

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

FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2011 AND 2010

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

Years Ended September 30, 2011 and 2010
Table of Contents

	<u>Page No.</u>
I. BASIC FINANCIAL STATEMENTS	
Independent Auditors' Report	1
Management's Discussion and Analysis	2
Statements of Net Assets	6
Statements of Revenues, Expenses and Changes in Net Assets	7
Statements of Cash Flows	8
Notes to Financial Statements	9
II. INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS	
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 <i>Government Auditing Standards</i>	20
Summary Schedule of Prior Year Findings and Questioned Costs	22

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Kosrae Utilities Authority:

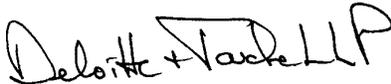
We have audited the accompanying statements of net assets of the Kosrae Utilities Authority, a component unit of the State of Kosrae, as of September 30, 2011 and 2010, and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Kosrae Utilities Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, the financial statements present fairly, in all material respects, the financial position of the Kosrae Utilities Authority as of September 30, 2011 and 2010, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 6, 2012, on our consideration of the Kosrae Utilities 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* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 2 through 5 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. The supplementary information is the responsibility of the Kosrae Utilities Authority's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.


June 6, 2012

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

Management's Discussion and Analysis
Years Ended September 30, 2011 and 2010

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, 2011. 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 staggering term of 2 to 4 years.

The Authority serves 1,905 customers during FY2011. With slight change in customer base from the previous operating year, the customer base ratios for FY2011 were approximately 80% residential with energy sales of 40%, 12% commercial with 28% energy sales, 4% Kosrae State Government with 18% energy sales, 3% non-Kosrae State Government with 8% energy sales, and 1% industrial with 6% kwh sales. The total energy sales slightly decreased by approximately 5% compared to the previous fiscal year due to a reduction in sales volume from residential and commercial sectors. The reduction in kwh sales were mainly caused by conservation efforts and unregistered kwh usage. With slow economic and development activities in the State, the energy sales ratio from various customer sectors are expected to remain constant for the next few years and will be reviewed annually since any changes in customer class can have an effect on future operating revenues.

KUA continued to face challenges during FY2011. These operating issues are the continued revenue shortfalls to adequately cover operating costs and to fund improvements of run-down fixed assets, the fuel inefficiencies of the aging generator units and the deteriorating Power Plant Substation, the increased system loss and the rising cost of fuel, equipment, parts and hardware materials. These continue to be the main priorities for the operation and plan of actions are focused toward improving these operating issues. The electric revenues from existing power rates and fuel adjustment charges provide for approximately 80% of the total operating expenses and the remaining were operating losses.

The following table summarizes the financial position and results of operation of Kosrae Utilities Authority for 2009 through 2011:

<u>Assets</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Current assets	\$ 1,377,031	\$ 1,510,683	\$ 1,661,986
Utility plant, net	3,728,307	4,118,863	4,512,088
Other non-current assets	<u>252,800</u>	<u>-</u>	<u>-</u>
	<u>\$ 5,358,138</u>	<u>\$ 5,629,546</u>	<u>\$ 6,174,074</u>
 <u>Liabilities and Net Assets</u>			
Current liabilities	\$ 713,354	\$ 583,577	\$ 400,521
Notes payable, net of current portion	<u>-</u>	<u>69,580</u>	<u>167,940</u>
Total liabilities	<u>713,354</u>	<u>653,157</u>	<u>568,461</u>
 Net Assets:			
Invested in capital assets, net of related debt	3,658,995	3,950,944	4,248,903
Restricted	90,000	90,000	90,000
Unrestricted	<u>895,789</u>	<u>935,445</u>	<u>1,266,710</u>
Total net assets	<u>4,644,784</u>	<u>4,976,389</u>	<u>5,605,613</u>
	<u>\$ 5,358,138</u>	<u>\$ 5,629,546</u>	<u>\$ 6,174,074</u>

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

Management's Discussion and Analysis
Years Ended September 30, 2011 and 2010

Revenue, Expenses and Changes in Net Assets

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating revenues	\$ 2,347,648	\$ 2,095,856	\$ 1,903,456
Operating expenses	<u>2,917,875</u>	<u>2,721,402</u>	<u>2,592,464</u>
Net operating loss	<u>(570,227)</u>	<u>(625,546)</u>	<u>(689,008)</u>
Operating grants	270,866	-	8,919
Interest income and net investment loss	<u>(32,244)</u>	<u>(3,678)</u>	<u>(40,821)</u>
Total non-operating loss	<u>238,622</u>	<u>(3,678)</u>	<u>(31,902)</u>
Capital contributions	<u>-</u>	<u>-</u>	<u>62,331</u>
Change in net assets	\$ <u>(331,605)</u>	\$ <u>(629,224)</u>	\$ <u>(658,579)</u>

FINANCIAL HIGHLIGHTS

Operating revenues derived from electricity sales are higher this year compared with the previous years. With the continued annual tariff rate increases and a rising fuel adjustment charge rate, sales revenue is expected to be increasing every year but with an opposite effect in kilowatt-hour volume of sales.

In this year's operation, income from electricity sales net of Fuel adjustment charge (FAC) is 1% less against last year. FAC rate applied to kilowatt-hour sales and in addition to the tariff rate, on the other hand, goes up from an average of negative 0.0080/kilowatt in last year to a positive 0.0472/kilowatt this year, thus increasing the FAC revenue during the year.

FY 2011 sales volume of 5,248,361 kilowatt-hour is 5% less compared with FY 2010, with residential and commercial customers comprises a big drop on their power consumptions. For the first quarter of FY 2012, where fuel price continues to go up, sales volume also decreases. With the resumption of various government projects undertaken in FY 2012, we are expecting that it would partially compensate for the decreasing residential and commercial customers' power consumption when the projects will be finished.

Operating expenses are higher by about 7% compared with last year. Fuel consumption and power generation is reduced by 4% and 5%, respectively, but with the prices of fuel continuing to go up, fuel expenses also increased from \$3.621 per gallon at the start of the fiscal year to \$4.4946 per gallon at the end of the year, a 24% increase in fuel prices. Maintenance cost on generators and distribution vehicles also attributed to the increase in operating expenses while administrative expenses and personnel costs are on the same level with last year's expenses.

In FY 2011, KUA is selling at an average of \$0.45/kilowatt-hour and the average cost of producing each kilowatt-hour is computed at \$0.55, which is a loss of \$0.10/kilowatt-hour sold, hence the reason why management and the Board adopted a gradual rate increase annually to slowly reduce the loss and temporarily use reserve funds to defray needed operational expenses.

A grant was received from US-DOI as a sub-grantee capacity through Kosrae State Government to be used for contracting a consultant to prepare a detailed study and strategic plan on the transfer of responsibility of the Kosrae state-owned water system to KUA referred to as the "Water Service Transition Plan". In FY 2011, KUA expended an amount equal to \$18,066 and the balance is projected to be disbursed by the first half of FY 2012. KUA also received \$252,800 of Japan grant funding through the FSM National Government, which funding is on deposit with its fuel supplier.

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

Management's Discussion and Analysis
Years Ended September 30, 2011 and 2010

Time certificate of deposit placed in Bank of the FSM is earning interest at 0.80% per annum at the start of the year which then reduced to 0.50% per annum in the middle of November 2010 until the end of FY 2011. Loan interest charged to KUA's loan balance in Bank of the FSM is 2.50% over the TCD rate. Interest rate accrued on the line of credit from Salomon Smith Barney is at 4.50% per annum.

During the year, a TCD withdrawal of \$50,000 was made to fund operations. Fair market value of Salomon Smith Barney investments declined by approximately 5%. Collections from receivables were higher specifically with the Kosrae State Government accounts but FAC receivable also increases. Decreases in inventories were withdrawal from stock used for maintenance and capital projects. Purchases of materials and parts for stock replenishment are less this year.

After the first quarter of FY 2011, KUA changed its billing software to the El Dorado billing system. Aside from saving the high cost of maintenance fees and upgrades from the old system, the new one is simple and can generate the same report. With 81% of the total customers under cash power prepayment meters, maintaining a simple and comprehensible billing system to cater to post paid customers with fewer annual maintenance fees is highly reasonable and necessary. Upgrades and adjustments in the system are done in FY 2012 to customize the program to fit KUA's operations. No significant capital asset acquisitions occurred in FY 2011. For more information concerning capital assets, please refer to note 5 to the financial statements.

In August 2011, KUA signed an agreement with FSM Petrocorp. for a line of credit facility of approximately 133,300 gallons. This is backed up by KUA's receipt of Japan's Non Project Grant Aid passed through the FSM National Government. With this scheme, KUA is granted 30 credit days in order to pay off a purchase order instead of the existing purchase on a cash basis. As of September 30, 2011, KUA's payable to FSM Petrocorp is valued at \$126,042 representing three outstanding purchase orders delivered close to the end of the fiscal year. The long-term loan from Bank of the FSM is expected to be fully paid by August 2012 and management is planning to refinance when the need for future funds arises. The line of credit from SSB, on the other hand, is still unpaid which includes the principal and interest accrued to date. For more information concerning debt, please refer to notes 6 and 7 to the financial statements.

With the existing financial condition and the continued loss on operation each year as tariff rates cannot cover the cost of production, reserve funds and investments will be withdrawn to facilitate the necessary operational expenses and therefore expected to deteriorate on the succeeding years.

Management's Discussion and Analysis for the year ended September 30, 2010 is set forth in KUA's report on the audit of financial statements, which is dated February 28, 2011. That Discussion and Analysis explains the major factors impacting the 2010 financial statements and can be viewed at the FSM Office of the National Public Auditors' website at www.fsmopa.fm.

Plan of Action for 2012

1. Complete the Rate Study Review funded by DOI and make recommendations to the Board to approve the Rate Study recommendations to cover the financial shortfalls and to sufficiently fund the urgent fixed asset improvements. Implement the gradual rate increase during the first month of the FY2012 as approved by the KUA Board on the existing Tariff.
2. Implement findings and recommendations made by KEMA on the KUA System Loss Reassessment Study to improve and reduce the power system loss for the operation.

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

Management's Discussion and Analysis
Years Ended September 30, 2011 and 2010

3. Implement the performance benchmarking indicators that KUA needs to improve upon as indicated in the findings of the Benchmarking Reports by Pacific Power Association (PPA) in order to improve operation efficiency and quality services to customers.
4. Expand and increase renewable energies of Solar PV to the power grid-lines to be funded by EU-North Rep. funds and managed by SPC and install the first 200 Kwp from the WaveSurf Power System to reduce fuel cost to the operation and to customers. Install stand-alone Solar PV System to Walung's school and dispensary.
5. Monitor and control unnecessary expenses to reduce operating cost and conduct daily review of cash collection to ensure revenues are properly recorded to prevent attempted fraud and theft. Schedule regular visits and inspection of all Prepayment Meters Customers to ensure proper functioning of meters and registering of kwh used to prevent revenues loss to KUA.
6. Seek funding to purchase a new CAT engine, 1.2 Mwp, Model 3512B-1200RBM to improve fuel efficiency to reduce fuel cost and to implement major overhaul for engine unit #7 (CAT 1.5 MW) to improve running efficiency and to increase power supply capacity to meet increasing power demand. Seek funding to upgrade the deteriorating Power Plant Substation to avoid major power blackouts to the island.
7. Increase number of Cash Power Meter Customers to achieve 85% of the customers' base to improve cash flows and account receivable accounts.
8. Continue to provide practical and hands-on trainings to employees to improve skill level and knowledge to perform services and job request effectively and efficiently to minimize cost and focusing trainings on repairs and maintenances of the renewable energies system.
9. Take measures to improve accountability of inventories, properties and establish better reporting system for capital and maintenance costs. Take maintenance programs to sustain power system facilities and equipments.
10. Conduct Demand Side Management Programs for customers to use energy efficiently in reducing power consumption as well as to reducing cost to KUA. Implement educational and public awareness programs to improve public relations.
11. Complete Water and Waste Water Transition Study Project funded by DOI and to prepare preliminary requirements and tasks for the establishment of Water Division under KUA.
12. Continue to take active roles in promoting the private sectors development to improve economic activities in Kosrae to increase revenues base for the KUA operation.

Contacting the Authority's Financial Management

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 asked or 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)

Statements of Net Assets
September 30, 2011 and 2010

<u>ASSETS</u>	<u>2011</u>	<u>2010</u>
Utility plant:		
Electric plant in service	\$ 11,720,314	\$ 11,675,177
Less accumulated depreciation	<u>(8,070,563)</u>	<u>(7,643,946)</u>
	3,649,751	4,031,231
Construction work in progress	<u>78,556</u>	<u>87,632</u>
Net utility plant	<u>3,728,307</u>	<u>4,118,863</u>
Other noncurrent assets:		
Deposit for fuel purchase contract	<u>252,800</u>	<u>-</u>
Current assets:		
Cash and cash equivalents	153,467	165,847
Investments	460,291	483,595
Time certificate of deposit - restricted	238,575	287,042
Accounts receivable, net	158,351	168,444
Prepayments	2,820	2,981
Inventories (net of allowance for obsolescence of \$142,684 and \$140,966 in 2011 and 2010, respectively)	<u>363,527</u>	<u>402,774</u>
Total current assets	<u>1,377,031</u>	<u>1,510,683</u>
Total assets	<u>\$ 5,358,138</u>	<u>\$ 5,629,546</u>
<u>LIABILITIES AND NET ASSETS</u>		
Long-term debt, net of current portion	<u>\$ -</u>	<u>\$ 69,580</u>
Current liabilities:		
Current portion of long-term debt	69,312	98,339
Short-term note payable	158,747	151,680
Accounts payable - fuel	126,042	-
Accounts payable - other	98,198	102,679
Federal grants payable	175,000	175,000
Accrued annual leave	15,889	15,494
Deferred revenue	53,478	21,200
Accrued taxes and other	<u>16,688</u>	<u>19,185</u>
Total current liabilities	<u>713,354</u>	<u>583,577</u>
Total liabilities	<u>713,354</u>	<u>653,157</u>
Commitments and contingency		
Net assets:		
Invested in capital assets, net of related debt	3,658,995	3,950,944
Restricted	90,000	90,000
Unrestricted	<u>895,789</u>	<u>935,445</u>
Total net assets	<u>4,644,784</u>	<u>4,976,389</u>
	<u>\$ 5,358,138</u>	<u>\$ 5,629,546</u>

See accompanying notes to financial statements.

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

Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended September 30, 2011 and 2010

	2011	2010
Operating revenues:		
Electricity sales	\$ 2,355,343	\$ 2,090,698
Less uncollectible accounts	<u>(7,695)</u>	<u>5,158</u>
Net operating revenues	<u>2,347,648</u>	<u>2,095,856</u>
Operating expenses:		
Production fuel	1,894,071	1,645,181
Depreciation and amortization	426,617	508,097
Salaries and wages	369,731	367,945
Administrative and general	144,028	145,742
Repairs and maintenance	<u>83,428</u>	<u>54,437</u>
Total operating expenses	<u>2,917,875</u>	<u>2,721,402</u>
Loss from operations	<u>(570,227)</u>	<u>(625,546)</u>
Nonoperating revenues (expenses):		
Interest expense	(10,647)	(8,664)
Interest income	1,707	3,911
Net change in fair value of investments	(23,304)	1,075
Federal grants	18,066	-
Government of Japan grant	<u>252,800</u>	<u>-</u>
Total nonoperating revenues (expenses), net	<u>238,622</u>	<u>(3,678)</u>
Change in net assets	(331,605)	(629,224)
Net assets at beginning of year	<u>4,976,389</u>	<u>5,605,613</u>
Net assets at end of year	<u>\$ 4,644,784</u>	<u>\$ 4,976,389</u>

See accompanying notes to financial statements.

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

Statements of Cash Flows
Years Ended September 30, 2011 and 2010

	2011	2010
Cash flows from operating activities:		
Cash received from customers	\$ 2,357,534	\$ 2,107,280
Cash paid to suppliers for goods and services	(1,964,208)	(1,841,183)
Cash paid to employees for services	(368,183)	(364,862)
Net cash provided by (used for) operating activities	25,143	(98,765)
Cash flows from investing activities:		
Net purchases, sales and maturities of investments	-	(53,156)
Withdrawal from time certificate of deposit	50,000	100,000
Interest and dividends received	275	4,036
Net cash provided by investing activities	50,275	50,880
Cash flows from noncapital financing activities:		
Operating grants received	50,450	-
Borrowing under a line of credit facility	-	150,000
Net cash provided by noncapital financing activities	50,450	150,000
Cash flows from capital financing activities:		
Principal payments on long-term debt	(98,607)	(95,266)
Interest paid on long-term debt	(3,580)	(7,102)
Capital expenditures for utility plant	(36,061)	(114,872)
Net cash used for capital financing activities	(138,248)	(217,240)
Net change in cash and cash equivalents	(12,380)	(115,125)
Cash and cash equivalents at beginning of year	165,847	280,972
Cash and cash equivalents at end of year	\$ 153,467	\$ 165,847
Reconciliation of loss from operations to net cash provided by (used for) operating activities:		
Operating loss	\$ (570,227)	\$ (625,546)
Adjustments to reconcile operating loss to net cash provided by (used for) operating activities:		
Depreciation and amortization	426,617	508,097
Bad debts	7,695	(5,158)
(Increase) decrease in assets:		
Accounts receivable	2,297	5,939
Prepayments	161	40,804
Inventories	39,247	(51,301)
Increase (decrease) in liabilities:		
Accounts payable - fuel	126,042	-
Accounts payable - other	(4,481)	16,124
Accrued annual leave	395	659
Deferred revenue	(106)	10,643
Accrued taxes and other	(2,497)	974
Net cash provided by (used for) operating activities	\$ 25,143	\$ (98,765)

Supplemental information of noncash operating financing activities:

During the year ended September 30, 2011, KUA received a sub-grant of \$252,800 from the FSM National Government through an increase in long-term deposit for its fuel purchase line with FSM Petroleum Corporation, a component unit of the FSM National Government.

See accompanying notes to financial statements.

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

Notes to Financial Statements
Years Ended September 30, 2011 and 2010

(1) Organization

The Kosrae Utilities Authority (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 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. 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 Principles 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.

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and modified by GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, establish financial reporting standards for governmental entities which require that management's discussion and analysis of the financial activities be included with the basic financial statements and notes and modifies certain other financial statement disclosure requirements.

To conform to the requirements of GASB Statement No. 34, equity is presented in the following net asset categories:

- Invested in capital assets; capital assets, net of accumulated depreciation and related debt, plus construction or improvement of those assets.
- Restricted:
 - Nonexpendable - Net assets subject to externally imposed stipulations that require KUA to maintain them permanently. For the years ended September 30, 2011 and 2010, KUA does not have nonexpendable restricted net assets.

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

Notes to Financial Statements
Years Ended September 30, 2011 and 2010

(2) Summary of Significant Accounting Policies, Continued

- Expendable - Net assets whose use by KUA is subject to externally imposed stipulations that can be fulfilled by actions of KUA pursuant to those stipulations or that expire by the passage of time. As of September 30, 2011 and 2010, KUA recorded restricted expendable net assets of \$90,000 representing appropriations received from the FSM National Government for the power extension project to Walung, which has yet to commence.
- Unrestricted; net assets that are not subject to externally imposed stipulations. Unrestricted net assets 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.

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 assets. Proprietary fund operating statements present increases and decreases in net total assets. 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. KUA considers utility revenues and costs that are directly related to utility operations to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

Cash and Cash Equivalents and Time Certificates of Deposit

Cash and cash equivalents include cash on hand and cash held in demand deposits. Deposits maintained in time certificates of deposit with original maturity dates greater than three months are separately classified on the statements of net assets within investments.

Investments

Investments and related investment earnings are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Restricted Assets

As of September 30, 2011 and 2010, time certificates of deposit of \$238,575 and \$287,042, respectively, are deposited with a local bank with annual interest rates of 0.25% in 2011 and 0.80% in 2010 and have been internally reserved for maintenance, capital improvements and work in progress. As of September 30, 2011, the time certificate of deposit of \$238,575 is pledged as collateral for KUA's loan with the same institution.

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

Notes to Financial Statements
Years Ended September 30, 2011 and 2010

(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.

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 90% and 10% of the net inventory value, respectively, as of September 30, 2011, and 94% and 6%, respectively, as of September 30, 2010.

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 cost. As of September 30, 2011 and 2010, approximately 1% and 2%, respectively, of utility plant transferred to KUA was stated at estimated net book value. The net book value of the utility plant assets transferred was \$33,450 and \$61,291 as of September 30, 2011 and 2010, respectively. KUA capitalizes individual items that have an estimated useful life of more than one year. Depreciation is calculated on the straight-line method over the estimated useful lives of the respective assets.

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 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, 2011 and 2010 are \$98,653 and \$90,862, respectively.

Federal Grants and Subsidies

During the year ended September 30, 2011, KUA was the recipient of federal funds from the U.S. Department of the Interior in a sub-recipient capacity.

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

Notes to Financial Statements
Years Ended September 30, 2011 and 2010

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

During fiscal year 2011, the Authority implemented the following pronouncements:

- GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions.
- GASB Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools.

The implementation of these pronouncements did not have a material effect on the accompanying financial statements.

In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to measurement of OPEB obligations by certain employers participating in agent multiple-employer OPEB plans. The provisions of Statement 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Authority.

In December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Authority.

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*, which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Authority.

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

Notes to Financial Statements
Years Ended September 30, 2011 and 2010

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Authority.

In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Authority.

In July 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions* (an amendment of GASB Statement No. 53), which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The provisions of this statement are effective for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Authority.

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

Notes to Financial Statements
Years Ended September 30, 2011 and 2010

(3) Deposits and Investments, Continued

A. Deposits

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

- Category 1 Deposits that are federally insured or collateralized with securities held by KUA or its agent in KUA's name;
- Category 2 Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in KUA's name; or
- Category 3 Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in KUA's name and non-collateralized deposits.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, KUA's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. KUA does not have a deposit policy for custodial credit risk.

As of September 30, 2011 and 2010, cash and cash equivalents and time certificates of deposit were \$392,042 and \$452,889, respectively, and the corresponding bank balances were \$404,164 and \$505,305, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2011 and 2010, bank deposits in the amount of \$404,164 and \$250,000, respectively, are FDIC 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

GASB Statement No. 3 previously required government entities to present investment risks in terms of whether the investments fell into the following categories:

- Category 1 Investments that are insured or registered, or securities held by KUA or its agent in KUA's name;
- Category 2 Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in KUA's name; or
- Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in KUA's name.

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

Notes to Financial Statements
Years Ended September 30, 2011 and 2010

(3) Deposits and Investments, Continued

B. Investments, Continued

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for investments falling into categories 1 and 2, and provided for disclosure requirements addressing other common risks of investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. GASB Statement No. 40 did retain and expand the element of custodial credit risk in GASB Statement No. 3.

As of September 30, 2011 and 2010, investments at fair value comprise the following:

	<u>2011</u>	<u>2010</u>
Money market funds	\$ 224,714	\$ 226,877
Common stock	<u>235,577</u>	<u>256,718</u>
	<u>\$ 460,291</u>	<u>\$ 483,595</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, 2011 and 2010.

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, 2011 and 2010, 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, 2011 and 2010, are summarized as follows:

	<u>2011</u>	<u>2010</u>
Utility:		
Residential	\$ 43,240	\$ 43,547
Commercial	146,645	143,685
Government	67,788	101,795
Fuel adjustment charge	<u>21,472</u>	<u>(1,130)</u>
	279,145	287,897

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

Notes to Financial Statements
Years Ended September 30, 2011 and 2010

(4) Accounts Receivable, Continued

Receivable from other governments	7,785	7,785
Other	<u>69,813</u>	<u>71,308</u>
	356,743	366,990
Less allowance for doubtful accounts	<u>(198,392)</u>	<u>(198,546)</u>
	<u>\$ 158,351</u>	<u>\$ 168,444</u>

(5) Utility Plant

Capital asset activity for the years ended September 30, 2011 and 2010, was as follows:

	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2010</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Balance at September 30, 2011</u>
<u>Depreciable assets:</u>					
Production plant	5 to 40 years	\$ 5,187,615	\$ -	\$ -	\$ 5,187,615
Distribution plant	5 to 30 years	5,769,063	37,317	-	5,806,380
General plant	3 to 20 years	<u>718,499</u>	<u>7,820</u>	<u>-</u>	<u>726,319</u>
Total electric plant in service		11,675,177	45,137	-	11,720,314
Less accumulated depreciation		<u>(7,643,946)</u>	<u>(426,617)</u>	<u>-</u>	<u>(8,070,563)</u>
		4,031,231	(381,480)	-	3,649,751
<u>Non-depreciable assets:</u>					
Construction work-in-progress		<u>87,632</u>	<u>20,038</u>	<u>(29,114)</u>	<u>78,556</u>
Electric plant in service, net		<u>\$ 4,118,863</u>	<u>\$ (361,442)</u>	<u>\$ (29,114)</u>	<u>\$ 3,728,307</u>
	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2009</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Balance at September 30, 2010</u>
<u>Depreciable assets:</u>					
Production plant	5 to 40 years	\$ 5,124,386	\$ 63,229	\$ -	\$ 5,187,615
Distribution plant	5 to 30 years	5,681,272	87,791	-	5,769,063
General plant	3 to 20 years	<u>626,215</u>	<u>92,284</u>	<u>-</u>	<u>718,499</u>
Total electric plant in service		11,431,873	243,304	-	11,675,177
Less accumulated depreciation		<u>(7,135,849)</u>	<u>(508,097)</u>	<u>-</u>	<u>(7,643,946)</u>
		4,296,024	(264,793)	-	4,031,231
<u>Non-depreciable assets:</u>					
Construction work-in-progress		<u>216,064</u>	<u>74,540</u>	<u>(202,972)</u>	<u>87,632</u>
Electric plant in service, net		<u>\$ 4,512,088</u>	<u>\$ (190,253)</u>	<u>\$ (202,972)</u>	<u>\$ 4,118,863</u>

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

Notes to Financial Statements
Years Ended September 30, 2011 and 2010

(6) Long-Term Debt

Long-term debt at September 30, 2011 and 2010, is as follows:

	<u>2011</u>	<u>2010</u>
Term loan payable to bank, interest at 2.5% per annum above the TCD rate pledged as collateral, monthly repayment of \$8,523, collateralized by a first security interest in a TCD. Interest rates effective as of September 30, 2011 and 2010 range from 3.3% to 3.0%. The proceeds of the loan were used to fund the acquisition of a new 1.2 MW generator.	\$ 69,312	\$ 167,919
Less current portion	(69,312)	(98,339)
Long-term debt, net of current portion	\$ <u>-</u>	\$ <u>69,580</u>

Annual repayment requirements to maturity for principal and interest are as follows:

<u>Year ended September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ <u>69,312</u>	\$ <u>861</u>	\$ <u>70,173</u>

Changes in long-term liabilities during the years ended September 30, 2011 and 2010, are as follows:

2011					
	Balance October 1, <u>2010</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, <u>2011</u>	Balance due in One Year
Term loan	\$ <u>167,919</u>	\$ <u>-</u>	\$ <u>(98,607)</u>	\$ <u>69,312</u>	\$ <u>69,312</u>
2010					
	Balance October 1, <u>2009</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, <u>2010</u>	Balance due in One Year
Term loan	\$ <u>263,185</u>	\$ <u>-</u>	\$ <u>(95,266)</u>	\$ <u>167,919</u>	\$ <u>98,339</u>

(7) Short-term Borrowing

A schedule of KUA's short-term borrowing as of September 30, 2011 and 2010, is as follows:

	<u>2011</u>	<u>2010</u>
Line of credit facility of \$150,000, interest at 4.5% per annum, collateralized by certain eligible investment securities.	\$ <u>158,747</u>	\$ <u>151,680</u>

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

Notes to Financial Statements
Years Ended September 30, 2011 and 2010

(7) Short-term Borrowing, Continued

During the year ended September 30, 2010, KUA drew down \$150,000 against the line. Proceeds from the line were used to fund operations. The balances of \$8,748 and \$1,680 represent related interest payable as of September 30, 2011 and 2010, respectively.

(8) Contributions

Contributions for the years ended September 30, 2011 and 2010 are as follows:

	<u>2011</u>	<u>2010</u>
U.S. Department of the Interior – Water project	\$ <u>18,066</u>	\$ <u> -</u>

(9) Significant Customers

KUA purchased all fuel from one supplier in 2011 and 2010.

(10) Commitments

Net assets at September 30, 2011 and 2010 have been appropriated in the amounts of \$1,616,919 and \$1,516,919, respectively, for repair and maintenance and capital improvement projects. This process will continue in fiscal year 2012 with a total of \$25,000 being further appropriated on a quarterly basis from net assets for this purpose.

In September 2011, KUA entered into a twenty-five year agreement to acquire power from a provider who is planning to construct related plant. The agreement documents the agreed prices for energy output, among other matters. KUA, in 2012 has agreed to pay \$50,000 for a 50% interest in this entity. This entity has not commenced activity as of September 30, 2011.

(11) 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 is substantially self-insured for all other risks. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years.

(12) Retirement Plan

KUA administers a retirement plan (the Plan) covering all employees with at least one year of service that is modeled after a U.S. defined contribution plan. 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, 2011 and 2010 were \$3,710 and \$5,827, respectively. Management is of the opinion that the Plan does not represent an asset or liability of KUA. For the years ended September 30, 2011 and 2010, Plan assets were \$30,863 and \$148,061, respectively, with the corresponding cash balances of \$30,474 and \$112,388, respectively.

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

Notes to Financial Statements
Years Ended September 30, 2011 and 2010

(13) Related Parties

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

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.

(14) Contingency

KUA participates in a number of U.S. Department of the Interior grant programs and other various federally assisted grants. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of \$65,534 relating to prior fiscal years have been set forth in KUA's Single Audit Report for the year ended September 30, 2011. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

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 the financial statements of the Kosrae Utilities Authority (KUA) as of and for the year ended September 30, 2011, and have issued our report thereon dated June 6, 2012. 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.

Internal Control Over Financial Reporting

Management of KUA is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered KUA's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of KUA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of KUA's internal control over financial reporting.

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.

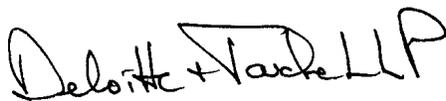
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

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 instance of noncompliance and other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of KUA in a separate letter dated June 6, 2012.

This report is intended for the information and use of the Board of Directors, management of Kosrae Utilities Authority, federal awarding agencies, pass-through entities, the cognizant audit and other federal agencies, and others within the entity, and is not intended to be and should not be used by anyone other than these specified parties.

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

June 6, 2012

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

Summary Schedule of Prior Year Findings and Questioned Costs
Year Ended September 30, 2011

The following is a summary of unresolved questioned costs of Kosrae Utilities Authority as of September 30, 2011:

	Questioned Costs Set Forth in <u>Prior Audit Reports</u>	Questioned Costs Resolved in Fiscal Year <u>2011</u>	Questioned Costs at <u>September 30, 2011</u>
Unresolved Questioned Costs FY 2008	\$ 44,172	\$ 44,172 ⁽¹⁾	\$ -
Unresolved Questioned Costs FY 2009	<u>65,534</u>	<u>-</u>	<u>65,534</u>
	\$ <u>109,706</u>	\$ <u>44,172</u>	\$ <u>65,534</u>

(1) Questioned costs resolved during fiscal year 2011 are a result of KUA exercising the two-year rule per OMB Circular A-133 Section .315(b)(4).