

CHUUK PUBLIC UTILITY CORPORATION

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

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2014 AND 2013



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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, 2014 and 2013, 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, 2014 and 2013, 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.

Emphasis of Matter

As described in note 12 to the financial statements, Typhoon Maysak ravaged Chuuk in March 2015, causing significant damage to CPUC's power distribution system. Management estimates that approximately 70% of the power distribution system was severely damaged and requires replacement. The ultimate impact on CPUC's infrastructure asset is presently indeterminable. Our opinion is not modified with respect to this matter.

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 28, 2015, 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 28, 2015

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

Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

The following Management's 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 as of and for the fiscal year ended September 30, 2014.

GASB 34 of the U.S. Government Accounting Standards Board requires that financial statements must contain a management's discussion and analysis. This section of the CPUC's annual report presents management's discussion of CPUC's performance for years ended September 30, 2014 and 2013. 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 operations of CPUC for fiscal years 2014, 2013 and 2012.

FINANCIAL HIGHLIGHTS

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Assets:			
Utility plant in service, net	\$ 8,891,991	\$ 7,298,925	\$ 4,247,512
Current assets	2,246,291	1,865,089	676,199
Non-current assets	<u>864,313</u>	<u>883,239</u>	<u>536,262</u>
Total assets	<u>\$ 12,002,595</u>	<u>\$ 10,047,253</u>	<u>\$ 5,459,973</u>
Net Position and Liabilities:			
Net investment in capital assets	\$ 3,840,735	\$ 2,835,322	\$ 1,279,478
Restricted	652,423	784,331	582,401
Unrestricted	<u>708,714</u>	<u>(173,337)</u>	<u>(2,137,535)</u>
Total net position	<u>5,201,872</u>	<u>3,446,316</u>	<u>(275,656)</u>
Long-term liabilities	4,843,618	3,653,277	2,210,712
Current liabilities	<u>1,957,105</u>	<u>2,947,660</u>	<u>3,524,917</u>
Total liabilities	<u>6,800,723</u>	<u>6,600,937</u>	<u>5,735,629</u>
Total net position and liabilities	<u>\$ 12,002,595</u>	<u>\$ 10,047,253</u>	<u>\$ 5,459,973</u>
Revenues, Expenses, and Changes in Net Position:			
Total operating revenues	\$ 6,277,663	\$ 6,445,773	\$ 5,357,313
Operating expenses	<u>6,846,514</u>	<u>6,417,995</u>	<u>5,676,006</u>
Operating (loss) income	<u>(568,851)</u>	<u>27,778</u>	<u>(318,693)</u>
Grants, subsidies and other income	2,374,721	3,883,855	804,038
Interest expense	<u>(50,314)</u>	<u>(189,661)</u>	<u>(78,780)</u>
Total nonoperating revenue, net and capital contributions	<u>2,324,407</u>	<u>3,694,194</u>	<u>725,258</u>
Change in net position	1,755,556	3,721,972	406,565
Net position at beginning of year	<u>3,446,316</u>	<u>(275,656)</u>	<u>(682,221)</u>
Net position at end of year	<u>\$ 5,201,872</u>	<u>\$ 3,446,316</u>	<u>\$ (275,656)</u>

**CHUUK PUBLIC UTILITY CORPORATION
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Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

CPUC continues to build up its asset-base to provide the essential utility services to the people of Chuuk State. Total assets at the end of FY2014 are \$12.0 million, compared with US\$10.0 million at the end of FY2013.

CPUC's net position at the end of the FY2014 is \$5.2 million compared to \$3.4 million in FY2013, and a significant improvement from the negative \$0.28 million in FY2012. CPUC has made important advances in clearing off long standing liabilities in FY2014 – in particular unpaid social security obligations, accumulated interest and penalties for the period FY2004 to 2010; and a long standing delinquent loan from the FSM Development Bank have been repaid – both settlements were negotiated and included forgiveness of interest and penalties. The settlements resulted in a reduction of US\$0.99 million in CPUC current liabilities.

Operating revenue in FY2014 slightly reduced by 3%, this reduction was due to a reduction in the price of fuel compared to prior year. The price reduction is being passed directly onto customers through the automatic Fuel Adjustment in the tariff. The reduction in fuel cost can be seen in the statements of revenues, expenses and changes in net position presented herein.

Operating expense in FY2014 increased by \$428,519. This increase in FY2014 is due to the inclusion of the cost of the professional management team in CPUC's statement of revenues, expenses and change in net position, specifically the line item cost \$505,552 noted as management support. In FY2014 the grant was administered by CPUC; hence, its inclusion in the accounts for FY2014. Prior to FY2014, the management team grant was administered by Chuuk State and the FSM National Government and therefore; not recorded in CPUC accounts for prior years.

Overall, the operating income before depreciation and the management support is \$247,788 and the income before capital contribution is \$575,983.

Capital Assets and Debts

For additional information concerning capital assets, please refer to notes 4 and 5 to the financial statements.

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

FISCAL YEAR (FY) 2015 OUTLOOK

CPUC anticipates continued improvement in operating position during FY2015 through improvements in power generating efficiency and power distribution power distribution efficiency as well as expansion of water and sewer services.

The two major power rehabilitation projects will continue in FY 2015 – the CPUC power plant Restoration project and the Power Distribution Rehabilitation Project. It is intended that both projects will be completed in FY 2016 and they will bring about efficiency improvements in future periods.

A power loss target of 20% has been set for FY 2015.

World Bank grant funding is being provided to the FSM Energy Sector. A key component of the grant is the preparation of a compressive investment master plan for electricity service expansion within Chuuk State. With the investment master plan in place CPUC will be able to seek funding to increase electricity service across the State and thereby achieve the State and National Energy service coverage Targets.

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Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

CPUC now have a total of 256 kWp of grid connected solar PV systems connected to the Weno power grid. This is installed at Chuuk International Airport (65 kWp) and Chuuk State High School (200 kWp). Jointly they contribute on average just over 2% to daily power generation. A further 200 kWp is scheduled to be installed under the World Bank Energy Sector Grant by the end of FY2016.

With regards to water supply and sewerage services CPUC focus will remain on the installation of water metering across the whole of the supply system.

CPUC Waste Water Treatment Plant (WWTP) Rehabilitation is ongoing with the work being carried out by international contractor - commissioning is expected in October 2015 with handover to CPUC by end of December 2015. The rehabilitation will improve the quality of wastewater being discharged to the lagoon and comply with environmental regulations.

As part of the WWTP rehabilitation project, CPUC is also undertaking the rehabilitation of 10 sewer grinder stations in the Northern part of Weno – these stations were built many years ago and have never been commissioned. This work will be completed within FY2015.

SUBSEQUENT EVENT

CPUC power distribution system was quite badly impacted by Typhoon Maysak that passed through Chuuk State on 29th March 2015. Approximately 70% of the power distribution system was severely damaged and requires replacement.

The system will be restored to full operation per pre - typhoon conditions by the end of July 2016. A national disaster declaration was made by FSM National Government as well as the US Government. As a result, it is anticipated that Capital and Operations support to rebuilding will be provided through USAID – as of June 2015 this support has not yet been affected.

CONTACTING CPUC'S FINANCIAL MANAGEMENT

Management's Discussion and Analysis for the year ended September 30, 2013, is set forth in the report on the audit of CPUC's financial statements, which is dated June 24, 2014, and that Discussion and Analysis explains the major factors impacting the 2013 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, 2014 and 2013

<u>Assets</u>	<u>2014</u>	<u>2013</u>
Utility plant, at cost:		
Depreciable utility plant:		
Electric plant in service	\$ 19,972,175	\$ 18,806,335
Water and sewer plant in service	9,536,512	9,636,438
General plant in service	10,913	10,913
	<u>29,519,600</u>	<u>28,453,686</u>
Less accumulated depreciation	<u>(23,227,729)</u>	<u>(23,124,425)</u>
	<u>6,291,871</u>	<u>5,329,261</u>
Non-depreciable utility plant:		
Construction in progress	<u>2,600,120</u>	<u>1,969,664</u>
Total utility plant	<u>8,891,991</u>	<u>7,298,925</u>
Current assets:		
Cash	542,834	307,874
Accounts receivable, net	366,393	339,102
Inventory	1,306,541	1,130,315
Prepaid expenses	11,597	68,872
Prepaid land lease, current	18,926	18,926
Total current assets	<u>2,246,291</u>	<u>1,865,089</u>
Noncurrent assets:		
Deposits	536,262	536,262
Prepaid land lease, net of current portion	328,051	346,977
Total noncurrent assets	<u>864,313</u>	<u>883,239</u>
	<u>\$ 12,002,595</u>	<u>\$ 10,047,253</u>
<u>Liabilities and Net Position</u>		
Current liabilities:		
Notes payable	\$ 104,044	\$ 739,243
Current portion of long-term debt	137,690	92,353
Accounts payable	519,595	503,469
Accrued taxes and other liabilities	628,116	1,010,051
Accrued interest expense	-	311,609
Payable to grantor	514,164	252,903
Unearned revenue	46,137	17,693
Accrued annual leave, current	7,359	20,339
Total current liabilities	<u>1,957,105</u>	<u>2,947,660</u>
Accrued annual leave, net of current portion	34,095	21,270
Long-term debt, net of current portion	<u>4,809,523</u>	<u>3,632,007</u>
Total liabilities	<u>6,800,723</u>	<u>6,600,937</u>
Commitments and contingencies		
Net position:		
Net investment in capital assets	3,840,735	2,835,322
Restricted	652,423	784,331
Unrestricted	708,714	(173,337)
Total net position	<u>5,201,872</u>	<u>3,446,316</u>
	<u>\$ 12,002,595</u>	<u>\$ 10,047,253</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, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Operating revenues:		
Electricity sales	\$ 5,989,455	\$ 6,229,092
Other sales	355,902	275,086
	<u>6,345,357</u>	<u>6,504,178</u>
Provision for uncollectable accounts	(67,694)	(58,405)
Total operating revenues	<u>6,277,663</u>	<u>6,445,773</u>
Operating and maintenance expenses:		
Production fuel	4,193,839	4,588,361
Administrative and general	1,836,036	1,605,266
Management support	505,552	-
Depreciation	311,087	224,368
Total operating and maintenance expenses	<u>6,846,514</u>	<u>6,417,995</u>
Operating (loss) income	<u>(568,851)</u>	<u>27,778</u>
Nonoperating revenues (expense), net:		
Operating grant-management support	505,552	500
Operating grant-other	478,225	-
Other income, net	211,371	792,266
Interest expense	(50,314)	(189,661)
Total nonoperating revenues, net	<u>1,144,834</u>	<u>603,105</u>
Income before capital contributions	575,983	630,883
Capital contributions:		
Contributions from foreign governments	-	1,680,000
Grants from the United States Government	1,179,573	1,411,089
Change in net position	1,755,556	3,721,972
Net position at beginning of year	<u>3,446,316</u>	<u>(275,656)</u>
Net position at end of year	<u>\$ 5,201,872</u>	<u>\$ 3,446,316</u>

See accompanying notes to financial statements.

**CHUUK PUBLIC UTILITY CORPORATION
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Statements of Cash Flows
Years Ended September 30, 2014 and 2013

	2014	2013
Cash flows from operating activities:		
Cash received from customers	\$ 6,490,187	\$ 6,533,954
Cash payments to suppliers for goods and services	(5,409,700)	(6,732,123)
Cash payments to employees	(1,224,973)	(652,700)
Net cash used in operating activities	(144,486)	(850,869)
Cash flows from noncapital financing activities:		
Cash receipts from grantor	766,813	180,772
Payments to grantor	-	(243,000)
Net cash provided by (used in) noncapital financing activities	766,813	(62,228)
Cash flows from capital and related financing activities:		
Proceeds from long-term debt	1,530,682	1,589,490
Cash receipts from grantor for capital projects	419,881	1,411,089
Acquisition of utility plant	(1,904,153)	(1,609,356)
Reduction of long-term debt	(285,075)	(93,921)
Payment of interest	(148,702)	(123,957)
Net cash (used in) provided by capital and related financing activities	(387,367)	1,173,345
Net change in cash	234,960	260,248
Cash at beginning of year	307,874	47,626
Cash at end of year	\$ 542,834	\$ 307,874
<u>Reconciliation of operating (loss) income to net cash used in operating activities:</u>		
Operating (loss) income	\$ (568,851)	\$ 27,778
Adjustments to reconcile operating (loss) income to net cash used in operating activities:		
Depreciation	311,087	224,368
Other income, net	211,371	227,476
Provision for uncollectable accounts	67,694	58,405
Decrease (increase) in assets:		
Accounts receivable	(94,985)	(147,373)
Inventory	(176,226)	(814,221)
Prepaid expenses	76,201	(372,430)
Increase (decrease) in liabilities:		
Accounts payable	16,126	58,941
Accrued taxes and other liabilities	(15,192)	(58,190)
Accrued annual leave	(155)	(5,296)
Unearned revenue	28,444	(50,327)
Net cash used in operating activities	\$ (144,486)	\$ (850,869)

Supplemental schedule of noncash activities:

In 2014, CPUC repaid accrued taxes of \$478,225 through a nonoperating grant.

In 2014, CPUC repaid note payable and accrued interest of \$657,953 and \$101,739, respectively, through a capital grant.

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, 2014 and 2013

(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, 2014 and 2013, the carrying amount of cash was \$542,834 and \$307,874, respectively, and the corresponding bank balances were \$602,331 and \$368,243, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2014 and 2013, bank deposits of \$250,000 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.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2014 and 2013

(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 uncollectable 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, which has a zero net book value as of September 30, 2014 and 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.

Operating and Nonoperating 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 nonoperating.

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, 2014 and 2013, unearned revenue recognized on cash power revenue was \$46,137 and \$5,710, respectively, which is included as a component of unearned revenues in the statements of net position.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2014 and 2013

(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).

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 2014, CPUC implemented the following pronouncements:

- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.

In June 2012, GASB issued 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 68 are effective for fiscal years beginning after June 15, 2014. Management does not believe that the implementation of this statement will have a material effect 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.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2014 and 2013

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*, which addresses an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. The provisions in Statement 71 are effective for fiscal years beginning after June 15, 2014. Management does not believe that the implementation of this statement will have a material effect 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.

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 2014 financial statements in order to conform with the 2013 presentation.

(3) Accounts Receivable

Accounts receivable at September 30, 2014 and 2013, are summarized as follows:

	<u>2014</u>	<u>2013</u>
Residential	\$ 358,335	\$ 272,052
Commercial	157,431	208,312
Government	12,602	50,608
Unbilled	105,876	37,754
Other	37,545	35,745
Chuuk State Government service tax	<u>24,649</u>	<u>-</u>
	696,438	604,471
Less allowance for uncollectable accounts	<u>(330,045)</u>	<u>(265,369)</u>
	<u>\$ 366,393</u>	<u>\$ 339,102</u>

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(3) Accounts Receivable, Continued

Receivables as of September 30, 2014 and 2013 include \$158,501 and \$171,784, 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, 2014 and 2013. In November 2013, a 5% Chuuk State service tax was applied to power tariffs. CPUC records service tax receivables in a separate account.

(4) Utility Plant

Utility plant and construction in progress consist of the following detailed balances at September 30, 2014 and 2013:

	Balance at October 1, 2013	Additions and Transfers	Deletions and Transfers	Balance at September 30, 2014
Depreciable assets:				
Electric plant in service	\$ 18,806,335	\$ 1,273,697	\$ (107,857)	\$ 19,972,175
Water and sewer plant in service	9,636,438	-	(99,926)	9,536,512
General plant in service	<u>10,913</u>	<u>-</u>	<u>-</u>	<u>10,913</u>
	28,453,686	1,273,697	(207,783)	29,519,600
Less accumulated depreciation	<u>(23,124,425)</u>	<u>(311,087)</u>	<u>207,783</u>	<u>(23,227,729)</u>
	5,329,261	962,610	-	6,291,871
Non-depreciable assets:				
Construction in progress	<u>1,969,664</u>	<u>1,885,266</u>	<u>(1,254,810)</u>	<u>2,600,120</u>
	<u>\$ 7,298,925</u>	<u>\$ 2,847,876</u>	<u>\$ (1,254,810)</u>	<u>\$ 8,891,991</u>
	Balance at October 1, 2012	Additions and Transfers	Deletions and Transfers	Balance at September 30, 2013
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>

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, 2014 and 2013, the cumulative cost of the uncompleted project of \$286,959 and \$288,070, respectively, is included as part of construction in progress.

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(4) Utility Plant, Continued

During the year ended September 30, 2013, CPUC received two contributed assets from FSMNG (see note 5).

Construction in progress at September 30, 2014 and 2013 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).

(5) 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.

(6) Grants and Subsidies

During the years ended September 30, 2014 and 2013, CPUC recorded federal grants from the U.S. DOI passed through by CSG totaling \$2,163,350 and \$1,411,089, respectively. Of the total grant proceeds at September 30, 2014 and 2013, \$514,164 and \$252,903, 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, 2014 and 2013 in the accompanying statements of net position.

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(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 \$104,044 and \$81,650 at September 30, 2014 and 2013, respectively. This note was subsequently settled and paid off in December 2014 (see note 12).

At September 30, 2013, notes payable and accrued interest payable included \$657,593 and \$317,688, respectively, on a matured and delinquent loan to the Federated States of Micronesia Development Bank (FSMDB), a component unit of the FSM National Government. In May 2014, CPUC and FSMDB entered into an agreement for the full and final settlement of the notes payable with forgiveness of a portion of interest and penalties. As a result, CPUC recognized a gain of \$225,099 during the year ended September 30, 2013.

Long-term Debt

Long-term debt consists of the following at September 30, 2014 and 2013:

<u>2014</u>	<u>2013</u>
<p>ADB loan no. 2099, administered by FSMNG, drawn against total Standard Drawing Rights (SDR), 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.</p>	<p>\$ 2,688,057 \$ 1,563,459</p>
<p>ADB loan no. 2100, administered by FSMNG, drawn against total SDR, 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, 2014 and 2013). Proceeds are used for the purchase of two generator sets and related costs.</p>	<p><u>2,259,156</u> <u>2,160,901</u></p>
<p>Total long-term debt</p>	<p>4,947,213 3,724,360</p>
<p>Less current portion of long-term debt</p>	<p><u>137,690</u> <u>92,353</u></p>
<p>Long-term debt, net of current portion</p>	<p>\$ <u>4,809,523</u> \$ <u>3,632,007</u></p>

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(7) Borrowings and Noncurrent Liabilities, Continued

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

<u>Year Ending</u> <u>September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2015	\$ 137,690	\$ 95,436	\$ 233,126
2016	182,449	84,034	266,483
2017	191,855	80,602	272,457
2018	202,294	77,096	279,390
2019	213,261	73,371	286,632
2020-2024	1,274,054	302,021	1,576,075
2025-2029	1,756,605	170,425	1,927,030
2030-2034	670,374	47,055	717,429
2035-2036	<u>318,631</u>	<u>7,710</u>	<u>326,341</u>
	<u>\$ 4,947,213</u>	<u>\$ 937,750</u>	<u>\$ 5,884,963</u>

Changes in noncurrent liabilities for the years ended September 30, 2014 and 2013 are as follows:

<u>2013</u>	<u>Outstanding</u> <u>October 1,</u> <u>Addition</u>	<u>Reduction</u>	<u>30, 2014</u>	<u>Outstanding</u> <u>September</u> <u>One Year</u>	<u>Amount</u> <u>due</u> <u>Within</u>
Notes payable	\$ 739,243	\$ 22,394	\$ (657,593)	\$ 104,044	\$ 104,044
Long-term debt	3,724,360	1,508,288	(285,435)	4,947,213	137,690
Accrued annual leave	<u>41,609</u>	<u>-</u>	<u>(155)</u>	<u>41,454</u>	<u>7,359</u>
	<u>\$ 4,505,212</u>	<u>\$ 1,530,682</u>	<u>\$ (943,183)</u>	<u>\$ 5,092,711</u>	<u>\$ 249,093</u>

<u>2012</u>	<u>Outstanding</u> <u>October 1,</u> <u>Addition</u>	<u>Reduction</u>	<u>30, 2013</u>	<u>Outstanding</u> <u>September</u> <u>One Year</u>	<u>Amount</u> <u>due</u> <u>Within</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>

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(8) Related Party Transactions

Revenue received from CSG representing power, water and other sales for the years ended September 30, 2014 and 2013 was \$1,521,502 and \$1,417,128, 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 in 2013 and prior. During the year ended September 30, 2014, CPUC recorded operating grant revenues and related general and management support expense of \$505,552 in the accompanying financial statements.

CPUC purchases virtually all of its fuel from FSMPC, a component unit of the FSMNG. 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). At September 30, 2014 and 2013, related payables of \$519,590 and \$479,075, respectively, are included in accounts payable in the accompanying statements of net position.

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.

(9) Commitments

Leases

CPUC is party to office and warehouse lease agreements expiring in March 2015 and September 2014, respectively. CPUC is in the process of renewing the warehouse lease agreement and continues to occupy the space on a month-to-month basis. Future minimum lease payments for the year ending September 30, 2015 is \$33,500.

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, 2014 and 2013, unamortized prepaid lease of \$346,977 and \$365,903, respectively, 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>	
2015	\$ 18,926
2016	18,926
2017	18,926
2018	18,926
2019	18,926
2020-2024	94,630
2025-2029	94,630
2030-2033	<u>63,087</u>
	\$ <u>346,977</u>

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(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, 2014 and 2013, net position is restricted for the following purposes:

	<u>2014</u>		<u>2013</u>
Capital improvements		\$ 116,161	\$ 248,069
Fuel deposit from fuel operating grant		<u>536,262</u>	<u>536,262</u>
		\$ <u>652,423</u>	\$ <u>784,331</u>

(12) Subsequent Events

On December 31, 2014, CPUC paid off its outstanding loan balance and related penalties and interest with Bank of FSM for a final settlement. Bank of FSM waived \$25,388 of accrued interest and CPUC's remaining balance paid off as of December 31, 2014, was \$68,215.

In March 2015, Typhoon Maysak ravaged Chuuk, causing significant damage to CPUC's power distribution system. Management estimates that approximately 70% of the power distribution system was severely damaged and requires replacement. Additionally, cost related to recovery effort is estimated at approximately \$1.17 million. The system is estimated to be restored to full operation per pre-typhoon conditions by the end of July 2016. A national disaster declaration was made by FSM National Government as well as the U.S. Government. As a result, it is anticipated that capital and operations support in rebuilding will be provided through grants. The ultimate impact on CPUC's infrastructure is presently indeterminable.