

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

FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2013 AND 2012

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

Years Ended September 30, 2013 and 2012
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INDEPENDENT AUDITORS' REPORT

The Board of Directors
Kosrae Utilities Authority:

Report on the Financial Statements

We have audited the accompanying financial statements of the Kosrae Utilities Authority (the Authority), a component unit of the State of Kosrae, which comprise the statements of net position as of September 30, 2013 and 2012, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

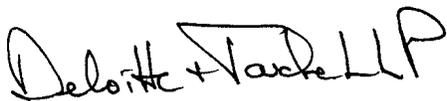
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kosrae Utilities Authority as of September 30, 2013 and 2012, and the results of its operations and its cash flows, for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 to 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 14, 2014 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

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

June 14, 2014

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

Management's Discussion and Analysis
Years Ended September 30, 2013 and 2012

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, 2013. Please read it in conjunction with the financial statements, which follow 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 five (5) board members appointed by the Governor with the advice and consent of the State Legislature for a staggered terms of 2 to 4 years.

The Authority serves 1,983 customers with 141 inactive during FY2013. The customer based ratio for FY2013 compared to the previous fiscal year remained constant with approximately 79% residential with energy sales of 39%, 12% commercial with 27% energy sales, 5% Kosrae State Government with 18% energy sales, 3% non-Kosrae State Government with 7% energy sales and 1% industrial with 7% kilowatt-hour sales and 2% for rental lights energy consumption. The total energy (kwh) sales were slightly lower by approximately 5% compared to the previous fiscal year due to improved management of power usage and conservation efforts by customers. The slight increase in operating revenues by 4% from residential and Kosrae State Government were mainly due to the approved tariff increase which took effect in April 2013. With economic conditions and development activities in the State, the energy sales ratio from various customer sectors is 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.

The operating challenges during FY2013 remained with the revenue shortfalls to adequately cover operating cost and improvements of run-down fixed assets, the fuel inefficiencies of the aging generator units, the deteriorating Power Plant Substation, the increased system loss and the rising cost of fuel, equipment, parts and hardware materials. These continued to be the main priorities for the operation and plan of action is focused towards improving these operating issues. The electric revenues from power rates and fuel adjustment charges provide approximately 85.7% of the total operating expenses and the remaining being operating losses. The approved tariff increase that took effect in April 2013 marginally improved the financial situation and the management is anticipating better financial outlook during the next fiscal year for increasing renewable energy penetration into the power system and improvements of fuel efficiency and services to customers.

The following table summarizes the financial position and results of operation of Kosrae Utilities Authority for 2013 through 2011:

<u>Assets</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>
Current assets	\$ 1,081,689	\$ 1,230,215	\$ 1,377,031
Utility plant, net	3,258,855	3,436,824	3,728,307
Other non-current assets	<u>302,800</u>	<u>277,800</u>	<u>252,800</u>
	\$ <u>4,643,344</u>	\$ <u>4,944,839</u>	\$ <u>5,358,138</u>

**KOSRAE UTILITIES AUTHORITY
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Management's Discussion and Analysis
Years Ended September 30, 2013 and 2012

Liabilities and Net Position

Current liabilities	\$ <u>587,365</u>	\$ <u>750,726</u>	\$ <u>713,354</u>
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Net Position:

Net investment in capital assets	3,258,855	3,436,824	3,658,995
Restricted	90,000	90,000	90,000
Unrestricted	<u>707,124</u>	<u>667,289</u>	<u>895,789</u>
Total net position	<u>4,055,979</u>	<u>4,194,113</u>	<u>4,644,784</u>
	\$ <u>4,643,344</u>	\$ <u>4,944,839</u>	\$ <u>5,358,138</u>

Revenue, Expenses and Changes

<u>in Net Position</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>
Operating revenues	\$ 2,607,025	\$ 2,516,176	\$ 2,347,648
Operating expenses	<u>3,044,287</u>	<u>3,137,272</u>	<u>2,917,875</u>
Net operating loss	<u>(437,262)</u>	<u>(621,096)</u>	<u>(570,227)</u>
Operating grants	143,466	39,152	270,866
Interest income and net investment Income (loss)	<u>21,950</u>	<u>50,876</u>	<u>(32,244)</u>
Total non-operating income	<u>165,416</u>	<u>90,028</u>	<u>238,622</u>
Capital contributions	<u>133,712</u>	<u>80,397</u>	<u>-</u>
Change in net position	\$ <u>(138,134)</u>	\$ <u>(450,671)</u>	\$ <u>(331,605)</u>

FINANCIAL HIGHLIGHTS

Revenue derived from electricity sales increased by approximately 4% this year. A tariff increase was initiated effective April 2013 to partially recover losses on the cost of service. Likewise a minimal increase in charges on yard lights and service orders was also undertaken. Residential and government accounts increased during the period while all the other sales categories declined.

Fuel adjustment charge (FAC) representing the value added to compensate for the fluctuation of fuel prices that are in the base rate is higher compared last year. Average FAC rate was up this year; from \$0.0800 last year to \$0.0997, an increase of \$0.0197 was charged for every kilowatt sold during the period contributing to higher FAC revenue. The FAC formula used in computing the FAC rate was also revised starting April 2013. The change reflects a 0.09 gallon consumed per every kilowatt produced versus 0.08 gallons consumed used in previous years.

Operating expenses decreased by 3% in the current fiscal year. Fuel expense increased by approximately 1% as fuel usage in gallon increased by approximately 2% against last year's consumption even when the average fuel cost slightly decreased from \$4.5448 to \$4.5342 per gallon. Personnel cost, maintenance and administrative expenses show reductions during the year.

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Management's Discussion and Analysis
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Grants received during the year were from FSM Congress of \$40,000 which were used to fund part of the cost of Engine #8 Stator; Japan Non Project Grant Aid through FSM National Government of \$143,466 representing the release of Counter value funds that were converted through a fuel delivery of 31,805 gallons and from North Rep-SPC grant of \$93,712 representing the cost of 300 units of new cash power meters and replacement units on KUA remote vending stations.

KUA sells power at an average rate of \$0.54 per kilowatt as against production cost of \$0.63; still operating at a loss of \$0.09 per kilowatt hour sold.

The net reduction in current assets approximates the decrease in KUA's investments with Morgan\Stanley. During the period, KUA withdrew \$100,000 from investments to be used for operations and paid off its Line of Credit with a principal amount of \$150,000 by offsetting the balance against the investment account including related accrued interest. Accounts receivable on the other hand increased this year as a result of unfavorable collections due to the tariff increase while the inventory account's decrease represents usage of materials in stock for operation and maintenance as few purchases were made during the year.

Utility plant's decrease in book value is due to depreciation provided during the year net of acquisition of new fixed assets. Some of KUA's fixed assets are fully depreciated and depreciation expense starts to go down. An additional investment of \$25,000 was made to Ocean's Energy Kosrae resulting in an increase in other non-current assets; this is aside from the long term deposit with FSMPC of \$252,800 backed up by the Japan Non Project Grant Aid. The deposit is used by KUA to cover the line of credit on its fuel and lubricants purchases. For more information concerning fixed assets, please refer to the notes to financial statements.

In January 2013, KUA drew down \$50,000 from its existing \$200,000 line of credit facility from Bank of FSM. Such was paid upon renewal of the line of credit in August 2013 with TCD#401-1068220 placed with the same bank serving as collateral. The same agreement was used on the renewal.

The existing tariff rate and management's effort in controlling operating expenses helped KUA to partially recover operational losses. In this fiscal year, the net loss decreased by about 70% against the previous fiscal year. If this trend continues and is supplemented with grants received from various agencies, management is projecting a positive result for the next fiscal year's operations.

KUA has no long-term debt at September 30, 2013 and 2012.

Plan of Action for 2014

1. Review and analyze the financial condition of the operation after the increased tariff in April 2013 with the anticipated increases of renewable energy (Solar PV) into the grid-lines during FY2014 and make recommendation to the Board for further review and actions to ensure sustainability of the operation as well as affordability to customers.
2. Construct and install 150 kwp Solar PV Grid-connected System funded by the EU-North-Rep. funding assistance under Secretariat of the Pacific Community (SPC) and 200 kwp Solar PV grid-connected System from Pacific Environment Community (PEC), Japan Government. These projects are expected to increase at a minimum 20% renewable solar PV energy into the grid-lines to reduce the diesel fuel required for the operation. Complete solar lighting to residents at Walung and stand-alone Solar PV System to Walung's school.

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Management's Discussion and Analysis
Years Ended September 30, 2013 and 2012

3. Implement Grid-Stability Study for the power system to ensure power supply stability to customers as KUA continues to increase renewable energy into the power system grid-lines.
4. Complete Fund Assistance Package Proposal to World Bank for the purchase of a new Engine/Generator Unit (1.25 kwp) to improve fuel efficiency and for improvement of the fuel injection services to the gensets and services to customers.
5. Secure funding assistance from the Government of Denmark thru SPREP to finance the Power Plant Substation Upgrades to ensure continuous power services to the island due to the deteriorating condition of the existing Substation as part of the KEMA recommendation to improve system loss.
6. Continue to work and negotiate with the financing firm for the purchase of OEK stock to be a major equity owner for financing the construction and installation of the 1.5 MW WaveSurf Power System and make necessary revisions to the Joint Venture Agreement to include a new equity owner of OEK. This project is anticipated to be implemented soon which will contribute most of the renewable energy into the grid-lines and will substantially reduce fossil fuel needs for the operation.
7. Work with the Kosrae State Energy Task Force in preparing project proposals for the next EU grants, EDF 11 for Kosrae State which will include Battery Storage or Fly Wheel Equipment to stabilize grid-lines from the increasing renewable energy penetration, Solar/LED street lightings, installation of additional Solar PV energy into the grid-lines and undertaking Hydro System and Waste to Energy Feasibility Study.
8. Complete the ongoing Suprima Upgrades activities on the remaining Prepayment Meters installed to customers from CTS to STS standard version with 20 digits to prevent loss and theft of kwh sales to customers.
9. Continue to update the performance benchmarking indicators and data based on the FY2013 operating performance, identify weak indicators and areas to be improved and set action plans and activities to be implemented with collaboration with the ongoing Pacific Power Association's (PPA) benchmarking program and training funded by the Asian Development Bank (ADB).
10. Collaborate with Asian Development Bank and National Dept. of Transportation & Infrastructure to secure start-off funds for the operation of Water Services under KUA and undertake necessary steps for the recruitment of the Water Engineer Specialist to oversee and manage the water functions and services initially to Utwe customers.
11. Collaborate with Shima Co. Ltd and Association of Micronesian Development, Japan for the survey and construction of a small Hydro System, about (3 to 5 kw) to supply power to Walung School.
12. Collaborate with Mr. Atsushi Sakane, Japanese Volunteer working at Dept. of Transportation and Infrastructure to prepare a Japan Grants Assistance package under the Grassroots Human Security Projects for a Waste Oil Incinerator to burn waste oil around the island including KUA and the KSG.
13. Continue to control and streamline operating expenses 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 revenue loss to KUA.

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Management's Discussion and Analysis
Years Ended September 30, 2013 and 2012

14. Continue to provide information and data requested from JICA to justify grant assistance request for specified projects such as a new CAT Engine, 1.2 MW with high-rated fuel efficiency to reduce fuel cost, upgrading of Lelu Distribution Power Lines to reduce system loss, upgrading of Power Plant Substation due to present deteriorating condition and installation of a spare feeder to airport/dock commercial area to avoid power services interruption and major power outages if the existing feeder fails.
15. Collaborate with Pacific Power Association (PPA), Sustainable Energy Industry Association of the Pacific Island (SEIAPI), International Renewable Energy Agency (IRENA) and Secretariat of the Pacific Communities (SPC) to formulate and provide practical and hands-on training to employees to improve skill level and knowledge to perform services and job requests effectively and efficiently to minimize cost with prioritizing renewable energy systems training and maintenance services.
16. Review existing procedures and policies and take appropriate measures to improve accountability of inventories, properties and internal control on cash collection and establish reporting system for capital and maintenance costs. Review and improve maintenance programs to maintain power system facilities and equipment in good working condition.
17. Continue to provide Demand Side Management Programs for customers to use energy efficiently in reducing power consumption as well as reducing cost to KUA. Implement educational and public awareness programs to improve public relations.
18. Continue to take active role in promoting the private sector development to spur economic activities in Kosrae to increase disposal income to families and individuals residing in Kosrae in order to afford the increasing energy cost.

Contacting the Authority's Financial Management

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.

Management's Discussion and Analysis for the year ended September 30, 2012 is set forth in KUA's report on the audit of financial statements which is dated April 26, 2013. That Discussion and Analysis explains in more detail major factors impacting the 2012 financial statements. A copy of that report can be obtained by contacting the address noted below.

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

KOSRAE UTILITIES AUTHORITY
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Statements of Net Position
September 30, 2013 and 2012

<u>ASSETS</u>	<u>2013</u>	<u>2012</u>
Utility plant:		
Electric plant in service	\$ 11,918,737	\$ 11,857,750
Less accumulated depreciation	<u>(8,888,257)</u>	<u>(8,494,676)</u>
	3,030,480	3,363,074
Construction work in progress	<u>228,375</u>	<u>73,750</u>
Net utility plant	<u>3,258,855</u>	<u>3,436,824</u>
Other noncurrent assets:		
Deposit for fuel purchase contract	252,800	252,800
Investment in OEK Inc.	<u>50,000</u>	<u>25,000</u>
	<u>302,800</u>	<u>277,800</u>
Current assets:		
Cash and cash equivalents	178,957	123,584
Investments	283,444	521,800
Time certificate of deposit - restricted	164,937	164,052
Accounts receivable, net	193,199	114,090
Prepayments	4,332	1,684
Inventories (net of allowance for obsolescence of \$157,882 and \$146,381 in 2013 and 2012, respectively)	<u>256,820</u>	<u>305,005</u>
Total current assets	<u>1,081,689</u>	<u>1,230,215</u>
	<u>\$ 4,643,344</u>	<u>\$ 4,944,839</u>

LIABILITIES AND NET POSITION

Current liabilities:		
Short-term notes payable	\$ 50,000	\$ 216,611
Accounts payable - fuel	236,031	222,069
Accounts payable - other	85,426	92,951
Federal grants payable	175,000	175,000
Accrued annual leave	9,741	13,560
Deferred revenue	14,148	10,268
Accrued taxes and other	<u>17,019</u>	<u>20,267</u>
Total liabilities	<u>587,365</u>	<u>750,726</u>
Commitments and contingency		
Net position:		
Net investment in capital assets	3,258,855	3,436,824
Restricted	90,000	90,000
Unrestricted	<u>707,124</u>	<u>667,289</u>
Total net position	<u>4,055,979</u>	<u>4,194,113</u>
	<u>\$ 4,643,344</u>	<u>\$ 4,944,839</u>

See accompanying notes to financial statements.

KOSRAE UTILITIES AUTHORITY
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Statements of Revenues, Expenses, and Changes in Net Position
Years Ended September 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Operating revenues:		
Electricity sales	\$ 2,636,046	\$ 2,521,582
Less uncollectible accounts	<u>(29,021)</u>	<u>(5,406)</u>
Net operating revenues	<u>2,607,025</u>	<u>2,516,176</u>
Operating expenses:		
Production fuel	2,122,395	2,094,155
Depreciation and amortization	393,913	424,113
Salaries and wages	348,046	361,748
Administrative and general	131,279	167,439
Repairs and maintenance	<u>48,654</u>	<u>89,817</u>
Total operating expenses	<u>3,044,287</u>	<u>3,137,272</u>
Loss from operations	<u>(437,262)</u>	<u>(621,096)</u>
Nonoperating revenues (expenses):		
Interest expense	(9,477)	(11,349)
Interest income	1,161	716
Net change in fair value of investments	29,934	61,509
Gain on disposal of capital asset	332	-
Federal grants	-	39,152
Government of Japan grant	<u>143,466</u>	<u>-</u>
Total nonoperating revenues, net	<u>165,416</u>	<u>90,028</u>
Capital Contributions:		
U.S. Government and others	<u>133,712</u>	<u>80,397</u>
Change in net position	(138,134)	(450,671)
Net position at beginning of year	<u>4,194,113</u>	<u>4,644,784</u>
Net position at end of year	<u>\$ 4,055,979</u>	<u>\$ 4,194,113</u>

See accompanying notes to financial statements.

KOSRAE UTILITIES AUTHORITY
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Statements of Cash Flows
September 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Cash received from customers	\$ 2,514,140	\$ 2,523,921
Cash paid to suppliers for goods and services	(2,092,481)	(2,223,539)
Cash paid to employees for services	(351,866)	(312,243)
Net cash provided by (used for) operating activities	69,793	(11,861)
Cash flows from investing activities:		
Purchase of investment	(25,000)	(25,000)
Withdrawal from investment	268,291	-
Withdrawal from time certificate of deposit	-	75,000
Interest and dividends received	276	240
Net cash provided by investing activities	243,567	50,240
Cash flows from noncapital financing activities:		
Operating grants received	-	6,768
Borrowing under a line of credit facility	50,000	50,000
Payment on a line of credit facility	(200,000)	-
Interest paid on a line of credit facility	(26,088)	-
Net cash (used in) provided by noncapital financing activities	(176,088)	56,768
Cash flows from capital financing activities:		
Capital contributions received	133,712	80,397
Capital expenditures for utility plant	(216,055)	(132,630)
Sale of capital asset	444	-
Principal payments on long-term debt	-	(69,312)
Interest paid on long-term debt	-	(3,485)
Net cash used for capital financing activities	(81,899)	(125,030)
Net change in cash and cash equivalents	55,373	(29,883)
Cash and cash equivalents at beginning of year	123,584	153,467
Cash and cash equivalents at end of year	\$ 178,957	\$ 123,584
Reconciliation of loss from operations to net cash provided by (used for) operating activities:		
Operating loss	\$ (437,262)	\$ (621,096)
Adjustments to reconcile operating loss to net cash provided by (used for) operating activities:		
Depreciation and amortization	393,913	424,113
Bad debts	29,021	5,406
(Increase) decrease in assets:		
Accounts receivable	(96,376)	41,698
Prepayments	(2,901)	1,991
Inventories	180,150	54,825
Increase (decrease) in liabilities:		
Accounts payable - fuel	13,962	96,027
Accounts payable - other	(7,525)	(5,247)
Accrued annual leave	(3,819)	(2,329)
Deferred revenue	3,880	(10,826)
Accrued taxes and other	(3,250)	3,577
Net cash provided by (used for) operating activities	\$ 69,793	\$ (11,861)

Supplemental information of noncash financing activities:

During the year ended September 30, 2013, KUA received \$143,466 of fuel from the Government of Japan.

See accompanying notes to financial statements.

**KOSRAE UTILITIES AUTHORITY
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Notes to Financial Statements
September 30, 2013 and 2012

(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.

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 position categories:

- Net investment in capital assets; capital assets, net of accumulated depreciation and related debt, plus construction or improvement of those assets.
- Restricted:
 - Nonexpendable - Net position subject to externally imposed stipulations that require KUA to maintain them permanently. For the years ended September 30, 2013 and 2012, KUA does not have nonexpendable restricted net assets.

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Notes to Financial Statements
September 30, 2013 and 2012

(2) Summary of Significant Accounting Policies, Continued

- Expendable - Net position 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, 2013 and 2012, 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 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.

Estimates

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

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statements of net position. Proprietary fund operating statements present increases and decreases in net position. The accrual basis of accounting is utilized by proprietary funds. Under this basis, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. 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 position 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, 2013 and 2012, time certificates of deposit of \$164,937 and \$164,052, respectively, are deposited with a local bank with annual interest rates of 0.50% in 2013 and 2012 and have been internally reserved for maintenance, capital improvements and work in progress. As of September 30, 2013, the time certificate of deposit of \$164,937 is pledged as collateral for KUA's line of credit facility with the same institution.

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

Notes to Financial Statements
September 30, 2013 and 2012

(2) Summary of Significant Accounting Policies, Continued

Receivables

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

Inventory

Materials and fuel inventory are substantially carried at the lower of cost or market. First-in first-out costing method is used for materials and the average method for fuel, which approximate 97% and 3% of the net inventory value, respectively, as of September 30, 2013, and 93% and 7%, respectively, as of September 30, 2012.

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, 2013, such plant assets are fully depreciated. The net book value of the utility plant assets transferred to KUA was \$5,609 as of September 30, 2012. 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 leave benefits.

Taxes

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

Revenues

Sales of electricity are recorded as billed to customers on a monthly billing cycle basis. At the end of each month, unbilled revenues are accrued based on the most recent cycle billing. Unbilled receivables at September 30, 2013 and 2012 are \$118,584 and \$84,296, respectively.

Federal Grants and Subsidies

The Authority receives federal grants either as a direct recipient or as a subrecipient from the Kosrae State Government.

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

Notes to Financial Statements
September 30, 2013 and 2012

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

During fiscal year 2013, the Authority implemented the following pronouncements:

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addressed 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 implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*, which improved 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 implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which enhanced the usefulness of its Codification by incorporating guidance that previously could only be found in certain FASB and American Institute of Certified Public Accountants (AICPA) pronouncements issued on or before November 30, 1989, which does not conflict or contradict GASB pronouncements. GASB Statement No. 62 superceded GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which established guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position, and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. These Statements amend the net asset reporting requirements in Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. With the implementation of GASB Statement No. 63 and Statement No. 65, the Statement of Net Assets was renamed the Statement of Net Position. In addition, the Statement of Net Position includes two new classifications separate from assets and liabilities. Amounts reported as deferred outflows of resources are reported in a separate section following assets. Likewise, amounts reported as deferred inflows of resources are reported in a separate section following liabilities.

**KOSRAE UTILITIES AUTHORITY
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Notes to Financial Statements
September 30, 2013 and 2012

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of the Authority.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements on the financial statements of the Authority.

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*, which improves accounting and financial reporting for state and local governments' combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. A disposal of government operations can occur through a transfer to another government or a sale. The provisions in Statement 69 are effective for fiscal years beginning after December 15, 2013. Management has not yet determined the effect of implementation of this statement on the financial statements of the Authority.

In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The provisions in Statement 70 are effective for fiscal years beginning after June 15, 2013. Management has not yet determined the effect of implementation of this statement 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.

**KOSRAE UTILITIES AUTHORITY
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Notes to Financial Statements
September 30, 2013 and 2012

(3) Deposits and Investments, Continued

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, 2013 and 2012, cash and cash equivalents and time certificates of deposit were \$343,894 and \$287,636, respectively, and the corresponding bank balances was \$339,698 and \$280,085, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2013 and 2012, bank deposits in the amount of \$265,043 and \$280,085, 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

As of September 30, 2013 and 2012, investments at fair value comprise the following:

	<u>2013</u>	<u>2012</u>
Fixed income securities:		
U.S. Treasury obligations	\$ 39,518	\$ 84,217
U.S. Government agencies	24,480	45,725
Corporate notes	<u>41,955</u>	<u>78,297</u>
	<u>105,953</u>	<u>208,239</u>
Other Investments:		
Common equities	166,641	299,949
Money market funds	<u>10,850</u>	<u>13,612</u>
	<u>177,491</u>	<u>313,561</u>
	<u>\$ 283,444</u>	<u>\$ 521,800</u>

As of September 30, 2013, the Authority's fixed income securities had the following maturities:

		<u>Fair Value</u>	<u>1 to 5 Years</u>	<u>6 to 10 Years</u>
U.S. Treasury obligations	AAA	\$ 39,518	\$ 27,939	\$ 11,579
U.S. Government agencies obligations	AAA	24,480	24,480	-
Corporate Notes	A1	3,395	3,395	-
Corporate Notes	A2	2,982	-	2,982
Corporate Notes	A2(-)	6,527	-	6,527
Corporate Notes	A3	2,871	-	2,871
Corporate Notes	A3(-)	6,913	6,913	-
Corporate Notes	BAA1	6,917	6,917	-
Corporate Notes	BAA2	6,606	-	6,606
Corporate Notes	BAA3	<u>5,744</u>	-	<u>5,744</u>
		<u>\$ 105,953</u>	<u>\$ 69,644</u>	<u>\$ 36,309</u>

**KOSRAE UTILITIES AUTHORITY
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Notes to Financial Statements
September 30, 2013 and 2012

(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, 2013 and 2012.

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, 2013 and 2012, 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.

C. Investment in OEK, Inc.

KUA invested an additional \$25,000 in a joint-venture, Ocean Energy Kosrae, Inc. (OEK) in 2013. 2,000 shares have been issued by OEK – 1,000 to KUA and 1,000 to Ocean Energy Industries, Inc. (OEI). The purpose of OEK is to be an Independent Power Producer based on OEI's WaveSurfer power generating facilities in the waters around Kosrae in order to significantly reduce energy generation cost. The joint-venture was recognized in KUA's financial statements using the cost method due to the uncertainty of obtaining future funds for the project. Travel expense of \$1,721 and \$15,918 related to OEK was included in KUA's administration and general expense in the years ended September 30, 2013 and 2012, respectively.

(4) Accounts Receivable

Accounts receivable at September 30, 2013 and 2012, are summarized as follows:

	<u>2013</u>	<u>2012</u>
Utility:		
Residential	\$ 46,417	\$ 39,796
Commercial	148,916	128,864
Government	101,210	55,275
Fuel adjustment charge	<u>28,158</u>	<u>11,377</u>
	324,701	235,312
Receivable from other governments	7,785	7,785
Other	<u>78,935</u>	<u>71,948</u>
	411,421	315,045
Less allowance for doubtful accounts	<u>(218,222)</u>	<u>(200,955)</u>
	<u>\$ 193,199</u>	<u>\$ 114,090</u>

KOSRAE UTILITIES AUTHORITY
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Notes to Financial Statements
September 30, 2013 and 2012

(5) Utility Plant

Capital asset activity for the years ended September 30, 2013 and 2012, was as follows:

	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2012</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Balance at September 30, 2013</u>
<u>Depreciable assets:</u>					
Production plant	5 to 40 years	\$ 5,194,390	\$ 1,963	\$ -	\$ 5,196,353
Distribution plant	5 to 30 years	5,927,565	52,835	-	5,980,400
General plant	3 to 20 years	<u>735,795</u>	<u>6,632</u>	<u>(443)</u>	<u>741,984</u>
Total electric plant in service		11,857,750	61,430	(443)	11,918,737
Less accumulated depreciation		<u>(8,494,676)</u>	<u>(393,913)</u>	<u>332</u>	<u>(8,888,257)</u>
		3,363,074	(332,483)	(111)	3,030,480
<u>Non-depreciable assets:</u>					
Construction work-in-progress		<u>73,750</u>	<u>200,194</u>	<u>(45,569)</u>	<u>228,375</u>
Electric plant in service, net		\$ <u>3,436,824</u>	\$ <u>(132,289)</u>	\$ <u>(45,680)</u>	\$ <u>3,258,855</u>
	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2011</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Balance at September 30, 2012</u>
<u>Depreciable assets:</u>					
Production plant	5 to 40 years	\$ 5,187,615	\$ 6,775	\$ -	\$ 5,194,390
Distribution plant	5 to 30 years	5,806,380	121,185	-	5,927,565
General plant	3 to 20 years	<u>726,319</u>	<u>9,476</u>	<u>-</u>	<u>735,795</u>
Total electric plant in service		11,720,314	137,436	-	11,857,750
Less accumulated depreciation		<u>(8,070,563)</u>	<u>(424,113)</u>	<u>-</u>	<u>(8,494,676)</u>
		3,649,751	(286,677)	-	3,363,074
<u>Non-depreciable assets:</u>					
Construction work-in-progress		<u>78,556</u>	<u>1,655</u>	<u>(6,461)</u>	<u>73,750</u>
Electric plant in service, net		\$ <u>3,728,307</u>	\$ <u>(285,022)</u>	\$ <u>(6,461)</u>	\$ <u>3,436,824</u>

**KOSRAE UTILITIES AUTHORITY
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Notes to Financial Statements
September 30, 2013 and 2012

(6) Short-term Borrowing

A schedule of KUA's short-term borrowing as of September 30, 2013 and 2012, is as follows:

	<u>2013</u>	<u>2012</u>
Line of credit facility of \$200,000, withdrawn \$50,000, interest at 7.0% per annum, collateralized by certain eligible investment securities and existing and future business accounts receivable. The line of credit expired on July 26, 2013, and was renewed for another year. Repayment will be due at that time.	\$ 50,000	\$ 50,240
Line of credit facility of \$150,000, interest at 4.5% per annum, collateralized by certain eligible investment securities.	-	<u>166,371</u>
	<u>\$ 50,000</u>	<u>\$ 216,611</u>

The balance of \$16,611 represents related interest payable as of September 30, 2012. Interest expense of \$7,462 and \$7,863 was charged for the years-ended September 30, 2013 and 2012, respectively.

Changes in short-term borrowing during the years ended September 30, 2013 and 2012, are as follows:

	2013				
	Balance October 1, <u>2012</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, <u>2013</u>	Balance due in One Year
LOC \$200,000	\$ 50,240	\$ 50,000	\$ (50,240)	\$ 50,000	\$ 50,000
LOC \$150,000	<u>166,371</u>	-	<u>(166,371)</u>	-	-
	<u>\$216,611</u>	<u>\$ 50,000</u>	<u>\$ (216,661)</u>	<u>\$ 50,000</u>	<u>\$ 50,000</u>
	2012				
	Balance October 1, <u>2011</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, <u>2012</u>	Balance due in One Year
LOC \$200,000	\$ -	\$ 50,240	\$ -	\$ 50,240	\$ 50,240
LOC \$150,000	<u>158,747</u>	<u>7,624</u>	-	<u>166,371</u>	<u>166,371</u>
	<u>\$158,747</u>	<u>\$ 57,864</u>	-	<u>\$216,611</u>	<u>\$216,611</u>

**KOSRAE UTILITIES AUTHORITY
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Notes to Financial Statements
September 30, 2013 and 2012

(7) Contributions

Contributions for the years ended September 30, 2013 and 2012 are as follows:

	<u>2013</u>	<u>2012</u>
Capital Related:		
FSM Congress	\$ 40,000	\$ -
North Rep – SPC	93,712	-
U.S. Department of Agriculture	<u>-</u>	<u>80,397</u>
	<u>\$ 133,712</u>	<u>\$ 80,397</u>
Noncapital Related:		
Government of Japan	\$ 143,466	\$ -
U.S. Department of Agriculture	-	2,218
U.S. Department of the Interior – Water project	<u>-</u>	<u>36,934</u>
	<u>\$ 143,466</u>	<u>\$ 39,152</u>

(8) Significant Suppliers

KUA purchased all fuel from one supplier in 2013 and 2012.

(9) Commitments

Net assets at September 30, 2013 and 2012 have been appropriated in the amounts of \$1,816,919 and \$1,716,919, respectively, for repair and maintenance and capital improvement projects. This process will continue in fiscal year 2014 with a total of \$25,000 being further appropriated on a quarterly basis from net position for this purpose.

(10) 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, 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.

(11) 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, 2013 and 2012 were \$2,045 and \$1,426, respectively. Management is of the opinion that the Plan does not represent an asset or liability of KUA. For the years ended September 30, 2013 and 2012, Plan assets were \$45,606 and \$39,125, respectively, with the corresponding cash balances of \$41,369 and \$37,420, respectively.

**KOSRAE UTILITIES AUTHORITY
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Notes to Financial Statements
September 30, 2013 and 2012

(12) 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 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.

(13) 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, 2013. 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, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Authority, which comprise the statements of net position as September 30, 2013, and the related statements of revenues, expenses and changes in net position and of cash flows for the year then ended and the related notes to the financial statements, and have issued our report thereon dated June 14, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Authority's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

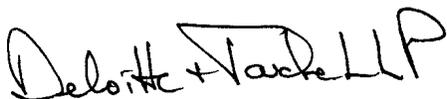
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

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

June 14, 2014

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

Summary Schedule of Prior Year Findings and Questioned Costs
Year Ended September 30, 2013

The following is a summary of unresolved questioned costs of Kosrae Utilities Authority as of September 30, 2013:

	<u>Questioned Costs Set Forth in Prior Audit Reports</u>	<u>Questioned Costs Resolved in Fiscal Year 2013</u>	<u>Questioned Costs at September 30, 2013</u>
Unresolved Questioned Costs FY 2009	\$ 65,534	-	\$ 65,534