

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

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2015 AND 2014

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

Years Ended September 30, 2015 and 2014
Table of Contents

	<u>Page No.</u>
I. INDEPENDENT AUDITORS' REPORT	1
II. MANAGEMENT'S DISCUSSION AND ANALYSIS	3
III. FINANCIAL STATEMENTS	
Statements of Net Position	8
Statements of Revenues, Expenses and Changes in Net Position	9
Statements of Cash Flows	10
Notes to Financial Statements	11
IV. 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>	21
Summary Schedule of Prior Year Findings and Questioned Costs	23

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, 2015 and 2014, 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

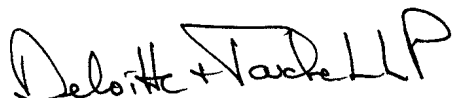
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kosrae Utilities Authority as of September 30, 2015 and 2014, and the results of its operations and its cash flows, for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters – Required Supplementary Information

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 23, 2016, 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 stylized, with the "D" and "T" being particularly prominent.

March 23, 2016

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

Management's Discussion and Analysis
Years Ended September 30, 2015 and 2014

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, 2015. 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 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 1,762 customers during FY2015. The customer based remained constant from the previous operating year with customers ratio of approximately 80% residential with energy sales of 42%, 12% commercials with 26% energy sales, 4% Kosrae State Government with 19% energy sales, 3% non-Kosrae State Government with 7% energy sales and 1% industrial with 6% kilowatt-hour sales. 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 of customer class can have an effect on future operating revenues.

KUA has continued to focus on improving operating issues and challenges faced during FY2015. The financial condition has continued to be a key challenge among other operating issues to ensure sustainability of the operation and to improve efficiency and be able to implement investments and improvement projects. The declining fuel cost during the fiscal year has significantly reduced operating cost but also affecting anticipated revenues on Fuel Adjustment Charges (FAC) as projected in the approved budget. KUA has continued to depend on outside donors to improve run-down fixed assets and essential investments needed for efficiency improvements and to reduce operating cost. The staff have collaborated closely with World Bank, JICA and EU and other donors with the support of the FSM National Government for funding of these needed capital improvements. Such challenges remain as system losses reduction, capacity building, depreciated fixed assets, inefficient Engine/Generator Units, high cost of operation and affordable rates to customers. These continue to be 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 96% 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 2015 through 2013:

<u>Assets</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Current assets	\$ 1,172,126	\$ 1,145,735	\$ 1,081,689
Utility plant, net	2,662,830	3,004,143	3,258,855
Other non-current assets	<u>252,800</u>	<u>302,800</u>	<u>302,800</u>
	\$ <u>4,087,756</u>	\$ <u>4,452,678</u>	\$ <u>4,643,344</u>
<u>Liabilities and Net Position</u>			
Current liabilities	\$ <u>253,139</u>	\$ <u>482,864</u>	\$ <u>587,365</u>
Net Position:			
Net investment in capital assets	2,662,830	3,004,143	3,258,855
Restricted	90,000	90,000	90,000
Unrestricted	<u>1,081,787</u>	<u>875,671</u>	<u>707,124</u>
Total net position	<u>3,834,617</u>	<u>3,969,814</u>	<u>4,055,979</u>
	\$ <u>4,087,756</u>	\$ <u>4,452,678</u>	\$ <u>4,643,344</u>

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

Management's Discussion and Analysis
Years Ended September 30, 2015 and 2014

Revenue, Expenses and Changes

<u>in Net Position</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Operating revenues	\$ 2,485,483	\$ 2,666,039	\$ 2,607,025
Operating expenses	<u>2,596,210</u>	<u>2,800,267</u>	<u>3,044,287</u>
Net operating loss	<u>(110,727)</u>	<u>(134,228)</u>	<u>(437,262)</u>
Non-operating grants	1,100	-	143,466
Loss on asset impairment	(184,096)	-	-
Interest income and net investment (income) loss	<u>(16,474)</u>	<u>25,084</u>	<u>21,950</u>
Total Non operating income (loss)	<u>(199,470)</u>	<u>25,084</u>	<u>165,416</u>
Capital contributions	<u>175,000</u>	<u>22,979</u>	<u>133,712</u>
Change in net position	\$ <u><u>(135,197)</u></u>	\$ <u><u>(86,165)</u></u>	\$ <u><u>(138,134)</u></u>

FINANCIAL HIGHLIGHTS

Operating revenues from electricity sales decreased by approximately 7%. Residential, Kosrae State Government and Government Non-Kosrae State Sales increased during the period while Industrial and Commercial sales, on the other hand, went down compared to last year's operation. Service orders income includes payment from the new installation undertaken to Luen Thai Fishing Venture and Orion General Contractors for the Utwe Water Project.

Fuel adjustment charge (FAC) revenue has declined tremendously as fuel prices decreased. Average FAC rate applied to kilowatt sales during the year is \$.0393 as against last year of \$.1168, a decrease of \$.0775 per kilowatt, which represents approximately a 66% reduction of the FAC revenue in the current year.

Operating expenses were reduced by around 7% significantly due to the drop in fuel prices while some expense components increased. Personnel costs increased by 12% as KUA initiated monthly incentive to employees that excel in their work performance starting FY 2015 and an engine shutdown was experienced, which required distribution crew and production operators to work overtime to repair the engine. Repair parts and materials used during the shutdown is one of the factors that maintenance costs went up. Tree trimmers were contracted to clear the lines in order to reduce outages, which makes administrative and general expenses higher under the contractual service account. The contracted individuals were later on hired by KUA as part of the distribution crew effective FY 2016. Fuel consumption in gallons increased by 3%, which was attributed to the continued operation of Engine#6 (1500KW engine) while Engine#8 (1050 KW) is still on stand-by as top end overhaul and maintenance repairs are performed. Power generation decreased by about 4%. Solar power generated from the 200kw solar panel grid connected PV funded by the Pacific Environment Community (PEC) of Japan is operational starting April 2015. It is projected to contribute 5% of the total power generation. Average fuel price is at \$4.4858 per gallon for FY 2014 while \$ 3.4357 in FY 2015; a reduction of 23%; hence, fuel expense was substantially reduced.

DOI approved the reprogramming of the \$175,000 OMIP 10th year grant intentionally for major overhaul of Engine#7(1650 KW) to be used for overhauling and major repairs of Engine#6 and Engine#8 due to difficulty in acquiring the parts for Generator#7 since this is an old engine unit. KUA received the grant in August 2009. Loss on asset impairment of \$134,096 was also recorded for the decommissioned Generator#7 and a valuation reserve of \$50,000 for the investment in Ocean Energy Kosrae (OEK).

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

Management's Discussion and Analysis
Years Ended September 30, 2015 and 2014

Average sales price per kilowatt hour this year is \$.55 as against generating cost of \$.57; KUA is still operating at a loss of \$.02 for every kilowatt hour sold. Kilowatt sales for FY 2015 is 4,560,838 kwh and 4,550,285 kwh for the last fiscal year.

Trade receivables decreased by about 4% and with billing/collection ratio of 99%. FAC receivable is the reason for the reduction. Non-trade receivables collection includes receivables from Chuuk State Public Utility Corporation for payment on materials sent by KUA, which has been outstanding for a few years. Both parties agreed that CPUC will settle half of its account provided that KUA will write-off the remaining amount. Likewise, the billing for labor used in the construction of the solar power project funded by Pacific Environment Community (PEC), which KUA paid is still pending reimbursement from the FSM National Government and is incorporated in non-trade receivables. The Board approved the write-off of some accounts recorded under A/R- others and travel advances. The allowance for bad debts was reduced in connection with the write-off.

The existing time certificate of deposit at Bank of the FSM was rolled over for another year on November 12, 2015 at a rate of .25% per annum. The TCD is used as collateral for our Line of Credit with the same bank. KUA gets the services of Raymond James and Associates to manage the investment portfolio previously handled by Smith Barney. Decrease of 3% in the fair market value of the investment represents the unrealized loss on total investments as of the end of FY 2015. No major purchase of inventory for stock replenishment was made during the period and decrease thereof was due to the usage of stock for maintenance repairs and new installations.

Utility plant composes of various fixed assets net of accumulated depreciation. During the period, certain assets were written off with the corresponding deduction on its related accumulated depreciation. Part of the written off assets are the costs of the decommissioned Generator#7 and some none functioning office equipment. Loss on impairment of the asset was reflected in the books for the remaining book value of the assets. Depreciation expense continued to decline as fully depreciated assets in FY 2014 were no longer being depreciated. Major additions to the account are Top End Overhaul of Engine#8, acquisition of 3-phase transformers for Luen Thai Fishing Venture and additional installation of prepayment meters.

Other noncurrent assets is composed of the deposit amount for a fuel purchase contract with FSMPC and an Investment in Ocean Energy Kosrae (OEK), net of the related valuation reserve.

KUA drew down \$100,000 and \$50,000 from the line of credit in Bank of the FSM on October 2014 and February 2015, respectively, to cover the cost of a top end overhaul of Engine#8 and to supplement the bulk purchase of fuel made on February 2015. This was substantially paid by the end of the fiscal year. Such line of credit was again renewed on December 11, 2015 for another year with the same interest rate per annum of 7% and matures one year thereafter. Federal grants payable of \$175,000 for OMIP 10th year grants received, which was pending implementation in previous years, was recorded as income after DOI approved the reprogramming of the grant from major overhaul on Engine#7 to be used for both Engine#6 and #8 overhaul and major repairs.

Net loss for the period increased by approximately 57%. A new generator funded by World Bank is expected to be received by the end of FY 2016 and with JICA funded projects to be approved and implemented in the succeeding fiscal years, plus the full operation of the solar power grid connected projects located in KUA ground and KSG parking area, management believes that these factors would significantly help in cost savings through reduction of generation costs in the next fiscal years.

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

Management's Discussion and Analysis
Years Ended September 30, 2015 and 2014

Management's Discussion and Analysis for the year ended September 30, 2014, is set forth in KUA's report on the audit of financial statements, which is dated June 1, 2015. That Discussion and Analysis explains the major factors impacting the 2014 financial statements and can be viewed at the FSM Office of the National Public Auditor's website at www.fsmopa.fm.

Plan of Action for 2016

1. Continue to maintain proper accountability of financial records, accurate financial and technical data, reduce operating expenditures as needed and improve revenues and collection.
2. Monitor accurate energy penetration data from the completed two Solar PV Grid-connected System (100 kwp Solar funded from EU and 200 kwp from Japan) and assess energy penetration to determine fuel savings contributed for the further review of tariff to customers.
3. Continue to collaborate with JICA and FSM National Government to finalize Energy Projects Proposal for submission to Japan Government to fund new Power Plant with two engine/generator units, Upgrading of run-down Lelu Distribution Lines, Underground power cable to the Dock/Airport and Upgrading of Sub Station. These are essential to improve power efficiency to the power system.
4. Continue to work with World Bank and FSM National Government for the procurement and installation of the new Genset approved from the WB grants and prepare engine specs and tenders for quotations to at least three suppliers for the purchase and installation of the engine unit. This unit is expected to be a high fuel efficient unit to improve fuel efficiency at the Power Plant.
5. Work with Luen Thai Fishing Co. and the Kosrae State Government for the installation of 250 capacity Transformer and meters to support the Fish Transshipment Operation at the Okat Dock. This operation is anticipated to provide additional revenues which will substantially improve financial condition of KUA.
6. Work with Kosrae State Government for the installation of the three phase power line to the Tropical Water Bottling Co. to support the restoration of the water bottling operation by an Australian Co. This is also anticipated, if successful to increase power load and revenues to KUA operation.
7. Continue to work with Indian Energy Pacifica Inc., U.S. to finalize micro-grid system design for the construction of the micro-grid power system and installation of the advanced storage facility system (Flywheel Device) to the Power System. This is part of KUA's targeted efforts to improve system efficiency and reduce power cost to customers.
8. Secure funding for the Grid-Stability Study for the power system to ensure stability of the power grid-lines before additional Solar PV energies and other renewable energy sources will be installed into the grid-lines. Expansion of renewable energies from various sources into the power grid-lines remain KUA's priorities to reduce fuel cost to the operation.
9. Secure funding to fund power line extension at various municipalities to provide power services to residents that plan to move to these new locations. Also, restore powers to residents at remote areas that have no power due to damages to the distribution lines.

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

Management's Discussion and Analysis
Years Ended September 30, 2015 and 2014

10. Continue to update the performance benchmarking indicators and data based on the FY2015 operating performances and 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 trainings funded under the Asian Development Bank (ADB).
11. Collaborate with the Kosrae State Government, FSM National Government and Utwe Municipal Gov't for the smooth transfer of Utwe Water System and other water systems to KUA. Establish and set up the Water Division under KUA to manage water functions that will be transferred to KUA. Work with KSG to seek funding to support the operation of the Water Division.
12. Continue to 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 trainings to employees to improve skill level and knowledge to perform services and job request effectively and efficiently to minimize cost with prioritizing renewable energies system training and maintenance services.
13. Continue to provide 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.
14. Continue to take active roles in promoting the private sectors development to spur economic activities in Kosrae to increase disposal incomes 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.

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

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

Statements of Net Position
September 30, 2015 and 2014

<u>ASSETS</u>	<u>2015</u>	<u>2014</u>
Utility plant:		
Electric plant in service	\$ 10,837,861	\$ 12,197,362
Less accumulated depreciation	<u>(8,242,003)</u>	<u>(9,263,284)</u>
	2,595,858	2,934,078
Construction work-in-progress	<u>66,972</u>	<u>70,065</u>
Net utility plant	<u>2,662,830</u>	<u>3,004,143</u>
Other noncurrent assets:		
Deposit for fuel purchase contract	252,800	252,800
Investment in OEK, Inc.	<u>-</u>	<u>50,000</u>
	<u>252,800</u>	<u>302,800</u>
Current assets:		
Cash and cash equivalents	322,096	277,246
Investments	298,588	308,842
Time certificate of deposit	166,121	165,764
Accounts receivable, net	166,279	146,781
Prepayments	1,981	3,205
Inventories (net of allowance for obsolescence of \$196,151 and \$197,727 in 2015 and 2014, respectively)	<u>217,061</u>	<u>243,897</u>
Total current assets	<u>1,172,126</u>	<u>1,145,735</u>
Total assets	\$ <u><u>4,087,756</u></u>	\$ <u><u>4,452,678</u></u>
 <u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Short-term notes payable	\$ 61	\$ -
Accounts payable - fuel	125,236	178,806
Accounts payable - other	84,123	84,454
Federal grants payable	-	175,000
Accrued annual leave	11,132	10,696
Unearned revenue	12,111	15,206
Accrued taxes and other	<u>20,476</u>	<u>18,702</u>
Total liabilities	<u>253,139</u>	<u>482,864</u>
Commitments and contingency		
Net position:		
Net investment in capital assets	2,662,830	3,004,143
Restricted	90,000	90,000
Unrestricted	<u>1,081,787</u>	<u>875,671</u>
Total net position	<u>3,834,617</u>	<u>3,969,814</u>
	\$ <u><u>4,087,756</u></u>	\$ <u><u>4,452,678</u></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 Position
Years Ended September 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Operating revenues:		
Electricity sales	\$ 2,468,946	\$ 2,712,101
Recovery of (provision for) uncollectible accounts	<u>16,537</u>	<u>(46,062)</u>
Net operating revenues	<u>2,485,483</u>	<u>2,666,039</u>
Operating expenses:		
Production fuel	1,487,923	1,858,866
Salaries and wages	423,127	377,500
Depreciation and amortization	368,256	375,027
Administrative and general	165,337	138,456
Repairs and maintenance	<u>151,567</u>	<u>50,418</u>
Total operating expenses	<u>2,596,210</u>	<u>2,800,267</u>
Loss from operations	<u>(110,727)</u>	<u>(134,228)</u>
Nonoperating revenues (expenses):		
Loss on asset impairment	(184,096)	-
Interest expense	(7,027)	(1,460)
Interest income	807	1,146
Net change in fair value of investments	(10,254)	25,398
Grant from U.S. Government	<u>1,100</u>	<u>-</u>
Total nonoperating revenues, net	<u>(199,470)</u>	<u>25,084</u>
Capital contributions:		
U.S. Government and others	<u>175,000</u>	<u>22,979</u>
Change in net position	<u>(135,197)</u>	<u>(86,165)</u>
Net position at beginning of year	<u>3,969,814</u>	<u>4,055,979</u>
Net position at end of year	\$ <u><u>3,834,617</u></u>	\$ <u><u>3,969,814</u></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, 2015 and 2014

	2015	2014
Cash flows from operating activities:		
Cash received from customers	\$ 2,462,890	\$ 2,717,987
Cash paid to suppliers for goods and services	(1,829,967)	(2,094,677)
Cash paid to employees for services	(421,618)	(376,544)
Net cash provided by operating activities	<u>211,305</u>	<u>246,766</u>
Cash flows from investing activities:		
Interest and dividends received on investments and others	<u>450</u>	<u>23,298</u>
Cash flows from noncapital financing activities:		
Contribution received from U.S. Government	1,100	-
Net borrowing under (payment on) a line of credit facility	61	(50,000)
Interest paid on a line of credit facility	(7,027)	(1,460)
Net cash used in noncapital financing activities	<u>(5,866)</u>	<u>(51,460)</u>
Cash flows from capital financing activities:		
Capital contributions received	-	22,979
Capital expenditures for utility plant	(161,039)	(143,294)
Net cash used in capital financing activities	<u>(161,039)</u>	<u>(120,315)</u>
Net change in cash and cash equivalents	44,850	98,289
Cash and cash equivalents at beginning of year	277,246	178,957
Cash and cash equivalents at end of year	<u>\$ 322,096</u>	<u>\$ 277,246</u>
Reconciliation of loss from operations to net cash provided by operating activities:		
Loss from operations	\$ (110,727)	\$ (134,228)
Adjustments to reconcile loss from operations to net cash provided by operating activities:		
Depreciation and amortization	368,256	375,027
(Recovery of) provision for uncollectible accounts	(16,537)	46,062
(Increase) decrease in assets:		
Accounts receivable	(2,961)	41,447
Prepayments	1,224	(119)
Inventories	26,836	(26,922)
Increase (decrease) in liabilities:		
Accounts payable - fuel	(53,570)	(57,225)
Accounts payable - other	(331)	(972)
Accrued annual leave	436	955
Unearned revenue	(3,095)	1,058
Accrued taxes and other	1,774	1,683
Net cash provided by operating activities	<u>\$ 211,305</u>	<u>\$ 246,766</u>
Supplemental information of noncash financing activities:		
Decommissioned Engine # 7:		
Capital assets	\$ 1,523,633	\$ -
Accumulated depreciation	(1,389,537)	-
Impairment loss	(134,096)	-
	<u>\$ -</u>	<u>\$ -</u>
Investment valuation reserve:		
Investment in OEK, Inc.	50,000	-
Impairment loss	(50,000)	-
	<u>\$ -</u>	<u>\$ -</u>
Redesignation of U.S. Federal grant:		
Federal grants payable	\$ (175,000)	\$ -
Capital contributions	175,000	-
	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2015 and 2014

(1) Organization

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

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

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

(2) Summary of Significant Accounting Policies

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

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

- *Net Investment in Capital Assets* – include capital assets, restricted and unrestricted, net of accumulated depreciation, reduced by outstanding debt, net of debt service reserves.
- *Restricted Nonexpendable* – net position subject to externally imposed stipulations that require the Authority to maintain such permanently.
- *Restricted Expendable* – net position whose use by the Authority is subject to externally imposed stipulations that can be fulfilled by actions of the Authority pursuant to those stipulations or that expire by the passage of time.
- *Unrestricted* – net position that is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

As of September 30, 2015 and 2014, KUA recorded restricted expendable net position of \$90,000 representing appropriations received from the FSM National Government for the power extension project to Walung, which has yet to commence.

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

Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

Estimates

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

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statements of net position. Proprietary fund operating statements present increases and decreases in net position. The accrual basis of accounting is utilized by proprietary funds. Under this basis, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. 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.

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, 2015 and 2014, such plant assets are fully depreciated. KUA capitalizes individual items that have an estimated useful life of more than one year regardless of costs. Depreciation is calculated on the straight-line method over the estimated useful lives of the respective assets.

Investment in OEK, Inc.

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

Cash and Cash Equivalents and Time Certificates of Deposit

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

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.

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

Notes to Financial Statements
September 30, 2015 and 2014

(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 85% and 15% of the net inventory value, respectively, as of September 30, 2015, and 90% and 10%, respectively, as of September 30, 2014.

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, 2015 and 2014 are \$80,807 and \$95,793, respectively. Cash power revenue is recognized as revenue upon point of sale; the estimated unearned portion is determined at year end and recorded as unearned revenue in the accompanying statements of net position.

Operating and Non-Operating Revenues and Expenses

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

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

Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

Grants and Subsidies

The Authority receives grants from the U.S. Government or other foreign governments or entities either as a direct recipient or as a subrecipient from the Kosrae State Government or the FSM National Government.

New Accounting Standards

During the year ended September 30, 2015, the Authority implemented the following pronouncements:

- GASB *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 implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB *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 implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB *Statement No. 71, Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*, which addresses an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. The implementation of this statement did not have a material effect on the accompanying financial statements.

In February 2015, GASB issued *Statement No. 72, Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements and requires entities to expand their fair value disclosures by determining major categories of debt and equity securities within the fair value hierarchy on the basis of the nature and risk of the investment. The provisions in Statement 72 are effective for fiscal years beginning after June 15, 2015. Management believes that the implementation of this statement only requires additional disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques and will not 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
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements 67 and 68 with the reporting requirements in Statement 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2015, with the exception of the provisions that address employers and governmental nonemployer contributing entities for pensions that are not within the scope of Statement 68, which are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Authority.

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB). The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Authority.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Authority.

In June 2015, GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which eliminates two of the four categories of authoritative GAAP that exist under the existing hierarchy prescribed by Statement 55. The two categories that will remain under the new standard are (1) GASB Statements and (2) GASB technical bulletins and implementation guides in addition to AICPA guidance that the GASB clears. The provisions in Statement No. 76 are effective for fiscal years beginning after June 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Authority.

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements. The provisions in Statement No. 77 are effective for fiscal years beginning after December 15, 2015. 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
September 30, 2015 and 2014

(3) Deposits and Investments

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

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

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

A. Deposits

As of September 30, 2015 and 2014, cash and cash equivalents and time certificates of deposit were \$488,217 and \$443,010, respectively, and the corresponding bank balances were \$484,227 and \$437,900, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2015 and 2014, bank deposits in the amount of \$306,333 and \$258,531, 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, 2015 and 2014, investments at fair value comprise the following:

	<u>2015</u>	<u>2014</u>
Fixed income securities:		
U.S. Treasury obligations	\$ 45,300	\$ 39,631
U.S. Government agencies	24,186	24,061
Corporate notes	<u>36,375</u>	<u>41,947</u>
	<u>105,861</u>	<u>105,639</u>
Other Investments:		
Common equities	171,708	188,550
Money market funds	<u>21,019</u>	<u>14,653</u>
	<u>192,727</u>	<u>203,203</u>
	\$ <u>298,588</u>	\$ <u>308,842</u>

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

Notes to Financial Statements
September 30, 2015 and 2014

(3) Deposits and Investments, Continued

As of September 30, 2015, the Authority's fixed income securities consist of the following:

		<u>Fair Value</u>	<u>1 to 5 Years</u>	<u>6 to 10 Years</u>
U.S. Treasury obligations	AAA	\$ 45,300	\$ 36,996	\$ 8,304
U.S. Government agencies	AAA	24,186	24,186	-
Corporate notes	A1	3,176	-	3,176
Corporate notes	A2	3,361	-	3,361
Corporate notes	A3	12,473	6,577	5,896
Corporate notes	BAA1	6,074	-	6,074
Corporate notes	BAA2	3,659	3,659	-
Corporate notes	BAA3	<u>7,632</u>	<u>2,706</u>	<u>4,926</u>
		<u>\$ 105,861</u>	<u>\$ 74,124</u>	<u>\$ 31,737</u>

As of September 30, 2014, the Authority's fixed income securities consist of the following:

		<u>Fair Value</u>	<u>1 to 5 Years</u>	<u>6 to 10 Years</u>
U.S. Treasury obligations	AAA	\$ 39,631	\$ 26,072	\$ 13,559
U.S. Government agencies	AAA	24,061	-	24,061
Corporate notes	A1	3,306	3,306	-
Corporate notes	A2	3,354	-	3,354
Corporate notes	A3	9,227	-	9,227
Corporate notes	A3(-)	2,982	-	2,982
Corporate notes	BAA1	6,560	6,560	-
Corporate notes	BAA2	7,094	3,800	3,294
Corporate notes	BAA3	<u>9,424</u>	<u>-</u>	<u>9,424</u>
		<u>\$ 105,639</u>	<u>\$ 39,738</u>	<u>\$ 65,901</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, 2015 and 2014.

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, 2015 and 2014, there was no concentration of credit risk for KUA's investments.

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

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

Notes to Financial Statements
September 30, 2015 and 2014

(4) Accounts Receivable

Accounts receivable at September 30, 2015 and 2014, are summarized as follows:

	<u>2015</u>	<u>2014</u>
Utility:		
Residential	\$ 39,335	\$ 44,445
Commercial	130,130	125,587
Government	73,192	67,480
Fuel adjustment charge	<u>2,042</u>	<u>18,793</u>
	244,699	256,305
Receivable from other governments	-	7,785
Other	<u>77,043</u>	<u>91,162</u>
	<u>321,742</u>	<u>355,252</u>
Less allowance for doubtful accounts	<u>(155,463)</u>	<u>(208,471)</u>
	<u>\$ 166,279</u>	<u>\$ 146,781</u>

(5) Utility Plant

Capital asset activity for the years ended September 30, 2015 and 2014, is as follows:

	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2014</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Balance at September 30, 2015</u>
<u>Depreciable assets:</u>					
Production plant	5 to 40 years	\$ 5,344,529	\$ 90,182	\$(1,341,968)	\$ 4,092,743
Distribution plant	5 to 30 years	6,080,040	66,378	-	6,146,418
General plant	3 to 20 years	<u>772,793</u>	<u>7,572</u>	<u>(181,665)</u>	<u>598,700</u>
Total electric plant in service		12,197,362	164,132	(1,523,633)	10,837,861
Less accumulated depreciation		<u>(9,263,284)</u>	<u>(368,256)</u>	<u>1,389,537</u>	<u>(8,242,003)</u>
		2,934,078	(204,124)	(134,096)	2,595,858
<u>Non-depreciable assets:</u>					
Construction work-in-progress		<u>70,065</u>	<u>124,411</u>	<u>(127,504)</u>	<u>66,972</u>
Electric plant in service, net		<u>\$ 3,004,143</u>	<u>\$ (79,713)</u>	<u>\$ (261,600)</u>	<u>\$ 2,662,830</u>
	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2013</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Balance at September 30, 2014</u>
<u>Depreciable assets:</u>					
Production plant	5 to 40 years	\$ 5,196,353	\$ 148,176	\$ -	\$ 5,344,529
Distribution plant	5 to 30 years	5,980,400	99,640	-	6,080,040
General plant	3 to 20 years	<u>741,984</u>	<u>30,809</u>	<u>-</u>	<u>772,793</u>
Total electric plant in service		11,918,737	278,625	-	12,197,362
Less accumulated depreciation		<u>(8,888,257)</u>	<u>(375,027)</u>	<u>-</u>	<u>(9,263,284)</u>
		3,030,480	(96,402)	-	2,934,078
<u>Non-depreciable assets:</u>					
Construction work-in-progress		<u>228,375</u>	<u>17,995</u>	<u>(176,305)</u>	<u>70,065</u>
Electric plant in service, net		<u>\$ 3,258,855</u>	<u>\$ (78,407)</u>	<u>\$ (176,305)</u>	<u>\$ 3,004,143</u>

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

Notes to Financial Statements
September 30, 2015 and 2014

(5) Utility Plant, Continued

In 2015, Engine #7 was decommissioned due to unavailability of repair parts. The asset cost and accumulated depreciation have been written-off as of September 30, 2015, resulting in an impairment loss of \$134,096.

(6) Short-Term Borrowings

In the normal course of operations, KUA obtains short-term borrowings primarily for the purpose of funding the purchase of fuel. As of September 30, 2015 and 2014, KUA has a bank credit line amounting to \$200,000 bearing interest at 7.0% per annum, with interest payable monthly and principal balance due upon maturity, which is collateralized by certain eligible investment securities and existing and future business accounts receivable.

Short-term borrowings drawn down and repaid during the years ended September 31, 2015 and 2014 are as follows:

	<u>Outstanding October 1, 2014</u>	<u>Increase</u>	<u>Decrease</u>	<u>Outstanding September 30, 2015</u>
<u>2015</u>				
Bank line of credit	\$ <u> -</u>	\$ <u>150,000</u>	\$ <u>(149,939)</u>	\$ <u> 61</u>
	<u>Outstanding October 1, 2013</u>	<u>Increase</u>	<u>Decrease</u>	<u>Outstanding September 30, 2014</u>
<u>2014</u>				
Bank line of credit	\$ <u>50,000</u>	\$ <u> -</u>	\$ <u>(50,000)</u>	\$ <u> -</u>

(7) Significant Suppliers

KUA purchased virtually all fuel from one supplier during the years ended September 30, 2015 and 2014.

(8) Contributions

Contributions for the years ended September 30, 2015 and 2014 are as follows:

	<u>2015</u>	<u>2014</u>
Capital Related:		
U.S. Government	\$ 175,000	\$ -
North Rep – SPC	<u> -</u>	<u>22,979</u>
	\$ <u>175,000</u>	\$ <u>22,979</u>
Noncapital Related:		
U.S. Government	\$ <u>1,100</u>	\$ <u> -</u>

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

Notes to Financial Statements
September 30, 2015 and 2014

(9) Commitments

Net position at September 30, 2015 and 2014 has been appropriated in the amounts of \$2,016,919 and \$1,916,919, respectively, for repair and maintenance and capital improvement projects. This process will continue in fiscal year 2015 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, 2015 and 2014 were \$2,576 and \$2,297, respectively. Management is of the opinion that the Plan does not represent an asset or liability of KUA. For the years ended September 30, 2015 and 2014, Plan assets were \$54,629 and \$51,211, respectively, with corresponding cash balances of \$54,425 and \$49,167, respectively.

(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.

As of September 30, 2015 and 2014, KUA has payables in the amount of \$71,760 to Kosrae State Government, which represents the cost of fuel purchased from Micronesia Petroleum Corporation, a component unit that closed down in 2009.

(13) Impairment Loss

KUA has invested \$50,000 in a joint venture business that constructs and installs a 1.5 Mwp WaveSurf Power System in the waters off Kosrae Island. The project has stopped due to lack of working capital. As a result of existing conditions, KUA recorded a \$50,000 impairment loss associated with this investment.

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

The Board of Directors
Kosrae Utilities Authority:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Authority, which comprise the statement of net position as September 30, 2015, and the related statements of revenues, expenses and changes in net position and of cash flows for the year then ended and the related notes to the financial statements, and have issued our report thereon dated March 23, 2016.

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.

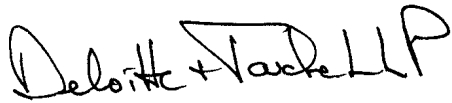
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not 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 + Nauck LLP". The signature is written in a cursive, stylized font.

March 23, 2016

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

Summary Schedule of Prior Year Findings and Questioned Costs
Year Ended September 30, 2015

The following is a summary of unresolved questioned costs of Kosrae Utilities Authority as of September 30, 2015:

	Questioned Costs Set Forth in <u>Prior Audit Reports</u>	Questioned Costs Resolved in Fiscal Year <u>2015</u>	Questioned Costs at <u>September 30, 2015</u>
Unresolved Questioned Costs FY 2009	\$ 65,534	\$ (65,534)	\$ -