

CHUUK PUBLIC UTILITY CORPORATION

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

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2013 AND 2012



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INDEPENDENT AUDITORS' REPORT

The Board of Directors
Chuuk Public Utility Corporation:

Report on Financial Statements

We have audited the accompanying financial statements of Chuuk Public Utility Corporation (CPUC), a component unit of the State of Chuuk, which comprise the statements of net position as of September 30, 2013 and 2012, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Chuuk Public Utility Corporation as of September 30, 2013 and 2012, and the changes in its net position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 24, 2014 on our consideration of CPUC's internal control over financial reporting and on 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* in considering CPUC's internal control over financial reporting and compliance.

Deloitte & Touche LLP

June 24, 2014

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

Management's Discussion and Analysis
Years Ended September 30, 2013 and 2012

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, 2013.

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, 2013 and 2012. 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 2013, 2012 and 2011.

FINANCIAL HIGHLIGHTS

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Assets:			
Utility plant in service, net	\$ 7,298,925	\$ 4,247,512	\$ 2,093,080
Current assets	1,865,089	676,199	759,753
Non-current assets	<u>883,239</u>	<u>536,262</u>	<u>346,262</u>
Total assets	\$ <u>10,047,253</u>	\$ <u>5,459,973</u>	\$ <u>3,199,095</u>
Net Position and Liabilities:			
Net investment in capital assets	\$ 2,835,322	\$ 1,279,478	\$ 855,398
Restricted for capital improvements	784,331	582,401	521,817
Unrestricted	<u>(173,337)</u>	<u>(2,137,535)</u>	<u>(2,059,436)</u>
Total net position	<u>3,446,316</u>	<u>(275,656)</u>	<u>(682,221)</u>
Long-term liabilities	3,653,277	2,210,712	514,379
Current liabilities	<u>2,947,660</u>	<u>3,524,917</u>	<u>3,366,937</u>
Total liabilities	<u>6,600,937</u>	<u>5,735,629</u>	<u>3,881,316</u>
Total net position and liabilities	\$ <u>10,047,253</u>	\$ <u>5,459,973</u>	\$ <u>3,199,095</u>
Revenues, Expenses, and Changes in Net Position:			
Operating revenues, net	\$ 6,445,773	\$ 5,357,313	\$ 2,983,031
Operating expenses	<u>6,417,995</u>	<u>5,676,006</u>	<u>4,024,299</u>
Operating income (loss)	<u>27,778</u>	<u>(318,693)</u>	<u>(1,041,268)</u>
Grants, subsidies and other income	3,883,855	804,038	1,531,754
Interest expense	<u>(189,661)</u>	<u>(78,780)</u>	<u>(75,780)</u>
Total non-operating revenue, net	<u>3,694,194</u>	<u>725,258</u>	<u>1,455,974</u>
Change in net position	3,721,972	406,656	414,706
Net position at beginning of year	<u>(275,656)</u>	<u>(682,221)</u>	<u>(1,096,927)</u>
Net position at end of year	\$ <u>3,446,316</u>	\$ <u>(275,656)</u>	\$ <u>(682,221)</u>

**CHUUK PUBLIC UTILITY CORPORATION
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Management's Discussion and Analysis
Years Ended September 30, 2013 and 2012

CPUC continues to build up its asset-base to provide the utility services to the people of Chuuk State. With the help of Office of Insular affairs (OIA) for funding of management and Capital Improvement and Recovery, loan from ADB and assistance from other foreign governments like Japan government and the Italian government, CPUC's asset-base more than doubled since 2011, indicating growth and improvement in ability to provide the utility services.

CPUC is solvent for the first time and its net position has come to a positive \$3.4 million as of September 30, 2013. As a comparison, the net position of CPUC in 2008 was a negative 4.6 million.

Revenue in 2013 is increased by 20% or \$1.08 million compared to 2012. Expenses increased by 13% or \$0.74 million necessary to meet the increased generation and the improvement in services.

In 2013, CPUC has an operating income of \$28,000, an improvement from a loss of \$319,000 last year and a loss of \$1 million in 2011.

Net income in 2013 after all contributions and grants (including capital grants) from the United States and other countries is \$3.7 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 (FY) 2014 OUTLOOK

CPUC anticipates continued improvement in operating position during FY2014 through improvements in power generating efficiency and power distribution efficiency as well as expansion of water and sewer services.

The two major power rehabilitation projects will continue in FY2014 – the CPUC Power Plant Restoration Project and the Power Distribution Rehabilitation Project. It is intended that both projects will be completed during FY2015 and that they will bring about efficiency improvements in future periods.

A power loss target of 20% has been set for FY2014.

CPUC will seek funds to undertake a comprehensive investment master plan for electricity service expansion within the Chuuk State. Discussions will continue with all stakeholders to understand the priorities of the communities and be connected.

The expansion of grid connected solar PV systems will continue with grant funding from the Japanese Government – a 200 kW system will be installed on Chuuk High School in the last quarter of FY2014.

With regard to water supply and sewerage services CPUC focus will remain on the installation of water metering across the whole of the supply system; CPUC sewer network will be cleaned out and audit undertaken of sewer connections

Bids for the rehabilitation of the Weno Waste Water Treatment plant will be issued in the first half of FY2014 with a view to contract completion prior to the end of FY2015. The rehabilitation will improve the quality of wastewater being discharged to the lagoon and comply with environmental regulations.

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Management's Discussion and Analysis
Years Ended September 30, 2013 and 2012

CPUC will seek funding to pay back long outstanding obligations to banks and national government institutions; this will significantly reduce CPUC current's liabilities.

CPUC will fully utilize the poles provided under the FEMA Pole Hardening Project in FY2014. Management further understands that the FEMA grant was repaid to FEMA by FSM NG sometime in 2013 and that Chuuk State will resolve the issue of payment to FSMNG on behalf of CPUC.

CONTACTING CPUC'S FINANCIAL MANAGEMENT

Management's Discussion and Analysis for the year ended September 30, 2012, is set forth in the report on the audit of CPUC's financial statements, which is dated June 21, 2013, and that Discussion and Analysis explains the major factors impacting the 2012 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
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Statements of Net Position
September 30, 2013 and 2012

<u>Assets</u>	<u>2013</u>	<u>2012</u>
Utility plant, at cost:		
Depreciable utility plant:		
Electric plant in service	\$ 18,806,335	\$ 16,682,027
Water and sewer plant in service	9,636,438	8,656,438
General plant in service	<u>10,913</u>	<u>13,984</u>
	28,453,686	25,352,449
Less accumulated depreciation	<u>(23,124,425)</u>	<u>(22,918,632)</u>
	<u>5,329,261</u>	<u>2,433,817</u>
Non-depreciable utility plant:		
Construction in progress	<u>1,969,664</u>	<u>1,813,695</u>
Total utility plant	<u>7,298,925</u>	<u>4,247,512</u>
Current assets:		
Cash	307,874	47,626
Accounts receivable, net	318,243	242,534
Other receivables	20,859	7,600
Inventory	1,130,315	316,094
Prepaid expenses	68,872	62,345
Prepaid land lease, current	<u>18,926</u>	<u>-</u>
Total current assets	<u>1,865,089</u>	<u>676,199</u>
Noncurrent assets:		
Deposits	536,262	536,262
Prepaid land lease, net of current portion	<u>346,977</u>	<u>-</u>
Total non-current assets	<u>883,239</u>	<u>536,262</u>
	<u>\$ 10,047,253</u>	<u>\$ 5,459,973</u>
<u>Liabilities and Net Position</u>		
Current liabilities:		
Notes payable	\$ 739,243	\$ 732,898
Current portion of long-term debt	92,353	50,059
Accounts payable	503,469	444,528
Accrued taxes and other liabilities	1,010,051	1,156,743
Accrued interest expense	311,609	735,768
Payable to grantor	252,903	315,631
Unearned revenue	17,693	68,020
Accrued annual leave	<u>20,339</u>	<u>21,270</u>
Total current liabilities	<u>2,947,660</u>	<u>3,524,917</u>
Accrued annual leave, net of current portion	21,270	25,635
Long-term debt, net of current portion	<u>3,632,007</u>	<u>2,185,077</u>
Total liabilities	<u>6,600,937</u>	<u>5,735,629</u>
Commitments and contingencies		
Net position:		
Net investment in capital assets	2,835,322	1,279,478
Restricted	784,331	582,401
Unrestricted	<u>(173,337)</u>	<u>(2,137,535)</u>
Net position	<u>3,446,316</u>	<u>(275,656)</u>
	<u>\$ 10,047,253</u>	<u>\$ 5,459,973</u>

See accompanying notes to financial statements.

CHUUK PUBLIC UTILITY CORPORATION
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Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Operating revenues:		
Electricity sales	\$ 6,229,092	\$ 5,246,951
Other sales	<u>275,086</u>	<u>110,362</u>
	6,504,178	5,357,313
Provision for uncollectable accounts	<u>(58,405)</u>	<u>-</u>
Total operating revenues	<u>6,445,773</u>	<u>5,357,313</u>
Operating and maintenance expenses:		
Production fuel	4,588,361	4,180,611
Administrative and general	1,605,266	1,118,594
Depreciation	<u>224,368</u>	<u>376,801</u>
Total operating and maintenance expenses	<u>6,417,995</u>	<u>5,676,006</u>
Operating income (loss)	<u>27,778</u>	<u>(318,693)</u>
Nonoperating revenues (expense):		
Nonfederal grants	500	190,000
Other income (expense), net	792,266	(47,471)
Interest expense	<u>(189,661)</u>	<u>(78,780)</u>
Total nonoperating revenues, net	<u>603,105</u>	<u>63,749</u>
Income (loss) before capital contributions	630,883	(254,944)
Capital contributions:		
Contributions from foreign governments	1,680,000	-
Grants from the United States Government	<u>1,411,089</u>	<u>661,509</u>
Change in net position	3,721,972	406,565
Net position at beginning of year	<u>(275,656)</u>	<u>(682,221)</u>
Net position at end of year	<u>\$ 3,446,316</u>	<u>\$ (275,656)</u>

See accompanying notes to financial statements.

CHUUK PUBLIC UTILITY CORPORATION
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Statements of Cash Flows
Years Ended September 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Cash received from customers	\$ 6,533,954	\$ 5,413,164
Cash payments to suppliers for goods and services	(6,732,123)	(4,793,283)
Cash payments to employees	(652,700)	(539,754)
Net cash (used in) provided by operating activities	(850,869)	80,127
Cash flows from noncapital financing activities:		
Cash receipts from grantor	180,772	209,778
Payments to grantor	(243,000)	(253,736)
Net cash used in noncapital financing activities	(62,228)	(43,958)
Cash flows from capital and related financing activities:		
Proceeds from long-term debt	1,589,490	1,776,259
Cash receipts from grantor for capital projects	1,411,089	661,509
Acquisition of utility plant	(1,609,356)	(2,531,233)
Reduction of long-term debt	(93,921)	(45,907)
Payment of interest	(123,957)	(3,000)
Net cash provided by (used in) capital and related financing activities	1,173,345	(142,372)
Net change in cash	260,248	(106,203)
Cash at beginning of year	47,626	153,829
Cash at end of year	\$ 307,874	\$ 47,626
<u>Reconciliation of operating income (loss) to net cash (used in) provided by operating activities:</u>		
Operating income (loss)	\$ 27,778	\$ (318,693)
Adjustments to reconcile operating income (loss) to net cash (used in) provided by operating activities:		
Depreciation	224,368	376,801
Other income (expense), net	227,476	(47,471)
Provision for uncollectable accounts	58,405	-
Decrease (increase) in assets:		
Accounts receivable	(134,114)	12,159
Other receivables	(13,259)	(46,956)
Inventory	(814,221)	12,148
Prepaid expenses	(372,430)	-
Increase (decrease) in liabilities:		
Accounts payable	58,941	61,867
Accrued taxes and other liabilities	(58,190)	22,096
Accrued annual leave	(5,296)	(29,294)
Unearned revenue	(50,327)	50,327
Lease obligation	-	(12,857)
Net cash (used in) provided by operating activities	\$ (850,869)	\$ 80,127

Supplemental schedule of noncash capital and related financing activities:

In 2013, Chuuk State Government transferred utility plant and equipment of \$1,680,000 to CPUC that was funded by grants from the Italian and Japan Governments.

See accompanying notes to financial statements.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2013 and 2012

(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.

Net Position

Net position represents the residual interest in CPUC's assets after liabilities are deducted and consist of four sections: Net investment in capital assets, restricted expendable and nonexpendable, and unrestricted. Net investment in capital assets includes capital assets, restricted and unrestricted, net of accumulated depreciation, reduced by outstanding debt net of debt service reserve. Net position is reported as restricted when constraints are imposed by third parties or enabling legislation. All other net position is 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 net position and cash flows, cash is defined as cash on hand and cash held in demand accounts. As of September 30, 2013 and 2012, the carrying amount of cash was \$307,874 and \$47,626, respectively, and the corresponding bank balances were \$368,243 and \$61,099, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2013 and 2012, bank deposits of \$250,000 and \$61,099, respectively, were FDIC insured. CPUC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

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Notes to Financial Statements
September 30, 2013 and 2012

(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 as of September 30, 2012 and was fully depreciated during the year ended September 30, 2013. CPUC's capitalization threshold is \$3,000, with an estimated useful life in excess of one year.

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, 2013 and 2012, the accumulated vacation leave liability totals \$41,609 and \$46,905, 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.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2013 and 2012

(2) Summary of Significant Accounting Policies, Continued

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 unearned revenue if determined to be significant. At September 30, 2013 and 2012, unearned revenue recognized on cash power revenue was \$5,710 and \$50,327, respectively.

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).

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 2013, CPUC implemented the following pronouncements:

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addressed how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*, which improved 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 implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which enhanced 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 issued on or before November 30, 1989, which does not conflict or contradict GASB pronouncements. GASB Statement No. 62 superseded GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. The implementation of this statement did not have a material effect on the accompanying financial statements.

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Notes to Financial Statements
September 30, 2013 and 2012

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which established guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position, and GASB 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. These Statements amend the net asset reporting requirements in Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. With the implementation of GASB Statement No. 63 and Statement No. 65, the Statement of Net Assets was renamed the Statement of Net Position. In addition, the Statement of Net Position includes two new classifications separate from assets and liabilities. Amounts reported as deferred outflows of resources are reported in a separate section following assets. Likewise, amounts reported as deferred inflows of resources are reported in a separate section following liabilities.

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 yet determined the effect of implementation of these statements on the financial statements of CPUC.

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*, which improves accounting and financial reporting for state and local governments' combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. A disposal of government operations can occur through a transfer to another government or a sale. The provisions in Statement 69 are effective for fiscal years beginning after December 15, 2013. Management has not yet determined the effect of implementation of this statement on the financial statements of CPUC.

In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The provisions in Statement 70 are effective for fiscal years beginning after June 15, 2013. Management has not yet determined the effect of implementation of this statement on the financial statements of CPUC.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2013 and 2012

(2) Summary of Significant Accounting Policies, Continued

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.

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, fire, automobile, 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 2013 financial statements in order to conform with the 2012 presentation.

(3) Accounts Receivable

Accounts receivable at September 30, 2013 and 2012, are summarized as follows:

	<u>2013</u>	<u>2012</u>
Residential	\$ 272,052	\$ 170,280
Commercial	208,312	216,084
Government	50,608	68,405
Other	14,886	9,168
Unbilled	<u>37,754</u>	<u>36,504</u>
	583,612	500,441
Less allowance for uncollectable accounts	<u>(265,369)</u>	<u>(257,907)</u>
	\$ <u>318,243</u>	\$ <u>242,534</u>

Receivables as of September 30, 2013 and 2012 include \$171,784 and \$136,646, 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% of the delinquent customer's cash power purchase at the time of collection during the years ended September 30, 2013 and 2012.

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(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.

In November 2012, CPUC entered into an agreement with FSMNG for the transfer of Weno water supply wells funded by the Japan Funds for Poverty Reduction Project of \$980,000. Under the agreement, CPUC is not required to provide monetary payment for the asset but is responsible for the operation and maintenance of the asset upon transfer.

In August 2013, FSMNG transferred the Weno Grid-Tied Solar Project installed at the Chuuk International Airport with a cost of \$700,000 to CPUC that was funded by the Italian Government. At the date of transfer, CPUC is responsible for the maintenance and operation of the asset.

(5) Utility Plant

Utility plant and construction in progress consist of the following detailed balances at September 30, 2013 and 2012:

	Balance at October <u>1, 2012</u>	Additions and <u>Transfers</u>	Deletions and <u>Transfers</u>	Balance at September <u>30, 2013</u>
Depreciable assets:				
Electric plant in service	\$ 16,682,027	\$ 2,151,458	\$ (27,150)	\$ 18,806,335
Water and sewer plant in service	8,656,438	980,000	-	9,636,438
General plant in service	<u>13,984</u>	<u>1,929</u>	<u>(5,000)</u>	<u>10,913</u>
	25,352,449	3,133,387	(32,150)	28,453,686
Less accumulated depreciation	<u>(22,918,632)</u>	<u>(224,368)</u>	<u>18,575</u>	<u>(23,124,425)</u>
	2,433,817	2,909,019	(13,575)	5,329,261
Non-depreciable assets:				
Construction in progress	<u>1,813,695</u>	<u>1,605,010</u>	<u>(1,449,041)</u>	<u>1,969,664</u>
	<u>\$ 4,247,512</u>	<u>\$ 4,514,029</u>	<u>\$ (1,462,616)</u>	<u>\$ 7,298,925</u>
	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>

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(5) Utility Plant, Continued

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 2014 along with a power distribution improvement project that will be funded by the ADB loan proceeds. As of September 30, 2013 and 2012, the cumulative cost of the uncompleted project of \$288,070 and \$252,268, respectively, is included as part of construction in progress.

During the year ended September 30, 2013, CPUC received two contributed assets from FSMNG (see note 4).

Construction in progress at September 30, 2013 and 2012 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, 2013 and 2012, CPUC recorded federal grants from the U.S. DOI passed through by CSG totaling \$1,411,089 and \$661,509, respectively. Of the total grant proceeds at September 30, 2013 and 2012, \$252,903 and \$315,631, 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 net position. The rest of the grant proceeds were used for the power plant rehabilitation project.

CPUC was also a recipient of a grant from the Japan Government passed through by FSMNG in 2011 and 2012 totaling \$536,262. The total grant proceeds are being held as collateral for a fuel and lubricant purchase line with the FSM Petroleum Corporation (FSMPC) and are presented as long-term deposit as of September 30, 2013 and 2012 in the accompanying statements of net position.

(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 \$81,650 and \$81,921 at September 30, 2013 and 2012, respectively, and is presented as current in the accompanying statements of net position as it is matured and due.

CPUC has notes payable to the Federated States of Micronesia Development Bank (FSMDB), a component unit of the FSM National Government, 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. In May 2014, CPUC and FSMDB entered into an agreement for the full and final settlement of the notes payable for a total consideration of \$750,182 (see note 12). As of September 30, 2013 and 2012, the notes payable balance is \$657,593 and \$650,977, respectively, with accrued interest payable of \$317,688. As a result of the subsequent settlement in May 2014, CPUC recognized a gain of \$225,099 which is included in other income in the accompanying statements of revenues, expenses and changes in net position.

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(7) Borrowings and Noncurrent Liabilities, Continued

Long-term Debt

Long-term debt consists of the following at September 30, 2013 and 2012:

	<u>2013</u>	<u>2012</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.	\$ 1,563,459	\$ 314,439
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, 2013 and 2012). Proceeds are used for the purchase of two generator sets and related costs.	<u>2,160,901</u>	<u>1,920,697</u>
Total long-term debt	3,724,360	2,235,136
Less current portion of long-term debt	<u>92,353</u>	<u>50,059</u>
Long-term debt, net of current portion	\$ <u>3,632,007</u>	\$ <u>2,185,077</u>

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>
2014	\$ 92,353	\$ 134,075	\$ 226,428
2015	97,729	142,727	240,456
2016	106,458	139,200	245,658
2017	116,034	135,150	251,184
2018	126,699	130,897	257,596
2019-2023	828,854	577,659	1,406,513
2024-2028	1,289,545	404,987	1,694,532
2029-2033	712,313	205,912	918,225
2034-2036	<u>354,375</u>	<u>48,943</u>	<u>403,318</u>
	\$ <u>3,724,360</u>	\$ <u>1,919,550</u>	\$ <u>5,643,910</u>

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(7) Borrowings and Noncurrent Liabilities, Continued

Changes in noncurrent liabilities for the years ended September 30, 2013 and 2012 are as follows:

	Outstanding October 1, <u>2012</u>	<u>Addition</u>	<u>Reduction</u>	Outstanding September <u>30, 2013</u>	Amount due Within <u>One Year</u>
Notes payable	\$ 732,898	\$ 6,345	\$ -	\$ 739,243	\$ 739,243
Long-term debt	2,235,136	1,589,490	(100,266)	3,724,360	92,353
Accrued annual leave	<u>46,905</u>	<u>33,558</u>	<u>(38,854)</u>	<u>41,609</u>	<u>20,339</u>
	<u>\$ 3,014,939</u>	<u>\$ 1,629,393</u>	<u>\$ (139,120)</u>	<u>\$ 4,505,212</u>	<u>\$ 851,935</u>
	Outstanding October 1, <u>2011</u>	<u>Addition</u>	<u>Reduction</u>	Outstanding September <u>30, 2012</u>	Amount due Within <u>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>

(8) Related Party Transactions

Revenue received from CSG representing power, water and other sales for the years ended September 30, 2013 and 2012 was \$1,417,128 and \$1,095,599, respectively.

CPUC entered into an Operation and Maintenance Management (OMM) contract for the management and maintenance of CPUC's operations. The contract is for an initial period of two years and is federally funded through a grant received by CSG. In 2013, the contract was extended for another year with expected completion in 2014. All transactions related to the contract are recorded by CSG.

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 secured by the long-term deposit held by FSMPC from a fuel grant received by CPUC (see note 6).

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(9) Commitments, Continued

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. Future minimum lease payments for the years ending September 30, 2014 and 2015 are \$63,120 and \$21,000, respectively.

In 2013, CPUC entered into 3 land leases which are effective from February 2013 to January 2033. The leases require advance payments totaling \$378,520. As of September 30, 2013, unamortized prepaid lease of \$365,903 has been included in the accompanying statements of net position and is amortized on a straight-line basis over the lease term as follows:

<u>Year Ending September 30,</u>	
2014	\$ 18,926
2015	18,926
2016	18,926
2017	18,926
2018	18,926
2019-2023	94,630
2024-2028	94,630
2029-2033	<u>82,013</u>
	<u>\$ 365,903</u>

(10) Contingencies

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 inability to predict the ultimate outcome. Any changes in this estimate will be resolved prospectively.

Other

In 2009, CPUC wrote-off \$154,195 of unearned revenue 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 Position

At September 30, 2013 and 2012, net position is restricted for the following purposes:

	<u>2013</u>	<u>2012</u>
Capital improvements	\$ 248,069	\$ 46,139
Fuel deposit from fuel operating grant	<u>536,262</u>	<u>536,262</u>
	<u>\$ 784,331</u>	<u>\$ 582,401</u>

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(12) Subsequent Events

On April 30, 2014, CPUC entered into an agreement with FSM Social Security Administration for a full and final settlement of unpaid tax liabilities and related penalties and interest for a total consideration of \$478,225. At September 30, 2013, unpaid tax liabilities and related penalties and interest totaled \$831,491. As such, CPUC recorded a \$353,266 gain on settlement which is included in other income in the accompanying statements of revenues, expenses and changes in net position for the year ended September 30, 2013.

As discussed in note 7, on May 23, 2014, CPUC entered into an agreement with FSMDB for a full and final settlement of a note payable for total consideration of \$750,182 payable in full immediately upon execution of the agreement.