

**KOSRAE STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2019 AND 2018

INDEPENDENT AUDITORS' REPORT

Board of Directors
Kosrae State Housing Authority:

Report on the Financial Statements

We have audited the accompanying financial statements of the Kosrae State Housing Authority (the "Authority" or "KHA"), a component unit of the State of Kosrae, which comprise the statements of net position as of September 30, 2019 and 2018, 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 qualified audit opinion.

Basis for Qualified Opinion

Because of the inadequacy of accounting records, documentary evidence available to us was limited as the Authority has been unable to identify the propriety of approximately \$60,000 of amounts that form part of loans receivable as of September 30, 2018. The impact of this matter is uncertain.

Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements referred to above present fairly, in all material respects, the statements of net position as of September 30, 2019 and 2018, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

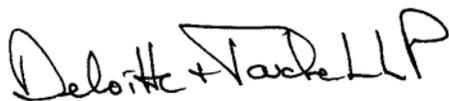
Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 to 5 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 29, 2020, on our consideration of the Authority'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 the Authority's internal control over financial reporting and compliance.



December 9, 2020

**KOSRAE STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)**

Management's Discussion and Analysis
September 30, 2019 and 2018

This analysis prepared by Kosrae Housing Authority (the Authority) offers readers of the Authority's financial statements a narrative overview and analysis of its activities for the year ended September 30, 2019. The Authority encourages readers to consider this information in conjunction with the financial statement, which follow this section. Fiscal year 2018 and 2017 comparative information has been included where appropriate. This analysis is required by the Government Accounting Standards Board (GASB), which provides guidelines on what must be included and excluded from the analysis.

FINANCIAL HIGHLIGHTS

- The Authority's net position as of September 30, 2019 is \$508.8 thousand, a decrease of \$88.8 thousand from prior year. Assets represents cash, net loans receivable, advances, net investment in capital assets, and restricted TCD's. The liabilities at year-end equal \$229.9 thousand, which increased primarily due to the addition of a long-term loan with the Bank of FSM.
- The assets of the Authority exceeded liabilities at the close of FY2019 by \$508.8 thousand (net position) which decreased by \$88.8 thousand (15%) from the prior year net position of \$597.6 thousand. Of this amount (\$508.8 thousand), \$87.3 thousand represents the net investment in capital assets and \$421.5 thousand represents an amount restricted for projects.
- During the year ended September 30, 2020, the Authority's operational expenses were \$202.3 thousand, which decreased (\$4.6 thousand) as compared to prior year. Operational expenses of the Authority continue to be funded by interest, fees and loan charges.
- The Authority continued to provide its service and run daily functions with limited resources as it relies heavily on loan interest and fees. For the current fiscal year, the Authority was fortunate to receive funding of \$33.4 thousand for its new Production Loan Program from the FSM Congress.
- The Authority was able to pay-off its Line of Credit facility with the Bank of FSM. The liabilities of the Authority for the current fiscal year 2019 comprised the loan with the Bank of FSM, due to the primary government, payroll accruals and unpaid invoices at the close of fiscal year 2019.

FINANCIAL ANALYSIS OF THE KOSRAE HOUSING & RURAL DEVELOPMENT AUTHORITY

Net Position

The net position may serve over time as a useful indicator of an organization's or government's financial position. In the case of the Authority, assets exceeded liabilities by \$508.7 thousand at the close of FY2019. However, this net position is either restricted as to purpose or is invested in capital assets. The majority of the Authority's net position is comprised of capital assets, net and restricted net assets. The current assets and liabilities are amounts that are available in the current period and obligations that will be paid within one year, respectively. The Authority's current assets amounted to \$451.4 thousand while current liabilities total \$87.8 thousand. The table below summarizes the Authority's net position at the close of current year compared with prior years FY2018 and FY2017:

**KOSRAE STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)**

Management's Discussion and Analysis
September 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>	<u>2017</u>
<u>Assets:</u>			
Current assets	\$ 451,417	\$ 487,999	\$ 581,809
Time certificates of deposit	200,000	200,000	200,000
Property and equipment, net	<u>87,292</u>	<u>99,841</u>	<u>6,984</u>
Total assets	<u>\$ 738,709</u>	<u>\$ 787,840</u>	<u>\$ 788,793</u>
<u>Liabilities:</u>			
Current liabilities	\$ 87,776	\$ 190,281	\$ 175,210
Long-term debt, net	<u>142,156</u>	-	-
Total liabilities	<u>229,932</u>	<u>190,281</u>	<u>175,210</u>
<u>Net position:</u>			
Net investment in capital asset	\$ 87,292	\$ 99,841	\$ 6,984
Restricted	<u>421,485</u>	<u>497,718</u>	<u>606,599</u>
Total net position	<u>508,777</u>	<u>597,559</u>	<u>613,583</u>
Total liabilities and net position	<u>\$ 738,709</u>	<u>\$ 787,840</u>	<u>\$ 788,793</u>

At the end of the current year, the Authority's restricted net position was \$421.5 thousand, a decrease from the prior year amount of \$497.7 thousand (or 15%).

Changes in Net Position

As noted earlier, the net position of the Authority decreased by \$88.7 thousand, representing a 15% decrease from the prior year's amount of \$597.5 thousand. The key elements of the differences from prior year are shown in the following schedule:

Revenues, Expenses and Changes in Net position

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Interest and fees	\$ 90,224	\$ 99,993	\$ 92,928
Provision for loan losses	<u>-</u>	<u>(28,000)</u>	<u>40,000</u>
Total revenues	<u>90,224</u>	<u>71,993</u>	<u>132,928</u>
Operating expenses	<u>202,309</u>	<u>206,903</u>	<u>240,621</u>
Non-operating revenues (expense):			
Subsidy from FSM National Government	33,365	24,100	44,083
Transfer from KSG	-	97,950	-
Interest Expense	<u>(10,082)</u>	<u>(3,164)</u>	<u>(7,883)</u>
Total non-operating revenue (expense)	<u>23,283</u>	<u>118,886</u>	<u>36,200</u>
Change in net position	(88,782)	(16,024)	(71,493)
Net position, beginning of the year	<u>597,559</u>	<u>613,583</u>	<u>685,076</u>
Net position, end of the year	<u>\$ 508,777</u>	<u>\$ 597,559</u>	<u>\$ 613,583</u>

**KOSRAE STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)**

Management's Discussion and Analysis
September 30, 2019 and 2018

Economic factors and Next Year's Budget

The Kosrae Housing Authority (the Authority) continues facing economic and financial challenges as the demands of its clients continue to increase and available resources to fill the gap of \$700 thousand and run its operation is still limited. As in prior years, the Authority continues to rely heavily on interest and fees on loans to run daily operations. The Authority still receives no funding assistance or subsidies from the State Government to offset the demands of our clients.

As noted in the schedule above, revenues (interest) generated from loans represented a slight decrease of \$9.7 thousand compared to prior year. This decrease resulted from loan pay-offs and loan lending having slowed down due to limited resources.

Kosrae State Law 10-115 authorized the Authority to lend toward rural development projects. For the year ended September 30, 2020, the FSM Congress continues to provide funding support thru appropriation not only to fund housing projects but also to promote small rural development projects such as the HRDA Producer Loan Program. The Authority is still working tirelessly to secure more funding for the Production Loan Program for expansion and revenue generation for Kosrae's economy.

The cost of running the Authority for the year ended September 30, 2019 was \$202.3 thousand and this is expected to increase given the changed program structure and need. The bulk of the expenses occurred in salaries. With its developed Strategic Development Plan, the Authority continues to encounter challenges including the need to expand its revenue streams through loan diversification other than housing loans as well as increasing lending toward off-island clients.

The Authority has a loan portfolio of \$1.77 million and carries an updated credit classification report. It is important to note that the delinquency rate has dropped to 16% after FY2019.

The work of the Authority can be measured by its own SDP, which has two monitoring devices: (i) outcome level monitoring; (ii) activity level monitoring. Its daily operation is linked against 3 outcome measures: (a) loan making to grow 2% each year; (b) loan collection to increase 5% each year; and (c) delinquency to drop to 10% or less in 3 years. It is important to note that the Authority was able to meet only 2 of its 4 major targets which are lending and loan collection. As in previous years, the Authority will continue to focus on achieving its set targets as outlined in the HRDA SDP.

Contacting the Authority's Financial Management

This financial report is designed to provide our customers, creditors, and other interested parties a general overview of Kosrae Housing & Rural Development Authority's finances. If you have questions about this report or need additional financial information, contact the Executive Director, Kosrae State Housing Authority P.O. Box 533 Tofol, Lelu, Kosrae, FM 96944.

**KOSRAE STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)**

Statements of Net Position
September 30, 2019 and 2018

	2019	2018
<u>ASSETS</u>		
Current assets:		
Cash	\$ 16,808	\$ 7,635
Loans receivable, net	411,570	456,886
Advances to employees	23,039	19,826
Travel advances	-	3,652
Total current assets	451,417	487,999
Restricted time certificates of deposit	200,000	200,000
Property and equipment, net	87,292	99,841
	\$ 738,709	\$ 787,840
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Current portion of long-term debt	\$ 37,165	\$ -
Short-term debt	-	149,912
Accrued liabilities	7,544	8,970
Accounts payable	19,287	7,619
Due to primary government	23,780	23,780
Total current liabilities	87,776	190,281
Long-term debt, net of current portion	142,156	-
Total liabilities	229,932	190,281
Commitments and contingencies		
Net position:		
Net investment in capital assets	87,292	99,841
Restricted	421,485	497,718
Total net position	508,777	597,559
	\$ 738,709	\$ 787,840

See accompanying notes to financial statements.

**KOSRAE STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)**

Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2019 and 2018

	2019	2018
Operating revenues:		
Interest and fees on loans	\$ 90,244	\$ 99,993
Provision for loan losses	-	(28,000)
Net operating revenues	90,244	71,993
Operating expenses:		
Salaries	119,144	124,215
Travel and transportation	28,895	32,797
Depreciation	13,649	10,163
Supplies and materials	8,531	6,888
Communication	6,959	4,145
Contractual services	6,439	14,932
Utilities	4,775	5,900
Meetings	3,600	3,050
Fuel	2,964	1,011
Food	2,695	1,575
Repairs and maintenance	1,038	837
Training	400	350
Miscellaneous	3,220	1,040
Total operating expenses	202,309	206,903
Operating loss	(112,065)	(134,910)
Nonoperating revenues (expenses), net:		
Operating grant from FSM National Government	33,365	24,100
Interest expense	(10,082)	(3,164)
Total nonoperating revenues, net	23,283	20,936
Capital contributions from Kosrae State Government	-	97,950
Change in net position	(88,782)	(16,024)
Net position at beginning of year	597,559	613,583
Net position at end of year	\$ 508,777	\$ 597,559

See accompanying notes to financial statements.

**KOSRAE STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)**

Statements of Cash Flows
Years Ended September 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Cash flows from operating activities:		
Cash received from customers	\$ 90,244	\$ 99,993
Cash paid to suppliers for goods and services	(57,848)	(64,906)
Cash paid to employees	<u>(120,131)</u>	<u>(134,683)</u>
Net cash used in operating activities	<u>(87,735)</u>	<u>(99,596)</u>
Cash flows from noncapital financing activities:		
Operating subsidy from FSM National Government	33,365	24,100
Repayment to Kosrae State Government	-	(22,516)
Short-term debt proceeds	-	29,000
Long-term debt proceeds	200,000	-
Principal repayment on short-term debt	(149,912)	-
Principal repayment on long-term debt	(20,679)	-
Interest payment on short-term debt	(3,858)	(3,164)
Interest payment on long-term debt	<u>(6,224)</u>	<u>-</u>
Net cash provided by noncapital financing activities	<u>52,692</u>	<u>27,420</u>
Cash flows from capital and related financing activities:		
Acquisition of fixed assets	<u>(1,100)</u>	<u>(5,070)</u>
Cash flows from investing activities:		
Loan originations and principal collections, net	<u>45,316</u>	<u>20,731</u>
Net change in cash	9,173	(56,515)
Cash at beginning of year	<u>7,635</u>	<u>64,150</u>
Cash at end of year	<u>\$ 16,808</u>	<u>\$ 7,635</u>
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (112,065)	\$ (134,910)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Provision for loan losses	-	28,000
Depreciation	13,649	10,163
Increase in advance to employees	(3,213)	(19,826)
Decrease in travel advance	3,652	8,390
(Decrease) increase in accrued liabilities	(1,426)	968
Increase in accounts payable	<u>11,668</u>	<u>7,619</u>
Net cash used in operating activities	<u>\$ (87,735)</u>	<u>\$ (99,596)</u>

Supplemental information on a noncash activity:

During the year ended September 30, 2018, the Authority received \$97,950 of capital assets from Kosrae State Government.

See accompanying notes to financial statements.

**KOSRAE STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)**

Notes to Financial Statements
September 30, 2019 and 2018

(1) Organization and Summary of Significant Accounting Policies

Organization

The Kosrae State Housing Authority (the "Authority" or "KHA") was established in October 2015 by Kosrae State Public Law 10-113. The purpose of the Authority is to manage and invest funds of Kosrae Home Improvement Program and other funds of the Authority and to lend money to qualified Kosraeans who wish to build and maintain residential homes in Kosrae.

The affairs of the Authority are managed by a five-member Board of Directors, consisting of representatives of the Kosrae State Government appointed by the Governor to four-year terms. Daily operation of the Authority is delegated to an executive director, who is also appointed by the Governor and serves at the pleasure of the Board.

The Authority was re-established as Kosrae Housing and Rural Development Authority by Kosrae State Public Law 11-115 and related corporate documentation revisions are in progress.

The Authority's financial statements are incorporated into the financial statements of the Kosrae State Government as a component unit.

Basis of Accounting

The accounting policies of the Authority conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds.

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*, establishes 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.

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statement 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. The Authority considers interest income and costs that are directly related to lending operations to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

**KOSRAE STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)**

Notes to Financial Statements
September 30, 2019 and 2018

(1) Organization and Summary of Significant Accounting Policies, Continued

Net Position

Net position represents the residual interest in the Authority's assets after liabilities are deducted and consist of three sections: net investment in capital assets, restricted and unrestricted. Net position classified as net investment in capital assets include capital assets, restricted and unrestricted, net of accumulated depreciation and reduced by outstanding debt, net of debt service reserve. Net position are reported as restricted when constraints are imposed by third parties or enabling legislation. The Authority's restricted assets are expendable, and are restricted for loan programs.

Management Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and 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. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses.

Cash

Custodial credit risk is the risk that in the event of a bank failure, the Authority'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. The Authority does not have a deposit policy for custodial credit risk.

For the purposes of the statements of net position and of cash flows, cash is defined as cash in checking accounts, savings accounts and cash on hand. As of September 30, 2019 and 2018, the carrying amount of the Authority's total cash and time certificates of deposit was \$216,808 and \$207,635, respectively, and the corresponding bank balance was \$217,976 and \$212,339, respectively, which is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2019 and 2018, total bank deposits in the amount of \$217,976 and \$212,339, respectively, were FDIC insured.

Property and Equipment

Property and equipment are stated at cost. Depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the respective assets, which range from one to five years. The Authority capitalizes all fixed assets, irrespective of value, that have estimated useful lives of more than one year.

Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and liability as the benefit accrues to employees. No liability is recorded for nonvesting accumulating rights to receive sick leave pay benefits. The related sick leave pay expense is recorded when the benefit is actually taken.

**KOSRAE STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)**

Notes to Financial Statements
September 30, 2019 and 2018

(1) Organization and Summary of Significant Accounting Policies, Continued

New Accounting Standards

During the year ended September 30, 2019, the Authority implemented the following pronouncements:

- GASB 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.
- GASB 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 implementation of these statements did not have a material effect on the Authority's 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 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 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.

In May 2019, GASB issued Statement No. 91, *Conduit Debt Obligations*, which clarifies the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. The provisions in Statement No. 91 are effective for fiscal years beginning after December 15, 2020. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

**KOSRAE STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)**

Notes to Financial Statements
September 30, 2019 and 2018

(2) Due to Primary Government

The Authority received \$96,296 of cash from the Kosrae State Government (KSG) during the year ended September 30, 2016. The outstanding balance is noninterest bearing. Account activities for the years ended September 30, 2019 and 2018 are as follows:

	Balance October 1, <u>2018</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, <u>2019</u>	Due Within <u>One Year</u>
Due to primary government	\$ <u>23,780</u>	\$ <u> -</u>	\$ <u> -</u>	\$ <u>23,780</u>	\$ <u>23,780</u>

	Balance October 1, <u>2017</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, <u>2018</u>	Due Within <u>One Year</u>
Due to primary government	\$ <u>46,296</u>	\$ <u> -</u>	\$ <u>(22,516)</u>	\$ <u>23,780</u>	\$ <u>23,780</u>

(3) Short-Term Debt

In April 2017, a \$150,000 bank credit line was obtained to fund operations. As of September 30, 2018, the balance outstanding was \$149,912, interest at 5.25% payable monthly with a maturity of May 5, 2019, collateralized by \$200,000 of time certificates of deposit. The debt was repaid in March 2019.

Changes in short-term debt during the years ended September 30, 2019 and 2018 are as follows:

	Balance October 1, <u>2018</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, <u>2019</u>	Due Within <u>One Year</u>
Short-term debt	\$ <u>149,912</u>	\$ <u> -</u>	\$ <u>149,912</u>	\$ <u> -</u>	\$ <u> -</u>

	Balance October 1, <u>2017</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, <u>2018</u>	Due Within <u>One Year</u>
Short-term debt	\$ <u>120,912</u>	\$ <u>29,000</u>	\$ <u> -</u>	\$ <u>149,912</u>	\$ <u>149,912</u>

(4) Long-Term Debt

In March 2019, a \$200,000 bank term-loan was obtained to fund operations. As of September 30, 2019, the balance outstanding was \$179,321, interest at 5.50% payable monthly with a maturity of February 25, 2024, collateralized by \$200,000 of time certificates of deposit.

Changes in long-term debt during the year ended September 30, 2019 are as follows:

	Balance October 1, <u>2018</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, <u>2019</u>	Due Within <u>One Year</u>
Long-term debt	\$ <u>200,000</u>	\$ <u> -</u>	\$ <u>20,679</u>	\$ <u>179,321</u>	\$ <u>37,165</u>

**KOSRAE STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)**

Notes to Financial Statements
September 30, 2019 and 2018

(5) Loans Receivable

The Authority's loan portfolio is comprised of Kosrae Home Improvement Program and USDA Rural Development ("USDA RD") loans.

The State of Kosrae transferred defaulted USDA Rural Development (RD) loans to the Authority. The Authority guarantees USDA RD loans and bears responsibility for collection. The balance of USDA Rural Development loans is \$76,321 and \$76,133 as of September 30, 2019 and 2018, respectively. The Authority has pledged an escrow account in support of USDA RD loans. As of September 30, 2019 and 2018, \$200,000 of time certificates of deposit and cash in the amount of approximately \$1,870 and \$200, respectively, has been so pledged. Per the USDA RD agreement with the State, \$300,000 is to be so pledged. In the event of default, the Authority could be exposed to an amount in excess of the escrow account balance, which is presently indeterminable.

Loans are stated at face value, net of an allowance for loan losses. The allowance represents an amount which, in management's judgment, will be adequate to absorb possible losses on existing loans that may become uncollectible. Management's judgment in determining the adequacy of the allowance is based on evaluations of the collectability of loans. The allowance for loan losses are reported based on certain assumptions pertaining to the Authority's periodic review and evaluation of the loan portfolio, which is subject to change. Due to uncertainties inherent in the estimations and assumptions process, it is at least reasonably possible that changes in the estimates and assumptions in the near term would be material to the financial statements.

A summary of loans receivable as of September 30, 2019 and 2018, is presented below:

	<u>2019</u>	<u>2018</u>
Kosrae Home Improvement Program loans	\$ 1,768,309	\$ 1,813,813
USDA Rural Development loans	<u>76,321</u>	<u>76,133</u>
	1,844,630	1,889,946
Less allowance for loan losses	<u>(1,433,060)</u>	<u>(1,433,060)</u>
Loans receivable, net	\$ <u>411,570</u>	\$ <u>456,886</u>

Movements in the allowance for loan losses during the years ended September 30, 2019 and 2018, are as follows:

	<u>2019</u>	<u>2018</u>
Balance at beginning of year	\$ 1,433,060	\$ 1,405,060
Provision for loan losses	-	28,000
Recoveries from loan losses	<u>-</u>	<u>-</u>
Balance at end of year	\$ <u>1,433,060</u>	\$ <u>1,433,060</u>

**KOSRAE STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)**

Notes to Financial Statements
September 30, 2019 and 2018

(6) Property and Equipment

Capital asset activities for the years ended September 30, 2019 and 2018 are as follows:

Depreciable:	<u>Estimated Useful Life</u>	Balance at October <u>1, 2018</u>	Additions and <u>Transfers</u>	Deletions and <u>Transfers</u>	Balance at September <u>30, 2019</u>
Building	10 years	\$ 79,000	\$ -	\$ -	\$ 79,000
Office equipment	1-5 years	7,594	-	-	7,594
Furniture and fixtures	1-5 years	2,200	1,100	-	3,300
Vehicles	1-5 years	<u>22,920</u>	<u>-</u>	<u>-</u>	<u>22,920</u>
		111,714	1,100	-	112,814
Less accumulated depreciation		<u>(11,873)</u>	<u>(13,649)</u>	<u>-</u>	<u>(25,522)</u>
		<u>\$ 99,841</u>	<u>\$ (12,549)</u>	<u>\$ -</u>	<u>\$ 87,292</u>
		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:	<u>Estimated Useful Life</u>				
Building	10 years	\$ -	\$ 79,000	\$ -	\$ 79,000
Office equipment	1-5 years	7,594	-	-	7,594
Furniture and fixtures	1-5 years	1,100	1,100	-	2,200
Vehicles	1-5 years	<u>-</u>	<u>22,920</u>	<u>-</u>	<u>22,920</u>
		8,694	103,020	-	111,714
Less accumulated depreciation		<u>(1,710)</u>	<u>(10,163)</u>	<u>-</u>	<u>(11,873)</u>
		<u>\$ 6,984</u>	<u>\$ 92,857</u>	<u>\$ -</u>	<u>\$ 99,841</u>

(7) Commitments and Contingencies

Loan Commitments

The Authority has loan commitments aggregating \$427,044 and \$448,945 as of September 30, 2019 and 2018, respectively. The loan commitments represent undisbursed balances of approved loans for housing projects.

Risk Management

The Authority does not purchase insurance to cover risks associated with potential losses. Management is of the opinion that no material losses during the years ended September 30, 2019 and 2018 have resulted from this practice.

(8) Related Parties

In December 2017, a building and vehicles valued at \$97,950 were transferred from Kosrae State Government (KSG) to the Authority.

The Authority is prohibited from lending money to its employees or their immediate relatives pursuant to Kosrae State Public Law 10-113. As of September 30, 2019 and 2018, the Authority has \$126,542 and \$128,269, respectively, of loans receivable from employee family members, who are eligible to file loan applications.

**KOSRAE STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)**

Notes to Financial Statements
September 30, 2019 and 2018

(8) Related Parties, Continued

The Authority initiated an Employee Pay Advance Program in May 2018. As of September 30, 2019 and 2018, the balance of advances to employees is \$23,039 and \$19,826, respectively. The Authority requires the employees to repay the amount of the advance with 10.5% interest within a one-year term.

**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
Kosrae State Housing Authority:

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 the Kosrae State Housing Authority (the "Authority"), which comprise the statement of net position as September 30, 2019, 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 December 9, 2020.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Authority'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 Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority'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. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses, that we consider to be material weaknesses as item 2019-001.

Compliance and Other Matters

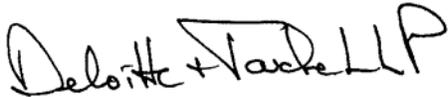
As part of obtaining reasonable assurance about whether the Authority's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material 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*.

The Authority's Responses to Findings

The Authority's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. The Authority's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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.

A handwritten signature in black ink that reads "Deloitte + Tatchell LLP". The signature is written in a cursive, stylized font.

December 9, 2020

**KOSRAE STATE HOUSING AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)**

Schedule of Findings and Responses
Year Ended September 30, 2019

Finding No. 2019-001 – Loan Receivable

Criteria: The Authority should maintain an adequate system of accounting to facilitate the reconciliation of its general ledger with subsidiary ledgers.

Condition: Because of inadequacies in the accounting records, detailed records regarding loans and allowance for loan losses were not substantiated by underlying supporting documentation evidencing the validity of loans. The Authority did not utilize accounting or loan software and did not maintain an adequate system of accounting.

Cause: The cause of this condition is primarily due to inadequate accounting assistance, the absence of closing procedures and review and the lack of adequate filing and document maintenance systems.

Effect: The effect of this condition is an inability to substantiate certain financial statement balances, financial statement transactions and compliance with laws and regulations.

Identification as a Repeat Finding: 2018-001

Recommendation: The Authority should acquire adequate accounting assistance, should prepare monthly financial statements that are supported by its books and records, and should maintain an adequate filing and retention system and be able to demonstrate compliance with laws and regulations.

Auditee Response and Corrective Action Plan: We agree with the finding. Although procurement of the new system was listed as high priority, we failed to accomplish it in FY2020. Housing & Rural Development Authority (HRDA) Board and Management consulted with FSM Congress and Kosrae Governor about this priority need. Their responses were positive but it may take time to identify the funding needed. We did manage to identify the vendor, the software and specific cost in FY2020. We are hopeful that in the coming years with a funding set, we can implement the new loan software and that should resolve this repeated finding.