

KOSRAE UTILITIES AUTHORITY

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2001 AND 2000

Deloitte & Touche LLP
361 South Marine Drive
Tamuning, Guam 96913-3911

Tel: (671)646-3884
Fax: (671)649-4932
www.dttguam.com



INDEPENDENT AUDITORS' REPORT

The Board of Directors
Kosrae Utilities Authority:

We have audited the accompanying balance sheets of the Kosrae Utilities Authority, a component unit of the Kosrae State Government, as of September 30, 2001 and 2000, and the related statements of operations and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Kosrae Utilities Authority's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Kosrae Utilities Authority as of September 30, 2001 and 2000, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 7 to the financial statements, the Authority changed its method of accounting for nonexchange transactions to conform with Government Accounting Standards Board Statement No. 33 and has restated the 2000 financial statements to reflect the change.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 22, 2002, on our consideration of the Kosrae Utilities Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

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March 22, 2002

KOSRAE UTILITIES AUTHORITY

Balance Sheets
September 30, 2001 and 2000

<u>ASSETS</u>	<u>2001</u>	<u>2000</u>
Utility plant (note 2):		
Electric plant in service	\$ 8,031,236	\$ 7,027,116
Construction work in progress	325,416	969,178
Less accumulated depreciation	<u>(3,211,284)</u>	<u>(2,710,819)</u>
Utility plant, net	<u>5,145,368</u>	<u>5,285,475</u>
Current assets:		
Cash, available for operations	200,551	154,766
Cash, available for capital projects	<u>2,279,024</u>	<u>1,826,354</u>
Total cash	2,479,575	1,981,120
Accounts receivable, net (note 3)	476,604	314,559
Receivable - OMIP grant	-	10,797
Receivable - FSM National Government grant	7,785	120,842
Prepayments	583	23,303
Inventories	<u>219,713</u>	<u>244,687</u>
Total current assets	<u>3,184,260</u>	<u>2,695,308</u>
	<u>\$ 8,329,628</u>	<u>\$ 7,980,783</u>
<u>CAPITALIZATION AND LIABILITIES</u>		
Capitalization:		
Retained earnings (note 5)	<u>\$ 8,192,234</u>	<u>\$ 7,732,783</u>
Total capitalization	<u>8,192,234</u>	<u>7,732,783</u>
Current liabilities:		
Accounts payable	100,789	208,509
Accrued taxes and other	14,392	15,471
Accrued annual leave	<u>22,213</u>	<u>24,020</u>
Total liabilities	<u>137,394</u>	<u>248,000</u>
Commitment and contingency (notes 5 and 6)	<u>\$ 8,329,628</u>	<u>\$ 7,980,783</u>

See accompanying notes to financial statements.

KOSRAE UTILITIES AUTHORITY

Statements of Operations and Retained Earnings Years Ended September 30, 2001 and 2000

	<u>2001</u>	<u>2000</u>
Operating revenues:		
Electricity sales	\$ <u>1,195,109</u>	\$ <u>1,099,684</u>
Operating expenses:		
Production fuel	721,641	658,635
Depreciation	500,465	492,134
Salaries and wages	386,832	396,657
Administrative and general	97,261	130,046
Repair and maintenance	<u>78,678</u>	<u>72,014</u>
Total operating expenses	<u>1,784,877</u>	<u>1,749,486</u>
Operating loss	<u>(589,768)</u>	<u>(649,802)</u>
Nonoperating revenues:		
Operating subsidies (note 4)	862,328	696,352
Interest income	109,727	92,037
Other income	<u>77,164</u>	<u>10,845</u>
Total nonoperating revenues	<u>1,049,219</u>	<u>799,234</u>
Net income	459,451	149,432
Retained earnings at beginning of year	<u>7,732,783</u>	<u>7,583,351</u>
Retained earnings at end of year	\$ <u><u>8,192,234</u></u>	\$ <u><u>7,732,783</u></u>

See accompanying notes to financial statements.

KOSRAE UTILITIES AUTHORITY

Statements of Cash Flows Years Ended September 30, 2001 and 2000

	<u>2001</u>	<u>2000</u>
Cash flows from operating activities:		
Loss from operations	\$ (589,768)	\$ (649,802)
Adjustments to reconcile loss from operations to net cash (used for) provided by operating activities:		
Depreciation	500,465	492,134
Other income	-	9,472
(Increase) decrease in assets:		
Receivables	38,974	105,948
Inventories	24,974	45,457
Prepayments	22,720	(17,661)
Increase (decrease) in liabilities:		
Accounts payable	(107,720)	182,612
Accrued taxes and other liabilities	<u>(2,886)</u>	<u>(79)</u>
Net cash (used for) provided by operating activities	<u>(113,241)</u>	<u>168,081</u>
Cash flows from investing activities:		
Interest income	<u>109,727</u>	<u>92,037</u>
Net cash provided by investing activities	<u>109,727</u>	<u>92,037</u>
Cash flows from noncapital financing activities:		
Operating grants received (note 4)	<u>862,328</u>	<u>506,250</u>
Net cash provided by noncapital financing activities	<u>862,328</u>	<u>506,250</u>
Cash flows from capital and related financing activities:		
Purchase of property, plant and equipment	(360,359)	(661,011)
Capital contribution from other sources	<u>-</u>	<u>191,475</u>
Net cash used for capital and related financing activities	<u>(360,359)</u>	<u>(469,536)</u>
Net increase in cash	498,455	296,832
Cash at beginning of year	<u>1,981,120</u>	<u>1,684,288</u>
Cash at end of year	<u>\$ 2,479,575</u>	<u>\$ 1,981,120</u>

See accompanying notes to financial statements.

KOSRAE UTILITIES AUTHORITY

Notes to Financial Statements
September 30, 2001 and 2000

(1) Summary of Significant Accounting Policies

The accounting policies of Kosrae Utilities Authority (KUA) conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting," requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. KUA has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

Basis of Accounting: All 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 this fund are included on the balance sheet.

The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses recorded at the time liabilities are incurred. Revenues are recorded as billed to customers on a monthly cycle billing basis. At the end of each month, unbilled revenues are accrued based on the most recent billing cycle.

General: KUA is a component unit of the Government of Kosrae. KUA commenced operations on October 1, 1993, with the assets and liabilities of the Division of Public Utilities of the Kosrae State Department of Public Works transferred as of that date.

Utility Plant: Utility plant assets were transferred from the Division of Public Utilities to KUA as of October 1, 1993 at the estimated net book value in the absence of documents to support cost. At September 30, 2001 and 2000, approximately 18 percent of utility plant transferred to KUA was stated at estimated cost. The net book value of the utility plant assets transferred was \$1,591,861 and \$1,852,293 as of September 30, 2001 and 2000, respectively.

Depreciation: Depreciation is computed using the straight-line method over the estimated useful lives of the assets (3 - 40 years for plant assets). Depreciation expense for 2001 and 2000 was approximately seven percent of the cost of depreciable properties.

Annual and Sick Leave: Earned but unused annual leave is paid to employees upon termination of their employment. Accordingly, KUA accrues these benefits in the period earned. It is the policy of KUA to record the cost of sick leave when leave is actually taken and a liability is actually incurred.

Revenues: Sales of electricity are recorded as billed to customers on a monthly billing cycle basis. At September 30, 2001 and 2000, unbilled revenues are estimated and accrued based on the most recent billing cycles.

KOSRAE UTILITIES AUTHORITY

Notes to Financial Statements
September 30, 2001 and 2000

(1) Summary of Significant Accounting Policies, Continued

Federal Grants and Subsidies: KUA receives federal grants as a subrecipient from Kosrae State in addition to the Kosrae State Legislature appropriated subsidies, FSM National Congress appropriated subsidies, and matching funds for federal programs as required.

Inventory: Inventories are carried at the lower of cost, using average cost, or market value. An allowance for obsolescence was not provided because management believes that all inventory items are usable.

Cash: For purposes of the balance sheets and statements of cash flows, cash includes cash on hand, cash in bank checking and savings accounts and time certificates of deposit with initial maturities of three months or less. Of cash balances at September 30, 2001, \$200,000 is subject to Federal Deposit Insurance Corp. (FDIC) coverage, with the remaining balance exceeding insurable limits. KUA does not require collateralization of its deposits. Therefore, the amounts which exceed FDIC limits are characterized as uncollateralized.

Restricted Cash: As of September 30, 2001, \$2,279,024 (\$1,826,354 in 2000) in time certificates of deposit placed with local banks with annual interest rates ranging from 3% to 6.5% has been internally reserved for maintenance, capital improvement and work in progress.

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

(2) Utility Plant

Utility plant consists of the following at September 30, 2001 and 2000:

	<u>Estimated Useful Lives</u>	<u>2001</u>	<u>2000</u>
Production plant	5 - 40 years	\$ 4,267,093	\$ 4,168,419
Distribution plant	5 - 30 years	3,332,752	2,428,949
General plant	3 - 20 years	<u>431,391</u>	<u>429,748</u>
Electric plant in service		8,031,236	7,027,116
Less accumulated depreciation		<u>(3,211,284)</u>	<u>(2,710,819)</u>
		\$ <u>4,819,952</u>	\$ <u>4,316,297</u>

KOSRAE UTILITIES AUTHORITY

Notes to Financial Statements
September 30, 2001 and 2000

(3) Accounts Receivable

Accounts receivable at September 30, 2001 and 2000, are summarized as follows:

	<u>2001</u>	<u>2000</u>
Residential	\$ 87,878	\$ 98,985
Commercial	198,096	207,915
Government	<u>154,503</u>	<u>208,556</u>
	440,477	515,456
Other	<u>199,860</u>	<u>40,000</u>
	640,337	555,456
Less allowance for doubtful receivables	<u>(163,733)</u>	<u>(240,897)</u>
	\$ <u>476,604</u>	\$ <u>314,559</u>

All of KUA's accounts receivable are with customers and government agencies based in Kosrae.

(4) Contributions

Contributions for the years ended September 30, 2001 and 2000 are as follows:

	<u>2001</u>	<u>2000</u>
U.S. Department of the Interior operations and maintenance improvement program (OMIP) grants	\$ 18,587	\$ 71,544
FSM National Government capital funds for extension of distribution lines	-	118,558
FSM National Government pass through grant for the pole hardening project	337,491	-
Compact energy grant	<u>506,250</u>	<u>506,250</u>
	\$ <u>862,328</u>	\$ <u>696,352</u>

(5) Commitments

Retained earnings at September 30, 2001 has been appropriated in the amount of \$616,919 for repair and maintenance and capital improvement projects. This process will continue in fiscal year 2002 with a total of \$25,000 being further appropriated on a quarterly basis from retained earnings for this purpose.

(6) Risk Management

Kosrae Utilities Authority carries insurance to cover its potential risks from fire on its building and the contents and full coverage on property damage. Kosrae Utilities Authority is substantially self-insured for all other risks. Management is of the opinion that no material losses have been sustained as a result of this practice.

KOSRAE UTILITIES AUTHORITY

Notes to Financial Statements
September 30, 2001 and 2000

(7) Adoption of New Accounting Principle

Effective October 1, 2000, KUA adopted GASB Statement No. 33, "Accounting and Financial Reporting for Nonexchange Transactions." GASB No. 33 establishes more uniform revenue recognition criteria and financial reporting standards regarding the timing of recognition of the results of nonexchange transactions involving cash and other financial and capital resources. The provisions of GASB No. 33 were applied to all periods presented; and accordingly, the statement of operations for 2000 has been restated to reflect grants of \$696,352. Implementation of GASB No. 33 had no impact on the balance sheets and statements of cash flows.



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL
CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

The Board of Directors
Kosrae Utilities Authority:

We have audited the financial statements of the Kosrae Utilities Authority (KUA), as of and for the year ended September 30, 2001, and have issued our report thereon dated March 22, 2002. We conducted our audit 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.

Compliance

As part of obtaining reasonable assurance about whether KUA's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered KUA's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended for the information of the Board of Directors and management of KUA and the cognizant audit and other federal agencies and is not intended to be, and should not be, used by anyone other than those specified parties.

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March 22, 2002



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND
INTERNAL CONTROL OVER COMPLIANCE APPLICABLE
TO EACH MAJOR FEDERAL AWARD PROGRAM AND THE
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

The Board of Directors
Kosrae Utilities Authority:

Compliance

We have audited the compliance of the Kosrae Utilities Authority (KUA) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to its one major federal program for the year ended September 30, 2001. KUA's major federal program is identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (page 12). Compliance with the requirements of laws, regulations, contracts and grants applicable to its one major federal program is the responsibility of KUA's management. Our responsibility is to express an opinion on KUA's compliance based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about KUA's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on KUA's compliance with those requirements.

In our opinion, KUA complied, in all material respects, with the requirements referred to above that are applicable to its one major federal program for the year ended September 30, 2001.

Internal Control Over Compliance

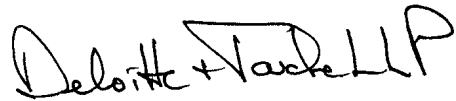
The management of KUA is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered KUA's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of KUA, as of and for the year ended September 30, 2001, and have issued our report thereon dated March 22, 2002. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. This schedule is the responsibility of the management of KUA. Such information has been subjected to the auditing procedures applied in our audit of the financial statements and, in our opinion, is fairly stated, in all material respects when considered in relation to the financial statements taken as a whole.

This report is intended for the information of the Board of Directors and management of KUA and the cognizant audit and other federal agencies and is not intended to be, and should not be, used by anyone other than those specified parties.

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March 22, 2002

KOSRAE UTILITIES AUTHORITY

Schedule of Expenditures of Federal Awards Year Ended September 30, 2001

<u>Grantor/Program Title</u>	<u>CFDA No.</u>	<u>Expenditures for the Year Ended September 30, 2001</u>
<u>U.S. Department of the Interior:</u>		
<u>Office of Territorial and International Affairs:</u>		
<u>Compact of Free Association:</u>		
Energy Program Funds, Section 214(c)	15.875	\$ <u>506,250</u>

Note: The Compact of Free Association programs are passed through Kosrae State to the Kosrae Utilities Authority. The OMIP grant is received in a direct capacity from the U.S. Department of the Interior. The above schedule has been prepared on the accrual basis of accounting.

KOSRAE UTILITIES AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 2001

Part I - Summary of Auditors' Results

1. The Independent Auditors' Report on the financial statements expressed an unqualified opinion.
2. Reportable conditions in internal control over financial reporting were not identified.
3. No instance of noncompliance considered material to the financial statements was disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal awards programs were not identified.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed an unqualified opinion.
6. The audit disclosed no findings required to be reported by OMB Circular A-133.
7. The Organization's one major program was:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
Compact of Free Association Energy Program Funds, Section 214 (c)	15.875

8. A threshold of \$300,000 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
9. The Organization did qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

Part II - Financial Statement Findings Section

No matters are reportable.

Part III – Federal Award Findings and Questioned Costs Section

No matters are reportable.