

CHUUK PUBLIC UTILITY CORPORATION

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

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2017 and 2016

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, 2017 and 2016, 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, 2017 and 2016, 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 financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the 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 May 31, 2018, 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

May 31, 2018

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

Management's Discussion and Analysis
Years Ended September 30, 2017 and 2016

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 (FY) ended September 30, 2017.

Statement No. 34 of the U.S. Governmental Accounting Standards Board (GASB) 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 the years ended September 30, 2017, 2016, and 2015. 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 FYs 2017, 2016 and 2015.

FINANCIAL HIGHLIGHTS

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Assets:			
Utility plant in service, net	\$ 21,189,020	\$ 19,338,815	\$ 12,199,661
Current assets	2,655,469	3,120,701	3,527,492
Non-current assets	<u>760,311</u>	<u>1,176,281</u>	<u>1,063,643</u>
Total assets	\$ <u>24,604,800</u>	\$ <u>23,635,797</u>	\$ <u>16,790,796</u>
Liabilities and Net Position:			
Long-term liabilities	\$ 4,457,918	\$ 4,732,089	\$ 4,603,719
Current liabilities	<u>647,760</u>	<u>1,880,794</u>	<u>2,537,429</u>
Total liabilities	<u>5,105,678</u>	<u>6,612,883</u>	<u>7,141,148</u>
Net investment in capital assets	16,496,411	14,395,978	7,442,961
Restricted	517,506	551,551	673,539
Unrestricted	<u>2,485,205</u>	<u>2,075,385</u>	<u>1,533,148</u>
Total net position	<u>19,499,122</u>	<u>17,022,914</u>	<u>9,649,648</u>
Total liabilities and net position	\$ <u>24,604,800</u>	\$ <u>23,635,797</u>	\$ <u>16,790,796</u>
Revenues, Expenses, and Changes in Net Position:			
Net operating revenues	\$ 6,321,837	\$ 5,657,919	\$ 5,501,614
Operating and maintenance expenses	<u>6,601,995</u>	<u>6,103,626</u>	<u>6,112,423</u>
Operating loss	<u>(280,158)</u>	<u>(445,707)</u>	<u>(610,809)</u>
Grants, subsidies and other income	2,811,110	7,818,973	5,058,585
Interest expense	<u>(54,744)</u>	<u>-</u>	<u>-</u>
Total nonoperating revenues, net and capital contributions	<u>2,756,366</u>	<u>7,818,973</u>	<u>5,058,585</u>
Change in net position	2,476,208	7,373,266	4,447,776
Net position at beginning of year	<u>17,022,914</u>	<u>9,649,648</u>	<u>5,201,872</u>
Net position at end of year	\$ <u>19,499,122</u>	\$ <u>17,022,914</u>	\$ <u>9,649,648</u>

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Management's Discussion and Analysis
Years Ended September 30, 2017 and 2016

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 FY2017 are \$24.6 million, compared with \$23.6 million at the end of FY2016.

The net position at the end of the FY2017 also increased to \$19.5 million from \$17.0 million at the end of FY2016.

Operating revenue continues to improve, bringing in \$6.3 million in service revenue, while expenses are relatively maintained.

Operations continue to improve financially, with operation loss of \$280,158 in FY2017 compared to \$445,707 in FY2016.

Capital Assets and Debts

In FY2017, CPUC completed and placed in service all significant capital projects, including the installation of two new slow speed engine generators; new switchgear and protection systems and the integration of three of the existing generators to deliver a power plant of 7.8 MW.

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 2018 OUTLOOK

CPUC anticipates continued improvement in operating position during FY2018 through improvements in power generating efficiency and power distribution efficiency as well as expansion and efficiency improvements in water and sewer services.

A power loss target of 15% has been set for FY 2018.

World Bank grant funding is being provided to the FSM Energy Sector. A key component of the grant is the preparation of a comprehensive 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.

CPUC now has a total of 265 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 Q1 FY2019.

CPUC will also be working in partnership with FSM Petroleum Corporation to reinstate the power supply in Tonoas (population 4,000) by mid FY2019; CPUC will complete the distribution construction in Q3 FY2018 and will enter into a power purchase agreement with FSM Petroleum Corporation whereby they will sell power to CPUC.

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Management's Discussion and Analysis
Years Ended September 30, 2017 and 2016

With regards to water supply and sewerage services, CPUC's focus will remain on the installation of water metering across the whole of the supply system, water loss reduction and revisiting of the water sewer tariff.

CONTACTING CPUC'S FINANCIAL MANAGEMENT

Management's Discussion and Analysis for the year ended September 30, 2016, is set forth in the report on the audit of CPUC's financial statements, which is dated June 30, 2017, and that Discussion and Analysis explains the major factors impacting the 2016 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, 2017 and 2016

<u>Assets</u>	<u>2017</u>	<u>2016</u>
Utility plant, at cost:		
Depreciable utility plant:		
Electric plant in service	\$ 19,217,464	\$ 10,540,545
Water and sewer plant in service	13,974,305	13,713,770
General plant in service	<u>316,570</u>	<u>150,318</u>
	33,508,339	24,404,633
Less accumulated depreciation	<u>(12,319,319)</u>	<u>(11,438,096)</u>
	<u>21,189,020</u>	<u>12,966,537</u>
Non-depreciable utility plant:		
Construction in progress	<u>-</u>	<u>6,372,278</u>
Total utility plant	<u>21,189,020</u>	<u>19,338,815</u>
Current assets:		
Cash	1,287,966	1,445,550
Accounts receivable, net	485,144	412,357
Other receivables	48,275	57,838
Inventory	762,075	1,119,645
Prepaid expenses	53,083	66,385
Prepaid land lease, current portion	<u>18,926</u>	<u>18,926</u>
Total current assets	<u>2,655,469</u>	<u>3,120,701</u>
Noncurrent assets:		
Deposits	489,040	886,084
Prepaid land lease, net of current portion	<u>271,271</u>	<u>290,197</u>
Total noncurrent assets	<u>760,311</u>	<u>1,176,281</u>
	<u>\$ 24,604,800</u>	<u>\$ 23,635,797</u>
<u>Liabilities and Net Position</u>		
Current liabilities:		
Current portion of long-term debt	\$ 263,043	\$ 243,529
Accounts payable	8,564	376,933
Accrued taxes and other liabilities	266,016	558,004
Payable to grantor	40,398	605,618
Unearned revenue	62,380	89,351
Accrued annual leave, current portion	<u>7,359</u>	<u>7,359</u>
Total current liabilities	647,760	1,880,794
Accrued annual leave, net of current portion	28,352	32,781
Long-term debt, net of current portion	<u>4,429,566</u>	<u>4,699,308</u>
Total liabilities	<u>5,105,678</u>	<u>6,612,883</u>
Commitments and contingencies		
Net position:		
Net investment in capital assets	16,496,411	14,395,978
Restricted	517,506	551,551
Unrestricted	<u>2,485,205</u>	<u>2,075,385</u>
Total net position	<u>19,499,122</u>	<u>17,022,914</u>
	<u>\$ 24,604,800</u>	<u>\$ 23,635,797</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, 2017 and 2016

	2017	2016
Operating revenues:		
Electricity sales	\$ 3,286,674	\$ 3,016,680
Cash power	2,558,947	2,139,595
Water sales	405,536	431,563
Other sales	70,680	91,934
	6,321,837	5,679,772
Provision for uncollectable accounts	-	(21,853)
Net operating revenues	6,321,837	5,657,919
Operating and maintenance expenses:		
Production fuel	3,058,352	2,695,490
Administrative and general	2,072,390	2,268,370
Depreciation	881,223	665,240
Management support	590,030	474,526
Total operating and maintenance expenses	6,601,995	6,103,626
Operating loss	(280,158)	(445,707)
Nonoperating revenues (expenses), net:		
Operating grant-management support	590,030	474,526
Operating grant-other	286,329	199,673
Other income, net	106,739	105,623
Interest expense	(54,744)	-
Interest income	832	181
Total nonoperating revenues, net	929,186	780,003
Income before capital contributions	649,028	334,296
Capital contributions:		
Grants from the United States Government	1,827,180	7,038,970
Change in net position	2,476,208	7,373,266
Net position at beginning of year	17,022,914	9,649,648
Net position at end of year	\$ 19,499,122	\$ 17,022,914

See accompanying notes to financial statements.

CHUUK PUBLIC UTILITY CORPORATION
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Statements of Cash Flows
Years Ended September 30, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Cash received from customers	\$ 6,338,381	\$ 5,789,352
Cash payments to suppliers for goods and services	(4,231,391)	(4,894,191)
Cash payments to employees	(1,367,325)	(1,120,021)
Net cash provided by (used in) operating activities	739,665	(224,860)
Cash flows from noncapital financing activities:		
Cash receipts from grantor	311,139	1,229,756
Net cash provided by noncapital financing activities	311,139	1,229,756
Cash flows from investing activities:		
Interest on bank deposits	832	181
Net cash provided by investing activities	832	181
Cash flows from capital and related financing activities:		
Proceeds from long-term debt	-	325,306
Interest paid	(54,744)	-
Cash receipts from grantor for capital projects	1,827,180	7,038,970
Acquisition of utility plant	(2,731,428)	(7,804,394)
Payments of long-term debt	(250,228)	(139,169)
Net cash used in capital and related financing activities	(1,209,220)	(579,287)
Net change in cash	(157,584)	425,790
Cash at beginning of year	1,445,550	1,019,760
Cash at end of year	\$ 1,287,966	\$ 1,445,550
<u>Reconciliation of operating loss to net cash provided by (used in) operating activities:</u>		
Operating loss	\$ (280,158)	\$ (445,707)
Adjustments to reconcile operating loss to net cash provided by (used in) operating activities:		
Depreciation	881,223	665,240
Other income, net	106,739	105,623
Provision for uncollectable accounts	-	21,853
(Increase) decrease in assets:		
Accounts receivable	(63,224)	(37,904)
Inventory	357,570	60,701
Prepaid expenses	32,228	(13,253)
Deposits	397,044	(131,565)
(Decrease) increase in liabilities:		
Accounts payable	(368,369)	(26,041)
Accrued taxes and other liabilities	(291,988)	(460,019)
Accrued annual leave	(4,429)	(5,649)
Unearned revenue	(26,971)	41,861
Net cash provided by (used in) operating activities	\$ 739,665	\$ (224,860)

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2017 and 2016

(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

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and modified by Statement No. 38, *Certain Financial Statement Note Disclosures*, establish financial reporting standards for governmental entities, which require that management's discussion and analysis of the financial activities be included with the basic financial statements and notes and modifies certain other financial statement disclosure requirements.

To conform to the requirements of GASB 34, equity is presented in the following net position categories:

- Net investment in capital assets - capital assets, net of accumulated depreciation, plus construction or improvement of those assets, net of related debts.
- Restricted: Nonexpendable - net position subject to externally imposed stipulations that requires CPUC to maintain such permanently. At September 30, 2017 and 2016, CPUC does not have nonexpendable net position. Expendable - net position whose use by CPUC is subject to externally imposed stipulations that can be fulfilled by actions of CPUC pursuant to those stipulations or that expire by the passage of time.
- Unrestricted - net position that is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and deferred outflows of resources, and liabilities and deferred inflows of resources associated with the operation of the fund are included in the statements of net position. Proprietary fund operating statements present increases and decreases in net position. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2017 and 2016

(2) Summary of Significant Accounting Policies, Continued

Cash

For purposes of the statements of net position and of cash flows, cash is defined as cash on hand and cash held in demand accounts.

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.

As of September 30, 2017 and 2016, the carrying amount of cash was \$1,287,966 and \$1,445,550, respectively, and the corresponding bank balances were \$1,265,147 and \$1,412,031, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2017 and 2016, 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.

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 have a zero net book value as of September 30, 2017 and 2016. 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.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2017 and 2016

(2) Summary of Significant Accounting Policies, Continued

Deferred Outflows of Resources

In addition to assets, the statements of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. As of September 30, 2017 and 2016, CPUC has no items that qualify for reporting in this category.

Deferred Inflows of Resources

In addition to liabilities, the statements of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. As of September 30, 2017 and 2016, CPUC has no items that qualify for reporting in this category.

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. At the end of each month, unbilled revenues are accrued for each cycle based on the most recent cycle 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, 2017 and 2016, unearned revenue recognized on cash power revenue was \$62,380 and \$89,351, respectively, which is presented as unearned revenue in the accompanying statements of net position.

Grants and Subsidies

CPUC receives grants from the United States Government or other foreign governments or organizations either as a direct recipient or as a sub-recipient from the Chuuk State Government (CSG) and FSM National Government (FSMNG).

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Notes to Financial Statements
September 30, 2017 and 2016

(2) Summary of Significant Accounting Policies, Continued

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 of Chuuk or FSMNG, if any, in such manner as provided by law.

New Accounting Standards

During fiscal year 2017, CPUC implemented the following pronouncements, which had no material effect on the accompanying financial statements:

- GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements 67 and 68 with the reporting requirements in Statement 68.
- GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB).
- GASB Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements.
- GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, which addresses a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*.
- GASB Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units.
- GASB Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2017 and 2016

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The provisions in Statement No. 81 are effective for fiscal years beginning after December 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) associated with the retirement of a tangible capital asset. The provisions in Statement No. 83 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments. The provisions in Statement No. 84 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2017, GASB issued Statement No. 85, *Omnibus 2017*, which address practice issues that have been identified during implementation and application of certain GASB Statements including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits). The provisions in Statement No. 85 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In May 2017, GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt. The provisions in Statement No. 86 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

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.

Reclassifications

Certain balances in the 2016 financial statements have been reclassified to conform with the 2017 presentation.

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Notes to Financial Statements
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(3) Accounts Receivable

Accounts receivable at September 30, 2017 and 2016, are summarized as follows:

	<u>2017</u>	<u>2016</u>
Residential	\$ 330,153	\$ 354,853
Commercial	183,822	197,273
Government	165,589	141,941
Unbilled	67,717	15,914
Other	59,507	28,032
Chuuk State Government service tax	<u>24,255</u>	<u>29,806</u>
	831,043	767,819
Less allowance for uncollectable accounts	<u>(297,624)</u>	<u>(297,624)</u>
	<u>\$ 533,419</u>	<u>\$ 470,195</u>

Receivables as of September 30, 2017 and 2016 include \$122,432 and \$125,463, respectively, of balances in arrears from customers who converted to the cash power meter system. These account balances 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, 2017 and 2016. 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 consists of the following detailed balances at September 30, 2017 and 2016:

	Balance at October <u>1, 2016</u>	Additions and <u>Transfers</u>	Deletions and <u>Transfers</u>	Balance at September <u>30, 2017</u>
Depreciable assets:				
Electric plant in service	\$ 10,540,545	\$ 8,676,919	\$ -	\$ 19,217,464
Water and sewer plant in service	13,713,770	260,535	-	13,974,305
General plant in service	<u>150,318</u>	<u>166,252</u>	-	<u>316,570</u>
	24,404,633	9,103,706	-	33,508,339
Less accumulated depreciation	<u>(11,438,096)</u>	<u>(881,223)</u>	-	<u>(12,319,319)</u>
	12,966,537	8,222,483	-	21,189,020
Non-depreciable assets:				
Construction in progress	<u>6,372,278</u>	<u>2,666,376</u>	<u>(9,038,654)</u>	-
	<u>\$ 19,338,815</u>	<u>\$ 10,888,859</u>	<u>\$ (9,038,654)</u>	<u>\$ 21,189,020</u>

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(4) Utility Plant, Continued

	Balance at October <u>1, 2015</u>	Additions and <u>Transfers</u>	Deletions and <u>Transfers</u>	Balance at September <u>30, 2016</u>
Depreciable assets:				
Electric plant in service	\$ 19,080,460	\$ 1,888,689	\$ (10,428,604)	\$ 10,540,545
Water and sewer plant in service	9,961,408	3,752,362	-	13,713,770
General plant in service	<u>4,027</u>	<u>146,291</u>	<u>-</u>	<u>150,318</u>
	29,045,895	5,787,342	(10,428,604)	24,404,633
Less accumulated depreciation	<u>(21,001,895)</u>	<u>(665,240)</u>	<u>10,229,039</u>	<u>(11,438,096)</u>
	8,044,000	5,122,102	(199,565)	12,966,537
Non-depreciable assets:				
Construction in progress	<u>4,155,661</u>	<u>7,699,027</u>	<u>(5,482,410)</u>	<u>6,372,278</u>
	\$ <u>12,199,661</u>	\$ <u>12,821,129</u>	\$ <u>(5,681,975)</u>	\$ <u>19,338,815</u>

At September 30, 2016, almost all construction in progress represents infrastructure projects such as power plant, waterline extension and others that are funded by grants from the U.S. Department of the Interior (US DOI) (see note 6), which have been completed and placed in service during 2017.

(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 civil and mechanical work of the FSMNG Water Supply and Sanitation Project. The remaining 90% is financed through a loan from the Asian Development Bank which was passed through the FSMNG to CSG and then to CPUC. The loan was transferred to CSG in 2010.

(6) Grants and Subsidies

During the years ended September 30, 2017 and 2016, CPUC recorded federal grants from the U.S. DOI passed through by the FSMNG totaling \$2,417,210 and \$7,513,496, respectively. Of the total grant proceeds at September 30, 2017 and 2016, \$40,398 and \$605,618, respectively, represent advances from the grantor used for infrastructure projects. The advances are to be repaid at the end of the grant term and are presented as payable to grantor in the accompanying statements of net position. The rest of the grant proceeds were used for other infrastructure projects.

During the year ended September 30, 2016, CPUC received LED light fixtures totaling \$199,673 from the World Bank.

During the year ended September 30, 2017, CPUC received an additional \$286,329 from International Organization for Migration funded by USAID for assistance relating to typhoon recovery costs related to Typhoon Maysak.

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(7) Borrowings and Noncurrent Liabilities

Long-term Debt

Long-term debt consists of the following at September 30, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
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.	\$ 2,073,600	\$ 2,195,038
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, 2017 and 2016). Proceeds are used for the purchase of two generator sets and related costs.	2,469,926	2,561,395
A \$207,000 loan with the FSM Development Bank, bearing interest fixed at 7% per annum, payable over 60 monthly installments of \$4,099, maturing in February 2021. The loan is collateralized by a security interest in fixed assets. Proceeds were used to pay off an existing outstanding payable.	<u>149,083</u>	<u>186,404</u>
Total long-term debt	4,692,609	4,942,837
Less current portion of long-term debt	<u>(263,043)</u>	<u>(243,529)</u>
Long-term debt, net of current portion	<u>\$ 4,429,566</u>	<u>\$ 4,699,308</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>
2018	\$ 263,043	\$ 97,966	\$ 361,009
2019	278,943	84,331	363,274
2020	296,910	76,897	373,807
2021	286,612	69,158	355,770
2022	283,815	63,679	347,494
2023-2027	1,743,093	227,238	1,970,331
2028-2032	1,286,943	71,217	1,358,160
2033-2036	<u>253,250</u>	<u>4,430</u>	<u>257,680</u>
	<u>\$ 4,692,609</u>	<u>\$ 694,916</u>	<u>\$ 5,387,525</u>

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(7) Borrowings and Noncurrent Liabilities, Continued

Noncurrent Liabilities

Changes in noncurrent liabilities for the years ended September 30, 2017 and 2016 are as follows:

	Outstanding October 1, <u>2016</u>	<u>Addition</u>	<u>Reduction</u>	Outstanding September <u>30, 2017</u>	Amount due Within <u>One Year</u>
Long-term debt	\$ 4,942,837	\$ -	\$ (250,228)	\$ 4,692,609	\$ 263,043
Accrued annual leave	<u>40,140</u>	<u>-</u>	<u>(4,429)</u>	<u>35,711</u>	<u>7,359</u>
	<u>\$ 4,982,977</u>	<u>\$ -</u>	<u>\$ (254,657)</u>	<u>\$ 4,728,320</u>	<u>\$ 270,402</u>

	Outstanding October 1, <u>2015</u>	<u>Addition</u>	<u>Reduction</u>	Outstanding September <u>30, 2016</u>	Amount due Within <u>One Year</u>
Long-term debt	\$ 4,756,700	\$ 325,306	\$ (139,169)	\$ 4,942,837	\$ 243,529
Accrued annual leave	<u>45,789</u>	<u>-</u>	<u>(5,649)</u>	<u>40,140</u>	<u>7,359</u>
	<u>\$ 4,802,489</u>	<u>\$ 325,306</u>	<u>\$ (144,818)</u>	<u>\$ 4,982,977</u>	<u>\$ 250,888</u>

(8) Related Party Transactions

Revenue received from CSG representing power, water and other sales for the years ended September 30, 2017 and 2016 was \$1,347,678 and \$1,213,328, respectively.

Effective November 1, 2013, CPUC entered into a contract with FSMNG to provide maintenance services on the lift stations. The contract expired in June 2014 and was extended through September 2017. Related income recorded of approximately \$55,140 and \$92,396 for the years September 30, 2017 and 2016, respectively, is included as a component of other nonoperating revenue 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. At September 30, 2017 and 2016, deposits in the amount of \$489,040 and \$886,084, respectively, for which \$489,040 and \$536,262, respectively, were received through a sub-grant from the FSMNG, are held by FSMPC as collateral for a fuel and lubricant purchase line. At September 30, 2017 and 2016, payables to FSMPC were \$8,564 and \$376,933, respectively.

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Notes to Financial Statements
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(9) Commitments

Leases

CPUC occupies office and warehouse spaces currently on a month-to-month basis.

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, 2017 and 2016, unamortized prepaid lease of \$290,197 and \$309,123, 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:

Year Ending September 30,

2018	\$ 18,926
2019	18,926
2020	18,926
2021	18,926
2022	18,926
2023-2027	94,630
2028-2032	94,630
2033	<u>6,307</u>
	\$ <u>290,197</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.

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.

Federal Award Programs

CPUC has received federal grants for specific purposes that are subject to review and audit by the grantor agencies. Questioned costs for the 2017 and prior year audits amounted to \$0. Audits of federal program funds may also be performed by various federal agencies. If the audits result in cost disallowances, CPUC may be liable. However, management does not believe that resolution of this matter will result in a material liability. Therefore, no liability for any amount, which may ultimately arise from these matters, has been recorded in the accompanying financial statements.

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Notes to Financial Statements
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(11) Restricted Net Position

At September 30, 2017 and 2016, net position is restricted for the following purposes:

	<u>2017</u>	<u>2016</u>
Capital improvements	\$ 28,466	\$ 15,289
Fuel deposit from fuel operating grant	<u>489,040</u>	<u>536,262</u>
	<u>\$ 517,506</u>	<u>\$ 551,551</u>