

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

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**FINANCIAL STATEMENTS AND ADDITIONAL  
INFORMATION AND  
INDEPENDENT AUDITORS' REPORT**

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**YEARS ENDED SEPTEMBER 30, 2018 AND 2017**

**KOSRAE UTILITIES AUTHORITY  
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Years Ended September 30, 2018 and 2017  
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## **INDEPENDENT AUDITORS' REPORT**

The Board of Directors  
Kosrae Utilities Authority:

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the Kosrae Utilities Authority (the "Authority" or "KUA"), a component unit of the State of Kosrae, which comprise the statements of net position as of September 30, 2018 and 2017, 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

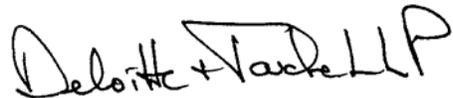
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kosrae Utilities Authority as of September 30, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles 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 April 18, 2019, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

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

April 18, 2019

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

Management's Discussion and Analysis  
Years Ended September 30, 2018 and 2017

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, 2018. Please read it in conjunction with the financial statements, which follows this section.

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

The Authority served 1,883 customers during FY2018, approximately a 3% increase from the previous fiscal year. The customer base is comprised of approximately 77% residential with total energy sales of 34%, 14% commercial customers with kwh sales of 32%, 4% Kosrae State Government with sales representing 19%, 4% non-state government accounts with kwh sales of 7% and 1% industrial with 4% kwh sales. The commercial and Kosrae State Government had a slight increase in sales and the other customer sectors had a decline in sales compared to the previous fiscal year. The total energy sales to all customer sectors were 5,398,858 kwh, a slight decrease in total energy sales from the previous year. The Cash Power Meter customers consisting of approximately 82% had contributed 53% revenue collection which had maintained a steady cash flow to support the daily needs of the operation. The customer's 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 State Energy Master Plan was completed setting the roadmap for the energy improvement and project development for the State. This Energy Plan outlines the energy projects to be implemented to achieve the energy targets of at least 30% renewable and 50% efficiency improvements by year 2020. The feasibility studies for these projects were undertaken to determine the least cost options for the construction of these projects. The staff has been working with the World Bank and ADB to secure funding to implement these projects. The completion of a new Power Plant with two new gensets from JICA/Gov't of Japan with capacity of 600kwp each and completion of power distribution upgrades and installation of two underground cables at the airport and additional installation of one new genset from World Bank will also contribute to system efficiency improvements to the existing power system. The anticipated completion of a Battery Storage Facility, Scada System and additional 2Mwp Solar PV System will support the renewable energy targets and efficiency improvements as stated under the State Energy Master Plan.

The following table summarizes the financial position and results of operation of Kosrae Utilities Authority for 2018 through 2016:

<u>Assets</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>
Current assets	\$ 1,680,804	\$ 1,731,424	\$ 1,570,624
Utility plant, net	2,143,926	2,241,506	2,399,065
Other non-current assets	<u>280,821</u>	<u>252,800</u>	<u>252,800</u>
	\$ <u>4,105,551</u>	\$ <u>4,225,730</u>	\$ <u>4,222,489</u>

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Years Ended September 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>	<u>2016</u>
<u>Liabilities and Net Position</u>			
Current liabilities	\$ <u>178,177</u>	\$ <u>254,020</u>	\$ <u>233,770</u>
Net Position:			
Net investment in capital assets	2,143,926	2,241,506	2,399,065
Restricted	90,000	90,000	90,000
Unrestricted	<u>1,693,448</u>	<u>1,640,204</u>	<u>1,499,654</u>
Total net position	<u>3,927,374</u>	<u>3,971,710</u>	<u>3,988,719</u>
	\$ <u>4,105,551</u>	\$ <u>4,225,730</u>	\$ <u>4,222,489</u>
<u>Revenue, Expenses and Changes in Net Position</u>			
	<u>2018</u>	<u>2017</u>	<u>2016</u>
Operating revenues	\$ 2,690,903	\$ 2,551,484	\$ 2,462,828
Operating expenses	<u>2,905,089</u>	<u>2,616,462</u>	<u>2,304,878</u>
Net operating earnings (loss)	<u>(214,186)</u>	<u>(64,978)</u>	<u>157,950</u>
Non-operating revenue (expenses):			
Loss on asset impairment	-	-	(22,265)
Gain on disposal of capital assets	-	71	-
Investment income	79,129	52,537	20,699
Interest income (expense)	<u>1,047</u>	<u>(4,639)</u>	<u>(2,282)</u>
Total non operating income (loss)	<u>80,176</u>	<u>47,969</u>	<u>(3,848)</u>
World Bank project grants	<u>89,674</u>	-	-
Change in net position	\$ <u>(44,336)</u>	\$ <u>(17,009)</u>	\$ <u>154,102</u>

**FINANCIAL HIGHLIGHTS**

Operating revenue from electricity sales and services increased by approximately 5% against last year with a corresponding decrease in kilowatt sales of 1%. The rise in revenue was due to the slight increases in sales from different power sectors plus income generated from the fuel adjustment charge (FAC) from negative fuel adjustment revenue last year to an increase of approximately 194% this year. Energy sales are composed of 47% from billing/post paid customers while 53% is coming from prepaid cash power customers. Electricity sales comprised 99% of the operating revenue while the remaining goes to other revenues generated from service orders, maintenance fees and miscellaneous revenue.

Fuel purchase price started to go up in FY 2018; it began with an average price of \$3.1472/gal in October 2017 and closed at \$3.6385 at end of the year, compared with the same period last year, fuel price monthly average was around \$2.8334/gal in early FY 2017 and ended at \$3.0296/gal. FAC rate was affected by these increases; initially the rate was negative for the first quarter and with the continued fuel price increases, the rate increased from \$.0146/kwhr in October 2017 to as high as \$.0365/kwhr at the end of the year causing the FAC revenue to be almost double of that of last year.

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Operating expenses increased by around 11% with all cost components contributing to the increase. Fuel expenses comprise 55% of the total operating expenses while personnel costs and depreciation represent 17% and 13%, respectively, while the remaining 15% is attributed to maintenance and administrative expenses and provision for inventory obsolescence. Fuel consumption in gallons was reduced by less than 1%. Average usage cost per gallon of consumption is \$2.9913 in FY 2017 and \$3.4143 for FY 2018 with an increase of \$.423 per gallon; hence, a rise in fuel expense of around 14%. Kilowatt-hours generated by the engines and solar power is about 5,614,847 kWhrs with a reduction of around 7% compared with previous year. Solar power generation for two solar panel grid connected PVs contributes 7% of the total power generation.

Kilowatt sales for FY 2017 and FY 2018 is 5,421,105 kwh and 5,398,858 kwh, respectively. Average selling price for this year is \$.50 per kwh and production costs of \$.53 per kwh; an operating loss of \$.03 per kilowatt sold. The World Bank donated in November 2017, 400 units of 120 watt LED streetlights costing \$89,674 and 274 units were installed by the end of FY 2018.

Current asset decreased by 1%. This is brought about by an increase in temporary investments from unrealized gains; a net decrease in cash on hand and in bank accounts, increases in accounts receivables, payment for prepaid purchase order and decreases of inventories net of allowances. Collection/billing ratio is around 95%; hence, there is an increase in accounts receivable as compared with last year's ratio of 98%.

Utility plant includes KUA's generation plant, buildings, vehicles, equipment and fixtures net of accumulated depreciation and work in progress accounts. The additions to fixed assets are capitalized costs for LED Streetlight installation donated by World Bank and new installation and replacement of transformers and prepayment meters to customer during the period. KUA upgraded the existing cash power Suprema System to "Supreasy". The program has its basic function of generating/registering codes using the prepaid cards that is available to the public starting September 2018. The upgrading costs are capitalized which attributes to the increase in capital assets. Likewise, some non-functioning vehicles, equipment and fixtures with zero book value were written off in the books during the period. For additional information concerning capital assets, please refer to note 5 to the financial statements.

Non-current assets are the deposit amount for a fuel purchase contract with FSMPC and an investment in Ocean Energy Kosrae (OEK), net of valuation reserves.

Current liabilities are short term obligations payable to suppliers within a year. Such liabilities were reduced by 30% in FY 2018. This is the result of the reduction of unpaid fuel deliveries and payables from other suppliers, unearned revenue from prepaid customers and a slight increase in accrued payroll, annual leave credits and taxes.

The line of credit with the Bank of the FSM of \$200,000, intended for emergency and large expenses. KUA is opting to renew the line of credit when it comes to maturity. For additional information, refer to note 6 to the financial statements.

The decline in net position is the result of operations for the period. KUA has a reduction in net position of \$44,336. The generators donated by JICA and World Bank are now in place and are expected to be functioning roughly on the 3<sup>rd</sup> quarter of FY 2019. We're of the opinion that it will significantly contribute to KUA's engine efficiency and save fuel costs in future operations.

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Management's Discussion and Analysis  
Years Ended September 30, 2018 and 2017

**Plan of Action for 2019**

1. Complete the new Power Plant funded by JICA and Government of Japan. The completion of this project was delayed due to unstable foundation/floor of the building, so project works have to be extended to FY2019. The new generator set units, capacity of 600 kwp each, are expected to improve fuel efficiency and secure power services to the island.
2. Completing the Distribution Line Upgrades at Lelu Island and two underground feeders at the airport/dock area. These will improve reliable power services to the subject area and safety issues to customers at these sites.
3. Complete installation of the new generator set funded by World Bank to operate in parallel with the two generator sets installed in the new Power Plant. With this unit, KUA will have sufficient reserved power capacity to supply increases in power load during the next several years. This unit will also contribute to improve fuel efficiency and reduce cost to the operation.
4. Collaborate with World Bank and Ricardo Consultancy Group on bidding out a Battery Storage Facility and Scada System considerably funded by World Bank to interested suppliers to start assessing the storage capacity need and identify suitable design for the scada system for KUA and for its implementation during FY2019.
5. Collaborate with ADB and Endura Co. to finalize feasibility study for additional installation of 2 Mwp Solar PV System and proposed Mini-grid system for Walung Community and to secure funds from World Bank and ADB for the implementation of these projects. These projects are identified in the State Energy Master Plan to be implemented within the next 4 years.
6. Continue to install more LED and solar Street/Yard Lights procured under the WB grants in the four municipalities to replace the existing lighting used to provide efficient lighting services and safety concerns to customers and the four communities.
7. Work with ADB Consultants, Tetra Tech Consulting Firm to conduct management and operation assessments to improve the Power System. This is ADB's initiatives to improve Island Energy Systems in the Pacific with support from the Green Climate Fund (GCF). This program entails comprehensive review of utility operations and the environment in which the utility operates and determine how best to address operational issues and inefficiencies that may exist. This will support the project proposal submitted for consideration by GCF.
8. Continue to work with Kosrae State Government to complete remaining work before transferring the system to KUA. KUA will also work with ADB for technical assistance fund to extend contracts for two water specialists currently employed to plan improvements of other water system and secure outside funding and manage the Utwe Water system.
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 technologies and conventional power system.
10. 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.

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11. Procurement and delivery of remaining equipment and materials funded by World Bank such as a new Bucket Truck from NBK, Japan, Overhead transformers from Dateline Exports, US and additional solar and LED street lights from South Austral Pty, LTD, AU. These will support maintenance of the distribution lines and efficient lighting for the public and customers.
12. Continue to seek alternative Renewable Energy Technologies that are more environmentally friendly and cost effective to increase renewable energy penetration into the power grid and reduce fuel cost to the operation.

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 2017 audit, which report was dated December 6, 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.

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Statements of Net Position  
September 30, 2018 and 2017

<u>ASSETS</u>	<u>2018</u>	<u>2017</u>
Utility plant:		
Electric plant in service	\$ 10,858,738	\$ 10,878,531
Less accumulated depreciation	<u>(8,777,372)</u>	<u>(8,666,306)</u>
	2,081,366	2,212,225
Construction work-in-progress	<u>62,560</u>	<u>29,281</u>
Net utility plant	<u>2,143,926</u>	<u>2,241,506</u>
Other noncurrent assets:		
Prepayments	28,021	-
Deposit for fuel purchase contract	<u>252,800</u>	<u>252,800</u>
Total noncurrent assets	<u>280,821</u>	<u>252,800</u>
Current assets:		
Cash and cash equivalents	345,641	474,760
Investments	750,952	671,823
Time certificate of deposit	167,119	166,702
Accounts receivable, net	178,622	184,171
Prepayments	9,461	2,335
Inventories (net of an allowance for obsolescence of \$276,431 and \$220,213 in 2018 and 2017, respectively)	<u>229,009</u>	<u>231,633</u>
Total current assets	<u>1,680,804</u>	<u>1,731,424</u>
Total assets	<u>\$ 4,105,551</u>	<u>\$ 4,225,730</u>
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Accounts payable - fuel	\$ 91,257	\$ 150,320
Accounts payable - other	17,030	26,878
Accrued annual leave	15,127	10,919
Unearned revenue	17,461	29,744
Accrued taxes and other	<u>37,302</u>	<u>36,159</u>
Total liabilities	<u>178,177</u>	<u>254,020</u>
Commitments and contingency		
Net position:		
Net investment in capital assets	2,143,926	2,241,506
Restricted	90,000	90,000
Unrestricted	<u>1,693,448</u>	<u>1,640,204</u>
Total net position	<u>3,927,374</u>	<u>3,971,710</u>
	<u>\$ 4,105,551</u>	<u>\$ 4,225,730</u>

See accompanying notes to financial statements.

**KOSRAE UTILITIES AUTHORITY**  
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Statements of Revenues, Expenses, and Changes in Net Position  
Years Ended September 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Operating revenues:		
Electricity sales	\$ 2,717,241	\$ 2,582,991
Bad debt expense	<u>(26,338)</u>	<u>(31,507)</u>
Net operating revenues	<u>2,690,903</u>	<u>2,551,484</u>
Operating expenses:		
Production fuel	1,589,009	1,403,785
Salaries and wages	504,574	495,205
Depreciation and amortization	381,904	371,550
Administrative and general	239,059	232,388
Repairs and maintenance	134,325	113,534
Provision for inventory obsolescence	<u>56,218</u>	<u>0</u>
Total operating expenses	<u>2,905,089</u>	<u>2,616,462</u>
Loss from operations	<u>(214,186)</u>	<u>(64,978)</u>
Nonoperating revenues (expenses):		
Interest expense	-	(5,975)
Interest income	1,047	1,336
Net change in fair value of investments	79,129	52,537
Gain on disposal of capital assets	<u>-</u>	<u>71</u>
Total nonoperating revenue (expenses), net	<u>80,176</u>	<u>47,969</u>
Capital contribution:		
WorldBank project grant	<u>89,674</u>	<u>-</u>
Change in net position	<u>(44,336)</u>	<u>(17,009)</u>
Net position at beginning of year	<u>3,971,710</u>	<u>3,988,719</u>
Net position at end of year	<u>\$ 3,927,374</u>	<u>\$ 3,971,710</u>

See accompanying notes to financial statements.

**KOSRAE UTILITIES AUTHORITY**  
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Statements of Cash Flows  
Years Ended September 30, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Cash received from customers	\$ 2,653,837	\$ 2,532,300
Cash paid to suppliers for goods and services	(2,133,392)	(1,685,560)
Cash paid to employees for services	(497,714)	(491,324)
Net cash provided by operating activities	22,731	355,416
Cash flows from investing activities:		
Additional investments	-	(300,000)
Interest and dividends received on investments and others	630	858
Net cash (used in) provided by investing activities	630	(299,142)
Cash flows from noncapital financing activities:		
Interest paid on line of credit facility	-	(5,975)
Net cash used in noncapital financing activities	-	(5,975)
Cash flows from capital financing activities:		
Proceeds from disposal of capital assets	-	71
Capital expenditures for utility plant	(152,480)	(282,502)
Net cash used in capital financing activities	(152,480)	(282,431)
Net change in cash and cash equivalents	(129,119)	(232,132)
Cash and cash equivalents at beginning of year	474,760	706,892
Cash and cash equivalents at end of year	\$ 345,641	\$ 474,760
Reconciliation of loss from operations to net cash provided by operating activities:		
Loss from operations	\$ (214,186)	\$ (64,978)
Adjustments to reconcile loss from operations to net cash provided by operating activities:		
Depreciation and amortization	381,904	371,550
Bad debt expense	26,338	31,507
Inventory obsolescence	56,218	-
(Increase) decrease in assets:		
Accounts receivable	(20,789)	(22,740)
Prepayments	(35,147)	12,680
Inventories	(95,765)	7,146
Increase (decrease) in liabilities:		
Accounts payable - fuel	(59,062)	68,969
Accounts payable - other	(9,848)	(56,272)
Accrued annual leave	4,208	2,736
Unearned revenue	(12,283)	1,383
Accrued taxes and other	1,143	3,435
Net cash provided by operating activities	\$ 22,731	\$ 355,416

Supplemental information of noncash capital and related financing activities:

During the year ended September 30, 2018, KUA recorded capital contributions from World Bank of \$89,674 for street lights.

See accompanying notes to financial statements.

**KOSRAE UTILITIES AUTHORITY  
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Notes to Financial Statements  
September 30, 2018 and 2017

(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, 2018 and 2017, 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.

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Notes to Financial Statements  
September 30, 2018 and 2017

(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, 2018 and 2017, 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.

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Notes to Financial Statements  
September 30, 2018 and 2017

(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 81% and 19% of the net inventory value, respectively, as of September 30, 2018, and 78% and 22%, respectively, as of September 30, 2017.

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, 2018 and 2017 are \$97,787 and \$90,883, 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, 2018 and 2017

(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, 2018, KUA implemented the following pronouncements:

- GASB 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.
- 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. 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).
- GASB Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt.

The implementation of these statements did not have a material effect on KUA's 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.

**KOSRAE UTILITIES AUTHORITY  
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Notes to Financial Statements  
September 30, 2018 and 2017

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

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.

In April 2018, GASB issued Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, which improves the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. The provisions in Statement No. 88 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 June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, which requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. The provisions in Statement No. 89 are effective for fiscal years beginning after December 15, 2019. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2018, GASB issued Statement No. 90, *Majority Equity Interests – an Amendment of GASB Statements No. 14 and No. 61*, which improves the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and the relevance of financial statement information for certain component units. The provisions in Statement No. 90 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.

(3) Deposits and Investments

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

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

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

A. Deposits

As of September 30, 2018 and 2017, cash and cash equivalents and time certificates of deposit were \$512,760 and \$641,462, respectively, and the corresponding bank balances were \$562,266 and \$641,326, respectively, which are maintained in financial institutions

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Notes to Financial Statements  
September 30, 2018 and 2017

(3) Deposits and Investments, Continued

A. Deposits, Continued

subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2018 and 2017, bank deposits in the amount of \$325,221 and \$284,482, respectively, are 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, 2018 and 2017, investments at fair value comprise the following:

	<u>2018</u>	<u>2017</u>
Fixed income securities:		
U.S. Treasury obligations	\$ 115,317	\$ 115,885
U.S. Government agencies	41,691	43,531
Corporate notes	<u>86,486</u>	<u>89,514</u>
	<u>243,494</u>	<u>248,930</u>
Other Investments:		
Common equities	493,067	399,290
Money market funds (at amortized cost)	<u>14,391</u>	<u>23,603</u>
	<u>507,458</u>	<u>422,893</u>
	<u>\$ 750,952</u>	<u>\$ 671,823</u>

As of September 30, 2018, the Authority's fixed income securities consist of the following:

		<u>Fair Value</u>	<u>1 to 5 Years</u>	<u>6 to 10 Years</u>
U.S. Treasury obligations	Aaa	\$ 115,317	\$ 82,983	\$ 32,334
U.S. Government agencies	Aaa	41,691	41,691	-
Corporate notes	A2	14,091	7,199	6,892
Corporate notes	A3	37,434	21,702	15,732
Corporate notes	Baa1	12,939	7,958	4,981
Corporate notes	Baa2	<u>22,022</u>	<u>7,835</u>	<u>14,187</u>
		<u>\$ 243,494</u>	<u>\$ 169,368</u>	<u>\$ 74,126</u>

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

		<u>Fair Value</u>	<u>1 to 5 Years</u>	<u>6 to 10 Years</u>
U.S. Treasury obligations	Aaa	\$ 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  
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Notes to Financial Statements  
September 30, 2018 and 2017

(3) Deposits and Investments, Continued

B. Investments, Continued

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, 2018 and 2017:

	September 30, <u>2018</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	\$ 115,317	\$ -	\$ 115,317	\$ -
U.S. Government Agencies	41,691	-	41,691	-
Corporate notes	<u>86,486</u>	<u>-</u>	<u>86,486</u>	<u>-</u>
	\$ <u>243,494</u>	\$ <u>-</u>	\$ <u>243,494</u>	\$ <u>-</u>
Equity securities:				
U.S. equities	\$ 481,263	\$ 481,263		
Non U.S. equities	<u>11,804</u>	<u>11,804</u>	\$ -	\$ -
Total investments at fair value	736,561	\$ <u>493,067</u>	\$ <u>243,494</u>	\$ <u>-</u>
Investments measured at amortized cost:				
Money market funds	<u>14,391</u>			
	\$ <u>750,952</u>			

	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>	\$ -	\$ -
Total investments at fair value	648,220	\$ <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>			

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.

**KOSRAE UTILITIES AUTHORITY  
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Notes to Financial Statements  
September 30, 2018 and 2017

(3) Deposits and Investments, Continued

B. Investments, Continued

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, 2018 and 2017.

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, 2018 and 2017, 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, 2018 and 2017, are summarized as follows:

	<u>2018</u>	<u>2017</u>
Utility:		
Residential	\$ 35,987	\$ 36,209
Commercial	55,774	49,399
Government	85,492	67,753
Fuel adjustment charge	<u>10,015</u>	<u>1,595</u>
	187,268	154,956
Other	<u>57,339</u>	<u>82,271</u>
	244,607	237,227
Less allowance for doubtful accounts	<u>(65,985)</u>	<u>(53,056)</u>
	\$ <u>178,622</u>	\$ <u>184,171</u>

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Notes to Financial Statements  
September 30, 2018 and 2017

(5) Utility Plant

Capital asset activity for the years ended September 30, 2018 and 2017, is as follows:

	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2017</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Balance at September 30, 2018</u>
<u>Depreciable assets:</u>					
Production plant	5 to 40 years	\$ 3,873,532	\$ 1,936	\$ (9,846)	\$ 3,865,622
Distribution plant	5 to 30 years	6,442,078	126,631	(189,243)	6,379,466
General plant	3 to 20 years	<u>562,921</u>	<u>122,478</u>	<u>(71,749)</u>	<u>613,650</u>
Total electric plant in service		10,878,531	251,045	(270,838)	10,858,738
Less accumulated depreciation		<u>(8,666,306)</u>	<u>(381,904)</u>	<u>270,838</u>	<u>(8,777,372)</u>
		2,212,225	(130,859)	-	2,081,366
<u>Non-depreciable assets:</u>					
Construction work-in-progress		<u>29,281</u>	<u>119,879</u>	<u>(86,600)</u>	<u>62,560</u>
Electric plant in service, net		\$ <u>2,241,506</u>	\$ <u>(10,980)</u>	\$ <u>(86,600)</u>	\$ <u>2,143,926</u>
	<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>

(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, 2018 and 2017, 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, 2018 and 2017 are as follows:

	<u>Outstanding October 1, 2017</u>	<u>Increase</u>	<u>Decrease</u>	<u>Outstanding September 30, 2018</u>
Bank line of credit	\$ _____	\$ _____	\$ _____	\$ _____
	<u>Outstanding October 1, 2016</u>	<u>Increase</u>	<u>Decrease</u>	<u>Outstanding September 30, 2017</u>
Bank line of credit	\$ _____	\$ <u>100,000</u>	\$ <u>(100,000)</u>	\$ _____

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Notes to Financial Statements  
September 30, 2018 and 2017

(7) Significant Suppliers

KUA purchased virtually all fuel from one supplier during the years ended September 30, 2018 and 2017.

(8) Commitments

Net position at September 30, 2018 and 2017 has been appropriated in the amounts of \$2,316,919 and \$2,216,919, respectively, for repair and maintenance and capital improvement projects. This process will continue in fiscal year 2019 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 and 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, 2018, 2017 and 2016 were \$2,557, \$2,442, and \$3,428, 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, 2018 and 2017, Plan assets were \$89,514 and \$78,141, respectively, with corresponding cash balances of \$84,042 and \$74,465, respectively.

(11) Related Parties

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

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, 2018, 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 18, 2019.

### **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.

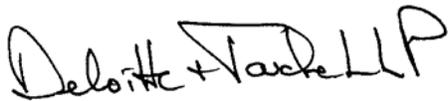
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not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

April 18, 2019

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

Summary Schedule of Prior Year Findings and Questioned Costs  
Year Ended September 30, 2018

There are no prior year findings or unresolved questioned costs of Kosrae Utilities Authority as of September 30, 2018.