

CHUUK PUBLIC UTILITY CORPORATION

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

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2012 AND 2011



Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA

Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

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, 2012 and 2011, 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 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 financial statements referred to above present fairly, in all material respects, the financial position of CPUC as of September 30, 2012 and 2011, and the changes in its net assets 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 21, 2013, 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.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 1 through 3 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Deloitte & Touche LLP

June 21, 2013

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

Management's Discussion and Analysis
Years Ended September 30, 2012 and 2011

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, 2012.

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, 2012 and 2011. 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 2012, 2011 and 2010.

FINANCIAL HIGHLIGHTS

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Assets:			
Utility plant in service, net	\$ 4,247,512	\$ 2,093,080	\$ 1,373,956
Current assets	676,199	759,753	259,586
Noncurrent assets	<u>536,262</u>	<u>346,262</u>	<u>-</u>
Total assets	\$ <u>5,459,973</u>	\$ <u>3,199,095</u>	\$ <u>1,633,539</u>
Deficiency and Liabilities:			
Invested in capital assets, net of related debt	\$ 1,279,478	\$ 855,398	\$ 565,038
Restricted	582,401	521,817	-
Unrestricted deficit	<u>(2,137,535)</u>	<u>(2,059,436)</u>	<u>(1,661,965)</u>
Total deficiency	<u>(275,656)</u>	<u>(682,221)</u>	<u>(1,096,927)</u>
Current liabilities	3,524,917	3,366,937	2,583,454
Long-term liabilities	<u>2,210,712</u>	<u>514,379</u>	<u>147,012</u>
Total liabilities	<u>5,735,629</u>	<u>3,881,316</u>	<u>2,730,466</u>
Total deficiency and liabilities	\$ <u>5,459,973</u>	\$ <u>3,199,095</u>	\$ <u>1,633,539</u>
Revenues, Expenses, and Changes in Deficiency:			
Operating revenues	\$ 5,357,313	\$ 2,983,031	\$ 3,296,158
Operating expenses	<u>5,676,006</u>	<u>4,024,299</u>	<u>4,409,215</u>
Operating loss	<u>(318,693)</u>	<u>(1,041,268)</u>	<u>(1,113,057)</u>
Grants, subsidies and other income	804,038	1,531,754	5,089,937
Interest expense	<u>(78,780)</u>	<u>(75,780)</u>	<u>(90,441)</u>
Total non-operating revenue, net	<u>725,258</u>	<u>1,455,974</u>	<u>4,999,496</u>
Change in deficiency	406,565	414,706	3,886,439
Deficiency at beginning of year	<u>(682,221)</u>	<u>(1,096,927)</u>	<u>(4,983,366)</u>
Deficiency at end of year	\$ <u>(275,656)</u>	\$ <u>(682,221)</u>	\$ <u>(1,096,927)</u>

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

Management's Discussion and Analysis
Years Ended September 30, 2012 and 2011

There was an increase in CPUC's assets in 2012 by \$2.3 million mainly due to the acquisition of two generators with 1.2 mega watt (MW) each and certain other assets to improve power, water and sewer service.

Deficiency decreased from \$1.1 million in 2010 to \$0.7 million in 2011 and was further reduced in 2012 to \$0.28 million. All this arose from the gain in improvement of operations and from capital contributions. The operating loss, for instance, was improved by \$0.7 million in 2012.

Revenues in 2012 increased by 80% or \$2.4 million. Expenses also increased by 41% or \$1.7 million. This was due to an increase in fuel used to deliver 24-hour power service.

The operating loss improved from \$1 million in 2011 to approximately \$0.3 million in 2012; and the loss before capital contributions also improved by about \$0.5 million.

The decrease in deficiency for 2012 is \$0.4 million.

Capital Assets and Debts

For additional information concerning capital assets, please refer to note 5 to the financial statements.

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

FISCAL YEAR 2013 OUTLOOK

CPUC anticipates continued improvement in its operating position during FY2013 through improvements in power generating and distribution efficiency as well as through charging for water and sewer service. External radiators will be installed on the two new containerized generators thereby reducing generation losses by around 2% after installation. Overhaul of an old 1.8 MW generator will be undertaken and fuel efficiency improvement in excess of 5% is anticipated on commissioning of this unit.

Two major rehabilitation projects will commence in FY2013 – the CPUC Power Plant Restoration Project and the Power Distribution Rehabilitation Project. Both projects are planned to be completed during FY2015, and they will bring about efficiency improvements as follows:

Power Generation Restoration:

- Improved fuel efficiency between 10% and 20% through technological advances
- Reduction in transformation losses between 2% and 3% by generating power at the distribution voltage of 13.8 kV

Power Distribution Rehabilitation:

- Improved efficiency of power transformation of around 5%. This will be achieved by the introduction of low loss transformers as part of the distribution system rebuild as well as by right-sizing the transformers in the system
- Improved efficiency of distribution of around 4% by the replacement of old cables and connections

CPUC will also commence planning for power service expansion within the Chuuk State with the goal of connecting more customers to the grid in FY2014. State-wide discussions will be held with all stakeholders in order to understand priorities.

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

Management's Discussion and Analysis
Years Ended September 30, 2012 and 2011

With regard to water supply and sewerage services, CPUC's focus will remain on the installation of water meters across the whole supply system. Efforts will also be made to regularize connections to the sewer system and remove surface water drain connections which will improve the control of the system and also reduce operating cost.

Discussions will be held with the Chuuk State Infrastructure Planning and Implementation Committee and Program Management Unit concerning the rehabilitation of the Weno sewer treatment plant with a view to commence rehabilitation in early FY2014, in order to improve the quality of wastewater being discharged to the lagoon and to comply with environmental regulations.

A major concern to CPUC is the long outstanding debts to banks and national government institutions. Management will look to start addressing these important issues with the concerned parties and put in place strategies to reduce CPUC liabilities in a sustainable manner.

CONTACTING CPUC'S FINANCIAL MANAGEMENT

The Management Discussion and Analysis report is intended to provide information concerning known facts and conditions affecting CPUC's operations. This financial report is designed to provide a general overview of CPUC's finances and to demonstrate CPUC's accountability for the funds it receives and expends.

Management's Discussion and Analysis for the year ended September 30, 2011, is set forth in the report on the audit of CPUC's financial statements, which is dated June 15, 2012, and that Discussion and Analysis explains the major factors impacting the 2011 financial statements and can be viewed at the Office of the Public Auditor's website at www.fsmopa.fm.

For additional information about this report, please contact Mr. Kelly Keller, Chief Financial Officer, Chuuk Public Utility Corporation, A's Mart Building 2, 2nd Floor, Weno, Chuuk FM 96942.

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

Statements of Deficiency
September 30, 2012 and 2011

<u>Assets</u>	<u>2012</u>	<u>2011</u>
Utility plant, at cost:		
Depreciable utility plant:		
Electric plant in service	\$ 16,682,027	\$ 15,038,408
Water and sewer plant in service	8,656,438	9,991,103
General plant in service	13,984	199,453
	<u>25,352,449</u>	<u>25,228,964</u>
Less accumulated depreciation	<u>(22,918,632)</u>	<u>(24,588,735)</u>
	<u>2,433,817</u>	<u>640,229</u>
Non-depreciable utility plant:		
Construction in progress	1,813,695	1,452,851
Total utility plant	<u>4,247,512</u>	<u>2,093,080</u>
Current assets:		
Cash	47,626	153,829
Accounts receivable, net	242,534	254,693
Other receivables	69,945	22,989
Inventory	316,094	328,242
Total current assets	<u>676,199</u>	<u>759,753</u>
Noncurrent assets:		
Deposits	536,262	346,262
	<u>\$ 5,459,973</u>	<u>\$ 3,199,095</u>
<u>Deficiency and Liabilities</u>		
Net deficiency:		
Invested in capital assets, net of related debt	\$ 1,279,478	\$ 855,398
Restricted	582,401	521,817
Unrestricted deficit	<u>(2,137,535)</u>	<u>(2,059,436)</u>
Net deficiency	<u>(275,656)</u>	<u>(682,221)</u>
Commitments and contingencies		
Current liabilities:		
Notes payable	732,898	778,805
Current portion of long-term debt	50,059	6,188
Accounts payable	444,528	382,661
Accrued taxes and other liabilities	1,156,743	1,141,596
Accrued interest expense	735,768	653,039
Payable to grantor	315,631	359,589
Deferred income	68,020	17,693
Accrued annual leave	21,270	27,366
Total current liabilities	<u>3,524,917</u>	<u>3,366,937</u>
Accrued annual leave, net of current portion	25,635	48,833
Long-term debt, net of current portion	2,185,077	452,689
Lease liability, net of current portion	-	12,857
Total liabilities	<u>5,735,629</u>	<u>3,881,316</u>
	<u>\$ 5,459,973</u>	<u>\$ 3,199,095</u>

See accompanying notes to financial statements.

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

Statements of Revenues, Expenses and Changes in Deficiency
Years Ended September 30, 2012 and 2011

	2012	2011
Operating revenues:		
Electricity sales	\$ 5,246,951	\$ 2,718,153
Other sales	110,362	16,419
	5,357,313	2,734,572
Recovery of uncollectable accounts	-	248,459
Total operating revenues	5,357,313	2,983,031
Operating and maintenance expenses:		
Production fuel	4,180,611	2,536,117
Administrative and general	1,118,594	896,580
Depreciation	376,801	591,602
Total operating and maintenance expenses	5,676,006	4,024,299
Operating loss	(318,693)	(1,041,268)
Nonoperating revenues (expense):		
Nonfederal grants	190,000	346,262
Other income (expense), net	(47,471)	9,631
Interest expense	(78,780)	(75,780)
Total nonoperating revenues, net	63,749	280,113
Loss before capital contributions	(254,944)	(761,155)
Capital contributions:		
Grants from the United States Government	661,509	1,175,861
Change in deficiency	406,565	414,706
Deficiency at beginning of year	(682,221)	(1,096,927)
Deficiency at end of year	\$ (275,656)	\$ (682,221)

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, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Cash received from customers	\$ 5,413,164	\$ 2,813,496
Cash payments to suppliers for goods and services	(4,793,283)	(2,811,748)
Cash payments to employees	(539,754)	(532,807)
Net cash provided by (used in) operating activities	80,127	(531,059)
Cash flows from noncapital financing activities:		
Cash receipts from grantor	209,778	359,589
Payments to grantor	(253,736)	-
Net cash (used in) provided by noncapital financing activities	(43,958)	359,589
Cash flows from capital and related financing activities:		
Proceeds from long-term debt	1,776,259	-
Cash receipts from grantor for capital projects	661,509	1,175,861
Acquisition of utility plant	(2,531,233)	(851,849)
Reduction of long-term debt	(45,907)	(30,113)
Payment of interest	(3,000)	-
Net cash (used in) provided by capital and related financing activities	(142,372)	293,899
Net change in cash	(106,203)	122,429
Cash at beginning of year	153,829	31,400
Cash at end of year	\$ 47,626	\$ 153,829
<u>Reconciliation of operating loss to net cash provided by (used in) operating activities:</u>		
Operating loss	\$ (318,693)	\$ (1,041,268)
Adjustments to reconcile operating loss to net cash provided by (used in) operating activities:		
Depreciation	376,801	591,602
Other income (expense), net	(47,471)	9,631
Recovery of uncollectable accounts	-	(248,459)
Decrease (increase) in assets:		
Accounts receivable	12,159	85,830
Other receivables	(46,956)	(16,537)
Inventory	12,148	(198,575)
Increase (decrease) in liabilities:		
Accounts payable	61,867	286,897
Accrued taxes and other liabilities	22,096	91,463
Accrued annual leave	(29,294)	(33,072)
Deferred income	50,327	-
Lease obligation	(12,857)	(58,571)
Net cash provided by (used in) operating activities	\$ 80,127	\$ (531,059)

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, 2012 and 2011
Long-term debt, net of current portion

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.

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2012 and 2011

(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 related 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.

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, 2012 and 2011, the carrying amount of cash was \$47,626 and \$153,829, respectively, and the corresponding bank balances were \$61,099 and \$184,274, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2012 and 2011, bank deposits were fully FDIC insured.

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

Notes to Financial Statements
September 30, 2012 and 2011

(2) Summary of Significant Accounting Policies, Continued

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. Accounts deemed uncollectible are written off against the allowance based on the specific identification method.

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, respectively, as of September 30, 2012 and 2011. Effective October 1, 2011, CPUC changed its capitalization policy from \$200 to \$3,000, with an estimated useful life in excess of one year. The change in policy did not result in an impact on the accompanying financial statements. Depreciation is calculated on the straight-line method based on the estimated useful lives of the assets, which range from 3 to 25 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, 2012 and 2011, the accumulated vacation leave liability totals \$46,905 and \$76,199, respectively.

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, 2012, deferred revenue recognized on cash power revenue is \$50,327, which is included as a component of deferred income in the accompanying statement of net deficiency. Deferred revenue on cash power at September 30, 2011 was not recognized as it was not considered material to the financial statements.

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

Notes to Financial Statements
September 30, 2012 and 2011

(2) Summary of Significant Accounting Policies, Continued

Grants and Subsidies

CPUC receives federal grants either as a direct recipient or as a subrecipient from the Chuuk State Government (CSG) and FSM National Government (FSMNG). 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.

New Accounting Standards

During fiscal year 2012, CPUC implemented the following pronouncements:

- 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 the frequency and timing of measurements for actuarial valuations first used to report funded status information in OPEB plan financial statements.
- GASB 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 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.

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

Notes to Financial Statements
September 30, 2012 and 2011

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

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 April 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of CPUC.

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of CPUC.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not evaluated the effect of these statements on the financial statements of CPUC.

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

Notes to Financial Statements
September 30, 2012 and 2011

(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.

Reclassifications

Certain reclassifications have been made to the 2011 financial statements in order to conform with the 2012 presentation.

(3) Accounts Receivable

Accounts receivable at September 30, 2012 and 2011, are summarized as follows:

	<u>2012</u>	<u>2011</u>
Residential	\$ 170,280	\$ 757,387
Commercial	216,084	381,656
Government	68,405	-
Other	9,168	5,590
Unbilled	<u>36,504</u>	<u>-</u>
	500,441	1,144,633
Less allowance for uncollectable accounts	<u>(257,907)</u>	<u>(889,940)</u>
	<u>\$ 242,534</u>	<u>\$ 254,693</u>

Electricity receivables as of September 30, 2012 and 2011 include \$136,646 and \$360,828, 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 30% and 65% of the delinquent customer's cash power purchase at the time of collection during the years ended September 30, 2012 and 2011, respectively.

(4) Contributed Assets

During the fiscal year ended September 30, 1999, CSG contributed various electric plant and water and sewer plant assets to CPUC. 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, 2012 and 2011.

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

Notes to Financial Statements
September 30, 2012 and 2011

(5) Utility Plant

Utility plant and construction in progress consist of the following detailed balances at September 30, 2012 and 2011:

	Balance at October <u>1, 2011</u>	Additions and <u>Transfers</u>	Deletions and <u>Transfers</u>	Balance at September <u>30, 2012</u>
Depreciable assets:				
Electric plant in service	\$ 15,038,408	\$ 2,189,108	\$ (545,489)	\$ 16,682,027
Water and sewer plant in service	9,991,103	-	(1,334,665)	8,656,438
General plant in service	<u>199,453</u>	<u>-</u>	<u>(185,469)</u>	<u>13,984</u>
	25,228,964	2,189,108	(2,065,623)	25,352,449
Less accumulated depreciation	<u>(24,588,735)</u>	<u>(376,801)</u>	<u>2,046,904</u>	<u>(22,918,632)</u>
	640,229	1,812,307	(18,719)	2,433,817
Non-depreciable assets:				
Construction in progress	<u>1,452,851</u>	<u>2,339,435</u>	<u>(1,978,591)</u>	<u>1,813,695</u>
	<u>\$ 2,093,080</u>	<u>\$ 4,151,742</u>	<u>\$ (1,997,310)</u>	<u>\$ 4,247,512</u>
	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>

During the year ended September 30, 2005, CPUC was rewarded and expended funds for capital improvements that is known as the "Pole Hardening Project." Management intends to incorporate the Project into the capital program in 2013 along with a power distribution improvement project that will be funded by the ADB loan proceeds. As of September 30, 2012 and 2011, cumulative cost of the uncompleted project of \$260,359 is included as part of the construction in progress.

Construction in progress at September 30, 2011 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 6) and loans obtained from the Asian Development Bank (ADB) that are administered by the FSMNG (see note 7).

(6) Grants and Subsidies

During the years ended September 30, 2012 and 2011, CPUC recorded federal grants from the U.S. DOI passed through by CSG totaling \$661,509 and \$1,175,861, respectively. Of the total grant proceeds at September 30, 2012 and 2011, \$315,631 and \$359,589, respectively, 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.

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

Notes to Financial Statements
September 30, 2012 and 2011

(6) Grants and Subsidies, Continued

CPUC was also a recipient of a non-federal grant passed through by FSMNG amounting to \$190,000 and \$346,262 during the years ended September 30, 2012 and 2011, respectively. The total grant proceeds of \$536,262 and \$346,262 as of September 30, 2012 and 2011, respectively, are 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.

(7) Borrowings and Noncurrent Liabilities

Notes Payable

CPUC has bank notes payable on an original line of credit of \$150,000 bearing interest at 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 at September 30, 2012 and 2011 and is presented as current in the accompanying statements of deficiency as it is matured and 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 interest at 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 an assignment of income. The balance of the note at September 30, 2012 and 2011 is \$650,977 and \$696,884, respectively, and is presented as current in the accompanying statements of deficiency.

Long-term Debt

Long-term debt consists of the following at September 30, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
ADB loan no. 2099, administered by FSMNG, drawn against 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.	\$ 314,439	\$ 170,608
ADB loan no. 2100, administered by FSMNG, drawn against 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 2.1% at September 30, 2012 and 2011). Proceeds are used for the purchase of two generator sets and related costs.	<u>1,920,697</u>	<u>288,269</u>
Total long-term debt	2,235,136	458,877
Less current portion of long-term debt	<u>50,059</u>	<u>6,188</u>
Long-term portion of long-term debt	\$ <u>2,185,077</u>	\$ <u>452,689</u>

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

Notes to Financial Statements
September 30, 2012 and 2011

(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>
2013	\$ 50,059	\$ 49,266	\$ 99,325
2014	54,798	44,052	98,850
2015	60,353	42,857	103,210
2016	66,112	41,642	107,754
2017	72,483	40,098	112,581
2018-2022	484,061	173,388	657,449
2023-2027	776,796	108,455	885,251
2028-2032	445,170	34,506	479,676
2033-2036	<u>225,304</u>	<u>15,450</u>	<u>240,754</u>
	<u>\$ 2,235,136</u>	<u>\$ 549,714</u>	<u>\$ 2,784,850</u>

Changes in noncurrent liabilities for the years ended September 30, 2012 and 2011 are as follows:

	<u>Outstanding October 1, 2011</u>	<u>Addition</u>	<u>Reduction</u>	<u>Outstanding September 30, 2012</u>	<u>Amount due Within One Year</u>
Notes payable	\$ 778,805	\$ -	\$ (45,907)	\$ 732,898	\$ 732,898
Long-term debt	458,877	1,811,059	(34,800)	2,235,136	50,059
Lease obligation	55,000	-	(55,000)	-	-
Accrued annual leave	<u>76,199</u>	<u>9,624</u>	<u>(38,918)</u>	<u>46,905</u>	<u>21,270</u>
	<u>\$ 1,368,881</u>	<u>\$ 1,820,683</u>	<u>\$ (174,625)</u>	<u>\$ 3,014,939</u>	<u>\$ 804,227</u>

	<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>

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

Notes to Financial Statements
September 30, 2012 and 2011

(8) Related Party Transactions

Revenue received from the CSG for the years ended September 30, 2012 and 2011 amounted to \$1,095,599 and \$492,905, respectively.

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) Commitments

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 6).

Leases

In November, 2010, CPUC terminated its office and warehouse lease agreements and entered into new agreements expiring in December 31, 2012. In March 2013, CPUC re-negotiated the office and warehouse lease agreements to expire in March 2015 and September 2014, respectively.

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, payable in varying installments approximately over 2 years. The unpaid balance of the lease settlement was \$55,000 as of September 30, 2011 and was fully paid in 2012.

Future minimum lease payments for the aforementioned leases are as follows:

<u>Year ending September 30,</u>	
2013	\$ 64,092
2014	63,120
2015	<u>21,000</u>
	\$ <u>148,212</u>

In 2013, CPUC negotiated various land leases expiring in 2033. The leases require advance payments in 2013 totaling \$378,520.

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

Notes to Financial Statements
September 30, 2012 and 2011

(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, 2012, current liabilities exceed current assets by \$2,848,718, and a net unrestricted deficiency of \$2,137,535.

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, 2012, 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 2012, CPUC received communication from a grantor agency requesting repayment of \$680,000 related to grant funds received for the uncompleted Pole Hardening Project (see note 5). Management believes that the responsibility for resolving the matter rests with CSG and therefore, has not provided any provision for a liability that may ultimately result from the claim.

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.

(11) Restricted Net Assets

At September 30, 2012 and 2011, net assets are restricted for the following purposes:

	<u>2012</u>	<u>2011</u>
Capital improvements	\$ 46,139	\$ 175,555
Fuel deposit from fuel operating grant	<u>536,262</u>	<u>346,262</u>
	\$ <u>582,401</u>	\$ <u>521,817</u>

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

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

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

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: | |

CFDA Number

Name of Federal Program

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

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

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

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.