Financial Statements and
Required Supplementary Information

Kosrae Housing and Rural Development Authority

(A Component Unit of the State of Kosrae)

Year Ended September 30, 2022
with Report of Independent Auditors

Building a better
working world

Kosrae Housing and Rural Development Authority
(A Component Unit of the State of Kosrae)

Financial Statements and Required Supplementary Information

Year Ended September 30, 2022

Contents

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Report of Independent Auditors

The Board of Directors
Kosrae Housing and Rural Development Authority

Report on the Audit of the Financial Statements

Opinion

We have audited the accompanying financial statements of the business-type activities of Kosrae Housing and Rural Development Authority (the Authority), as of and for the year ended September 30, 2022, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of Kosrae Housing and Rural Development Authority at September 30, 2022, and the changes in financial position and its cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States (*Government Auditing Standards*). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Authority, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Authority's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibility for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit 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 Authority's internal control. Accordingly, no such opinion is expressed.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Authority's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 7 be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with GAAS, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 18, 2024, 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 the effectiveness of Authority's 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.

Ernst + Young LLP

April 18, 2024

This analysis prepared by Kosrae Housing and Rural Development Authority (Authority) offers readers of the Authority's financial statements this narrative overview and analysis of its financial activities for the year ended September 30, 2022 (FY2022). We encourage readers to consider the information presented here in conjunction with Authority's financial statement, which follow this section. Fiscal year 2021 comparative information has been included where appropriate. This analysis is required by the Government Accounting Standards Board (GASB), which provides guidelines on what must be included and excluded from the analysis.

FINANCIAL HIGHLIGHTS

- The assets of the Authority exceeded its liabilities at the close of FY2022 with $578.0 thousand (net position), increasing by $31.7 thousand (or 6%) from a net position of $546.3 thousand in the prior year (FY2021). Of this amount, $45.2 thousand represents the Authority's investments in capital assets, $532.8 thousand represents amount restricted for housing and producers' programs and services.

- For the year ended September 30, 2022, the Authority's liabilities continue to consist of short term and long-term which included the LOC facility and loan with the Bank of FSM which now has a $50.0 thousand and $60.0 thousand balance, respectively. Other liabilities included payables and payroll accruals.

- During the FY2022 the Authority's expenses for operation were $226.4 thousand and were funded part by $124 thousand in interest income, fees and charges and $131.9 thousand in federal grants from US Department of Commerce.

- The operational expenses of the Authority for FY2022 total up to $226.4 thousand, a 14% increase compared to prior year. The operation of the Authority continued to rely heavily on interest, fees and charges on loans.

- As in previous years, the main source of revenue is loan interest fees and charges. For FY2022, total revenues collected was $108.0 thousand as adjusted balance with bad debt adjustments. $131.9 thousand was drawn down from the US EDA grant to fund producers' projects and to support administrative costs needed to continue the implementation of the program.

FINANCIAL ANALYSIS OF THE KOSRAE HOUSING & RURAL DEVELOPMENT AUTHORITY

Net Position

As noted earlier, the net position may serve over time as a useful indicator of an organization's or governments' financial position. In the case of the Authority, the assets exceeded liabilities by $578 thousand at the close of FY2022. However, such is restricted as to the purpose it can be used for or is invested in capital assets. The Authority is using these capital assets to provide services to the citizens, consequently these assets are not available for future spending. The majority of the Authority's net position is comprised of its capital assets and current liabilities. Current assets and liabilities are amounts that are available in the current period and obligations that will be paid within one year, respectively. The current assets of the Authority amounted to $13.6 thousand while current liabilities amounted to $137.1 thousand. The table below summarizes the Authority's net position at the close of current year compared with prior year FY2021:

	2022	2021
Assets:		
Cash and receivables	$485,987	$526,539
Time certificates of deposit	200,000	200,000
Property and equipment, net	45,238	62,005
Total assets	$731,225	$788,544
Liabilities:		
Current liabilities	$137,056	$182,231
Long term liabilities	16,135	59,941
Total liabilities	153,191	242,172
Net position:		
Net investment in capital asset	45,238	62,005
Restricted	532,796	484,367
Total net position	578,034	546,372
Total liabilities and net position	$731,225	$788,544

The Authority's restricted net position at the close of FY22 increased to $532,796 (a $48.4 thousand increase), a result of commitments or obligations that are less than currently available resources. The decrease in current liabilities is resulted in the dues to KSG being written off and resolved.

Changes in Net Position

As noted earlier, the net position of the Authority increased by $31.7 thousand, representing a 6% increase from the prior year's amount of $546.4 thousand. This result indicates that the Authority's financial condition has slight improvements from prior year. The key elements of the differences from prior year are shown in the following schedule:

Revenues, Expenses and Changes in Net position

	2022	2021	% change (2022-2021)
Operating revenue:			
Interest and fees	$124,088	$ 95,841	29.5%
(Provision for) recovery of loan loss	(16,125)	47,000	(65.7%)
Total operating revenue,	107,963	142,841	(24.4%)
Operating expenses	226,433	196,325	15.3%
Non-operating income (expenses):			
Operating grant from US Government	131,916	212,995	(38.1%)
Other income	23,780	---	100%
Interest expense	(5,564)	(6,736)	17.4%
Total non-operating revenues, net	150,132	206,259	(27.2%)
Change in net position	31,662	152,775	(79.3%)
Net position, beginning of the year	546,372	393,597	38.8%
Net position, end of the year	$578,034	$546,372	5.8%

Economic Factors and Next Year's Budget

The Authority continue facing economic and financial challenges as the demands from its clients continue to increase and available resources to fill the gap of $700 thousand and run its operation still limited. As in previous years and stated earlier, the Authority continues to rely heavily on interest and fees on loans to run daily operation. The grant received from the US Economic Development Assistance under the Department of Commerce continues to support significant increase in its resources. The Authority still receive no funding assistance or subsidies from the State Government to offset demands of our clients.

As noted in the schedule provided above, the revenues (interest) generated from loans presented an increase of $28.2 thousand compared to prior year. The decrease resulted from loan losses which derived from several contributed factors in the operating revenues.

The Authority continues to seek other funds to support and expand its services as well as generating more revenues to Kosrae's economy. In this current year, the Authority focuses its effort on securing funding to support home repair and improvement. It is fortunate that US Department of Agriculture awarded the Authority with $149.0 thousand for home loans. In FY2022, $131.9 thousand were made available or drawn down from the US Department of Commerce EDA grant to fund projects and administrative cost expended during the year.

The cost of running the Authority for the year ended September 30, 2022 expenditures was $226.4 thousand demonstrated a slight increase due to increased number of employees with salary increases, and cost of living allowance being approved. As in prior years, the bulk of the expenses occurred in the salaries category.

The Authority has a loan portfolio of $1.9 million and carries an updated credit classification report. The Authority expects a higher level of bad expense for FY2023 since the delinquency rate has increased to 21% after year end of FY2022.

Although the Authority's Strategic Development Plan (SDP) has not been updated, the Authority continues to monitor and measure its work against its own SDP. The Authority continued to measure its work with two monitoring device: (i) outcome level monitoring; (ii) activity level monitoring. Its daily operation is linked against 3 outcome measures: (a) loan making to grow 2% each year; (b) loan collection to increase 5% each year; and (c) delinquency to drop to 10% or less in 3 years. It is important to note that the Authority was able to meet only 2 of 4 major targets which is the lending and loan collection.

Management's Discussion and Analysis for the year ended September 30, 2021 is set forth in the Authority's report on the audit of financial statements, which is dated December 5, 2022. That Discussion and Analysis explains the major factors impacting the 2021 financial statements and can be viewed at the Office of the Public Auditor's website at www.fsmopa.fm.

Contacting the Authority's Financial Management

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

Kosrae Housing and Rural Development Authority
(A Component Unit of the State of Kosrae)

Statement of Net Position

September 30, 2022

Assets	
Current assets:	
Cash	$ 13,615
Total current assets	13,615
Loans receivable, net	472,372
Restricted time certificates of deposit	200,000
Property and equipment, net	45,238
	$731,225
Liabilities and net position	
Current liabilities:	
Notes payable	$ 50,000
Current portion of long-term debt	43,893
Accrued liabilities	31,494
Accounts payable	11,669
Total current liabilities	137,056
Long-term debt, net of current portion	16,135
Total liabilities	153,191
Commitments and contingencies	
Net position:	
Net investment in capital assets	45,238
Restricted	532,796
Total net position	578,034
	$731,225

See accompanying notes.

Kosrae Housing and Rural Development Authority
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Statement of Revenues, Expenses and Changes in Net Position

Year Ended September 30, 2022

Operating revenues:	
Interest and fees on loans	$124,088
Bad debt	(16,125)
Net operating revenues	107,963
Operating expenses:	
Salaries	181,631
Depreciation	16,767
Supplies and materials	5,310
Communication	4,719
Utilities	4,640
Contractual services	3,995
Fuel	3,711
Meetings	2,635
Food	2,346
Repairs and maintenance	679
Total operating expenses	226,433
Operating loss	(118,470)
Non-operating revenues (expenses):	
Operating grant from U.S. Government	131,916
Other income	23,780
Interest expense	(5,564)
Total non-operating revenues, net	150,132
Change in net position	31,662
Net position at beginning of year	546,372
Net position at end of year	$578,034

See accompanying notes.

Kosrae Housing and Rural Development Authority
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Statement of Cash Flows

Year Ended September 30, 2022

Cash flows from operating activities:	
Cash received from customers	$ 124,088
Cash paid to suppliers for goods and services	(60,434)
Cash paid to employees	(172,483)
Net cash used in operating activities	(108,829)
Cash flows from noncapital financing activities:	
Operating grant from U.S. Government	131,916
Principal repayment on long-term debt	(41,900)
Interest payment on long-term debt	(5,564)
Net cash provided by noncapital financing activities	84,452
Cash flows from investing activities:	
Loan originations and principal collections, net	7,221
Net change in cash	(17,156)
Cash at beginning of year	30,771
Cash at end of year	$ 13,615
Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	$(118,470)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation	16,767
Bad debt	16,125
Decrease in advance to employees	50
Increase in accrued liabilities	9,098
Decrease in accounts payable	(32,399)
Net cash used in operating activities	$(108,829)

See accompanying notes.

1. Organization

The Kosrae Housing and Rural Development Authority (the "Authority"), formerly named Kosrae Housing Authority, was established in October 2015 by Kosrae State Public Law 10-113 with the name change in June 2017 by Kosrae State Public Law 11-115. The purpose of the Authority is to manage and invest funds of Kosrae Home Improvement Program and other funds of the Authority and to lend money to qualified Kosraeans who wish to build and maintain residential homes in Kosrae.

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

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

2. Summary of Significant Accounting Policies

The accounting policies of the Authority conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. GASB establishes financial reporting standards for governmental entities, which require that management's discussion and analysis of the financial activities be included with the basic financial statements and notes and modifies certain other financial statement disclosure requirements.

Net Position

Net position represents the residual interest in the Authority's assets after liabilities are deducted and consist of three sections: net investment in capital assets, restricted and unrestricted. Net position classified as net investment in capital assets include capital assets, restricted and unrestricted, net of accumulated depreciation and reduced by outstanding debt, net of debt service reserve. Net position are reported as restricted when constraints are imposed by third parties or enabling legislation. At September 30, 2022, all of the Authority's restricted assets are expendable, and are restricted for loan programs.

2. Summary of Significant Accounting Policies, continued

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and deferred outflows of resources, and liabilities and deferred inflows of resources 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 method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Accounting Estimates

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

Cash and Time Certificate of Deposits

For the purposes of the statements of net position and of cash flows, cash is defined as cash in checking accounts, savings accounts and time c and cash on hand. Time certificates of deposit with original maturity term over ninety-days or restricted for specific purposes are separately presented. At September 30, 2022, the Authority's time certificate of deposit is restricted as pledges for USDA Rural Development loan guarantees (note 3), a line of credit (note 5) and a long-term debt (note 6).

As of September 30, 2022, the carrying amount of the Authority's total cash and time certificates of deposit was $213,615 and the corresponding bank balance was $224,419, which is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2022 total bank deposits in the amount of $224,419, were FDIC insured.

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

2. Summary of Significant Accounting Policies, continued

Property and Equipment

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

Loans and Allowance for Loan Losses

Loans receivable are stated at unpaid principal balance less the allowance for loan losses. A majority of the Authority's loans has a maturity term of 10 years or over, and as such, loans, net have been presented as non-current asset in the accompanying statement of net position.

Management maintains the allowance for loan losses at a level adequate to absorb probable losses. Management determines the adequacy of the allowance based upon reviews of individual loans, recent loss experience, current economic conditions, the risk characteristics of the various categories of loans and other pertinent factors. Loans deemed uncollectible are charged to the allowance. Provisions for losses and recoveries on loans previously charged off are added to the allowance and recorded as reduction or addition to operating revenues.

Interest on loans is accrued and credited to income based on the principal amount outstanding. The accrual of interest on loans is discontinued when, in the opinion of management, there is an indication that the borrower may be unable to meet payments as they become due. Upon such discontinuance, all unpaid accrued interest is reversed.

Deferred Outflows of Resources

In addition to assets, the statements of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. As of September 30, 2022, the Authority has no items that qualify for reporting in this category.

Deferred Inflows of Resources

In addition to liabilities, the statements of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. As of September 30, 2022, the Authority has no items that qualify for reporting in this category.

2. Summary of Significant Accounting Policies, continued

Compensated Absences

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

Taxes

The Authority exists and operates solely for the benefit of the public and shall be exempted from any State or Municipal taxes or assessments on any of its property, operations or activities. The Authority shall be liable for employees' contributions to the National Social Security System or other employees' benefits of the State or FSM National Governments, if any, in such manner as provided by law.

Operating and Non-operating Revenues and Expenses

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund’s principal ongoing operations, which is lending. Operating expenses include the cost to provide services, including cost of funds, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Authority enters into off-balance sheet financial instruments consisting of commitments to extend credit and loan guarantees. Such financial instruments are recorded in the financial statements when they become payable.

Recently Adopted Accounting Pronouncements

In June 2017, GASB issued Statement No. 87, *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments’ financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and as inflows of resources or outflows of resources recognized based on the payment provisions of the contract. The adoption of GASB Statement No. 87 did not have an effect on the accompanying financial statements.

2. Summary of Significant Accounting Policies, continued

Recently Adopted Accounting Pronouncements, Continued

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*. The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period. The adoption of GASB Statement No. 89 did not have an effect on the accompanying financial statements.

In January 2020, GASB issued Statement No. 92, *Omnibus 2020*. The requirements of this Statement will enhance comparability in the application of accounting and financial reporting requirements and will improve the consistency of authoritative literature. More comparable reporting will improve the usefulness of information for users of state and local government financial statements. This Statement addresses a variety of topics and includes specific provisions about leases; reporting of intra-entity transfers of assets between a primary government employer and a component unit defined benefit pension plan or defined benefit other postemployment benefit (OPEB) plan; applicability of Statement no. 73 and 84 for postemployment benefits, measurement of liabilities (and assets, if any) related to asset retirement obligations (AROs) in a government acquisition; reporting by public entity risk pools for amounts that are recoverable from reinsurers or excess insurers; reference to nonrecurring fair value measurements of assets or liabilities in authoritative literature and terminology used to refer to derivative instruments. The adoption of GASB Statement No. 92 did not have an effect on the accompanying financial statements.

In March 2020, GASB issued Statement No. 93, *Replacement of Interbank Offered Rates*. Some governments have entered into agreements in which variable payments made or received depend on an interbank offered rate (IBOR) – most notably, the London Interbank Offered Rate (LIBOR). As a result of global reference rate reform, LIBOR is expected to cease to exist in its current form, prompting governments to amend or replace financial instruments for the purpose of replacing LIBOR with other reference rates by either (a) changing the reference rate or (b) adding or changing fallback provisions related to the reference rate. The objective of this Statement is to address the accounting and financial reporting effects that result from the replacement of IBORs with other reference rates in order to preserve the reliability, consistency, and comparability of reported information. The adoption of GASB Statement No. 93 did not have an effect on the accompanying financial statements.

2. Summary of Significant Accounting Policies, continued

Recently Adopted Accounting Pronouncements, Continued

In June 2020, GASB issued Statement No. 97, *Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code 457 Deferred Compensation Plans*. The primary objectives of this Statement are to (a) increase consistency and comparability related to the reporting of fiduciary component units in circumstances in which a potential component unit does not have a governing board and the primary government performs the duties that a governing board typically would perform; (b) mitigate costs associated with the reporting of certain defined contribution pension plans, defined contribution OPEB plans, and employee benefit plans other than pension plans or OPEB plans as fiduciary component units in fiduciary fund financial statements; and (c) enhance the relevance, consistency, and comparability of the accounting and financial reporting for Internal Revenue Code (IRC) Section 457 deferred compensation plans (Section 457 plans) that meet the definition of a pension plan and for benefits provided through those plans. The adoption of GASB Statement No. 97 did not have an effect on the accompanying financial statements.

Upcoming Accounting Pronouncements

In May 2019, GASB issued Statement No. 91, *Conduit debt obligations*. The primary objectives of this statement are to provide a single method reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This statement achieves those objectives by clarifying the existing definition of a conduit obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. GASB Statement No. 91 will be effective for fiscal year ending September 30, 2023.

In March 2020, GASB issued Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*. The primary objective of this Statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements (PPPs). As used in this Statement, a PPP is an arrangement in which a government (the transferor) contracts with an operator (a governmental or nongovernmental entity) to provide public services by conveying control of the right to operate or use a nonfinancial asset, such as infrastructure or other capital asset (the underlying PPP asset), for a period of time in an exchange or exchange-like transaction. Some PPPs meet the definition of a service concession arrangement (SCA), which the Board defines in this Statement as a PPP in which (1) the operator collects and is compensated by fees from third parties; (2) the transferor determines or has the ability to modify or approve which services the operator is required to provide, to whom the operator is required to provide the services, and the prices or rates that can be charged for the services; and (3) the transferor is entitled to significant residual interest in the service utility of the underlying PPP asset at the end of the arrangement. GASB Statement No. 94 will be effective for fiscal year ending September 30, 2023.

2. Summary of Significant Accounting Policies, continued

Upcoming Accounting Pronouncements, continued

In May 2020, GASB issued Statement No. 96, *Subscription-Based Information Technology Arrangements*. This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset - an intangible asset - and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 96 will be effective for fiscal year ending September 30, 2023.

In April 2022, GASB issued Statement No. 99, *Omnibus 2022*. The requirements of this Statement will enhance comparability in the application of accounting and financial reporting requirements and will improve the consistency of authoritative literature. Consistent authoritative literature enables governments and other stakeholders to locate and apply the correct accounting and financial reporting provisions, which improves the consistency with which such provisions are applied more easily. The comparability of financial statements also will improve as a result of this Statement. Better consistency and comparability improve the usefulness of information for users of local government financial statements. GASB Statement No. 99 will be effective for fiscal year ending September 30, 2023.

In June 2022, GASB issues Statement No. 100, *Accounting Changes an Error Corrections – An Amendment of GASB Statement No. 62*. The primary objective of this Statement is to enhance accounting and financial reporting requirements for accounting changes and error corrections to provide more understandable, reliable, relevant, consistent and comparable information for making decisions or assessing accountability. The requirements of this Statement will improve the clarity of the accounting and financial reporting requirements for accounting changes and error corrections, which will result in greater consistency in application in practice. In turn, more understandable, reliable, relevant, consistent, and comparable information will be provided to financial statement users for making decisions or assessing accountability. In addition, the display and note disclosure requirements will result in more consistent, decision useful, understandable, and comprehensive information for users about accounting changes and error corrections. GASB Statement No. 100 will be effective for fiscal year ending September 30, 2024.

2. Summary of Significant Accounting Policies, continued

Upcoming Accounting Pronouncements, continued

In June 2022, GASB issued Statement No. 101, *Compensated Absences*. The objective of this Statement is to better meet the information needs of financial statement users by updating the recognition and measurement guidance for compensated absences. That objective is achieved by aligning the recognition and measurement guidance under a unified model and by amending certain previously required disclosures. The unified recognition and measurement model in this Statement will result in a liability for compensated absences that more appropriately reflects when a government incurs an obligation. In addition, the model can be applied consistently to any type of compensated absence and will eliminate potential comparability issues between governments that offer different types of leave. The model also will result in a more robust estimate of the amount of compensated absences that a government will pay or settle, which will enhance the relevance and reliability of information about the liability for compensated absences. GASB Statement No. 101 will be effective for fiscal years ending September 30, 2025.

The Authority is currently evaluating the effects the above upcoming accounting pronouncements might have on its financial statements.

3. Loans Receivable

The Authority's loan portfolio is comprised of Kosrae Home Improvement Program, USDA Rural Development ("USDA RD") loans and Economic Development Administration Revolving Loan Fund ("EDA RLF") loans.

The State of Kosrae transferred defaulted USDA Rural Development (RD) loans to the Authority. The Authority guarantees USDA RD loans and bears responsibility for collection. The balance of USDA Rural Development loans is $32,311 as of September 30, 2022. The Authority has pledged an escrow account in support of USDA RD loans. As of September 30, 2022, $200,000 of time certificates of deposit has been pledged for this purpose. Per the USDA RD agreement with the State, $300,000 is to be so pledged.

The Authority administers EDA RLF loans and bears responsibility for collection. The balance of EDA Revolving Loan Fund loans is $271,348 as of September 30, 2022. The EDA RLF funds were established through a $400,000 grant award from the United States Department of Commerce Economic Development Administration in July 2020. The grant requires a non-federal matching at 20% of total project expense, or $100,000. The Authority provides its non-Federal Matching Share contribution for eligible project expenses in proportion to the Federal share requested for such project expenses.

3. Loans Receivable, continued

A summary of loans receivable as of September 30, 2022, is presented below:

Kosrae Home Improvement Program loans	$1,554,773
EDA Revolving Loan Fund loans	271,348
USDA Rural Development loans	32,311
	1,858,432
Less allowance for loan losses	(1,386,060)
Loans receivable, net	$ 472,372

There are no recorded loan loss provisions, charge-offs or recoveries during the year ended September 30, 2022.

4. Due to Primary Government

During the year ended September 30, 2022, the Authority wrote off its remaining balance of $23,780 due to the State of Kosrae based on communication received from the State and recognized as other non-operating income in the accompanying financial statement.

5. Notes payable

The Authority maintains a $50,000 bank Line of Credit for working capital, which may be subject to annual renewal. The line is secured by a $200,000 time certificate of deposit (TCD) maintained with the same Bank. Borrowing against the line bears interest floating at 3.5% plus the TCD interest rate (effective rate of 3.51% at September 30, 2022), payable monthly. As of September 30, 2022, the balance outstanding of $50,000 is due upon maturity date of February 1, 2023.

Changes in short-term debt during the year ended September 30, 2022 are as follows:

	Balance October 1, 2021	Additions	Reductions	Balance September 30, 2022	Due Within One Year
Short-term debt	$50,000	$50,000	$(50,000)	$50,000	$50,000

6. Long-Term Debt

In March 2019, a $200,000 bank term-loan was obtained to fund operations. The line is secured by the $200,000 time certificate of deposit (TCD). The loan bears an interest floating at 5.0% plus the TCD interest rate (effective rate of 5.01% at September 30, 2022).   .

Changes in long-term debt during the year ended September 30, 2022 are as follows:

	Balance October 1, 2021	Additions	Reductions	Balance September 30, 2022	Due Within One Year
Long-term debt	$101,928	$ ---	$(41,900)	$60,028	$43,893

As of September 30, 2022, the scheduled payments of the above long-term debt are as follows:

Year Ending September 30,	Principal	Interest	Total
2023	$43,893	$2,227	$46,120
2024	16,135	200	16,335
	$60,028	$2,427	$62,455

7. Property and Equipment

Capital asset activities for the year ended September 30, 2022 are as follows:

	Estimated Useful Life	Balance at October 1, 2021	Additions and Transfers	Deletions and Transfers	Balance at September 30, 2022
Depreciable:					
Building	10 years	$ 79,000	$ ---	$ ---	$ 79,000
Office equipment	1-5 years	7,594	---	---	7,594
Furniture and fixtures	1-5 years	9,610	---	---	9,610
Vehicles	1-5 years	18,970	---	---	18,970
		115,174	---	---	115,174
Less accumulated depreciation		(53,169)	(16,767)	---	(69,936)
		$ 62,005	$(16,767)	$ ---	$ 45,238

8. Related Parties

Except when a loan is under EDA RLF and is specifically approved by the Board because it is determined that the Authority is a sole provider, the Authority is generally prohibited from lending money to its employees or their immediate relatives pursuant to Kosrae State Public Law 10-113. As of September 30, 2022, the Authority has $135,099 of loans receivable from employee family members, who are eligible under the EDA RLF program.

The Authority initiated an Employee Pay Advance Program in May 2018. The Authority requires employees to repay the amount of the advance with 10.5% interest within a one-year term. As of September 30, 2022, the balance of advances to employees of $16,125 was fully provided with allowance due to lack of collection.

9. Grants and Subsidies

The Authority receives grants from the United States Government and other foreign governments and organization either as a direct or as a sub-recipient from the Kosrae State Government or the FSM National Government. During the year ended September 30, 2022, the Authority recorded grant revenue of $131,916 under the $400,000 EDA RLF grant (note 3). The remaining grant balance of $50,335 was subsequently drawn in December 2022.

10. Commitments and Contingencies

Loan Commitments

The Authority has loan commitments aggregating $493,791 as of September 30, 2022. The loan commitments represent undisbursed balances of approved loans for housing projects.

Risk Management

The Authority does not purchase insurance to cover risks associated with potential losses. Management is of the opinion that no material losses during the year ended September 30, 2022 have resulted from this practice.

Litigation

The Authority is a party to various legal proceedings, the ultimate impact of which is not currently predictable. Therefore, no liability has been recorded in the accompanying financial statements due to management’s inability to predict the ultimate outcome of these proceedings.

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Report of Independent Auditors 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 Housing and Rural Development Authority:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Kosrae Housing and Rural Development Authority (the "Authority"), which comprise the statement of net position as September 30, 2022, 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, 2024.

Report on Internal Control Over Financial Reporting

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify a certain deficiency in internal control, described in the accompanying Schedule of Findings and Questioned Costs, that we consider to be a material weakness as item 2022-001.

Report on Compliance and Other Matters

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

The Authority's Responses to Findings

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

Purpose of this Report

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

Ernst + Young LLP

April 18, 2024

Finding No.: 2022-001
Area: Loan Receivable

Criteria: The Authority should maintain an adequate system of accounting to facilitate the reconciliation of its general ledger with supporting schedules, including individual loan account history reports.

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

USDA loan collections were recorded in the incorrect GL account.

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

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

Identification as a Repeat Finding: 2021-001

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

Auditee Response and Corrective Action Plan: The Authority agrees with this finding as a repeat finding. The office has revived contract discussions with software company and will procure the loan and accounting system likely in FY2024. Funding is the primary cause of delays.