

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

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2017 AND 2016

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

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Years Ended September 30, 2017 and 2016

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Kosrae State Housing Authority:

Report on the Financial Statements

We have audited the accompanying financial statements of the Kosrae State Housing Authority (the "Authority" or "KHA"), a component unit of the State of Kosrae, which comprise the statements of net position as of September 30, 2017 and 2016, 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 qualified audit opinion.

Basis for Qualified Opinion

Because of the inadequacy of accounting records, documentary evidence available to us was limited as the Authority has been unable to identify the propriety of approximately \$60,000 of amounts that form part of loans receivable. The impact of this matter is uncertain.

Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements referred to above present fairly, in all material respects, the statements of net position as of September 30, 2017 and 2016, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

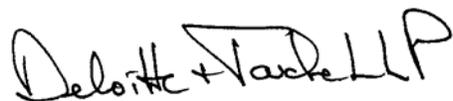
Other Matters

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 5 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 April 25, 2018, 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.



April 25, 2018

**KOSRAE STATE HOUSING AUTHORITY
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Management's Discussion and Analysis
September 30, 2017 and 2016

This analysis prepared by Kosrae State Housing Authority (Authority) offers readers of the Authority's financial statements a narrative overview of its activities for the year ended September 30, 2017. This analysis is required by the Governmental Accounting Standards Board (GASB), which provides guidelines on what must be included and excluded from the analysis.

The Statement of Net Position and Statement of Revenues, Expenses and Changes in Net Position provide an indication of the Authority's financial condition. The Authority's net position reflects the difference between assets and liabilities. An increase in net position over time typically indicates an improvement in the Authority's financial condition.

The Authority's Net Position

- The Authority's net position for the fiscal year ended September 30, 2017 decreased by \$71,493 (or 10%) from the \$685,076 in the prior year to the \$613,583 in the current year. The decrease is derived mainly from the line of credit facility (LOC) utilized in the current year and the transfer from KSG from prior year.
- The Authority's assets at the end of fiscal year 2017 exceeded liabilities by \$613,583. The bulk of the amount comes from the loan receivables and the restricted certificate of deposit. The net of loan receivables and certificate of deposit are both restricted.
- For the year ended September 30, 2017, the Authority's net investment in capital assets was \$8,694, net of accumulated depreciation of \$1,710, resulting in a net book value of \$6,984. The net increase in capital assets of \$3,787 (118%) was due to additional office equipment procured during the year from the FSM National Government subsidy. For more information concerning capital assets, refer to Note 5 to the financial statements.

Financial Analysis of Kosrae Housing Authority

The following summarizes the financial position and results of operations of Kosrae State Housing Authority for the years ended September 30, 2017 and 2016.

	<u>2017</u>	<u>2016</u>	<u>Change</u>	<u>%</u>
<u>Assets:</u>				
Current assets	\$ 581,809	\$ 585,456	\$ (3,647)	-1%
Restricted time certificates of deposit	200,000	200,000	-	0%
Property and equipment, net	<u>6,984</u>	<u>3,197</u>	<u>3,787</u>	<u>118%</u>
Total assets	\$ <u>788,793</u>	\$ <u>788,653</u>	\$ <u>140</u>	<u>0%</u>
<u>Liabilities and net position:</u>				
Current liabilities	\$ 175,210	\$ 57,281	\$ 117,929	206%
Due to primary government, net of current portion	<u>-</u>	<u>46,296</u>	<u>(46,296)</u>	<u>-100%</u>
Total liabilities	<u>175,210</u>	<u>103,577</u>	<u>71,633</u>	<u>69%</u>
<u>Net position:</u>				
Net investment in capital assets	6,984	3,197	3,787	118%
Unrestricted	<u>606,599</u>	<u>681,879</u>	<u>(75,280)</u>	<u>-11%</u>
Total net position	<u>613,583</u>	<u>685,076</u>	<u>(71,493)</u>	<u>-10%</u>
Total liabilities and net position	\$ <u>788,793</u>	\$ <u>788,653</u>	\$ <u>140</u>	<u>0%</u>

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Management's Discussion and Analysis
September 30, 2017 and 2016

At the end of fiscal year 2017, the Authority's restricted net position showed a surplus of \$606,599, a decrease of \$75,280 (11%) as compared to prior year. The decrease of \$71,493 (10%) in the overall net position of the Authority for the year ended September 30, 2017 compared to prior year was due to its current liabilities (line of credit facility) in which the Authority did not include in its annual budget the full amount needed to repay and the absence of the operating grants from the primary government (transfer from KSG). The Authority will include the amount for repayment of such facility in the future year's budget as financial resources permit.

The overall net position decrease of \$71,493 (10%) compared with prior year and the key elements of the differences from prior year are shown in the following schedule:

Revenues, Expenses and Changes in Net Position:

	<u>2017</u>	<u>2016</u>	<u>Change</u>	<u>%</u>
Operating revenues	\$ 92,928	\$ 100,713	\$ (7,785)	-8%
Recovery from (provision for) loan losses	<u>40,000</u>	<u>(80,577)</u>	<u>120,557</u>	<u>-150%</u>
Net operating revenues	<u>132,928</u>	<u>20,156</u>	<u>112,772</u>	<u>559%</u>
Operating expenses	<u>240,621</u>	<u>147,266</u>	<u>93,355</u>	<u>63%</u>
Operating loss	<u>(107,693)</u>	<u>(127,110)</u>	19,417	-15%
Nonoperating revenues	<u>36,200</u>	<u>812,186</u>	<u>(775,986)</u>	<u>-96%</u>
Change in net position	<u>(71,493)</u>	685,076	<u>(756,569)</u>	<u>-110%</u>
Net position at beginning of the year	<u>685,076</u>	_____	<u>685,076</u>	<u>100%</u>
Net position at end of the year	\$ <u>613,583</u>	\$ <u>685,076</u>	\$ <u>(71,493)</u>	<u>-10%</u>

Financial Highlights

- During the year ended September 30, 2017, the Authority continued to receive operating subsidies from the FSM National Government which increased compared to prior year by \$29,426.
- At the end of fiscal year 2017, the Authority exceeded its lending target by 5%. Compared to this year's target of \$260,100, more than \$271,000 (7%) was disbursed for housing projects.
- The collection of loans for fiscal year 2017 also exceeded its target by 1%. Total loan collected for fiscal year 2017 were \$289,616 wherein the target was \$278,651.

The total lending and collection as of September 30, 2017 has shown an upward trend in the past years, an indication of improved services and promising increases of the Authority's financial resources. The following provides an analysis of the Authority's loan lending and collection for FY2017:

	<u>Target</u>	<u>Actual</u>	<u>Change</u>	<u>Change (%)</u>	<u>Target%</u>
<i>Lending</i>	\$ 260,100	\$ 279,772	\$ 19,672	7%	2%
<i>Collection</i>	\$ 278,651	\$ 289,616	\$ 10,965	3%	2%

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Management's Discussion and Analysis
September 30, 2017 and 2016

Economic factors and Next Year's Budget

The Kosrae State Housing Authority continues to face economic and financial challenges as it relies heavily on interest and fees on loans. Revenues generated from loans for the year ended September 30, 2017 showed a decrease of \$7,785 as compared to prior year. There are several factors that contributed to this year's decline in operating revenues. The Authority has approved measures such as online payment (ACH) with the Bank, new accounting system and loan software, among others, which will hopefully address such decline.

On the other hand, the expenditures are still expected to increase given the changed program structure and need. With its developed Strategic Development Plan (SDP), the Authority continues to encounter challenges including the need to expand its revenue streams through loan diversification other than housing loans as well as increasing lending toward off-island clients.

For fiscal year 2017, the Authority continues to perform under its SDP, linking its daily operation against 3 outcome measures: (a) loan making to grow 2% each year; (b) loan collection to increase 5% each year; and (c) delinquency to drop to single digit at 10% or less in 3 years. For the year ended September 30, 2017, the Authority has seen positive progress in loan making and loan collection: *outcome measure (a) and outcome measure (b)*.

Contacting the Authority's Financial Management

Management's Discussion and Analysis for the year ended September 30, 2016 is set forth in the Authority's report on the audit of financial statements, which is dated June 27, 2017. That Discussion and Analysis explains the major factors impacting the 2016 financial statements and can be viewed at the Office of the Public Auditor's website at www.fsmopa.fm.

This financial report is designed to provide our customers, creditors, and other interested parties a general overview of Kosrae State Housing Authority's finances. If you have questions about this report or need additional financial information, contact the Executive Director, Kosrae State Housing Authority P.O. Box 533 Tofol, Lelu, Kosrae, FM 96944.

**KOSRAE STATE HOUSING AUTHORITY
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Statements of Net Position
September 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
<u>ASSETS</u>		
Current assets:		
Cash	\$ 64,150	\$ 69,940
Loans receivable, net	505,617	515,516
Travel advance	<u>12,042</u>	<u>-</u>
Total current assets	581,809	585,456
Restricted time certificates of deposit	200,000	200,000
Property and equipment, net	<u>6,984</u>	<u>3,197</u>
	<u>\$ 788,793</u>	<u>\$ 788,653</u>
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Short-term debt	\$ 120,912	\$ -
Accrued liabilities	8,002	6,612
Accounts payable	-	669
Due to primary government, current portion	<u>46,296</u>	<u>50,000</u>
Total current liabilities	175,210	57,281
Due to primary government, net of current portion	<u>-</u>	<u>46,296</u>
Total liabilities	<u>175,210</u>	<u>103,577</u>
Commitments and contingencies		
Net position:		
Net investment in capital assets	6,984	3,197
Restricted	<u>606,599</u>	<u>681,879</u>
Total net position	<u>613,583</u>	<u>685,076</u>
	<u>\$ 788,793</u>	<u>\$ 788,653</u>

See accompanying notes to financial statements.

KOSRAE STATE HOUSING AUTHORITY
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Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2017 and 2016

	2017	2016
Operating revenues:		
Interest and fees on loans	\$ 92,928	\$ 100,713
Recovery from (provision for) loan losses	40,000	(80,557)
Net operating revenues	132,928	20,156
Operating expenses:		
Salaries	103,095	79,044
Travel and transportation	70,451	31,512
Contractual services	32,548	8,918
Supplies and materials	10,311	8,602
Utilities	5,000	3,200
Meetings	4,375	4,445
Training	3,874	-
Communication	2,636	2,973
Food	1,783	2,143
Repairs and maintenance	1,604	1,899
Fuel	1,459	2,098
Depreciation	911	799
Miscellaneous	2,574	1,633
Total operating expenses	240,621	147,266
Operating loss	(107,693)	(127,110)
Nonoperating revenues (expenses), net:		
Operating grant from Kosrae State Government	-	797,529
Operating grant from FSM National Government	44,083	14,657
Interest expense	(7,883)	-
Total nonoperating revenues, net	36,200	812,186
Change in net position	(71,493)	685,076
Net position at beginning of year	685,076	-
Net position at end of year	\$ 613,583	\$ 685,076

See accompanying notes to financial statements.

KOSRAE STATE HOUSING AUTHORITY
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Statements of Cash Flows
Years Ended September 30, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Cash received from customers	\$ 92,928	\$ 100,713
Cash paid to suppliers for goods and services	(137,284)	(66,754)
Cash paid to employees	(113,747)	(72,432)
Net cash used in operating activities	(158,103)	(38,473)
Cash flows from noncapital financing activities:		
Operating subsidy from Kosrae State Government	-	84,142
Operating subsidy from FSM National Government	44,083	14,657
Repayment to Kosrae State Government	(50,000)	(60,000)
Short-term debt proceeds	150,000	-
Principal repayment on short-term debt	(29,088)	-
Interest payment on short-term debt	(7,883)	-
Net cash provided by noncapital financing activities	107,112	38,799
Cash flows from capital and related financing activities:		
Acquisition of fixed assets	(4,698)	(3,996)
Cash flows from investing activities:		
Loan originations and principal collections, net	49,899	73,610
Net change in cash	(5,790)	69,940
Cash at beginning of year	69,940	-
Cash at end of year	\$ 64,150	\$ 69,940
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (107,693)	\$ (127,110)
Adjustments to reconcile operating loss to net cash used in operating activities:		
(Recovery from) provision for loan losses	(40,000)	80,557
Depreciation	911	799
(Increase) in travel advance	(12,042)	-
Increase in accrued liabilities	1,390	6,612
(Decrease) increase in accounts payable	(669)	669
Net cash used in operating activities	\$ (158,103)	\$ (38,473)

Supplemental information on a noncash activity:

During the year ended September 30, 2016, the Authority received \$200,000 and \$513,387, which substantially consisted of restricted time certificates of deposit and the net loan portfolio, respectively, previously carried in the books of Kosrae State Government.

See accompanying notes to financial statements.

**KOSRAE STATE HOUSING AUTHORITY
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Notes to Financial Statements
September 30, 2017 and 2016

(1) Organization and Summary of Significant Accounting Policies

Organization

The Kosrae State Housing Authority (the "Authority" or "KHA") was established in October 2015 by Kosrae State Public Law 10-113. The purpose of the Authority is to manage and invest funds of Kosrae Home Improvement Program and other funds of the Authority and to lend money to qualified Kosraeans who wish to build and maintain residential homes in Kosrae.

The affairs of the Authority are managed by a five-member Board of Directors, consisting of representatives of the Kosrae State Government appointed by the Governor to four-year terms. Daily operation of the Authority is delegated to an executive director, who is also appointed by the Governor and serves at the pleasure of the Board.

The Authority's financial statements are incorporated into the financial statements of the Kosrae State Government as a component unit.

Basis of Accounting

The accounting policies of the Authority 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 Statement No. 37, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments: Omnibus*, and modified by Statement No. 38, *Certain Financial Statement Note Disclosures*, establishes 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.

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 statement 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 method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The Authority considers interest income and costs that are directly related to lending operations to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

Net Position

Net position represents the residual interest in the Authority's assets after liabilities are deducted and consist of three sections: net investment in capital assets; restricted and unrestricted. Net position classified as net investment in capital assets, include capital assets, restricted and unrestricted, net of accumulated depreciation and reduced by outstanding debt, net of debt service reserve. Net position are reported as restricted when constraints are imposed by third parties or enabling legislation. The Authority's restricted assets are expendable, and are restricted for loan programs.

**KOSRAE STATE HOUSING AUTHORITY
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Notes to Financial Statements
September 30, 2017 and 2016

(1) Organization and Summary of Significant Accounting Policies, Continued

Management Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses.

Cash

Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. The Authority does not have a deposit policy for custodial credit risk.

For the purposes of the statements of net position and of cash flows, cash is defined as cash in checking accounts, savings accounts and cash on hand. As of September 30, 2017 and 2016, the carrying amount of the Authority's total cash and time certificates of deposit was \$264,150 and \$269,940, respectively, and the corresponding bank balance was \$258,924 and \$284,587, respectively, which is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2017 and 2016, total bank deposits in the amount of \$256,657 and \$258,490, respectively, were FDIC insured.

Property and Equipment

Property and equipment are stated at cost. Depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the respective assets, which range from one to five years. The Authority capitalizes all fixed assets, irrespective of value, that have estimated useful lives of more than one year.

Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and liability as the benefit accrues to employees. No liability is recorded for nonvesting accumulating rights to receive sick leave pay benefits. The related sick leave pay expense is recorded when the benefit is actually taken.

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Notes to Financial Statements
September 30, 2017 and 2016

(1) Organization and Summary of Significant Accounting Policies, Continued

New Accounting Standards

During the year ended September 30, 2017, KHA implemented the following pronouncements:

- GASB 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.
- GASB 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).
- GASB Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements.
- GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, which addresses a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*.
- GASB Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units.
- GASB Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

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

In June 2015, GASB issued Statements 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.

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Notes to Financial Statements
September 30, 2017 and 2016

(1) Organization and Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The provisions in Statement No. 81 are effective for fiscal years beginning after December 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) associated with the retirement of a tangible capital asset. The provisions in Statement No. 83 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments. The provisions in Statement No. 84 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2017, GASB issued Statement No. 85, *Omnibus 2017*, which addresses practice issues that have been identified during implementation and application of certain GASB Statements including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits). The provisions in Statement No. 85 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.

In May 2017, GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt. The provisions in Statement No. 86 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.

In June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

(2) Due to Primary Government

The Authority received \$96,296 of cash from the Kosrae State Government (KSG) during the year ended September 30, 2016. Per agreement with KSG, \$50,000 was repaid in 2017 and the outstanding balance in the amount of \$46,296 will be paid in 2018. This balance is noninterest bearing. Account activities for the years ended September 30, 2017 and 2016 are as follows:

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Notes to Financial Statements
September 30, 2017 and 2016

(2) Due to Primary Government, Continued

	Balance October 1, <u>2016</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, <u>2017</u>	Due Within <u>One Year</u>
Due to primary government	\$ 96,296	\$ -	\$ (50,000)	\$ 46,296	\$ 46,296

	Balance October 1, <u>2015</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, <u>2016</u>	Due Within <u>One Year</u>
Due to primary government	\$ -	\$ 156,296	\$ (60,000)	\$ 96,296	\$ 50,000

(3) Short-Term Debt

In April 2017, a \$150,000 bank credit line was obtained to fund operations. As of September 30, 2017, the balance outstanding was \$120,912, interest at 5.25% payable monthly with a maturity of April 30, 2018, collateralized by \$200,000 of time certificates of deposit.

Future debt service on the above short-term debt is as follows:

<u>Year Ending September 30,</u> 2018	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
	\$ <u>120,912</u>	\$ <u>4,748</u>	\$ <u>125,660</u>

Changes in short-term debt during the year ended September 30, 2017 are as follows:

	Balance October 1, <u>2016</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, <u>2017</u>	Due Within <u>One Year</u>
Short-term debt	\$ <u>-----</u>	\$ <u>150,000</u>	\$ <u>(29,088)</u>	\$ <u>120,912</u>	\$ <u>120,912</u>

(4) Loans Receivable

The Authority's loan portfolio is comprised of Kosrae Home Improvement Program and USDA Rural Development ("USDA RD") loans.

During the year ended September 30, 2016, the State of Kosrae transferred \$80,557 of defaulted USDA Rural Development (RD) loans to the Authority. The Authority guarantees USDA RD loans and bears responsibility for collection. The Authority has pledged an escrow account in support of USDA RD loans. As of September 30, 2017 and 2016, \$200,000 of time certificates of deposit and cash in the amount of approximately \$9,000 and \$6,000, respectively, has been so pledged. Per the USDA RD agreement with the State, \$300,000 is to be so pledged. In the event of default, the Authority could be exposed to an amount in excess of the escrow account balance, which is presently indeterminable.

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

Notes to Financial Statements
September 30, 2017 and 2016

(4) Loans Receivable, Continued

Loans are stated at face value, net of an allowance for loan losses. The allowance represents an amount which, in management's judgment, will be adequate to absorb possible losses on existing loans that may become uncollectible. Management's judgment in determining the adequacy of the allowance is based on evaluations of the collectability of loans. The allowance for loan losses are reported based on certain assumptions pertaining to the Authority's periodic review and evaluation of the loan portfolio, which is subject to change. Due to uncertainties inherent in the estimations and assumptions process, it is at least reasonably possible that changes in the estimates and assumptions in the near term would be material to the financial statements. A summary of loans receivable as of September 30, 2017 and 2016, is presented below:

	<u>2017</u>	<u>2016</u>
Kosrae Home Improvement Program loans	\$ 1,842,459	\$ 1,880,019
USDA Rural Development loans	<u>68,218</u>	<u>80,557</u>
	1,910,677	1,960,576
Less allowance for loan losses	<u>(1,405,060)</u>	<u>(1,445,060)</u>
Loans receivable, net	\$ <u>505,617</u>	\$ <u>515,516</u>

There were \$40,000 of loan recoveries and no write-offs were recorded during the year ended September 2017. There were no loan recoveries or write-offs recorded during the year ended September 30, 2016.

(5) Property and Equipment

Capital asset activities for the years ended September 30, 2017 and 2016 are as follows:

Depreciable:	<u>Estimated Useful Life</u>	Balance at October <u>1, 2016</u>	Additions and <u>Transfers</u>	Deletions and <u>Transfers</u>	Balance at September <u>30, 2017</u>
Office equipment	1-5 years	\$ 3,996	\$ 3,598	\$ -	\$ 7,594
Furniture and fixtures	1-5 years	<u>-</u>	<u>1,100</u>	<u>-</u>	<u>1,100</u>
		3,996	4,698	-	8,694
Less accumulated depreciation		<u>(799)</u>	<u>(911)</u>	<u>-</u>	<u>(1,710)</u>
		\$ <u>3,197</u>	\$ <u>3,787</u>	\$ <u>-</u>	\$ <u>6,984</u>
Depreciable:	<u>Estimated Useful Life</u>	Balance at October <u>1, 2015</u>	Additions and <u>Transfers</u>	Deletions and <u>Transfers</u>	Balance at September <u>30, 2016</u>
Office equipment	1-5 years	\$ <u>-</u>	\$ <u>3,996</u>	\$ <u>-</u>	\$ <u>3,996</u>
		-	3,996	-	3,996
Less accumulated depreciation		<u>-</u>	<u>(799)</u>	<u>-</u>	<u>(799)</u>
		\$ <u>-</u>	\$ <u>3,197</u>	\$ <u>-</u>	\$ <u>3,197</u>

**KOSRAE STATE HOUSING AUTHORITY
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Notes to Financial Statements
September 30, 2017 and 2016

(6) Commitments and Contingencies

Loan Commitments

The Authority has loan commitments aggregating \$313,441 and \$323,290 as of September 30, 2017 and 2016, respectively. The loan commitments represent undisbursed balances of approved loans for housing projects.

Risk Management

The Authority does not purchase insurance to cover risks associated with potential losses. Management is of the opinion that no material losses during the years ended September 30, 2017 and 2016 have resulted from this practice.

(7) Related Parties

The Authority became a component unit of the State of Kosrae in October 2015 and \$513,387 of the prior fund balance of the Home Improvement Program Revolving Fund and restricted time certificates deposits of \$200,000 were transferred from Kosrae State Government (KSG) to the Authority.

The Authority is not allowed to lend money to its employees or their immediate relatives pursuant to Kosrae State Public Law 10-113. As of September 30, 2017 and 2016, the Authority has \$131,031 and \$126,467, respectively, of loans receivable from employee family members, who are eligible to file loan applications.

The Authority utilizes various KSG capital assets at no cost in its operations. KSG transferred title of these capital assets to the Authority in 2018.

(8) Subsequent Event

In December 2017, a building and vehicles were transferred from the Kosrae State Government (KSG) to the Authority. The total carrying cost of capital assets acquired from KSG is \$97,950.

The Authority was re-established as Kosrae Housing and Rural Development Authority by Kosrae State Public Law 11-115 and related corporate documentation revisions are in progress.

**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 State Housing 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 Kosrae State Housing Authority (the "Authority"), which comprise the statement of net position as September 30, 2017, 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 April 25, 2018.

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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses, that we consider to be material weaknesses as item 2017-001.

Compliance and Other Matters

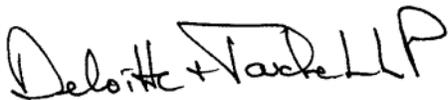
As part of obtaining reasonable assurance about whether the Authority's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material 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*.

The Authority's Responses to Findings

The Authority's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. The Authority's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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 + Tatchell LLP". The signature is written in a cursive, slightly stylized font.

April 25, 2018

**KOSRAE STATE HOUSING AUTHORITY
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Schedule of Findings and Responses
Year Ended September 30, 2017

Finding No. 2017-001 – Loan Receivable

Criteria: The Authority should maintain an adequate system of accounting and be able to reconcile its general ledger with subsidiary ledgers.

Condition: Because of inadequacies in the accounting records, detailed records regarding loans and allowance for loan losses were not substantiated by underlying supporting documentation evidencing the validity of loans. The Authority did not utilize accounting or loan software and did not maintain an adequate system of accounting.

Cause: The cause of this condition is primarily due to inadequate accounting assistance, the absence of closing procedures and review and the lack of adequate filing and document maintenance systems.

Effect: The effect of this condition is an inability to substantiate certain financial statement balances, financial statement transactions and compliance with laws and regulations.

Identification as a Repeat Finding: 2016-001

Recommendation: The Authority should acquire adequate accounting assistance, should prepare monthly financial statements that are supported by its books and records, and should maintain an adequate filing and retention system and must be able to demonstrate compliance with laws and regulations.

Auditee Response and Corrective Action Plan: We agree to this finding as we had responded to in FY2016. Although the software was purchased in FY2017, we were not able to operationalize the new loan management system for FY2017. We are hopeful that the new system be completed before June 2018. Once it is completed, it should be able to resolve discrepancies in the loan management system clearly identified in the audit.