

CHUUK PUBLIC UTILITY CORPORATION

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

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2018 AND 2017

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

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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, 2018 and 2017, 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, 2018 and 2017, 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 3 through 5 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 June 25, 2019, 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 25, 2019

CHUUK PUBLIC UTILITY CORPORATION
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Management's Discussion and Analysis
Years Ended September 30, 2018 and 2017

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, 2018.

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, 2018, 2017, and 2016. 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 2018, 2017 and 2016.

FINANCIAL HIGHLIGHTS

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Assets:			
Utility plant, net	\$ 21,360,514	\$ 21,189,020	\$ 19,338,815
Current assets	2,636,776	2,655,469	3,120,701
Non-current assets	<u>904,146</u>	<u>760,311</u>	<u>1,176,281</u>
Total assets	<u>\$ 24,901,436</u>	<u>\$ 24,604,800</u>	<u>\$ 23,635,797</u>
Net Position and Liabilities:			
Net investment in capital assets	\$ 16,959,555	\$ 16,496,411	\$ 14,395,978
Restricted	642,194	517,506	551,551
Unrestricted	<u>2,403,358</u>	<u>2,485,205</u>	<u>2,075,385</u>
Total net position	<u>20,005,107</u>	<u>19,499,122</u>	<u>17,022,914</u>
Long-term liabilities	4,157,177	4,457,918	4,732,089
Current liabilities	<u>739,152</u>	<u>647,760</u>	<u>1,880,794</u>
Total liabilities	<u>4,896,329</u>	<u>5,105,678</u>	<u>6,612,883</u>
Total net position and liabilities	<u>\$ 24,901,436</u>	<u>\$ 24,604,800</u>	<u>\$ 23,635,797</u>
Revenues, Expenses, and Changes in Net Position:			
Total operating revenues	\$ 7,302,028	\$ 6,321,837	\$ 5,657,919
Operating expenses	<u>7,537,272</u>	<u>6,601,995</u>	<u>6,103,626</u>
Operating loss	<u>(235,244)</u>	<u>(280,158)</u>	<u>(445,707)</u>
Grants, subsidies and other income	780,549	2,811,110	7,818,973
Interest expense	<u>(39,320)</u>	<u>(54,744)</u>	<u>-</u>
Total nonoperating revenue, net and capital contributions	<u>741,229</u>	<u>2,756,366</u>	<u>7,818,973</u>
Change in net position	505,985	2,476,208	7,373,266
Net position at beginning of year	<u>19,499,122</u>	<u>17,022,914</u>	<u>9,649,648</u>
Net position at end of year	<u>\$ 20,005,107</u>	<u>\$ 19,499,122</u>	<u>\$ 17,022,914</u>

**CHUUK PUBLIC UTILITY CORPORATION
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Management's Discussion and Analysis
Years Ended September 30, 2018 and 2017

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 FY2018 are \$24.9 million, compared with US\$24.6 million at the end of FY2017.

The net position at the end of the FY2018 also increased to \$20 million from \$19.5 million at the end of FY2017.

Operating revenue in FY2018 is \$1 million more than FY2017, with a total of \$7.3 million in FY2018 compared with \$6.3 million in FY 2017.

Operating expenditure correspondingly increased in FY2018 by \$0.9 million, resulting in an operating loss of \$235,000. The trend however has been improving for CPUC over the years; operation loss for FY 2017 for example was \$280,000 compared with FY2018's loss of \$235,000.

Capital Assets and Debts

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

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

FISCAL YEAR 2019 OUTLOOK

CPUC anticipates continued improvement in operating position during FY2019 through improvements in power generating efficiency and power distribution efficiency, collection as well as expansion and efficiency improvements in water and sewer services.

A power loss target of 15% has been set for FY 2019.

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 should be able to seek funding to increase electricity service across the State and thereby should achieve the State and National Energy service coverage targets.

CPUC now has 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 FY2019.

CPUC will also be working in partnership with FSM Petroleum Corporation (FSMPC) to reinstate the power supply in Tonoas (population 4,000) by the end of calendar year 2019; CPUC will complete the distribution construction by September and will enter into a power purchase agreement with FSMPC whereby they sell power to CPUC.

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 and water loss reduction and revisiting of the water sewer tariff. An Asian Development Bank (ADB) grant of approximately \$16 million has been approved for CPUC to improve the water supply and distribution for the island of Weno. CPUC anticipates the project to start in October 2019.

**CHUUK PUBLIC UTILITY CORPORATION
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Management's Discussion and Analysis
Years Ended September 30, 2018 and 2017

CONTACTING CPUC'S FINANCIAL MANAGEMENT

Management's Discussion and Analysis for the year ended September 30, 2017, is set forth in the report on the audit of CPUC's financial statements, which is dated May 31, 2018, and that Discussion and Analysis explains the major factors impacting the 2017 financial statements and can be viewed at the Office of the Public Auditor's website at www.fsmop.fm.

For additional information about this report, please contact Ms. Leialoha Shirai, 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, 2018 and 2017

<u>Assets</u>	2018	2017
Utility plant, at cost:		
Depreciable utility plant:		
Electric plant in service	\$ 19,855,624	\$ 19,217,464
Water and sewer plant in service	13,998,498	13,974,305
General plant in service	337,985	316,570
	34,192,107	33,508,339
Less accumulated depreciation	(13,545,894)	(12,319,319)
	20,646,213	21,189,020
Non-depreciable utility plant:		
Construction in progress	714,301	-
Total utility plant	21,360,514	21,189,020
Current assets:		
Cash	1,145,702	1,287,966
Accounts receivable, net	686,594	533,419
Inventory	763,479	762,075
Prepaid expenses	15,955	53,083
Prepaid land lease, current portion	25,046	18,926
Total current assets	2,636,776	2,655,469
Noncurrent assets:		
Deposits	634,300	489,040
Prepaid land lease, net of current portion	269,846	271,271
Total noncurrent assets	904,146	760,311
	\$ 24,901,436	\$ 24,604,800
<u>Liabilities and Net Position</u>		
Current liabilities:		
Current portion of long-term debt	\$ 278,943	\$ 263,043
Accounts payable	25,466	8,564
Accrued taxes and other liabilities	305,185	266,016
Payable to grantor	63,801	40,398
Unearned revenue	58,398	62,380
Accrued annual leave, current portion	7,359	7,359
Total current liabilities	739,152	647,760
Accrued annual leave, net of current portion	35,161	28,352
Long-term debt, net of current portion	4,122,016	4,429,566
Total liabilities	4,896,329	5,105,678
Commitments and contingencies		
Net position:		
Net investment in capital assets	16,959,555	16,496,411
Restricted	642,194	517,506
Unrestricted	2,403,358	2,485,205
Total net position	20,005,107	19,499,122
	\$ 24,901,436	\$ 24,604,800

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, 2018 and 2017

	2018	2017
Operating revenues:		
Electricity sales	\$ 3,765,423	\$ 3,286,674
Cash power	3,080,509	2,558,947
Water sales	414,883	405,536
Other sales	41,213	70,680
Operating revenues	7,302,028	6,321,837
Operating and maintenance expenses:		
Production fuel	3,705,086	3,058,352
Administrative and general	2,111,056	2,072,390
Depreciation	1,226,575	881,223
Management support	494,555	590,030
Total operating and maintenance expenses	7,537,272	6,601,995
Operating loss	(235,244)	(280,158)
Nonoperating revenues (expenses), net:		
Operating grant-management support	232,523	590,030
Operating grant-other	-	286,329
Other income, net	158,121	106,739
Interest expense	(39,320)	(54,744)
Interest income	819	832
Total nonoperating revenues, net	352,143	929,186
Income before capital contributions	116,899	649,028
Capital contributions:		
Grants from the United States Government	389,086	1,827,180
Change in net position	505,985	2,476,208
Net position at beginning of year	19,499,122	17,022,914
Net position at end of year	\$ 20,005,107	\$ 19,499,122

See accompanying notes to financial statements.

CHUUK PUBLIC UTILITY CORPORATION
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Statements of Cash Flows
Years Ended September 30, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Cash received from customers	\$ 7,302,992	\$ 6,338,381
Cash payments to suppliers for goods and services	(5,101,436)	(4,231,391)
Cash payments to employees	(1,260,612)	(1,367,325)
Net cash provided by operating activities	940,944	739,665
Cash flows from noncapital financing activities:		
Cash receipts from grantor	255,926	311,139
Net cash provided by noncapital financing activities	255,926	311,139
Cash flows from investing activities:		
Interest on bank deposits	819	832
Net cash provided by investing activities	819	832
Cash flows from capital and related financing activities:		
Interest paid	(39,320)	(54,744)
Cash receipts from grantor for capital projects	389,086	1,827,180
Acquisition of utility plant	(1,398,069)	(2,731,428)
Payments of long-term debt	(291,650)	(250,228)
Net cash used in capital and related financing activities	(1,339,953)	(1,209,220)
Net change in cash	(142,264)	(157,584)
Cash at beginning of year	1,287,966	1,445,550
Cash at end of year	\$ 1,145,702	\$ 1,287,966
<u>Reconciliation of operating loss to net cash provided by operating activities:</u>		
Operating loss	\$ (235,244)	\$ (280,158)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation	1,226,575	881,223
Other income, net	158,121	106,739
(Increase) decrease in assets:		
Accounts receivable	(153,175)	(63,224)
Inventory	(1,404)	357,570
Prepaid expenses	32,433	32,228
Deposits	(145,260)	397,044
(Decrease) increase in liabilities:		
Accounts payable	16,902	(368,369)
Accrued taxes and other liabilities	39,169	(291,988)
Accrued annual leave	6,809	(4,429)
Unearned revenue	(3,982)	(26,971)
Net cash provided by operating activities	\$ 940,944	\$ 739,665

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2018 and 2017

(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, 2018 and 2017, 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, 2018 and 2017

(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, 2018 and 2017, the carrying amount of cash was \$1,145,702 and \$1,287,966, respectively, and the corresponding bank balances were \$1,151,360 and \$1,265,147, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2018 and 2017, 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, 2018 and 2017. 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, 2018 and 2017

(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, 2018 and 2017, 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, 2018 and 2017, 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, 2018 and 2017, unearned revenue recognized on cash power revenue was \$58,398 and \$62,380, 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 and 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, 2018 and 2017

(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 2018, CPUC implemented the following pronouncements, which had no material effect on the accompanying financial statements:

- GASB 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.
- GASB 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.
- GASB 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).
- GASB Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt.

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.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

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.

In April 2018, GASB issued Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, which improves the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. The provisions in Statement No. 88 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 June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, which requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. The provisions in Statement No. 89 are effective for fiscal years beginning after December 15, 2019. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2018, GASB issued Statement No. 90, *Majority Equity Interests – an Amendment of GASB Statements No. 14 and No. 61*, which improves the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and the relevance of financial statement information for certain component units. The provisions in Statement No. 90 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.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

(3) Accounts Receivable

Accounts receivable at September 30, 2018 and 2017, are summarized as follows:

	<u>2018</u>	<u>2017</u>
Residential	\$ 333,382	\$ 330,153
Commercial	239,660	183,822
Government	250,542	165,589
Unbilled	86,117	67,717
Other	19,652	59,507
Chuuk State Government service tax	<u>32,805</u>	<u>24,255</u>
	962,158	831,043
Less allowance for uncollectable accounts	<u>(275,564)</u>	<u>(297,624)</u>
	<u>\$ 686,594</u>	<u>\$ 533,419</u>

Receivables as of September 30, 2018 and 2017 include \$106,678 and \$122,432, 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, 2018 and 2017. 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, 2018 and 2017:

	Balance at October <u>1, 2017</u>	Additions and <u>Transfers</u>	Deletions and <u>Transfers</u>	Balance at September <u>30, 2018</u>
Depreciable assets:				
Electric plant in service	\$ 19,217,464	\$ 638,160	\$ -	\$ 19,855,624
Water and sewer plant in service	13,974,305	24,193	-	13,998,498
General plant in service	<u>316,570</u>	<u>21,415</u>	<u>-</u>	<u>337,985</u>
	33,508,339	683,768	-	34,192,107
Less accumulated depreciation	<u>(12,319,319)</u>	<u>(1,226,575)</u>	<u>-</u>	<u>(13,545,894)</u>
	21,189,020	(542,807)	-	20,646,213
Non-depreciable assets:				
Construction in progress	<u>-</u>	<u>714,301</u>	<u>-</u>	<u>714,301</u>
	<u>\$ 21,189,020</u>	<u>\$ 171,494</u>	<u>\$ -</u>	<u>\$ 21,360,514</u>

CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

(4) Utility Plant, Continued

	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>-</u>
	\$ <u>19,338,815</u>	\$ <u>10,888,859</u>	\$ <u>(9,038,654)</u>	\$ <u>21,189,020</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. During the year ended September 30, 2018, construction in progress of \$714,301 represents water treatment plant project and electrification project in Tonoas. Of the total amount, \$344,540 was funded by grants from the US DOI and remaining amount of \$369,761 was funded internally.

(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, 2018 and 2017, CPUC recorded federal grants from the U.S. DOI passed through by the FSMNG totaling \$621,609 and \$2,417,210, respectively. Of the total grant proceeds at September 30, 2018 and 2017, \$63,801 and \$40,398, 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, 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.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

(7) Borrowings and Noncurrent Liabilities

Long-term Debt

Long-term debt consists of the following at September 30, 2018 and 2017:

	<u>2018</u>	<u>2017</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.	\$ 1,944,797	\$ 2,073,600
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, 2018 and 2017). Proceeds are used for the purchase of two generator sets and related costs.	2,346,112	2,469,926
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>110,050</u>	<u>149,083</u>
Total long-term debt	4,400,959	4,692,609
Less current portion of long-term debt	<u>(278,943)</u>	<u>(263,043)</u>
Long-term debt, net of current portion	\$ <u>4,122,016</u>	\$ <u>4,429,566</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>
2019	\$ 278,943	\$ 84,331	\$ 363,274
2020	296,910	76,897	373,807
2021	287,587	69,158	356,745
2022	283,815	63,679	347,494
2023	302,759	58,188	360,947
2024-2028	1,868,628	192,779	2,061,407
2029-2033	985,276	50,735	1,036,011
2034-2036	<u>97,041</u>	<u>1,184</u>	<u>98,225</u>
	\$ <u>4,400,959</u>	\$ <u>596,951</u>	\$ <u>4,997,910</u>

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

(7) Borrowings and Noncurrent Liabilities, Continued

Noncurrent Liabilities

Changes in noncurrent liabilities for the years ended September 30, 2018 and 2017 are as follows:

	Outstanding October 1, <u>2017</u>	<u>Addition</u>	<u>Reduction</u>	Outstanding September <u>30, 2018</u>	Amount due Within <u>One Year</u>
Long-term debt	\$ 4,692,609	\$ -	\$ (291,650)	\$ 4,400,959	\$ 278,943
Accrued annual leave	<u>35,711</u>	<u>6,809</u>	<u>-</u>	<u>42,520</u>	<u>7,359</u>
	<u>\$ 4,728,320</u>	<u>\$ 6,809</u>	<u>\$ (291,650)</u>	<u>\$ 4,443,479</u>	<u>\$ 286,302</u>

	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>

(8) Related Party Transactions

Revenue received from CSG representing power, water and other sales for the years ended September 30, 2018 and 2017 was \$1,486,575 and \$1,364,837, 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 for the year September 30, 2017, 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, 2018 and 2017, deposits in the amount of \$634,300 and \$489,040, respectively, all of which 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, 2018 and 2017, payables to FSMPC were \$25,466 and \$8,564, respectively.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

(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. In 2018, CPUC entered into 2 land lease agreements for the for the water treatment plant in Tonoas which are effective from January 2018 to September 30, 2022. The leases require advance payments totaling \$27,712. As of September 30, 2018 and 2017, unamortized prepaid lease of \$294,892 and \$290,197, 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>	
2019	\$ 25,046
2020	24,760
2021	24,760
2022	24,760
2023	18,926
2024-2028	94,630
2029-2033	<u>82,010</u>
	\$ <u>294,892</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. Audits of federal program funds may also be performed by various federal agencies. If the audits result in cost disallowances, CPUC may be liable. There are no reported questioned costs as of September 30, 2018.

**CHUUK PUBLIC UTILITY CORPORATION
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Notes to Financial Statements
September 30, 2018 and 2017

(11) Restricted Net Position

At September 30, 2018 and 2017, net position is restricted for the following purposes:

	<u>2018</u>	<u>2017</u>
Capital improvements	\$ 7,894	\$ 28,466
Fuel deposit from fuel operating grant	<u>634,300</u>	<u>489,040</u>
	<u>\$ 642,194</u>	<u>\$ 517,506</u>

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Board of Directors
Chuuk Public Utility Corporation:

We have audited, in accordance with the 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, the financial statements of Chuuk Public Utility Corporation (the Corporation), which comprise the statement of net position as September 30, 2018, and the related statements of revenues, expenses and changes in net position and of cash flows for the year then ended and the related notes to the financial statements, and have issued our report thereon dated June 25, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Corporation's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Corporation's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Deloitte & Touche LLP

June 25, 2019

CHUUK PUBLIC UTILITY CORPORATION
(A Component Unit of the State of Chuuk)

Unresolved Prior Year Findings
Year Ended September 30, 2018

There are no unresolved findings from prior year audits of the Corporation.