

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

FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2017 AND 2016

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

Years Ended September 30, 2017 and 2016
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" or "KUA"), 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 audit opinion.

Opinion

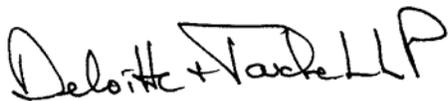
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kosrae Utilities Authority as of September 30, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles 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 December 6, 2017, 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.



December 6, 2017

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

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

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, 2017. Please read it in conjunction with the financial statements, which follow this section.

Kosrae Utilities Authority (KUA) was mandated by law in October 1993 as a semi-agency of the Kosrae State Government to assume the operation and responsibility of providing electric power services to the Island of Kosrae. KUA is governed by five (5) board members appointed by the Governor with the advice and consent of the State Legislature for staggered terms of 2 to 4 years.

The Authority served 1,823 customers during FY2017, approximately a 2% increase from the previous fiscal year. The customer base has remained relatively constant and is comprised of approximately 76.8% residential with total energy sales of 38.6%, 13.7% commercial customers with kwh sales of 30.8%, 4.5% Kosrae State Government with sales representing 17.4%, 4.4% non-state government accounts with kwh sales of 7.8% and .6% industrial with 5.4% kwh sales. The commercial and residential sales had a slight increase in sales unlike the other customer sectors which declined in sales compared to the previous fiscal year. The total energy sales to all customer sectors were 5,421,105 kwh, approximately a 1.8% increase in total energy sales from the previous year. The Cash Power Meter customers consisting of 83.6% of the active customers continued to contribute to the steady cash flow to support the basic needs of the operation. The customer base ratios are expected to remain with slight changes for the next few years and will be reviewed annually since any changes of customer class can have an effect on future operating revenues.

The operation during FY2017 went fairly smooth with occasional power interruptions and downtime problems with the aging engine/generator units and overhead distribution lines due to weather conditions. Overall, KUA has continued to provide reliable services to the island with no major problems that critically affected the island. Management and the Board anticipate that with the actual implementation of the Power Improvement Projects funded by JICA/Japan Gov't and procurement of new equipment and undertaking a Energy Master Plan funded from the WB grants will significantly improve power services and will minimize power problems experienced during the past fiscal years.

Major tasks and activities have been focused more on the ongoing Energy Improvement Projects to increase renewable energies into the power system and improve system efficiency to achieve energy targets mandated in the State SDP and Nat'l Energy Plan and Policy. These improvement projects will significantly lead toward meeting the energy goals for Kosrae State as well as FSM. The ongoing construction of the new Power Plant with two new gensets, Upgrading the Primary Distribution Power Lines in Lelu, Installation of new Underground Power Cables at Airport/Dock Area and Installation LED Street Lights will greatly enhance the existing Power System. Additional renewable energies are also proposed and considered from the World Bank and Green Climate Fund to increase capacity of the Solar PV into the Grid-lines and other renewable sources to reduce fuel required for operations.

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

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

The following table summarizes the financial position and results of operations of Kosrae Utilities Authority for 2017 through 2015:

<u>Assets</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Current assets	\$ 1,731,424	\$ 1,570,624	\$ 1,172,126
Utility plant, net	2,241,506	2,399,065	2,662,830
Other non-current assets	<u>252,800</u>	<u>252,800</u>	<u>252,800</u>
	\$ <u>4,225,730</u>	\$ <u>4,222,489</u>	\$ <u>4,087,756</u>
<u>Liabilities and Net Position</u>			
Current liabilities	\$ <u>254,020</u>	\$ <u>233,770</u>	\$ <u>253,139</u>
Net Position:			
Net investment in capital assets	2,241,506	2,399,065	2,662,830
Restricted	90,000	90,000	90,000
Unrestricted	<u>1,640,204</u>	<u>1,499,654</u>	<u>1,081,787</u>
Total net position	<u>3,971,710</u>	<u>3,988,719</u>	<u>3,834,617</u>
	\$ <u>4,225,730</u>	\$ <u>4,222,489</u>	\$ <u>4,087,756</u>
<u>Revenue, Expenses and Changes in Net Position</u>			
	<u>2017</u>	<u>2016</u>	<u>2015</u>
Operating revenues	\$ 2,551,484	\$ 2,462,828	\$ 2,485,483
Operating expenses	<u>2,616,462</u>	<u>2,304,878</u>	<u>2,596,210</u>
Net operating earnings (loss)	<u>(64,978)</u>	<u>157,950</u>	<u>(110,727)</u>
Operating grants	-	-	1,100
Loss on asset impairment	-	(22,265)	(184,096)
Gain on disposal of capital assets	71	-	-
Interest income-net and investment income (loss)	<u>47,898</u>	<u>18,417</u>	<u>(16,474)</u>
Total non operating income (loss)	<u>47,969</u>	<u>(3,848)</u>	<u>(199,470)</u>
Capital contributions	<u>-</u>	<u>-</u>	<u>175,000</u>
Change in net position	\$ <u>(17,009)</u>	\$ <u>154,102</u>	\$ <u>(135,197)</u>

FINANCIAL HIGHLIGHTS

Operating revenue from electricity sales and services increased by around 5% in comparison with the same period last year and 2% increased volume of kilowatt sales. This is attributed to the slight increase of sales from different power sectors net of negative fuel adjustment revenue. Energy sales comprise 96% of total revenue while the remaining 4% is from service orders, rental lights and miscellaneous revenues received during the year.

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

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

Fluctuation in fuel prices has a corresponding effect on fuel adjustment revenue that is charged to the customers monthly. For this fiscal year, such revenue is still negative, which indicates that the fuel prices during the period are below the fuel cost included in the base rate. Average fuel adjustment rate applied to kilowatt sales is (\$.0188) as against last year of (\$.0336); a net reduction of (\$.0148) per kilowatt.

Operating expenses slightly increased by about 14% with all cost components contributing to the increase. Fuel expenses composed 54% of the total operating expenses while 46% represents expenses paid for personnel costs, repairs and maintenance, depreciation and admin and general expenses. Fuel consumption in gallons reduced by around 2% but average fuel price per gallon increased by \$.2317. Current year's average fuel price is \$2.9913 per gallon against \$2.7596 last year. Kilowatts generated by the engines and solar power were reduced by 7%. Solar power generation for two solar panel grid connected PV contributes 6% of total power generation.

Kilowatt sales for FY 2017 are 5,421,105 kwh while sales were 5,320,992 kwh for FY 2016. Average sales price for this year is \$.46 per kwh and approximate production costs of \$.48 per kwh. This results in a net operating loss of around \$.02 per kilowatt sold.

Current assets increased by about 10%. This was caused by increases in temporary investments resulting from unrealized gains, changes in time certificate of deposit for interest earned and minimal increases in receivables, prepayments and inventories net of allowances. Receivables rose by around 12% with a collection/billing ratio of 98% for the year.

Utility plant includes KUA's buildings, vehicles, equipment and fixtures net of accumulated depreciation including work in progress accounts. The increase is largely due to acquisition of a second hand auger and bucket trucks, computer equipment, furniture and vehicles during the year. It also includes poles, transformers and prepayment meters that are installed for new customers and replacements issued from KUA inventories. For additional information concerning capital assets, see note 5 to the financial statements.

Deposit amount for a fuel purchase contract with FSMPC and Investment in Ocean Energy Kosrae (OEK) net of valuation reserve under non-current assets remained unchanged.

Current liabilities are short term obligations due to suppliers, payable practically within a year. Total current liabilities increased by 9% for FY 2017. It includes net changes in payables for fuel deliveries and others, additional annual leave credit accruals net of leave usage, deferred revenue for prepaid customers and accrued salaries, taxes and other expenses.

KUA has an existing line of credit in Bank of the FSM that is renewable annually to supplement any large and necessary expenditures not covered by KUA's working funds. For the year, we were able to drawdown \$100,000 from the facility, on November 2016 to be used for the acquisition of a second hand auger and bucket truck. It was fully paid by September 2017. The line of credit is renewable by January 2018.

Change in net position represents net loss for the period. JICA funded projects which started this year are expected to be finished and operational by FY 2018. A generator from World Bank grant is also due by next fiscal year. These projects will help significantly on KUA's engine efficiency, reduce line losses, contribute costs savings and lessen fuel consumption.

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

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

Plan of Action for 2018

1. Commissioning of the new Power Plant funded by JICA/Japan Gov't during 3rd. quarter of FY2018. This project is anticipated to significantly improve service reliability and improve fuel efficiency to reduce cost to the operation.
2. Completing the Distribution Line Power improvement and Upgrades at Lelu Island. This project will replace wooden poles with fiber glass poles, transformers and overhead hardware and install new cutout overhead switches to improve services and minimize unexpected power outages and improve system efficiency.
3. Completing the installation of two new underground cables at airport/dock commercial sites to improve and ensure continuous services in case of line faults of the existing underground cable that provide power to the airport area.
4. Procure and complete installation of the new genset funded by World Bank to operate in parallel with the two gensets installed in the new Power Plant. With this unit, KUA will have sufficient reserved power capacity to supply increases in load within the next few years. This unit will also contribute to improve fuel efficiency and reduce cost to the operation.
5. Installing more LED Street/Yard Lights procured under the WB grants in the four municipalities to replace the existing lightings used and provide efficient lighting services and safety to these communities.
6. Work with World Bank and Castalia Limited, Ltd on the State Energy Master Plan. Castalia Limited is contracted to produce the Nat'l and State Energy Master Plan and is expected to finalize and complete during FY2018. KUA staff will coordinate with the State Leaders and stakeholders to review and endorse the draft before finalizing the Energy Master Plan.
7. Work with ADB for the proposed energy projects submitted to Green Climate Funds for additional Solar PV Renewable Projects and new Power Distribution Network to support the Coastal Management Plan for Kosrae.
8. Continue to work with Kosrae State Government for the transfer of Utwe Water System to KUA and improvements of other public water systems.
9. Collaborate with Pacific Power Association and JICA to support capacity building and implement Training Programs that are appropriate to improve knowledge and skills for the maintenance and operation of renewable energy projects and the diesel engines.
10. Staking and procure poles, hardware and materials for new power extensions lines in the municipalities to encourage people to reside inland due to erosion and expand farm production upon securing of funds.
11. Promote and conduct demand side management public awareness program and energy efficiency program for people to use power more efficiently and to reduce cost to customers.

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

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

12. Submit Renewable Energy Project proposal for battery storage, grid-stability to maximize the use of Solar PV penetration and to stabilize power services to customers to donor countries that support energy improvement projects for the FSM.
13. Upgrade the Suprima billing software to improve cash collection and reports and to improve services to customers.

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. Please also refer to the Management's Discussion and Analysis for the Authority's 2016 audit which report was dated June 8, 2017.

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, 2017 and 2016

<u>ASSETS</u>	<u>2017</u>	<u>2016</u>
Utility plant:		
Electric plant in service	\$ 10,878,531	\$ 10,625,223
Less accumulated depreciation	<u>(8,666,306)</u>	<u>(8,295,463)</u>
	2,212,225	2,329,760
Construction work-in-progress	<u>29,281</u>	<u>69,305</u>
Net utility plant	<u>2,241,506</u>	<u>2,399,065</u>
Other noncurrent assets:		
Deposit for fuel purchase contract	<u>252,800</u>	<u>252,800</u>
Current assets:		
Cash and cash equivalents	474,760	706,892
Investments	671,823	319,287
Time certificate of deposit	166,702	166,225
Accounts receivable, net	184,171	164,760
Prepayments	2,335	15,015
Inventories (net of an allowance for obsolescence of \$220,213 and \$192,034 in 2017 and 2016, respectively)	<u>231,633</u>	<u>198,445</u>
Total current assets	<u>1,731,424</u>	<u>1,570,624</u>
Total assets	<u>\$ 4,225,730</u>	<u>\$ 4,222,489</u>
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Accounts payable - fuel	\$ 150,320	\$ 81,351
Accounts payable - other	26,878	83,151
Accrued annual leave	10,919	8,183
Unearned revenue	29,744	28,361
Accrued taxes and other	<u>36,159</u>	<u>32,724</u>
Total liabilities	<u>254,020</u>	<u>233,770</u>
Commitments and contingency		
Net position:		
Net investment in capital assets	2,241,506	2,399,065
Restricted	90,000	90,000
Unrestricted	<u>1,640,204</u>	<u>1,499,654</u>
Total net position	<u>3,971,710</u>	<u>3,988,719</u>
	<u>\$ 4,225,730</u>	<u>\$ 4,222,489</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, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Operating revenues:		
Electricity sales	\$ 2,582,991	\$ 2,456,882
Bad debt (expense) recovery	<u>(31,507)</u>	<u>5,946</u>
Net operating revenues	<u>2,551,484</u>	<u>2,462,828</u>
Operating expenses:		
Production fuel	1,403,785	1,267,662
Salaries and wages	495,205	461,045
Depreciation and amortization	371,550	328,475
Administrative and general	232,388	171,893
Repairs and maintenance	<u>113,534</u>	<u>75,803</u>
Total operating expenses	<u>2,616,462</u>	<u>2,304,878</u>
Earnings (loss) from operations	<u>(64,978)</u>	<u>157,950</u>
Nonoperating revenues (expenses):		
Loss on asset impairment	-	(22,265)
Interest expense	(5,975)	(3,536)
Interest income	1,336	1,254
Net change in fair value of investments	52,537	20,699
Gain on disposal of capital assets	<u>71</u>	<u>-</u>
Total nonoperating revenue (expenses), net	<u>47,969</u>	<u>(3,848)</u>
Change in net position	(17,009)	154,102
Net position at beginning of year	<u>3,988,719</u>	<u>3,834,617</u>
Net position at end of year	<u>\$ 3,971,710</u>	<u>\$ 3,988,719</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, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Cash received from customers	\$ 2,532,300	\$ 2,436,748
Cash paid to suppliers for goods and services	(1,685,560)	(1,607,228)
Cash paid to employees for services	(491,324)	(393,199)
Net cash provided by operating activities	355,416	436,321
Cash flows from investing activities:		
Additional investments	(300,000)	-
Interest and dividends received on investments and others	858	1,150
Net cash (used in) provided by investing activities	(299,142)	1,150
Cash flows from noncapital financing activities:		
Net borrowing under (payment on) line of credit facility	-	(61)
Interest paid on line of credit facility	(5,975)	(3,536)
Net cash used in noncapital financing activities	(5,975)	(3,597)
Cash flows from capital financing activities:		
Proceeds from disposal of capital assets	71	-
Capital expenditures for utility plant	(282,502)	(49,078)
Net cash used in capital financing activities	(282,431)	(49,078)
Net change in cash and cash equivalents	(232,132)	384,796
Cash and cash equivalents at beginning of year	706,892	322,096
Cash and cash equivalents at end of year	\$ 474,760	\$ 706,892
Reconciliation of earnings (loss) from operations to net cash provided by operating activities:		
Earnings (loss) from operations	\$ (64,978)	\$ 157,950
Adjustments to reconcile earnings (loss) from operations to net cash provided by operating activities:		
Depreciation and amortization	371,550	328,475
Bad debt expenses (recovery)	31,507	(5,946)
(Increase) decrease in assets:		
Accounts receivable	(22,740)	3,608
Prepayments	12,680	(11,097)
Inventories	7,146	(17,361)
Increase (decrease) in liabilities:		
Accounts payable - fuel	68,969	(43,885)
Accounts payable - other	(56,272)	(972)
Accrued annual leave	2,736	(2,949)
Unearned revenue	1,383	16,250
Accrued taxes and other	3,435	12,248
Net cash provided by operating activities	\$ 355,416	\$ 436,321

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2017 and 2016

(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, 2017 and 2016, 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, 2017 and 2016

(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 costs. As of September 30, 2017 and 2016, 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 the 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.

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

Notes to Financial Statements
September 30, 2017 and 2016

(2) Summary of Significant Accounting Policies, Continued

Investments

Investments and related investment earnings are reported at fair value using quoted market prices. Fair value is the price that would be received to sell an asset or paid to transfer a liability (i.e. the exit price) in an orderly transaction between market participants at the date as of which the fair value of an asset or liability is determined.

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 78% and 22% of the net inventory value, respectively, as of September 30, 2017, and 79% and 21%, respectively, as of September 30, 2016.

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, 2017 and 2016 are \$90,883 and \$89,329, 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.

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

Notes to Financial Statements
September 30, 2017 and 2016

(2) Summary of Significant Accounting Policies, Continued

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.

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, 2017, KUA 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. 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. 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.
- 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.

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

Notes to Financial Statements
September 30, 2017 and 2016

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

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.

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 address 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.

(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.

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

Notes to Financial Statements
September 30, 2017 and 2016

(3) Deposits and Investments, Continued

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, 2017 and 2016, cash and cash equivalents and time certificates of deposit were \$641,462 and \$873,117, respectively, and the corresponding bank balances were \$641,326 and \$904,529, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2017 and 2016, bank deposits in the amount of \$284,482 and \$298,696, 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, 2017 and 2016, investments at fair value comprise the following:

	<u>2017</u>	<u>2016</u>
Fixed income securities:		
U.S. Treasury obligations	\$ 115,885	\$ 46,244
U.S. Government agencies	43,531	25,235
Corporate notes	<u>89,514</u>	<u>39,887</u>
	<u>248,930</u>	<u>111,366</u>
Other Investments:		
Common equities	399,290	201,920
Money market funds (at amortized cost)	<u>23,603</u>	<u>6,001</u>
	<u>422,893</u>	<u>207,921</u>
	<u>\$ 671,823</u>	<u>\$ 319,287</u>

As of September 30, 2017, the Authority's fixed income securities consist of the following:

		Fair <u>Value</u>	1 to 5 <u>Years</u>	6 to 10 <u>Years</u>
U.S. Treasury obligations	AAA	\$ 115,885	\$ 83,925	\$ 31,960
U.S. Government agencies	AAA	17,680	17,680	-
Corporate notes	A1	7,334	-	7,334
Corporate notes	A2	7,518	7,518	-
Corporate notes	A3	38,225	14,683	23,542
Corporate notes	BAA1	16,218	8,085	8,133
Corporate notes	BAA2	15,063	-	15,063
Corporate notes	BAA3	5,156	-	5,156
U.S. Government agencies	Not rated	<u>25,851</u>	<u>25,851</u>	-
		<u>\$ 248,930</u>	<u>\$ 157,742</u>	<u>\$ 91,188</u>

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

Notes to Financial Statements
September 30, 2017 and 2016

(3) Deposits and Investments, Continued

B. Investments, Continued

As of September 30, 2016, the Authority's fixed income securities consist of the following:

		Fair <u>Value</u>	1 to 5 <u>Years</u>	6 to 10 <u>Years</u>
U.S. Treasury obligations	AAA	\$ 46,244	\$ 37,890	\$ 8,354
U.S. Government agencies	AAA	25,235	25,235	-
Corporate notes	A1	3,255	-	3,255
Corporate notes	A2	3,312	-	3,312
Corporate notes	A3	16,924	3,269	13,655
Corporate notes	BAA1	6,309	-	6,309
Corporate notes	BAA2	4,025	-	4,025
Corporate notes	BAA3	3,182	3,182	-
Corporate notes	BA3	<u>2,880</u>	<u>-</u>	<u>2,880</u>
		\$ <u>111,366</u>	\$ <u>69,576</u>	\$ <u>41,790</u>

KUA categorizes its fair value measurements within the fair value hierarchy established by GASB Statement No.72. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

KUA has the following recurring fair value measurements as of September 30, 2017 and 2016:

	September 30, <u>2017</u>	Fair Value Measurements Using		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments by fair value level:				
Fixed income:				
U.S. Treasury obligations	\$ 115,885	\$ -	\$ 115,885	\$ -
U.S. Government Agencies	43,531	-	43,531	-
Corporate notes	<u>89,514</u>	<u>-</u>	<u>89,514</u>	<u>-</u>
	\$ <u>248,930</u>	\$ <u>-</u>	\$ <u>248,930</u>	\$ <u>-</u>
Equity securities:				
U.S. equities	\$ 383,746	\$ 383,746	\$ -	\$ -
Non U.S. equities	<u>15,544</u>	<u>15,544</u>	-	-
	<u>399,290</u>	<u>399,290</u>	-	-
Total investments at fair value	<u>648,220</u>	<u>399,290</u>	<u>248,930</u>	<u>-</u>
Investments measured at amortized cost:				
Money market funds	<u>23,603</u>			
	\$ <u>671,823</u>			

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

Notes to Financial Statements
September 30, 2017 and 2016

(3) Deposits and Investments, Continued

B. Investments, Continued

	September 30, <u>2016</u>	Fair Value Measurements Using		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments by fair value level:				
Fixed income:				
U.S. Treasury obligations	\$ 46,244	\$ -	\$ 46,244	\$ -
U.S. Government Agencies	25,235	-	25,235	-
Corporate notes	<u>39,887</u>	<u>-</u>	<u>39,887</u>	<u>-</u>
	\$ <u>111,366</u>	\$ <u>-</u>	\$ <u>111,366</u>	\$ <u>-</u>
Equity securities:				
U.S. equities	\$ <u>201,920</u>	\$ <u>201,920</u>	\$ <u>-</u>	\$ <u>-</u>
Total investments at fair value	<u>313,286</u>	\$ <u>201,920</u>	\$ <u>111,366</u>	\$ <u>-</u>
Investments measured at amortized cost:				
Money market funds	<u>6,001</u>			
	\$ <u>319,287</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, 2017 and 2016.

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, 2017 and 2016, there was no concentration of credit risk for KUA's investments.

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

(4) Accounts Receivable

Accounts receivable at September 30, 2017 and 2016, are summarized as follows:

	<u>2017</u>	<u>2016</u>
Utility:		
Residential	\$ 36,209	\$ 34,796
Commercial	49,399	62,404
Government	67,753	61,895
Fuel adjustment charge	<u>1,595</u>	<u>(5,960)</u>
	154,956	153,135
Other	<u>82,271</u>	<u>61,353</u>
	237,227	214,488
Less allowance for doubtful accounts	<u>(53,056)</u>	<u>(49,728)</u>
	\$ <u>184,171</u>	\$ <u>164,760</u>

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

Notes to Financial Statements
September 30, 2017 and 2016

(5) Utility Plant

Capital asset activity for the years ended September 30, 2017 and 2016, is as follows:

	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2016</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Balance at September 30, 2017</u>
<u>Depreciable assets:</u>					
Production plant	5 to 40 years	\$ 3,873,532	\$ -	\$ -	\$ 3,873,532
Distribution plant	5 to 30 years	6,207,842	234,236	-	6,442,078
General plant	3 to 20 years	<u>543,849</u>	<u>19,779</u>	<u>(707)</u>	<u>562,921</u>
Total electric plant in service		10,625,223	254,015	(707)	10,878,531
Less accumulated depreciation		<u>(8,295,463)</u>	<u>(371,550)</u>	<u>707</u>	<u>(8,666,306)</u>
		2,329,760	(117,535)	-	2,212,225
<u>Non-depreciable assets:</u>					
Construction work-in-progress		<u>69,305</u>	<u>62,964</u>	<u>(102,988)</u>	<u>29,281</u>
Electric plant in service, net		\$ <u>2,399,065</u>	\$ <u>(54,571)</u>	\$ <u>102,988</u>	\$ <u>2,241,506</u>
	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2015</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Balance at September 30, 2016</u>
<u>Depreciable assets:</u>					
Production plant	5 to 40 years	\$ 4,092,743	\$ 10,685	\$ (229,896)	\$ 3,873,532
Distribution plant	5 to 30 years	6,146,418	61,424	-	6,207,842
General plant	3 to 20 years	<u>598,700</u>	<u>12,533</u>	<u>(67,384)</u>	<u>543,849</u>
Total electric plant in service		10,837,861	84,642	(297,280)	10,625,223
Less accumulated depreciation		<u>(8,242,003)</u>	<u>(328,475)</u>	<u>275,015</u>	<u>(8,295,463)</u>
		2,595,858	(243,833)	(22,265)	2,329,760
<u>Non-depreciable assets:</u>					
Construction work-in-progress		<u>66,972</u>	<u>18,474</u>	<u>(16,141)</u>	<u>69,305</u>
Electric plant in service, net		\$ <u>2,662,830</u>	\$ <u>(225,359)</u>	\$ <u>(38,406)</u>	\$ <u>2,399,065</u>

(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, 2017 and 2016, 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 30, 2017 and 2016 are as follows:

	<u>Outstanding October 1, 2016</u>	<u>Increase</u>	<u>Decrease</u>	<u>Outstanding September 30, 2017</u>
Bank line of credit	\$ <u> -</u>	\$ <u>100,000</u>	\$ <u>(100,000)</u>	\$ <u> -</u>
	<u>Outstanding October 1, 2015</u>	<u>Increase</u>	<u>Decrease</u>	<u>Outstanding September 30, 2016</u>
Bank line of credit	\$ <u> 61</u>	\$ <u>100,000</u>	\$ <u>(100,061)</u>	\$ <u> -</u>

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

Notes to Financial Statements
September 30, 2017 and 2016

(7) Significant Suppliers

KUA purchased virtually all fuel from one supplier during the years ended September 30, 2017 and 2016.

(8) Commitments

Net position at September 30, 2017 and 2016 has been appropriated in the amounts of \$2,216,919 and \$2,116,919, respectively, for repair and maintenance and capital improvement projects. This process will continue in fiscal year 2018 with a total of \$25,000 being further appropriated on a quarterly basis from net position for this purpose.

(9) 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.

(10) 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, 2017, 2016 and 2015 were \$2,442, \$3,428, and \$2,576, respectively, which were equal to the employer contributions required by the plan. Management is of the opinion that the Plan does not represent an asset or liability of KUA. For the years ended September 30, 2017 and 2016, Plan assets were \$78,141 and \$65,770, respectively, with corresponding cash balances of \$74,465 and \$61,195, respectively.

(11) 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.

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, 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 December 6, 2017.

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.

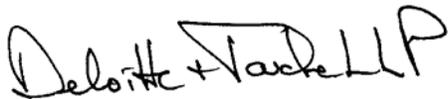
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not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

December 6, 2017

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

Summary Schedule of Prior Year Findings and Questioned Costs
Year Ended September 30, 2017

There are no prior year findings or unresolved questioned costs of Kosrae Utilities Authority as of September 30, 2017.