Financial Statements and
Required Supplementary Information

Kosrae Utilities Authority

(A Component Unit of the State of Kosrae)

Year Ended September 30, 2022
with Report of Independent Auditors

Building a better
working world

Kosrae Utilities Authority
(A Component Unit of the State of Kosrae)

Financial Statements and Required Supplementary Information

Year Ended September 30, 2022

Contents

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Report of Independent Auditors

The Board of Directors
Kosrae Utilities Authority

Report on the Audit of the Financial Statements

Opinion

We have audited the accompanying financial statements of the business-type activities of Kosrae Utilities Authority (the Authority), a component unit of the State of Kosrae, as of and for the year ended September 30, 2022, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of September 30, 2022, and the changes in financial position and its cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States (*Government Auditing Standards*). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Authority, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Authority's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards,* we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit 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 Authority's internal control. Accordingly, no such opinion is expressed.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Authority's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 9 be presented to supplement the financial statements. Such information is the responsibility of management and, 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 GAAS, 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 October 5, 2023, 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 solely 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 the effectiveness of the Authority's 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.

Ernst + Young LLP

October 5, 2023

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, 2022 (FY2022). 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-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 term of 4 years.

KUA as always, had continued to provide services to the island during FY2022 with no major challenges to critically impact the power services to its customers. The operating issues faced were mainly rising Fuel cost which caused marginal increases in the operation cost that resulted in a net loss during FY2022. Revenues received were mainly from electric sales and a nominal built-up water reserves to fund water operation when transfer to KUA. Although, the operation was financially in the red during FY2022, the services had continued to meet the island demand with no alarming issues to tackle. The management and staff had continued to collaborate with the outside donors mainly ADB, World Bank and JICA along with the FSM R&D Department and the Kosrae State Government in preparing and meeting the grants requirements before the implementation of these renewable energy projects.

The travel restriction due to Covid19 pandemic had eased up early part of FY2022 which enabled consultant and interested firms to visit the island to assess and inspect the proposed sites for these energy projects. The project bidding for the energy projects were evaluated and submitted bids for these projects were evaluated and screened during FY2022. There were safeguard issues mainly land ownership and environmental concerns that contributed to the delay of the design works of these projects, but resolved after several months of consultation with the landowners and the Kosrae State Government. The design works had commenced early part of FY2023 and hopefully the actual implementation is anticipated early part of FY2024 and be completed at the end of the same year.

Management's Discussion and Analysis, continued

The following table summarizes the financial position and results of operation of Kosrae Utilities Authority for 2022 through 2021:

Assets	2022	2021
Current Assets	$2,750,105	$2,748,385
Utility plant, net	1,564,184	1,746,483
Other non-current assets	252,800	252,800
	$4,567,089	$4,747,668
Liabilities and Net Position		
Current Liabilities	$ 329,291	$ 274,013
Net Position:		
Invested in capital assets	1,564,184	1,746,483
Restricted	90,000	90,000
Unrestricted	2,583,614	2,637,172
Total net position	4,237,798	4,473,655
	$4,567,089	$4,747,668

Revenue, Expenses and Changes in Net Position

	2022	2021
Operating revenues	$3,248,137	$2,583,489
Operating expenses	3,339,924	2,658,592
Net operating loss	(91,787)	(75,103)
Non-operating revenue (expenses)		
Subsidies from FSM National Government	21,903	28,097
(Loss) gain on disposal of capital asset	(383)	148
Net change in fair value of investments	(167,010)	143,275
Interest income (expense)	1,420	(2,918)
Total Non-operating (expense) revenue	(144,070)	168,602
Change in net position	$(235,857)	$ 93,499

FINANCIAL HIGHLIGHTS

Operating Revenues are from sales of electricity and water services and other revenues related to the utility operation. Water operating income represents 1% of the total sales and 99% derived from electricity operation. Electric revenue are shared 49% and 51% respectively by post-paid and prepaid users with customers composition of Residential/Private sales of 30%, Kosrae State Government sales of 15%, Government Non-Kosrae State sales of 7%, Industrial sales of 4%, Commercial sales of 27% and Fuel Adjustment Charge (FAC) revenue of 17%. FY2021 revenue in comparison with FY2022 shows an increase of approximately 26% mainly due to increase in FAC revenue brought about by the effect of sudden increase in fuel prices. Total kwhr sold for electricity sales is 5,475,105 and 3,014,442 gallons for water, a reduction of approximately 2% against kwhr sold while water operates only for seven months last year with total gallons sold of 3,089,940.

Fuel Adjustment Revenue are fuel adjustments charged to customers to cover for fluctuation of fuel prices. With the skyrocket increase in fuel prices in FY2022, average FAC rate went up by as much as 670%, from an average negative FAC rate of ($.0109/kwhr) for FY2021 to positive $.1109/kwhr in FY2022 resulting to a higher FAC revenue.

Operating Expenses increased by 27% compared last year and almost in proportion with the increase in sales revenue hence the purpose of why fuel adjustments are initiated to accommodate for fuel price fluctuation. Almost all expense categories increased with production fuel contributing to as high as 23% of the total 27% growth in operating expenses while the remaining 4% is shared by the other expense accounts. Operating expenses comprises production fuel representing 63%, salaries and wages 17%, maintenance 4%, depreciation 11% and administrative expenses of 5%. Expenses is over by 4% from the operating revenue which represents the net operating loss for the period.

Production Fuel are fuel consumed by the engines. A total of 485,427 gallons are used by the engines compared with 490,490 gallons last year thus a reduction of roughly 1% in fuel consumption. Average fuel usage cost per gallon for FY2022 is $4.3325 while $3.0029 in FY2021, an increase of around 44% between the two periods hence the reason of the surge in fuel expense in this fiscal year.

Non-operating revenue and expenses are the net of subsidies received from FSM National Government for the streetlights power consumption installed on public places, interests and the unrealized loss of fair value of KUA investments resulting to a net non-operating loss of $144,070. In FY2023 market value started to increase and recover partially the losses experienced in this fiscal year.

Current Assets is composed of cash and cash equivalents (75%), accounts receivable (11%), inventories (13%) and prepayments (1%). This represents 60 % of KUA's total assets and almost the same level as last year.

Utility Plant are electric plant in service composed of KUA's buildings, vehicles, equipment, system software, fixtures and work in projects net of accumulated depreciation. Total fixed assets acquired for the year is $144,782, asset disposals of $7,950 and write off of non-operational and fully depreciated assets of $25,333 are the significant movement of the fixed assets account. Depreciation provided is decreased by around 18% in comparison with last year's provision.

Non-Current Assets are the deposit amount for fuel purchase contract with FSMPC. The amount still remains unchanged. The OEK investment amount of $50,000 is written off this year since the joint venture was already dissolved by the board in December 2016 and is offset against the corresponding reserve in the books.

Current Liabilities are short term obligations payable to employees and suppliers. Of the total amount accounts payable to FSMPC for fuel represents 61% of the outstanding obligation and 39% are owed to employees, customers and taxes. A net increase of 20% is noted in comparison with last year's current liabilities substantially due to payable to FSMPC for a higher unpaid fuel deliveries received bearing a higher fuel price as compared with previous year.

Management discontinued the yearly renewal for the $200,000 line of credit with Bank of the FSM since KUA is able to sustain operational and emergency expenses on its own funds and is very much liquid that outside borrowing is no longer necessary.

Net Position is the accumulated results of KUA's operation and contributed capital. The net change for the period represents the net loss for FY2022.

Plan of Action for 2023

1. Finalizing negotiation with selected project contractor, Vergnet Co. in regard to the terms of the contract and to commence project design and scope of work schedule to start constructing the 1.2 Mwp Solar PV grid-connected system, BESS, Walung Mini-grid hybrid system and the Scada system both funded by WB and ADB.

2. Resolve the remaining safeguard issues with the private land owners at Walung for the Mini-grid hybrid power system installation and State Gov't request to relocate project site within the same vicinity to make ways for future state plan for infrastructure development.

3. Collaborate with JICA to approve another term of capacity development training to ensure that capacity to operate and maintain the Solar PV System and BESS with the new Scada System is available after the completion of these projects to properly run and maintain the new Power Plant and the Solar PV grid-connected Facility.

4. Continue to work with JICA and Power Plant Contractor to extend their services after expiration of the original contract to continue assessing and monitoring the stability of the building structure and ensure that structure is stable and will not cause major problem in the near future.

5. Schedule and implement required Top End overhaul of the new Daithsu Engine units at the new Power Plant during fiscal year 2023 and inviting FSM Utilities to participate as a technical training program for the FSM Utilities' employees.

6. Ensure the Utwe Water System is fully operational before transferring to KUA to run the system. Seek funds to finance the Water Division with sufficient budget to improve the system and prepare with Board approval the required water tariff and service regulation to manage the water operation.

7. Upgrade the Accounting and Server System to sage to improve financial records and protect records from power interruptions. Also upgrade Suprima billing software to its newer version and require features to improve services to customers.

8. Continue the partnership with State Gov't to provide street lights for public safety and security and Yard lights services to customers. KUA will continue to provide this service with quality lights to withstand corrosive salty environment as one issue to improve.

9. Complete Training/Meeting Rooms at the Distribution Warehouse to accommodate trainings and meetings for the Production and Distribution Division Employees. Perform renovation works to replace roofing at the Administrative Office Building.

10. Continue to support related trainings to improve knowledge and skills in areas of Renewable Energy and Diesel Generation, Audit and Financial, Billing and Accounting Software and related areas that are essentials to improve the operation.

11. Continue to improve data collection and technical reports from the generation including the existing solar PV and other required operational reports. Improve facility management of fixed assets

12. Seek new suppliers for street/yard lights with better quality and reasonable cost, Prepayment Meters and other essential spare parts for the Power Plant Engine units.

13. Prepare new energy development project funding proposal to seek funding from the newly approved Compact Funds and the other outside Donors to increase renewable energies into the power gridlines and to reduce fuel usage to meet the target of the Energy Master Plan for Kosrae.

Management's Discussion and Analysis, continued

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 2021 audit, which report was dated September 20, 2022.

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
(A Component Unit of the State of Kosrae)

Statement of Net Position

September 30, 2022

Assets	
Utility plant	
Depreciable:	
Electric plant in service	$ 11,384,574
Less accumulated depreciation	(9,892,230)
	1,492,344
Non-depreciable:	
Construction work-in-progress	71,840
Net utility plant	1,564,184
Other noncurrent assets:	
Deposit for fuel purchase contract	252,800
Total noncurrent assets	1,816,984
Current assets:	
Cash and cash equivalents	1,106,424
Investments	780,249
Time certificate of deposit	169,662
Accounts receivable, net	300,079
Prepayments	43,659
Inventories, net	350,032
Total current assets	2,750,105
Total assets	$ 4,567,089

See accompanying notes.

Kosrae Utilities Authority
(A Component Unit of the State of Kosrae)

Statement of Net Position, continued

Liabilities and Net Position	
Current liabilities:	
Accounts payable - fuel	$ 202,109
Accounts payable - other	21,921
Accrued annual leave	30,091
Unearned revenue	34,339
Accrued taxes and other	40,831
Total liabilities	329,291
Commitments and contingency	
Net position:	
Net investments in capital assets	1,564,184
Restricted	90,000
Unrestricted	2,583,614
Total net position	4,237,798
Total liabilities	$4,567,089

See accompanying notes.

Kosrae Utilities Authority
(A Component Unit of the State of Kosrae)

Statement of Revenues, Expenses, and Changes in Net Position

Year ended September 30, 2022

Operating revenues:	
Electricity sales	$3,233,220
Water sales	19,516
Bad debt expense	(4,599)
Net operating revenues	3,248,137
Operating expenses:	
Production fuel	2,126,999
Salaries and wages	571,166
Depreciation and amortization	325,193
Administrative and general	173,934
Repairs and maintenance	141,937
Provision for inventory obsolescence	695
Total operating expenses	3,339,924
Loss from operations	(91,787)
Nonoperating revenues (expenses):	
Subsidies from FSM National Government	21,903
Interest income, net	1,420
Net change in fair value of investments	(167,010)
Loss on disposal of capital assets	(383)
Total nonoperating expenses, net	(144,070)
Change in net position	(235,857)
Net position at beginning of year	4,473,655
Net position at end of year	$4,237,798

See accompanying notes.

Kosrae Utilities Authority
(A Component Unit of the State of Kosrae)

Statement of Cash Flows

Year ended September 30, 2022

Cashflows from operating activities:	
Cash received from customers	$3,117,062
Cash paid to suppliers for goods and services	(2,364,230)
Cash paid to employees for services	(561,635)
Net cash provided by operating activities	191,197
Cashflows from investing activities:	
Increase in investments	37,328
Interest and dividends received on investments and others	1,403
Cash provided by investing activities	38,731
Cash flows from noncapital financing activities -	
Subsidies from FSM National Government	21,903
Cashflows from capital and related financing activities:	
Proceeds from disposal of capital assets	1,506
Capital expenditures for utility plant	(144,783)
Net cash used in capital and related financing activities	(143,277)
Net change in cash and cash equivalents	108,554
Cash and cash equivalents at beginning of year	997,870
Cash and cash equivalents at end of year	$1,106,424

See accompanying notes.

Kosrae Utilities Authority
(A Component Unit of the State of Kosrae)

Statement of Cash Flows, continued

Reconciliation of loss from operations to net cash provided by operating activities:	
Loss from operations	$(91,787)
Adjustments to reconcile loss from operations to net cash provided by operating activities:	
Depreciation and amortization	325,193
Bad debt expense	4,599
Inventory provision	695
(Increase) decrease in assets:	
Accounts receivable	(140,548)
Prepayments	15,228
Inventories	22,539
Increase in liabilities:	
Accounts payable - fuel	42,956
Accounts payable - other	1,678
Accrued annual leave	7,191
Unearned revenue	354
Accrued taxes and other	3,099
Net cash provided by operating activities	$ 191,197

See accompanying notes.

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.

2. Summary of Significant Accounting Policies, continued

As of September 30, 2022, 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.

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.

Accounting 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.

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, 2022, 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.

2. Summary of Significant Accounting Policies, continued

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.

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 collectability of these accounts and prior collection experience. The allowance is established through a provision for bad debts recorded against operating revenues. Bad debts are written off against the allowance on the specific identification method.

Inventory

Materials and fuel inventories are carried at the lower of cost (using the first-in first-out and the average cost method, respectively) or net realizable value.

Allowance for inventory obsolescence may be provided for inventory items with no movement for two years or as specifically identified as unusable.

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.

2. Summary of Significant Accounting Policies, continued

Taxes

KUA exists and operates solely for the benefit of the public and shall be exempted from any State or Municipal taxes or assessments on any of its property, operations or activities. KUA shall be liable for employees' contributions to the National Social Security System or other employees' benefits of the State of Kosrae or FSMNG, if any, in such manner as provided by law.

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, 2022 is $154,472. 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 statement 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, investing and financing activities, costs and related recoveries from natural disasters, and certain other non-recurring income and costs.

Recently Adopted Accounting Pronouncements

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. The adoption of GASB Statement No. 87 did not result in a material effect on the accompanying financial statements.

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. The adoption of GASB Statement No. 89 did not result in a material effect on the accompanying financial statements.

2. Summary of Significant Accounting Policies, continued

Recently Adopted Accounting Pronouncements, continued

In January 2020, GASB issued Statement No. 92, *Omnibus 2020*. The requirements of this Statement will enhance comparability in the application of accounting and financial reporting requirements and will improve the consistency of authoritative literature. More comparable reporting will improve the usefulness of information for users of state and local government financial statements. This Statement addresses a variety of topics and includes specific provisions about leases; reporting of intra-entity transfers of assets between a primary government employer and a component unit defined benefit pension plan or defined benefit other postemployment benefit (OPEB) plan; applicability of Statement no. 73 and 84 for postemployment benefits, measurement of liabilities (and assets, if any) related to asset retirement obligations (AROs) in a government acquisition; reporting by public entity risk pools for amounts that are recoverable from reinsurers or excess insurers; reference to nonrecurring fair value measurements of assets or liabilities in authoritative literature and terminology used to refer to derivative instruments. The adoption of GASB Statement No. 92 did not have an effect on the accompanying financial statements.

In March 2020, GASB issued Statement No. 93, *Replacement of Interbank Offered Rates*. Some governments have entered into agreements in which variable payments made or received depend on an interbank offered rate (IBOR) – most notably, the London Interbank Offered Rate (LIBOR). As a result of global reference rate reform, LIBOR is expected to cease to exist in its current form, prompting governments to amend or replace financial instruments for the purpose of replacing LIBOR with other reference rates by either (a) changing the reference rate or (b) adding or changing fallback provisions related to the reference rate. The objective of this Statement is to address the accounting and financial reporting effects that result from the replacement of IBORs with other reference rates in order to preserve the reliability, consistency, and comparability of reported information. The adoption of GASB Statement No. 93 did not have an effect on the accompanying financial statements.

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 (a) 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; (b) mitigate costs associated with the reporting of certain defined contribution pension plans, defined contribution OPEB plans, and employee benefit plans other than pension plans or OPEB plans as fiduciary component units in fiduciary fund financial statements; and (c) 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. The adoption of GASB Statement No. 97 did not have an effect on the accompanying financial statements.

2. Summary of Significant Accounting Policies, continued

Upcoming Accounting Pronouncements

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 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. To the extent relevant, the standards for SBITAs are based on the standards established in Statement No. 87, *Leases*, as amended. GASB Statement No. 96 will be effective for fiscal year ending September 30, 2023.

2. Summary of Significant Accounting Policies, continued

Upcoming Accounting Pronouncements, continued

In April 2022, GASB issued Statement No. 99, *Omnibus 2022*. The requirements of this Statement will enhance comparability in the application of accounting and financial reporting requirements and will improve the consistency of authoritative literature. Consistent authoritative literature enables governments and other stakeholders to more easily locate and apply the correct accounting and financial reporting provisions, which improves the consistency with which such provisions are applied. The comparability of financial statements also will improve as a result of this Statement. Better consistency and comparability improve the usefulness of information for users of local government financial statements. GASB Statement No. 99 will be effective for fiscal year ending September 30, 2023.

In June 2022, GASB issued Statement No. 100, *Accounting Changes and Error Corrections – An Amendment of GASB Statement No. 62*. The primary objective of this Statement is to enhance accounting and financial reporting requirements for accounting changes and error corrections to provide more understandable, reliable, relevant, consistent, and comparable information for making decisions or assessing accountability. The requirements of this Statement will improve the clarity of the accounting and financial reporting requirements for accounting changes and error corrections, which will result in greater consistency in application in practice. In turn, more understandable, reliable, relevant, consistent, and comparable information will be provided to financial statement users for making decisions or assessing accountability. In addition, the display and note disclosure requirements will result in more consistent, decision useful, understandable, and comprehensive information for users about accounting changes and error corrections. GASB Statement No. 100 will be effective for fiscal year ending September 30, 2024.

In June 2022, GASB issued Statement No. 101, *Compensated Absences*. The objective of this Statement is to better meet the information needs of financial statement users by updating the recognition and measurement guidance for compensated absences. That objective is achieved by aligning the recognition and measurement guidance under a unified model and by amending certain previously required disclosures. The unified recognition and measurement model in this Statement will result in a liability for compensated absences that more appropriately reflects when a government incurs an obligation. In addition, the model can be applied consistently to any type of compensated absence and will eliminate potential comparability issues between governments that offer different types of leave. The model also will result in a more robust estimate of the amount of compensated absences that a government will pay or settle, which will enhance the relevance and reliability of information about the liability for compensated absences. GASB Statement No. 101 will be effective for fiscal year ending September 30, 2025.

The Authority is currently evaluating the effects the above upcoming accounting pronouncements might have on its financial statements.

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.

A. Deposits

As of September 30, 2022, cash and cash equivalents and time certificates of deposit were $1,276,086 and the corresponding bank balances were $1,285,563, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2022 bank deposits in the amount of $393,674 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, 2022, investments at fair value comprise the following:

Fixed income securities:	
U.S. Treasury obligations	$195,236
Corporate notes	139,779
	335,015
Other Investments:	
Common equities	435,549
Real estate and tangibles	9,685
	445,234
	$780,249

3. Deposits and Investments, continued

B. Investments, continued

As of September 30, 2022, the Authority's fixed income securities consist of the following:

		Fair Value	Maturity 1 to 5 Years	Maturity 6 to 10 Years
U.S. Treasury obligations	Aaa	$195,236	$174,935	$20,301
Corporate notes	A1	20,717	20,717	---
Corporate notes	A2	20,650	20,650	---
Corporate notes	A3	20,461	10,786	9,675
Corporate notes	Baa1	9,078	---	9,078
Corporate notes	Baa2	68,873	50,084	18,789
		$335,015	$277,172	$57,843

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, 2022:

		Fair Value Measurements Using		
	September 30, 2022	Level 1	Level 2	Level 3
Investments by fair value level:				
Fixed income:				
U.S. Treasury obligations	$195,236	$ ---	$195,236	$ ---
Corporate notes	139,779	---	139,779	---
	335,015	---	335,015	---
Equity securities:				
U.S. equities	426,667	426,667	---	---
Non U.S. equities	8,882	8,882	---	---
	435,549	435,549		
Real estate and tangibles	9,685	9,685	---	---
Total investments at fair value	$780,249	$ 445,234	$335,015	$ ---

3. Deposits and Investments, continued

B. Investments, continued

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, 2022.

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, 2022, 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.

4. Accounts Receivable

Accounts receivable at September 30, 2022, are summarized as follows:

Utility:	
Commercial	$ 96,542
Residential	75,850
Government	71,098
Fuel adjustment charge	72,309
	315,799
Travel advances	515
Other	52,389
	368,703
Less allowance for doubtful accounts	(68,624)
	$300,079

5. Inventory

Inventory at September 30, 2022, are summarized as follows:

Parts and supplies	$524,513
Fuel	108,987
	633,500
Less allowance for inventory obsolescence	(283,468)
	$350,032

6. Utility Plant

Capital asset activity for the year ended September 30, 2022 is as follows:

	Estimated Useful Lives	Balance at October 1, 2021	Transfers and Additions	Transfers and Deletions	Balance at September 30, 2022
Depreciable assets:					
Production plant	5 to 40 years	$ 3,874,173	$ 850	$(2,750)	$ 3,872,273
Distribution plant	5 to 30 years	6,735,726	114,925	(6,798)	6,843,853
General plant	3 to 20 years	659,491	32,692	(23,735)	668,448
Total electric plant in service		11,269,390	148,467	(33,283)	11,384,574
Less accumulated depreciation		(9,598,431)	(325,193)	31,395	(9,892,229)
		1,670,959	(176,726)	(1,889)	1,492,344
Non-depreciable assets:					
Construction work-in-progress		75,524	---	(3,684)	71,840
Electric plant in service, net		$ 1,746,483	$(176,726)	$(5,573)	$ 1,564,184

7. Commitments

Net position at September 30, 2022 has been appropriated in the amounts of $2,716,919, for repair and maintenance and capital improvement projects. This process will continue in fiscal year 2023 with a total of $25,000 being further appropriated on a quarterly basis from net position for this purpose.

8. 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.

9. 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 year ended September 30, 2022 was $3,580, which were equal to the employer contributions required by the Plan. At September 30, 2022, Plan assets were $114,857, with corresponding cash balances of $104,234. Management is of the opinion that the Plan does not represent an asset or a liability of KUA and as such no related assets or liabilities have been recorded in the accompanying statement of net position.

10. 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. Virtually 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.

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Report of Independent Auditors 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*

Management and the Board of Directors
Kosrae Utilities Authority

We have audited, in accordance with auditing standards generally accepted in the United States 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 Utilities Authority (the Authority), which comprise the statement of net position as of September 30, 2022, and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 5, 2023.

Report on 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) as a basis for designing 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 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 or significant deficiencies may exist that were not identified.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of 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 financial statements. 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.

Ernst + Young LLP

October 5, 2023