

KOSRAE UTILITIES AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)

**FINANCIAL STATEMENTS AND
ADDITIONAL INFORMATION AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2020 AND 2019

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

Years Ended September 30, 2020 and 2019
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INDEPENDENT AUDITORS' REPORT

The Board of Directors
Kosrae Utilities Authority:

Report on the Financial Statements

We have audited the accompanying financial statements of the Kosrae Utilities Authority (the "Authority" or "KUA"), a component unit of the State of Kosrae, which comprise the statements of net position as of September 30, 2020 and 2019, 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

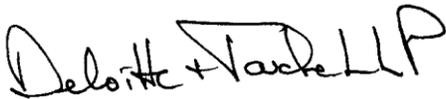
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kosrae Utilities Authority as of September 30, 2020 and 2019, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles 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 to 6 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 March 29, 2021, 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.



March 29, 2021

**KOSRAE UTILITIES AUTHORITY
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Management's Discussion and Analysis
Years Ended September 30, 2020 and 2019

This section of the Kosrae Utilities Authority's (the Authority) annual financial report presents the analysis of the Authority's financial performance during the fiscal year ended September 30, 2020. Please read it in conjunction with the financial statements, which follows this section.

Kosrae Utilities Authority (KUA) was mandated by law in October 1993 as a semi-autonomous agency of the Kosrae State Government to assume the operation and responsibility of providing electric power services to the Island of Kosrae. KUA is governed by a five (5) board members appointed by the Governor with the advice and consent of the State Legislature for a staggering term of 2 to 4 years.

The FY2020 operation was stable financially with no critical challenges, except, the unexpected caveat of COVID-19 that somewhat disrupted the implementation schedule of targeted activities and projects to be undertaken during the fiscal year. Due to COVID-19 situation, the staffs have resorted to series of virtual conferences to discuss energy projects that are approved by World Bank and Asian Development Bank (ADB) for implementation and data survey and collection at the proposed sites were not possible due to the travel restrictions imposed by COVID-19. The implementation and actual construction of these projects is anticipated to commence after ceasing of travel restrictions hopefully during last quarter of the next fiscal year. These improvement projects will significantly increase renewable energy into the island power grid whereby reducing fuel needed to run the engine units and also improve and secure continuous services to the island.

Management and the KUA Board have continued to pursue energy projects that will gradually meet the immediate and long-term energy goals for Kosrae, that is increasing renewable energy mix to the power system and improve system efficiency. The energy projects that were approved and funded by World Bank and ADB and ready for implementation are the 1.05 Mwp Solar PV grid-connected system, hybrid energy system for remote community of Walung, Energy Information (Scada) System and Battery Storage Facility Project. All these will support in meeting the immediate energy targets as outlined in the State Energy Master Plan. The capacity building program is presently ongoing with the support and assistance from JICA to ensure qualified manpower are locally available to operate the system.

The following table summarizes the financial position and results of operations of Kosrae Utilities Authority for 2020 through 2018:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
<u>Assets</u>			
Current assets	\$ 2,344,758	\$ 1,966,340	\$ 1,680,804
Utility plant, net	2,048,296	2,169,981	2,143,926
Other non-current assets	<u>252,800</u>	<u>252,800</u>	<u>280,821</u>
	<u>\$ 4,645,854</u>	<u>\$ 4,389,121</u>	<u>\$ 4,105,551</u>
<u>Liabilities and Net Position</u>			
	<u>2020</u>	<u>2019</u>	<u>2018</u>
Current liabilities	\$ <u>265,698</u>	\$ <u>231,941</u>	\$ <u>178,177</u>
Net Position:			
Invested in capital assets	2,048,296	2,169,981	2,143,926
Restricted	90,000	90,000	90,000
Unrestricted	<u>2,241,860</u>	<u>1,897,199</u>	<u>1,693,448</u>
Total net position	<u>4,380,156</u>	<u>4,157,180</u>	<u>3,927,374</u>
	<u>\$ 4,645,854</u>	<u>\$ 4,389,121</u>	<u>\$ 4,105,551</u>

**KOSRAE UTILITIES AUTHORITY
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Management's Discussion and Analysis
Years Ended September 30, 2020 and 2019

Revenue, Expenses and Changes in Net Position

	<u>2020</u>	<u>2019</u>	<u>2018</u>
Operating revenues	\$ 2,681,779	\$ 2,771,353	\$ 2,690,903
Operating expenses	<u>2,642,102</u>	<u>2,994,857</u>	<u>2,905,089</u>
Net operating earnings (loss)	<u>39,677</u>	<u>(223,504)</u>	<u>(214,186)</u>
Non-operating revenue (expenses):			
Subsidies from FSM National Government	90,000	93,079	-
Gain on disposal of capital asset	67	-	-
Net change in fair value of investments	94,452	(4,092)	79,129
Interest (expense) income	<u>(1,220)</u>	<u>1,551</u>	<u>1,047</u>
Total non-operating revenue	183,299	90,538	80,176
Capital contributions	<u>-</u>	<u>362,772</u>	<u>89,674</u>
Change in net position	\$ <u>222,976</u>	\$ <u>229,806</u>	\$ <u>(44,336)</u>

FINANCIAL HIGHLIGHTS

Operating Revenues: Energy sales and services for the period decreased by 3% against last year's operation. Residential and Commercial accounts increased while other power accounts declined with FAC revenue contributing a decrease in the income component. Postpaid sales charged through monthly billing represents 44% of sales revenue while 56% came from prepaid cash power customers. A total of 5,690,232 kwhr are sold in FY 2020 and 5,380,400 kwhr in FY 2019, an increase of approximately 5% from last year's kwhr sales. Same percentage composes the sources of operating revenue which is at 99% from electricity sales and 1% from other services.

Fuel Adjustment Revenue: Fuel adjustments are charged to customers based on the existing fuel prices and the rate is calculated in relation to engine and system efficiency per gallon deducted by the cost of fuel per kwhr that is already in the base rate. This varies monthly due to the fluctuating fuel purchasing cost. FAC revenue is added on top of the basic tariff rate. For FY 2020, the average FAC rate is around (\$.0190/kwhr) and \$.0312/kwhr for FY 2019 with a decrease of \$.0502 per kwhr sold resulting in a reduced FAC revenue of 140% this year.

Operating Expenses: Operating expenses decreased by 12% this year with all cost components contributing to the decrease. Production fuel represents approximately 51% of the reduction attributed to the decrease in fuel prices. Production fuel, salaries and wages and depreciation expense comprise 57%, 19% and 15%, respectively, of total operational costs while the remaining 9% is shared by maintenance and administrative expenses. Operating expenses represents 98% of operating revenue in FY2020.

Production Fuel: Fuel used by the engines for FY 2020 is around 491,530 gals which represents an increase in consumption of approximately 5% compared with last year. Average fuel cost per gal for FY 2019 is \$3.4874/gal with \$2.9797/gal in FY 2020, a reduction of \$0.51/gal during the period. Fuel prices declined by almost 17% but with the increase in fuel consumption during the period, it resulted in a net decrease in fuel expense of 11% against last year.

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Management's Discussion and Analysis
Years Ended September 30, 2020 and 2019

Non-operating Revenue: KUA continues to receive subsidies from the FSM National Government for power consumption of the World Bank donated streetlights installed on public places this year. For FY 2020 an amount of \$90,000 was received for such subsidy. The increase in fair value of investments of \$94,452 is reflected under non-operating revenue which contributed to KUA's increase in net position during the operating year.

Current Assets: A total of \$2,344,758 is recorded as current assets as of FY 2020. This represents approximately 50% of KUA's total assets. Current assets increased by 19% from last year's figure primarily brought about by an increase in cash and cash equivalents including the net increase of investments plus the net reduction of receivables, inventories and prepayments during the period.

Utility Plant: Electric plant in service is composed of KUA's buildings, vehicles, equipment, system software and fixtures net of accumulated depreciation including work in progress projects. Fixed assets acquired for the period include \$286,447, which includes a new Pre-Fabricated Distribution warehouse building of \$182,187 that is under construction. Fully depreciated vehicles, equipment, fixtures and computer software amounting \$132,325 that are not functioning were written-off this period. The change in accumulated depreciation is the depreciation net of the related written off assets. The net book value of utility plant is decreased by 6% compared with last fiscal year.

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

Non-Current Assets: The account remains the same as in prior years. Such amount represents the deposit amount for a fuel purchase contract with FSMPC and an Investment in Ocean Energy Kosrae (OEK) net of a 100% valuation reserve.

Current Liabilities: These are short term obligations payable to suppliers within a year. An increase of 15% is noted this year with the payable to FSMPC representing 45% of total current liabilities. It also includes the unpaid amount drawdown from a line of credit with a bank of \$40,000, which constitutes 15% of the liabilities. The remaining 40% is due to unused annual leave credits, Social Security and taxes payable, unearned revenue and other current liabilities.

The line of credit in a bank of \$200,000 was renewed on May 19, 2020 for another year. It bears a fixed interest rate of 7% per annum. Two drawdowns of \$100,000 each were made in November 2019 and July 2020 respectively to cover the construction of the new distribution warehouse and to be used for bulk purchase of fuel. The outstanding balance of \$40,000 for the second drawdown is reflected in current liabilities and was fully paid in the first quarter of FY 2021.

Net Position: The net change of 6% more than the value last year of net position was attributed to net income resulting from current year's operations.

Plan of Action for 2021

1. Continue working with World Bank, FSM Implementation Unit, Nat'l Gov't and State Gov't for the selection and recruitment of the Owner Engineer to assist KUA for the project bidding of the Energy Management System (Scada) and the Battery Storage Projects and coordinate with the evaluation and awarding of the projects to the supplier that will do the implementation of these projects.
2. Continue working with ADB, Nat'l Gov't Energy Division and State Gov't for the bidding and awarding of the 1.05 Mwp Solar PV grid-connected System to the main island power and Hybrid Power System for Walung Community. Continue to assist with the land easement matters for the Walung Project.

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Management's Discussion and Analysis
Years Ended September 30, 2020 and 2019

Plan of Action for 2021, Continued

3. Collaborate with the State Gov't for the transfer of the water operation and management to KUA. Set up the Water Service Division to fully function and be responsible for the management of the water system at Utwe Municipality and seek funding to upgrade water system at other municipalities.
4. Continue to coordinate with JICA and Yachiyo Engineering Firm for the ongoing Hybrid Power Generation Programs for Diesel Generation and Renewable Energy Training and technical assistance provided to employees for proper operation of the new Power Plant.
5. Procure and install more street lights to provide safety and security to the public and yard lights to customers. The lighting services have become a high demand item from customers including solar lighting for remote households. KUA will continue the services with quality lighting to withstand the salty environment as one of the present issues to improve.
6. Complete construction of the new warehouse and heavy equipment shelter. These will be utilized for inventory storage, training, heavy equipment and working spaces for the distribution crew.
7. Conduct training to improve knowledge and skills to employees in areas of renewable energy and diesel generation, audit and financial, renewable energy project management, billing and accounting software and related areas that are essential to improve the operation.
8. Perform renovation and maintenance of the building structure and facilities within the KUA compound and perform maintenance and necessary repairs to heavy equipment as required.
9. Work to improve data collection and technical reports from generation including the existing solar PV and other required operational reports.

The Management Discussion and Analysis report is intended to provide information concerning known facts and conditions affecting the Authority's operations. This financial report is designed to provide a general overview of the Authority's finances and to demonstrate KUA's accountability for the funds it receives and expends. Please also refer to the Management's Discussion and Analysis for the Authority's 2019 audit, which report was dated June 2, 2020.

This financial report is designed to provide our customers, creditors, Board of Directors and other interested parties with the general overview of KUA's financial activities. Questions or additional financial information can be obtained from Finance Division with the permission of the General Manager at P.O. Box KUA, Kosrae, FM 96944.

**KOSRAE UTILITIES AUTHORITY
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Statements of Net Position
September 30, 2020 and 2019

<u>ASSETS</u>	<u>2020</u>	<u>2019</u>
Utility plant:		
Electric plant in service	\$ 11,072,015	\$ 11,064,535
Less accumulated depreciation	<u>(9,303,610)</u>	<u>(9,027,803)</u>
	1,768,405	2,036,732
Construction work-in-progress	<u>279,891</u>	<u>133,249</u>
Net utility plant	<u>2,048,296</u>	<u>2,169,981</u>
Other noncurrent assets:		
Deposit for fuel purchase contract	<u>252,800</u>	<u>252,800</u>
Total noncurrent assets	<u>252,800</u>	<u>252,800</u>
Current assets:		
Cash and cash equivalents	861,918	525,845
Investments	841,312	746,860
Time certificate of deposit	168,800	167,539
Accounts receivable, net	187,585	220,195
Prepayments	7,927	15,658
Inventories (net of an allowance for obsolescence of \$278,515 and \$283,956 in 2020 and 2019, respectively)	<u>277,216</u>	<u>290,243</u>
Total current assets	<u>2,344,758</u>	<u>1,966,340</u>
Total assets	<u>\$ 4,645,854</u>	<u>\$ 4,389,121</u>
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Short-term borrowings	\$ 40,000	\$ -
Accounts payable - fuel	118,827	123,655
Accounts payable - other	32,695	24,647
Accrued annual leave	22,080	16,039
Unearned revenue	20,881	24,537
Accrued taxes and other	<u>31,215</u>	<u>43,063</u>
Total liabilities	<u>265,698</u>	<u>231,941</u>
Commitments and contingency		
Net position:		
Net investment in capital assets	2,048,296	2,169,981
Restricted	90,000	90,000
Unrestricted	<u>2,241,860</u>	<u>1,897,199</u>
Total net position	<u>4,380,156</u>	<u>4,157,180</u>
	<u>\$ 4,645,854</u>	<u>\$ 4,389,121</u>

See accompanying notes to financial statements.

**KOSRAE UTILITIES AUTHORITY
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Statements of Revenues, Expenses, and Changes in Net Position
Years Ended September 30, 2020 and 2019

	<u>2020</u>	<u>2019</u>
Operating revenues:		
Electricity sales	\$ 2,687,612	\$ 2,781,875
Bad debt expense	(5,833)	(10,522)
Net operating revenues	<u>2,681,779</u>	<u>2,771,353</u>
Operating expenses:		
Production fuel	1,505,666	1,686,613
Salaries and wages	509,728	535,052
Depreciation and amortization	408,132	438,127
Administrative and general	160,932	245,691
Repairs and maintenance	63,197	80,121
(Recovery) provision for inventory obsolescence	(5,553)	9,253
Total operating expenses	<u>2,642,102</u>	<u>2,994,857</u>
Earnings (loss) from operations	<u>39,677</u>	<u>(223,504)</u>
Nonoperating revenues (expenses):		
Subsidies from FSM National Government	90,000	93,079
Interest (expense) income, net	(1,220)	1,551
Net change in fair value of investments	94,452	(4,092)
Gain on disposal of capital assets	67	-
Total nonoperating revenues, net	<u>183,299</u>	<u>90,538</u>
Capital contribution:		
WorldBank project grant	-	362,772
Change in net position	222,976	229,806
Net position at beginning of year	<u>4,157,180</u>	<u>3,927,374</u>
Net position at end of year	\$ <u><u>4,380,156</u></u>	\$ <u><u>4,157,180</u></u>

See accompanying notes to financial statements.

KOSRAE UTILITIES AUTHORITY
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Statements of Cash Flows
Years Ended September 30, 2020 and 2019

	2020	2019
Cash flows from operating activities:		
Cash received from customers	\$ 2,710,733	\$ 2,741,137
Cash paid to suppliers for goods and services	(1,551,180)	(1,773,902)
Cash paid to employees for services	(664,619)	(779,831)
Net cash provided by operating activities	494,934	187,404
Cash flows from investing activities:		
Interest and dividends received on investments and others	976	1,131
Cash provided by investing activities	976	1,131
Cash flows from noncapital financing activities:		
Interest paid	(3,457)	-
Proceeds from short-term borrowings	40,000	-
Subsidies from FSM National Government	90,000	93,079
Net cash provided by noncapital financing activities	126,543	93,079
Cash flows from capital and related financing activities:		
Proceeds from disposal of capital assets	67	-
Capital expenditures for utility plant	(286,447)	(101,410)
Cash used in capital and related financing activities	(286,380)	(101,410)
Net change in cash and cash equivalents	336,073	180,204
Cash and cash equivalents at beginning of year	525,845	345,641
Cash and cash equivalents at end of year	\$ 861,918	\$ 525,845
Reconciliation of earnings (loss) from operations to net cash provided by operating activities:		
Earnings (loss) from operations	\$ 39,677	\$ (223,504)
Adjustments to reconcile earnings (loss) from operations to net cash provided by operating activities:		
Depreciation and amortization	408,132	438,127
Bad debt expense	5,833	10,522
Inventory (recovery) obsolescence	(5,553)	9,253
(Increase) decrease in assets:		
Accounts receivable	26,777	(47,814)
Prepayments	7,731	17,543
Inventories	18,580	(70,487)
Increase (decrease) in liabilities:		
Accounts payable - fuel	(4,828)	32,398
Accounts payable - other	8,048	7,617
Accrued annual leave	6,041	912
Unearned revenue	(3,656)	7,076
Accrued taxes and other	(11,848)	5,761
Net cash provided by operating activities	\$ 494,934	\$ 187,404

Supplemental information of noncash capital and related financing activities:

During the year ended September 30, 2019, KUA recorded non-cash capital contributions from World Bank of \$362,772 for street lights and other capital assets.

During the years ended September 30, 2020 and 2019, KUA transferred construction in progress of \$55,429 and \$151,160, respectively, to electric plant in service for completed projects.

During the years ended September 30, 2020 and 2019, KUA wrote off \$132,325 and \$187,696, respectively, of fully depreciated capital assets.

See accompanying notes to financial statements.

**KOSRAE UTILITIES AUTHORITY
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Notes to Financial Statements
September 30, 2020 and 2019

(1) Organization

The Kosrae Utilities Authority (the “Authority” or “KUA”), a component unit of the State of Kosrae (KSG), was created under KSG State Law 5-38 for the purpose of generating and transmitting electricity. Effective October 1, 1993, all assets and liabilities were transferred from KSG’s Public Works Department to KUA. The principal market for the generation and transmission of electricity are government agencies, businesses and residential customers located in the State of Kosrae. KUA has adopted the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC).

KUA is governed by a five-member Board of Directors appointed by the Governor of KSG with the consent of the KSG Legislature.

KUA’s financial statements are incorporated into the financial statements of KSG as a discretely presented component unit.

(2) Summary of Significant Accounting Policies

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

KUA adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – Management’s Discussion and Analysis for State and Local Governments*. GASB Statement No. 34 establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into four net position categories:

- *Net Investment in Capital Assets* – include capital assets, restricted and unrestricted, net of accumulated depreciation, reduced by outstanding debt, net of debt service reserves.
- *Restricted Nonexpendable* – net position subject to externally imposed stipulations that require the Authority to maintain such permanently.
- *Restricted Expendable* – net position whose use by the Authority is subject to externally imposed stipulations that can be fulfilled by actions of the Authority 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.

As of September 30, 2020 and 2019, KUA recorded restricted expendable net position of \$90,000 representing appropriations received from the FSM National Government for the power extension project to Walung, which has yet to commence.

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Notes to Financial Statements
September 30, 2020 and 2019

(2) Summary of Significant Accounting Policies, Continued

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure 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.

Basis of Accounting

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 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 basis, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Utility Plant

Utility plant assets were transferred from KSG's Public Works Department at estimated net book value in the absence of documents to support costs. As of September 30, 2020 and 2019, such plant assets are fully depreciated. KUA capitalizes individual items that have an estimated useful life of more than one year regardless of costs. Depreciation is calculated on the straight-line method over the estimated useful lives of the respective assets.

Investment in OEK, Inc.

Investment in OEK, Inc. represents 50% interest in the joint-venture, Ocean Energy Kosrae, Inc. (OEK) with the remaining 50% held by Ocean Energy Industries, Inc. (OEI). The purpose of OEK is to be an Independent Power Producer based on OEI's WaveSurfer power generating facilities in the waters around Kosrae in order to significantly reduce energy generation cost. The joint-venture was recognized in the accompanying financial statements using the cost method due to the uncertainty of obtaining future funds for the project. During the year ended September 30, 2015, the Authority recognized an impairment loss of \$50,000 associated with this investment and the investment is carried at nil value at September 30, 2020 and 2019.

Cash and Cash Equivalents and Time Certificates of Deposit

Cash and cash equivalents include cash on hand and cash held in demand deposit accounts. Deposits maintained in time certificate of deposit accounts with original maturity dates greater than three months are separately classified.

Investments

Investments and related investment earnings are reported at fair value using quoted market prices. Fair value is the price that would be received to sell an asset or paid to transfer a liability (i.e. the exit price) in an orderly transaction between market participants at the date as of which the fair value of an asset or liability is determined.

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Notes to Financial Statements
September 30, 2020 and 2019

(2) Summary of Significant Accounting Policies, Continued

Receivables

All receivables are due from government agencies, businesses and individuals located within the State of Kosrae and are interest free and uncollateralized. The allowance for uncollectible accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts and prior collection experience. The allowance is established through a provision for bad debts charged to expense. Bad debts are written off against the allowance on the specific identification method.

Inventory

Materials and fuel inventory are substantially carried at the lower of cost or market. First-in first-out costing method is used for materials and the average method for fuel, which approximate 80% and 20% of the net inventory value, respectively, as of September 30, 2020, and 74% and 26%, respectively, as of September 30, 2019.

Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and liability as the benefits accrue to employees. Unused annual leave is paid to employees upon termination of their employment. No liability is recorded for nonvesting accumulating rights to receive sick leave benefits.

Taxes

Corporate profits are not subject to income tax in the Federated States of Micronesia (FSM). The FSM National Government imposes a gross receipts tax of 3% on revenues. KUA is specifically exempt from this tax. In addition, KUA is exempt from any taxes or assessments on any of its property, operations or activities imposed by KSG or local governments.

Revenues

Sales of electricity are recorded as billed to customers on a monthly billing cycle basis. At the end of each month, unbilled revenues are accrued based on the most recent cycle billing. Unbilled receivables at September 30, 2020 and 2019 are \$97,112 and \$120,606, respectively. Cash power revenue is recognized as revenue upon point of sale; the estimated unearned portion is determined at year end and recorded as unearned revenue in the accompanying statements of net position.

Operating and Non-Operating Revenues and Expenses

Operating revenues and expenses generally result directly from the operation and maintenance of the Authority. Non-operating revenues and expenses result from capital and financing activities, costs and related recoveries from natural disasters, and certain other non-recurring income and costs.

**KOSRAE UTILITIES AUTHORITY
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Notes to Financial Statements
September 30, 2020 and 2019

(2) Summary of Significant Accounting Policies, Continued

Reclassifications

Certain reclassifications have been made to the 2019 financial statements to conform to the 2020 presentation. These reclassifications had no impact on operating loss, net position or cash flows as previously reported.

New Accounting Standards

During the year ended September 30, 2020, KUA implemented the following pronouncements:

GASB issued Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, which postpones the effective dates of GASB Statement Nos. 84, 89, 90, 91, 92 and 93 by one year and GASB Statement No. 87 by 18 months; however, earlier application of the provisions addressed in GASB Statement No. 95 is encouraged and is permitted to the extent specified in each pronouncement as originally issued. In accordance with GASB Statement No. 95, management has elected to postpone implementation of these statements.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*. This Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. The requirements of this Statement will enhance consistency and comparability by (1) establishing specific criteria for identifying activities that should be reported as fiduciary activities and (2) clarifying whether and how business-type activities should report their fiduciary activities. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 84 will be effective for fiscal year ending September 30, 2021.

In June 2017, GASB issued Statement No. 87, *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and as inflows of resources or outflows of resources recognized based on the payment provisions of the contract. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 87 will be effective for fiscal year ending September 30, 2022.

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*. The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 89, GASB Statement No. 89 will be effective for fiscal year ended September 30, 2022.

**KOSRAE UTILITIES AUTHORITY
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Notes to Financial Statements
September 30, 2020 and 2019

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In March 2018, GASB issued Statement No. 90, *Majority Equity Interests - An Amendment of GASB Statements No. 14 and 61*. The primary objectives of this Statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. It defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. A majority equity interest that meets the definition of an investment should be measured using the equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund. Those governments and funds should measure the majority equity interest at fair value. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 90 will be effective for fiscal year ending September 30, 2021.

In May 2019, GASB issued Statement No. 91, *Conduit Debt Obligations*. The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement achieves those objectives by clarifying 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. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 91 will be effective for fiscal year ending September 30, 2023.

In January 2020, GASB issued Statement No. 92, *Omnibus 2020*. The objectives of this Statement are to enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics and includes specific provisions about the effective date of Statement No. 87, *Leases*, and Implementation Guide No. 2019-3, *Leases*, for interim financial reports, the terminology used to refer to derivative instruments and the applicability of certain requirements of Statement No. 84, *Fiduciary Activities*, to postemployment benefits. The requirements related to the effective date of GASB Statement No. 87 and Implementation Guide 2019-3, reissuance recoveries and terminology used to refer to derivative instruments are effective upon issuance. The remaining requirements of GASB Statement No. 92 are effective for the fiscal year ending September 30, 2022.

In March 2020, GASB issued Statement No. 93, *Replacement of Interbank Offered Rates*. The primary objective of this Statement is to address those and other accounting and financial reporting implications of the replacement of an IBOR. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 93 will be effective for fiscal year ending September 30, 2022.

**KOSRAE UTILITIES AUTHORITY
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Notes to Financial Statements
September 30, 2020 and 2019

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In March 2020, GASB issued Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*. The primary objective of this Statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements. This Statement also provides guidance for accounting and financial reporting for availability payment arrangements. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 94 will be effective for fiscal year ending September 30, 2023.

In May 2020, GASB issued Statement No. 96, *Subscription-Based Information Technology Arrangements*. This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset - an intangible asset - and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 96 will be effective for fiscal year ending September 30, 2023.

In June 2020, GASB issued Statement No. 97, *Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans - an amendment of GASB Statements No. 14 and No. 84, and a supersession of GASB Statement No. 32*. The primary objectives of this Statement are to (1) increase consistency and comparability related to the reporting of fiduciary component units in circumstances in which a potential component unit does not have a governing board and the primary government performs the duties that a governing board typically would perform; (2) mitigate costs associated with the reporting of certain defined contribution pension plans, defined contribution other postemployment benefit (OPEB) plans, and employee benefit plans other than pension plans or OPEB plans as fiduciary component units in fiduciary fund financial statements; and (3) enhance the relevance, consistency, and comparability of the accounting and financial reporting for Internal Revenue Code (IRC) Section 457 deferred compensation plans (Section 457 plans) that meet the definition of a pension plan and for benefits provided through those plans. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 97 will be effective for fiscal year ending September 30, 2022.

(3) Deposits and Investments

GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

The deposit and investment policies of KUA are governed by the Board of Directors. As such, the Board of Directors is authorized to delegate certain responsibilities to third parties. Investment managers have discretion to purchase, sell, or hold the specific securities to meet the objectives set forth in the investment policy.

Generally, KUA can invest in bonds and other indebtedness of the U.S. and in preferred or common stock of any corporation created or existing under the laws of the U.S. or any U.S. state, territory, or commonwealth. Additionally, a maximum of 25% of the total portfolio may be invested in non-U.S. equities per the revised investment policy adopted in February 2010.

**KOSRAE UTILITIES AUTHORITY
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Notes to Financial Statements
September 30, 2020 and 2019

(3) Deposits and Investments, Continued

A. Deposits

As of September 30, 2020 and 2019, cash and cash equivalents and time certificates of deposit were \$1,030,718 and \$693,384, respectively, and the corresponding bank balances were \$1,049,703 and \$741,323, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2020 and 2019, bank deposits in the amount of \$312,188 and \$308,949, respectively, are insured. KUA 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.

B. Investments

As of September 30, 2020 and 2019, investments at fair value comprise the following:

	<u>2020</u>	<u>2019</u>
Fixed income securities:		
U.S. Treasury obligations	\$ 143,227	\$ 136,241
U.S. Government agencies	18,668	36,046
Corporate notes	<u>109,423</u>	<u>88,204</u>
	<u>271,318</u>	<u>260,491</u>
Other Investments:		
Common equities	534,973	468,882
Money market funds (at amortized cost)	<u>35,021</u>	<u>17,487</u>
	<u>569,994</u>	<u>486,369</u>
	<u>\$ 841,312</u>	<u>\$ 746,860</u>

As of September 30, 2020, the Authority's fixed income securities consist of the following:

		Fair <u>Value</u>	1 to 5 <u>Years</u>	6 to 10 <u>Years</u>
U.S. Treasury obligations	Aaa	\$ 143,227	\$ 125,960	\$ 17,267
U.S. Government agencies	Aaa	18,668	18,668	-
Corporate notes	A2	26,721	9,049	17,672
Corporate notes	A3	23,704	15,627	8,077
Corporate notes	Baa1	9,113	9,113	-
Corporate notes	Baa2	41,258	24,303	16,955
Corporate notes	Baa3	<u>8,627</u>	<u>-</u>	<u>8,627</u>
		<u>\$ 271,318</u>	<u>\$ 202,720</u>	<u>\$ 68,598</u>

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

Notes to Financial Statements
September 30, 2020 and 2019

(3) Deposits and Investments, Continued

B. Investments, Continued

As of September 30, 2019, the Authority's fixed income securities consist of the following:

		Fair <u>Value</u>	1 to 5 <u>Years</u>	6 to 10 <u>Years</u>
U.S. Treasury obligations	Aaa	\$ 136,241	\$ 102,647	\$ 33,594
U.S. Government agencies	Aaa	36,046	36,046	-
Corporate notes	A2	25,322	25,322	-
Corporate notes	A3	23,885	-	23,885
Corporate notes	Baa1	7,189	7,189	-
Corporate notes	Baa2	23,808	6,855	16,953
Corporate notes	Baa3	<u>8,000</u>	<u>-</u>	<u>8,000</u>
		<u>\$ 260,491</u>	<u>\$ 178,059</u>	<u>\$ 82,432</u>

KUA categorizes its fair value measurements within the fair value hierarchy established by GASB Statement No.72. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

KUA has the following recurring fair value measurements as of September 30, 2020 and 2019:

	September 30, <u>2020</u>	Fair Value Measurements Using		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments by fair value level:				
Fixed income:				
U.S. Treasury obligations	\$ 143,227	\$ -	\$ 143,227	\$ -
U.S. Government agencies	18,668	-	18,668	-
Corporate notes	<u>109,423</u>	<u>-</u>	<u>109,423</u>	<u>-</u>
	<u>271,318</u>	<u>-</u>	<u>271,318</u>	<u>-</u>
Equity securities:				
U.S. equities	510,032	510,032	-	-
Non U.S. equities	<u>24,941</u>	<u>24,941</u>	<u>-</u>	<u>-</u>
Total investments at fair value	<u>806,291</u>	<u>\$ 534,973</u>	<u>\$ 271,318</u>	<u>\$ -</u>
Investments measured at amortized cost:				
Money market funds	<u>35,021</u>			
	<u>\$ 841,312</u>			

**KOSRAE UTILITIES AUTHORITY
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Notes to Financial Statements
September 30, 2020 and 2019

(3) Deposits and Investments, Continued

B. Investments, Continued

	September 30, <u>2019</u>	Fair Value Measurements Using		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments by fair value level:				
Fixed income:				
U.S. Treasury obligations	\$ 136,241	\$ -	\$ 136,241	\$ -
U.S. Government agencies	36,046	-	36,046	-
Corporate notes	<u>88,204</u>	<u>-</u>	<u>88,204</u>	<u>-</u>
	<u>260,491</u>	<u>-</u>	<u>260,491</u>	<u>-</u>
Equity securities:				
U.S. equities	<u>468,882</u>	<u>468,882</u>	<u>-</u>	<u>-</u>
Total investments at fair value	729,373	\$ <u>468,882</u>	\$ <u>260,491</u>	\$ <u>-</u>
Investments measured at amortized cost:				
Money market funds	<u>17,487</u>			
	\$ <u>746,860</u>			

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, KUA will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

KUA's investments are held and administered by trustees. Accordingly, these investments are exposed to custodial credit risk. Based on negotiated trust and custody contracts, all of these investments were held in KUA's name by KUA's custodial financial institutions at September 30, 2020 and 2019.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for KUA. As of September 30, 2020 and 2019, there was no concentration of credit risk for KUA's investments.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. KUA does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

**KOSRAE UTILITIES AUTHORITY
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Notes to Financial Statements
September 30, 2020 and 2019

(4) Accounts Receivable

Accounts receivable at September 30, 2020 and 2019, are summarized as follows:

	<u>2020</u>	<u>2019</u>
Utility:		
Residential	\$ 47,000	\$ 34,892
Commercial	84,617	83,954
Government	74,465	67,452
Fuel adjustment charge	<u> -</u>	<u>5,290</u>
	206,082	191,588
Travel advances	540	16,102
Other	<u>63,303</u>	<u>89,012</u>
	269,925	296,702
Less allowance for doubtful accounts	<u>(82,340)</u>	<u>(76,507)</u>
	<u>\$ 187,585</u>	<u>\$ 220,195</u>

(5) Utility Plant

Capital asset activity for the years ended September 30, 2020 and 2019, is as follows:

	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2019</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Balance at September 30, 2020</u>
<u>Depreciable assets:</u>					
Production plant	5 to 40 years	\$ 3,876,428	\$ 8,162	\$ -	\$ 3,884,590
Distribution plant	5 to 30 years	6,570,055	73,124	(91,684)	6,551,495
General plant	3 to 20 years	<u>618,052</u>	<u>58,519</u>	<u>(40,641)</u>	<u>635,930</u>
Total electric plant in service		11,064,535	139,805	(132,325)	11,072,015
Less accumulated depreciation		<u>(9,027,803)</u>	<u>(408,132)</u>	<u>132,325</u>	<u>(9,303,610)</u>
		2,036,732	(268,327)	-	1,768,405
<u>Non-depreciable assets:</u>					
Construction work-in-progress		<u>133,249</u>	<u>203,247</u>	<u>(56,605)</u>	<u>279,891</u>
Electric plant in service, net		<u>\$ 2,169,981</u>	<u>\$ (65,080)</u>	<u>\$ (56,605)</u>	<u>\$ 2,048,296</u>
	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2018</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Balance at September 30, 2019</u>
<u>Depreciable assets:</u>					
Production plant	5 to 40 years	\$ 3,865,622	\$ 75,400	\$ (64,594)	\$ 3,876,428
Distribution plant	5 to 30 years	6,379,466	305,045	(114,456)	6,570,055
General plant	3 to 20 years	<u>613,650</u>	<u>13,048</u>	<u>(8,646)</u>	<u>618,052</u>
Total electric plant in service		10,858,738	393,493	(187,696)	11,064,535
Less accumulated depreciation		<u>(8,777,372)</u>	<u>(438,127)</u>	<u>187,696</u>	<u>(9,027,803)</u>
		2,081,366	(44,634)	-	2,036,732
<u>Non-depreciable assets:</u>					
Construction work-in-progress		<u>62,560</u>	<u>224,537</u>	<u>(153,848)</u>	<u>133,249</u>
Electric plant in service, net		<u>\$ 2,143,926</u>	<u>\$ 179,903</u>	<u>\$ (153,848)</u>	<u>\$ 2,169,981</u>

**KOSRAE UTILITIES AUTHORITY
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Notes to Financial Statements
September 30, 2020 and 2019

(6) Short-Term Borrowings

In the normal course of operations, KUA obtains short-term borrowings primarily for the purpose of funding the purchase of fuel. As of September 30, 2020 and 2019, KUA has a bank credit line amounting to \$200,000 bearing interest at 7.0% per annum, with interest payable monthly and principal balance due upon maturity, which is collateralized by certain eligible investment securities and existing and future business accounts receivable. As of September 30, 2020, KUA has drawn down \$40,000, with principal balance due within one year.

Changes in short-term borrowings for the year ended September 30, 2020 are as follows:

	Outstanding October 1, <u>2019</u>	<u>Addition</u>	<u>Reduction</u>	Outstanding September <u>30, 2020</u>
Short-term borrowing	\$ -	\$ 40,000	\$ -	\$ 40,000

(7) Significant Suppliers

KUA purchased virtually all fuel from one supplier during the years ended September 30, 2020 and 2019.

(8) Commitments

Net position at September 30, 2020 and 2019 has been appropriated in the amounts of \$2,516,919 and \$2,416,919, respectively, for repair and maintenance and capital improvement projects. This process will continue in fiscal year 2020 with a total of \$25,000 being further appropriated on a quarterly basis from net position for this purpose.

(9) Risk Management

KUA 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. KUA has elected to purchase commercial insurance from independent third parties for the risks of loss to which it is exposed to from fire on its building and the contents and full coverage on property damage. KUA also pays for workers' compensation to cover for wage replacement and medical benefits to employees injured in the course of employment. KUA is substantially self-insured for all other risks. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years.

(10) Retirement Plan

KUA administers a defined contribution retirement plan (the Plan) covering all employees with at least one year of service. Vesting occurs upon plan entry. Employee contributions can be made from 1% to 15% of earnings with a 50% match by KUA up to 5% of employee compensation. KUA's controller is the designated Plan administrator. Contributions to the Plan during the years ended September 30, 2020, 2019 and 2018 were \$3,393, \$3,184, and \$2,557, respectively, which were equal to the employer contributions required by the Plan. Management is of the opinion that the Plan does not represent an asset or liability of KUA. For the years ended September 30, 2020 and 2019, Plan assets were \$119,726 and \$102,654, respectively, with corresponding cash balances of \$115,399 and \$95,457, respectively.

**KOSRAE UTILITIES AUTHORITY
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Notes to Financial Statements
September 30, 2020 and 2019

(11) Related Parties

KUA is a component unit of KSG and is therefore affiliated with all KSG-owned and affiliated entities. All KUA services to KSG and its component units are provided on the same basis as provided to unrelated parties. All production fuel is purchased from FSM Petroleum Corporation (FSMPC), a component unit of the FSM National Government (FSMNG).

A long-term deposit in the amount of \$252,800, through a sub-grant from the FSMNG, is held by FSMPC as collateral for fuel and lubricant purchases.

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 Utilities 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 Authority, which comprise the statement of net position as September 30, 2020, 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 March 29, 2021.

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.

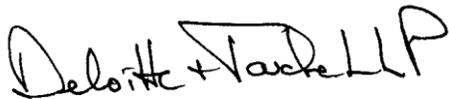
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not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

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 + Tuckers LLP". The signature is written in a cursive, stylized font.

March 29, 2021

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

Summary Schedule of Prior Year Findings and Questioned Costs
Year Ended September 30, 2020

There are no prior year findings or unresolved questioned costs of Kosrae Utilities Authority as of September 30, 2020.