 2011 and February 2012. These new generators will allow CPUC to operate on a 24-hour basis; thereby, improving production and increasing revenues. The generators will also operate more efficiently than the older generators; thereby, improving fuel economy.
2. CPUC amended its power tariff to include a fuel surcharge to eliminate the risk of loss when the price of fuel escalates. This new amendment became effective October 2011.
3. CPUC amended its water tariff and introduced an environmental charge which will cover the cost of operating the water and sewer facilities.
4. CPUC continues to investigate customer meters for illegal and faulty connections. This will improve the non-technical losses and revenues.
5. With an increase in CPUC's power reliability, customers who were self generating will return to island power; thereby, increasing revenues for CPUC.
6. New water connections program as part of the CRISP grant project is progressing and with rehabilitated wells and improve power for pumping, CPUC will experience increased water sales.

CONTACTING CPUC'S FINANCIAL MANAGEMENT

Management's Discussion and Analysis for the year ended September 30, 2010, is set forth in the report on the audit of CPUC's financial statements, which is dated June 11, 2011, and that Discussion and Analysis explains the major factors impacting the 2010 financial statements and can be viewed at the Office of the Public Auditor's website at www.fsmopa.fm.

CHUUK PUBLIC UTILITY CORPORATION
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Statements of Deficiency
September 30, 2011 and 2010

<u>Assets</u>	<u>2011</u>	<u>2010</u>
Utility plant, at cost:		
Electric plant in service	\$ 15,038,408	\$ 14,920,174
Water and sewer plant in service	9,991,103	9,991,103
General plant in service	199,453	199,453
	<u>25,228,964</u>	<u>25,110,730</u>
Less accumulated depreciation	(24,588,735)	(23,997,133)
	<u>640,229</u>	<u>1,113,597</u>
Construction in progress	1,452,851	260,359
Total utility plant	<u>2,093,080</u>	<u>1,373,956</u>
Current assets:		
Cash	153,829	31,400
Accounts receivable, net	254,693	92,064
Other receivables	22,989	6,452
Inventory	328,242	129,667
Total current assets	<u>759,753</u>	<u>259,583</u>
Noncurrent assets:		
Deposits	346,262	-
	<u>\$ 3,199,095</u>	<u>\$ 1,633,539</u>
<u>Deficiency and Liabilities</u>		
Net deficiency:		
Invested in capital assets, net of related debt	\$ 855,398	\$ 565,038
Restricted for capital improvements	175,555	-
Unrestricted deficit	(1,713,174)	(1,661,965)
Net deficiency	<u>(682,221)</u>	<u>(1,096,927)</u>
Commitments and contingencies		
Current liabilities:		
Notes payable	778,805	808,918
Current portion of long-term debt	6,188	-
Accounts payable	382,661	95,764
Accrued taxes and other liabilities	1,141,596	1,154,169
Accrued interest expense	653,039	473,223
Payable to grantor	359,589	-
Deferred income	17,693	17,693
Accrued annual leave	27,366	33,687
Total current liabilities	<u>3,366,937</u>	<u>2,583,454</u>
Accrued annual leave, net of current portion	48,833	75,584
Long-term debt, net of current maturities	452,689	-
Lease liability, net of current portion	12,857	71,428
Total liabilities	<u>3,881,316</u>	<u>2,730,466</u>
	<u>\$ 3,199,095</u>	<u>\$ 1,633,539</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, 2011 and 2010

	2011	2010
Operating revenues:		
Electricity sales	\$ 2,718,153	\$ 3,384,406
Other sales	16,419	102,660
	2,734,572	3,487,066
Recovery of (provision for) uncollectable accounts	248,459	(190,908)
Total operating revenues	2,983,031	3,296,158
Operating and maintenance expenses:		
Production fuel	2,536,117	2,856,154
Administrative and general	896,580	918,889
Depreciation	591,602	634,172
Total operating and maintenance expenses	4,024,299	4,409,215
Operating loss	(1,041,268)	(1,113,057)
Nonoperating revenues (expense):		
Nonfederal grants	346,262	-
Other income	9,631	126,766
Interest expense	(75,780)	(90,441)
Gain on transfer of liabilities	-	4,963,171
Total nonoperating revenues, net	280,113	4,999,496
(Loss) income before capital contributions	(761,155)	3,886,439
Capital contributions:		
Grants from the United States Government	1,175,861	-
Change in deficiency	414,706	3,886,439
Deficiency at beginning of year	(1,096,927)	(4,983,366)
Deficiency at end of year	\$ (682,221)	\$ (1,096,927)

See accompanying notes to financial statements.

CHUUK PUBLIC UTILITY CORPORATION
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Statements of Cash Flows
Years Ended September 30, 2011 and 2010

	2011	2010
Cash flows from operating activities:		
Cash received from customers	\$ 2,813,496	\$ 3,612,143
Cash payments to suppliers for goods and services	(2,811,748)	(3,076,388)
Cash payments to employees	(532,807)	(529,685)
Net cash (used in) provided by operating activities	(531,059)	6,070
Cash flows from noncapital financing activities:		
Cash receipts from grantor	359,589	-
Net gain on transfer of liabilities	-	46,000
Decrease in Chuuk State Government related advances	-	(6,071)
Net cash provided by noncapital financing activities	359,589	39,929
Cash flows from capital and related financing activities:		
Cash receipts from grantor for capital projects	1,175,861	-
Acquisition of utility plant	(851,849)	(5,000)
Reduction of long-term debt	(30,113)	(4,263)
Payment of interest	-	(10,000)
Net cash provided by (used in) capital and related financing activities	293,899	(19,263)
Net change in cash	122,429	26,736
Cash at beginning of year	31,400	4,664
Cash at end of year	\$ 153,829	\$ 31,400
<u>Reconciliation of operating loss to net cash (used in) provided by operating activities:</u>		
Operating loss	\$ (1,041,268)	\$ (1,113,057)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation	591,602	634,172
Other income	9,631	126,766
(Recovery of) provision for uncollectable accounts	(248,459)	190,908
Loss on disposal of assets	-	6,913
Decrease (increase) in assets:		
Accounts receivable	85,830	50,627
Other receivables	(16,537)	12,925
Inventory	(198,575)	11,427
Increase (decrease) in liabilities:		
Accounts payable	286,897	11,553
Accrued taxes and other liabilities	91,463	68,043
Accrued annual leave	(33,072)	5,793
Lease obligation	(58,571)	-
Net cash (used in) provided by operating activities	\$ (531,059)	\$ 6,070

See accompanying notes to financial statements.

CHUUK PUBLIC UTILITY CORPORATION
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Statements of Cash Flows, Continued
Years Ended September 30, 2011 and 2010

Supplemental schedule of noncash financing activities:

In 2011, proceeds from the Asian Development Bank loan administered by the FSM National Government was used as a deposit for the purchase of two generator sets and for other costs incurred related to the power plant rehabilitation project totaling \$458,877.

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, CPUC 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>4,917,171</u>

See accompanying notes to financial statements.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2011 and 2010

(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 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

Basis of Accounting

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. CPUC utilizes the flow of economic resources measurement focus. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. 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, except those that conflict with a GASB pronouncement. CPUC has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

Net Assets

Net assets represent the residual interest in CPUC's assets after liabilities are deducted and consist of four sections: invested in capital assets, net of related debt; restricted expendable and nonexpendable, and unrestricted. Net assets invested in capital assets, net of debt, include capital assets, restricted and unrestricted, net of accumulated depreciation, reduced by outstanding debt net of debt service reserve. Net assets are reported as restricted when constraints are imposed by third parties or enabling legislation. All other net assets are unrestricted.

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.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2011 and 2010

(2) Summary of Significant Accounting Policies, Continued

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, 2011 and 2010, the carrying amount of cash was \$153,829 and \$31,400, respectively, and the corresponding bank balances were \$184,274 and \$24,542, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2011 and 2010, bank deposits were fully FDIC insured.

Receivables and Allowance for Uncollectable Accounts

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 uncollectable accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectable based on evaluations of the collectability of these accounts and prior collection experience. Management determines the adequacy of the allowance for uncollectable accounts based upon review of the aged accounts receivable. The allowance is established through a provision for bad debts charged to expense.

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 and Depreciation

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 transferred to CPUC was \$287,475 and \$777,752 as of September 30, 2011 and 2010, respectively. 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, 2011 and 2010, the accumulated vacation leave liability totals \$76,199 and \$109,271, respectively.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2011 and 2010

(2) Summary of Significant Accounting Policies, Continued

Operating and Non-operating Revenues and Expenses

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 non-operating.

Revenue Recognition

Sales of electricity are recorded as billed to customers. Customer accounts are read and billed weekly for large customers and on a bi-weekly basis for the rest of the customers. Billings are due and payable 15 days after billing. Cash power revenue is recognized as revenue at point of sale with the estimated unearned portion at year-end recognized as deferred revenue if determined to be significant. At September 30, 2011 and 2010, deferred revenue was not recognized on cash power revenue as it was not considered material to the financial statements.

Grants and Subsidies

CPUC receives federal grants either as a direct recipient or as a subrecipient from the Chuuk State Government (CSG). CPUC also receives appropriated subsidies from the Chuuk State Legislature.

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.

Reclassification

Certain balances in the 2010 financial statements have been reclassified to correspond with the 2011 presentation.

New Accounting Standards

During fiscal year 2011, CPUC implemented the following pronouncements:

- GASB 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.
- GASB 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.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2011 and 2010

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools.

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

In December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CPUC.

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*, which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CPUC.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CPUC.

In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CPUC.

In July 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions (an amendment of GASB Statement No. 53)*, which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty’s credit support provider, is replaced. The provisions of this statement are effective 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 CPUC.

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Notes to Financial Statements
September 30, 2011 and 2010

(2) Summary of Significant Accounting Policies, Continued

Risk Management

CPUC is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. CPUC has elected to purchase general liability and workmen's compensation insurance from independent third parties for the risks of loss to which it is exposed while 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.

(3) Accounts Receivable

Accounts receivable at September 30, 2011 and 2010, are summarized as follows:

	<u>2011</u>	<u>2010</u>
Residential	\$ 757,387	\$ 590,839
Commercial	381,656	845,336
Other	5,590	4,290
Unbilled	<u>-</u>	<u>46,000</u>
	1,144,633	1,486,465
Less allowance for doubtful receivables	<u>(889,940)</u>	<u>(1,394,401)</u>
	<u>\$ 254,693</u>	<u>\$ 92,064</u>

Accounts receivable as of September 30, 2011 includes charges for electricity and water amounting to \$1,139,814 and \$4,819, respectively, while accounts receivable as of September 30, 2010 mainly consisted of electricity accounts. Electricity receivables as of September 30, 2011 and 2010 include \$360,828 and \$271,453, respectively, of balances in arrears from customers who have converted to the cash power meter system. The balances of these accounts are reduced through an application of 65% of the delinquent customer's cash power purchase at the time of collection.

(4) Utility Plant

Utility plant and construction in progress consist of the following detailed balances at September 30, 2011 and 2010:

	Balance at October <u>1, 2010</u>	Additions and <u>Transfers</u>	Deletions and <u>Transfers</u>	Balance at September <u>30, 2011</u>
Depreciable assets:				
Electric plant in service	\$ 14,920,174	\$ 118,234	\$ -	\$ 15,038,408
Water and sewer plant in service	9,991,103	-	-	9,991,103
General plant in service	<u>199,453</u>	<u>-</u>	<u>-</u>	<u>199,453</u>
	25,110,730	118,234	-	25,228,964
Less accumulated depreciation	<u>(23,997,133)</u>	<u>(591,602)</u>	<u>-</u>	<u>(24,588,735)</u>
	1,113,597	(473,368)	-	640,229
Non-depreciable assets:				
Construction in progress	<u>260,359</u>	<u>1,192,492</u>	<u>-</u>	<u>1,452,851</u>
	<u>\$ 1,373,956</u>	<u>\$ 719,124</u>	<u>\$ -</u>	<u>\$ 2,093,080</u>

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(4) Utility Plant, Continued

	Balance at October <u>1, 2009</u>	Additions and <u>Transfers</u>	Deletions and <u>Transfers</u>	Balance at September <u>30, 2010</u>
Depreciable assets:				
Electric plant in service	\$ 15,126,436	\$ -	\$ (206,262)	\$ 14,920,174
Water and sewer plant in service	10,088,111	-	(97,008)	9,991,103
General plant in service	<u>321,314</u>	<u>5,000</u>	<u>(126,861)</u>	<u>199,453</u>
	25,535,861	5,000	(430,131)	25,110,730
Less accumulated depreciation	<u>(23,786,179)</u>	<u>(634,172)</u>	<u>423,218</u>	<u>(23,997,133)</u>
	1,749,682	(629,172)	(6,913)	1,113,597
Non-depreciable assets:				
Construction in progress	<u>260,359</u>	-	-	<u>260,359</u>
	<u>\$ 2,010,041</u>	<u>\$ (629,172)</u>	<u>\$ (6,913)</u>	<u>\$ 1,373,956</u>

The Pole Hardening project has not been completed. Management intends to incorporate the project into the capital program in 2012 along with a power distribution improvement project that will be funded by the ADB loan proceeds. As of September 30, 2011 and 2010, cumulative cost of the uncompleted project is \$260,359 is included as part of the construction in progress.

Construction in progress also includes infrastructure projects for rehabilitation of the power plant and the purchase of two generator sets funded by a grant from the U.S. Department of the Interior (US DOI) (see note 5) and loans obtained from the Asian Development Bank (ADB) that are administered by the FSM National Government (FSMNG) (see note 7). Outstanding commitment on the purchase of two generator sets amounted to \$2 million at September 30, 2011.

(5) Contributed Assets

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

The contributions from the FSMNG result from compliance with Section 7.01 of the Financing Agreement between FSMNG, CSG and CPUC wherein the FSMNG is obligated to finance 10% (ceiling of \$186,900) of the actual costs of the civil and mechanical works of the FSMNG Water Supply and Sanitation Project. The remaining 90% is financed through a loan from the Asian Development Bank which is passed through the FSMNG to CSG and then to CPUC. The loan was transferred to CSG in 2010 (see note 8).

There are no net contributions for the years ended September 30, 2011 and 2010.

(6) Grants and Subsidies

During the year ended September 30, 2011, CPUC received two federal grants from the U.S. DOI passed through by CSG totaling \$1,175,861. Of the total grant proceeds, \$359,589 represent advances from the grantor used for working capital purposes. The advances are to be repaid at the end of the grant term and are presented as payable to grantor on the accompanying statements of deficiency. The rest of the grant proceeds were used for the power plant rehabilitation project.

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(6) Grants and Subsidies, Continued

CPUC was also a recipient of a non-federal grant passed through by FSMNG amounting to \$346,262 during the year ended September 30, 2011. The grant is held as collateral for a fuel and lubricant purchase line with the FSM Petroleum Corporation (FSMPC) and is presented as long-term deposit in the accompanying statements of deficiency. There were no grants and subsidies received during the year ended September 30, 2010.

(7) Borrowings and Noncurrent Liabilities

Notes Payable

CPUC has notes payable to a commercial bank on an original line of credit of \$150,000 bearing an interest of 7.25% per annum. The loan is collateralized by a security interest in fixed assets, accounts receivable and inventories. The note has a balance of \$81,921 and is presented as current in the accompanying statements of deficiency as it fully due.

CPUC has notes payable to the Federated States of Micronesia Development Bank (FSMDB) on an amount drawn with an available total of \$737,743 bearing an interest of 9% per annum with principal installments of \$4,000 per month. Proceeds from the note were used for cash power meters and other equipment purchases and is collateralized by major machinery, equipment and assignment of income. The balance of the note at September 30, 2011 and 2010 is \$696,884 and \$726,997, respectively. The loan requires that CPUC maintain hazard insurance which has not been obtained. The ultimate impact of this matter is currently unknown. As such, the balance of the note is presented as current in the accompanying statements of deficiency.

Long-term Debt

Long-term debt consists of the following at September 30, 2011:

ADB loan no. 2099, administered by FSMNG, drawn against the total Standard Drawing Rights (SDR) of \$9.9 million (\$1.8 million allocated to CPUC), principal due in semi-annual installments of \$85,883 from January 15, 2013 to July 15, 2036. Interest is payable at 1% per annum during the grace period and at 1.5% thereafter. Proceeds are to be used for infrastructure projects: power distribution upgrades, decommissioning and environmental remediation of the existing power station, and institutional strengthening.	\$ 170,608
ADB loan n. 2100, administered by FSMNG, drawn against the total SDR of \$4.8 million (\$2.8 million allocated to CPUC), principal due in semi-annual installments of varying amounts as a percentage of total SDRs through January 15, 2029. Interest is payable at LIBOR plus 0.6% (effective of 2.1% at September 30, 2011). Proceeds are to be used for the purchase of two generator sets and related costs.	<u>288,269</u>
Total long-term debt	458,877
Less current portion of long-term debt	<u>6,188</u>
Long-term portion of long-term debt	\$ <u>452,689</u>

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(7) Borrowings and Noncurrent Liabilities, Continued

Long-term Debt, Continued

Principal payments for subsequent years ending September 30 and applicable interest due are as follows:

<u>Year Ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 6,188	\$ 7,801	\$ 13,989
2013	11,505	10,294	21,799
2014	13,563	8,236	21,799
2015	14,462	7,977	22,439
2016	15,392	7,714	23,106
2017-2021	94,458	33,563	128,021
2022-2026	135,746	22,581	158,327
2027-2031	126,502	8,620	135,122
2032-2036	<u>41,061</u>	<u>1,584</u>	<u>42,645</u>
	<u>\$ 458,877</u>	<u>\$ 108,370</u>	<u>\$ 567,247</u>

Changes in noncurrent liabilities for the years ended September 30, 2011 and 2010 are as follows:

	<u>Outstanding October 1, 2010</u>	<u>Addition</u>	<u>Reduction</u>	<u>Outstanding September 30, 2011</u>	<u>Amount due Within One Year</u>
Notes payable	\$ 808,918	\$ -	\$ (30,113)	\$ 778,805	\$ 778,805
Long-term debt	-	458,877	-	458,877	6,188
Lease obligation	125,000	-	(70,000)	55,000	42,143
Accrued annual leave	<u>109,271</u>	<u>9,630</u>	<u>(42,702)</u>	<u>76,199</u>	<u>27,366</u>
	<u>\$ 1,043,189</u>	<u>\$ 468,507</u>	<u>\$ (142,815)</u>	<u>\$ 1,368,881</u>	<u>\$ 854,502</u>

	<u>Outstanding October 1, 2009</u>	<u>Addition</u>	<u>Reduction</u>	<u>Outstanding September 30, 2010</u>	<u>Amount due Within One Year</u>
Notes payable	\$ 4,363,353	\$ -	\$ (3,554,435)	\$ 808,918	\$ 808,918
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>

(8) Related Party Transactions

Revenue received from the CSG for the years ended September 30, 2011 and 2010 amounted to \$492,905 and \$497,371, respectively.

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(8) Related Party Transactions, Continued

On December 21, 2010, CPUC and CSG agreed through a memorandum of understanding to offset claims and transfer certain debt between CPUC and CSG to include among others, the transfer of ADB loan no. 1459 and its related interest payable. As a result of the offset of claims and transfers of liabilities, CPUC recognized a gain of \$4,963,171 that is presented as a gain on transfer of liabilities in the accompanying statements of revenues, expenses and changes in deficiency.

CPUC entered into an Operation and Maintenance Management (OMM) contract for the management and maintenance of CPUC's operations. The contract is for a period of two years and is federally funded through a grant received by CSG. All transactions related to the contract are recorded by CSG. At September 30, 2011, reimbursements from CSG related to the OMM contract amounted to \$11,538 and is included in other receivables in the accompanying statements of deficiency.

CPUC purchases virtually all of its fuel from FSMPC, a component unit of the FSMNG (see note 9).

(9) Commitment

Leases

In November, 2010, CPUC terminated its office 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>	
2012	42,000
2013	10,500

In February 2011, CPUC entered into an agreement with a landowner to settle a 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. The unpaid balance of the lease settlement is \$55,000 and \$125,000 as of September 30, 2011 and 2010, respectively. A lease covering the 3-year period from May 11, 2010 is currently under negotiation.

Fuel Supply Agreement

CPUC entered into fuel supply agreement with FSMPC, effective August 1, 2011, for a period of three years in which CPUC will purchase production and vehicle fuel and lubricants with a minimum of 850,000 gallons and maximum 1,400,000 gallons in annual quantity. Purchase prices are based on movements of the base price for fuel and lubricants plus add-on costs, fees and taxes. Purchases are payable up to a maximum of thirty days and are fully secured by the long-term deposit held by FSMPC from a fuel grant received by CPUC (see note 5).

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Notes to Financial Statements
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(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, 2011, current liabilities exceed current assets by \$2,607,184, and a net unrestricted deficiency of \$1,713,174.

Should CSG choose to discontinue payment for services rendered, CPUC management may have to consider alternative measures including, among other possibilities, the CSG 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, 2011, 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 the rehabilitation of its power infrastructure, revision of pricing mechanisms and rigorous collection efforts, 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.

Other

In 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.