

*Financial Statements,
Required Supplementary Information and
Compliance and Internal Control*

Kosrae Utilities Authority

(A Component Unit of the State of Kosrae)

*Years ended September 30, 2023 and 2022
with Report of Independent Auditors*



Kosrae Utilities Authority
(A Component Unit of the State of Kosrae)

Financial Statements, Required Supplementary Information and
Compliance and Internal Control

Years ended September 30, 2023 and 2022

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Report of Independent Auditors

The Board of Directors
Kosrae Utilities Authority

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of the business-type activities of Kosrae Utilities Authority (the Authority), a component unit of the State of Kosrae, as of and for the years ended September 30, 2023 and 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 accompanying financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the Authority as of September 30, 2023 and 2022, and the changes in financial position and cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits 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 audits. 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 Responsibilities 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 9 be presented to supplement the 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 July 17, 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 solely 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 the 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

July 17, 2024

Kosrae Utilities Authority
(*A Component Unit of the State of Kosrae*)

Management's Discussion and Analysis

Years ended September 30, 2023 and 2022

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 years ended September 30, 2023 and 2022. Please read it in conjunction with the financial statements, which follows this section.

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

KUA had continued to provide needed services to its customers and the general public with generally stable operation financially during FY2023. Although, the operation had experienced nominal increases in expenditures due to fuel prices and others, the revenues realized from the energy sales were sufficient to cover the operation cost. Essential Renewable Energy Development Projects continue to depend on outside funds mainly from World Bank, ADB and JICA to support and reduce operation cost by increasing renewable energies into the power system. There were no major challenges or issues facing the operation during this fiscal year. The staff had mostly focused their work activities on daily task to keep the power on to service the island and preparing ground works for the implementation of the funded Renewable Energy Development Projects for Kosrae which were mostly done thru virtual conferences between the Contractor, DoRD FSM, Project Consultants and Managers, KUA and Donor Agencies.

These Renewable Energy Projects, both Solar PV and BESS with SCADA System are slated to commence construction during 1st quarter of FY2025 and be completed in mid FY2025. These are anticipated to contribute at least 40% of renewable energies into the gridlines and thus reducing One-fourth of the fuel requirements for the Diesel Engine Units. KUA will hopefully achieve the energy targets stated in the Energy Master Plan for Kosrae.

Kosrae Utilities Authority
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Management's Discussion and Analysis, continued

The following table summarizes the financial position and results of operation of Kosrae Utilities Authority for 2023 through 2021:

<u>Assets</u>	<u>2023</u>	<u>2022</u>	<u>2021</u>
Current Assets	\$2,958,424	\$2,750,105	\$2,748,385
Utility plant, net	1,490,411	1,564,184	1,746,483
Other non-current assets	<u>252,800</u>	<u>252,800</u>	<u>252,800</u>
	<u>\$4,701,635</u>	<u>\$4,567,089</u>	<u>\$4,747,668</u>

Liabilities and Net Position

Current Liabilities	\$ <u>390,049</u>	\$ <u>329,291</u>	\$ <u>274,013</u>
Net Position:			
Invested in capital assets	1,490,411	1,564,184	1,746,483
Restricted	90,000	90,000	90,000
Unrestricted	<u>2,731,175</u>	<u>2,583,614</u>	<u>2,637,172</u>
Total net position	<u>4,311,586</u>	<u>4,237,798</u>	<u>4,473,655</u>
	<u>\$4,701,635</u>	<u>\$4,567,089</u>	<u>\$4,747,668</u>

Revenue, Expenses and Changes in Net Position

	<u>2023</u>	<u>2022</u>	<u>2021</u>
Operating revenues	\$3,403,673	\$3,248,137	\$2,583,489
Operating expenses	<u>3,414,682</u>	<u>3,339,924</u>	<u>2,658,592</u>
Net operating loss	(<u>11,009</u>)	(<u>91,787</u>)	(<u>75,103</u>)
Non-operating revenue (expenses) :			
Subsidies from FSM National Government	-	21,903	28,097
Gain (loss) on disposal of capital asset	100	(383)	148
Net change in fair value of investments	79,801	(167,010)	143,275
Interest income (expense)	<u>4,896</u>	<u>1,420</u>	(<u>2,918</u>)
Total Non-operating (expense) revenue	<u>84,797</u>	(<u>144,070</u>)	<u>168,602</u>
Change in net position	\$ <u>73,788</u>	\$ (<u>235,857</u>)	\$ <u>93,499</u>

Kosrae Utilities Authority
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Management's Discussion and Analysis, continued

FINANCIAL HIGHLIGHTS

Operating Revenues are derived from sales of electricity, water services and other income related to the utility operation with water operation contributing to less than 1% of the revenue. Electric revenue are from post-paid and prepaid users at almost the same ratio as last year with 51% and 49% respectively. Revenue increased by almost 5% as customer consumption increased by 417,226 kwhr representing approximately 8% more than last year's usage of almost all customer type. Customer sales composition comprises Residential/Private sales of 29%, Kosrae State Government sales of 15%, Government Non-Kosrae State sales of 6%, Industrial sales of 4%, Commercial sales of 28% and Fuel Adjustment Charge (FAC) revenue of 18%, relatively few changes on customer classification against last year. Total kwhr sale for the period is 5,894,332 and 3,605,750 gallons for water consumption, an effect of reduction of 8% in electricity sales and 20% gallon usage respectively. Water billing was reduced from \$6 for every 1,000 gal to \$2 for every thousand effective March 2023 as a result of court decision that causes the decrease in water revenue by around 45% against last year.

Fuel Adjustment Revenue are income coming from fuel adjustments in addition to customer's tariff to cover for fluctuation of fuel prices. Average FAC rate for FY 2023 and FY 2022 is \$.1054 and \$.1109 respectively. With the increase in kwhr sales and a slight decrease in FAC rate, the effect in FAC revenue is reduced by around 4%.

Operating Expenses increased by 2%. It is the net effect of increases in personnel cost of 6%, decrease in maintenance cost of 21%, fuel expense increased by less than 1%, depreciation decreased by 2% and administrative expenses 35% increase, with personnel training expense contributing the rise in administrative expenses for the period.

Production Fuel are diesel fuel and lubricants consumed by the engines. Fuel consumption of the engine for this period is 497,644 gallons, an increase of approximately 2% of last year's usage. Fuel prices slightly decreased but with the increase in engine consumption on diesel and lubricants, the change has not affected much on the fuel expense account which is almost the same level from the previous year. Average fuel usage cost per gallon for FY2022 and FY 2023 is \$4.3325 and \$4.2363 respectively, a minimal reduction of roughly 2% between the two periods.

Non-operating revenue and expenses are the proceeds of asset disposal, increase in fair value KUA investments and interest income. No interest expense is paid during the period.

Current Assets comprises the cash and cash equivalents (80%), accounts receivable (8%), inventories (11%) and prepayments (1%). The net change of \$208,319 representing approximately 7% increase against last year is the net effect of increases in cash and cash equivalents of 14%, decreases in accounts receivable, prepayments and inventories of 24%, 3% and 3% respectively. Current assets represents 63% of the total assets with 3% increase from last year.

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Management's Discussion and Analysis, continued

Utility Plant are electric plant in service composed of KUA's buildings, vehicles, equipment, system software, fixtures and work in projects net of accumulated depreciation. Total fixed assets addition of \$246,069, asset disposals of \$777 and write off of non-operational and fully depreciated assets of \$369,338 are the significant movement of the fixed assets account. Depreciation provided for the period of \$318,708 is 2% less compared with the provision last year.

Non-Current Assets are the deposit amount for fuel purchase contract with FSMPC. The amount still remains the same to date.

Current Liabilities are short term obligations payable to employees and suppliers. Payable to FSMPC for fuel and lubricants represents 60% of the outstanding obligation and 40% are owed to employees and taxes. A net increase of 18% in comparison with last year's current liabilities is significantly due to a higher unpaid obligation to FSMPC while other liabilities due to employees and taxes are within the same level as the previous period.

Net Position is the accumulated results of KUA's operation and contributed capital. The net change for the period represents the net earning for FY2023.

Plan of Action for 2024

1. Complete procurement and delivery of project materials, hardware for the 1.2 Mw Solar PV, Walung Mini-grid System, BESS and Scada to project site before construction commence on 1st quarter of FY2025.
2. Collaborate with World Bank and ADB for funding to implement a Tariff Study to reassess the increased renewable energies into the grid and Grid-Stability Study to control and stabilize the power line system.
3. Submit new Energy Development Projects proposal to World Bank and ADB for Resiliency Projects to strengthen the power Infrastructure including relocation and replacement of electric poles and additional Solar PV Projects to increase share of renewable energies into the power system.
4. Collaborate with ADB and OCA, Global for the completion of the Disaster Risk Reduction (DRR) Policy Framework and secure funding to implement the DRR recommendation stated in the DRR Policy after approval by the KUA Board.
5. Install the Trip-Savers II Reclosers to the power distribution lines to regulate the unscheduled power outages and thus reduce outage duration unexpectedly affecting the power lines.

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Management's Discussion and Analysis, continued

6. Work with the Kosrae State Government to complete the water connection to all customers at Utwe Water System and start discussing transfer terms and conditions with start-up subsidy to run the water operation division at KUA.
7. Continue to collaborate with JICA to support technical training programs for generation and renewable energy system to ensure that KUA employees possess the skills to maintain and operate the Solar PV System, BESS Facility and the Scada System.
8. Implement Top End overhaul of the new Daithsu Engine units at the new Power Plant and provide regular maintenances and repairs of the two Genset. Continue to work and identify Engine problem on #11 Engine and repairs to complement the running engine units when island demand is called for.
9. Upgrade Suprima billing software from Key Revision I to Key Revision II, since the former is outdated and need to be upgraded to its newer version.
10. stalled meters to change codes for the new billing software upgrade revision.
11. Continue to search quality street/yard lights to withstand the salty environment and corrosion to replace the old lights for public safety service and security to the general public.
12. Continue to support and seek related trainings to improve knowledge and skills in areas of Renewable Energy and Diesel Generation, Audit and Financial, Billing and Accounting Software and related areas that are essentials to improve the operation.
13. Continue to prioritize improvements of data collection and technical reports from the generation including the existing solar PV and other required operational reports. Improve facility management of fixed assets.
14. Collaborate with Vital, the local fuel supplier for better fuel prices and fuel specs that meet the Generators Fuel Specification requirements to ensure proper fuel are being purchased for the Power Plant Engines.
15. Prepare new energy development project funding proposal to seek funding from the newly approved Compact Funds and the other outside Donors to increase renewable energies into the power gridlines and to reduce fuel usage to meet the target of the Energy Master Plan for Kosrae.

Kosrae Utilities Authority
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Management's Discussion and Analysis, continued

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 2022 audit, which report was dated October 5, 2023.

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

Kosrae Utilities Authority
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Statements of Net Position

	September 30, <u>2023</u>	<u>2022</u>
Assets		
Utility plant		
Depreciable:		
Electric plant in service	\$11,213,631	\$11,384,574
Less accumulated depreciation	(9,840,823)	(9,892,230)
	1,372,808	1,492,344
Non-depreciable:		
Construction work-in-progress	<u>117,603</u>	<u>71,840</u>
Net utility plant	<u>1,490,411</u>	<u>1,564,184</u>
Other noncurrent assets:		
Deposit for fuel purchase contract	<u>252,800</u>	<u>252,800</u>
Total noncurrent assets	<u>1,743,211</u>	<u>1,816,984</u>
Current assets:		
Cash and cash equivalents	1,333,649	1,106,424
Investments	846,401	780,249
Time certificate of deposit	169,679	169,662
Accounts receivable, net	241,702	300,079
Prepayments	28,505	43,659
Inventories, net	<u>338,488</u>	<u>350,032</u>
Total current assets	<u>2,958,424</u>	<u>2,750,105</u>
Total assets	<u>\$ 4,701,635</u>	<u>\$ 4,567,089</u>

See accompanying notes.

Kosrae Utilities Authority
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Statements of Net Position, continued

	September 30, <u>2023</u>	<u>2022</u>
Liabilities and Net Position		
Current liabilities:		
Accounts payable – fuel	\$ 235,553	\$ 202,109
Accounts payable - other	37,444	21,921
Accrued annual leave	30,449	30,091
Unearned revenue	47,692	34,339
Accrued taxes and other	<u>38,911</u>	<u>40,831</u>
Total liabilities	<u>390,049</u>	<u>329,291</u>
Commitments and contingency		
Net position:		
Net investments in capital assets	1,490,411	1,564,184
Restricted	90,000	90,000
Unrestricted	<u>2,731,175</u>	<u>2,583,614</u>
Total net position	<u>4,311,586</u>	<u>4,237,798</u>
Total liabilities	<u>\$4,701,635</u>	<u>\$4,567,089</u>

See accompanying notes.

Kosrae Utilities Authority
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Statements of Revenues, Expenses, and Changes in Net Position

	Years ended September 30,	
	<u>2023</u>	<u>2022</u>
Operating revenues:		
Electricity sales	\$3,391,216	\$3,233,220
Water sales	13,438	19,516
Bad debt expense	(981)	(4,599)
Net operating revenues	<u>3,403,673</u>	<u>3,248,137</u>
Operating expenses:		
Production fuel	2,136,362	2,126,999
Salaries and wages	607,936	571,166
Depreciation and amortization	318,708	325,193
Administrative and general	241,066	173,934
Repairs and maintenance	111,590	141,937
(Recovery of) provision for inventory obsolescence	(980)	695
Total operating expenses	<u>3,414,682</u>	<u>3,339,924</u>
Loss from operations	(11,009)	(91,787)
Nonoperating revenues (expenses):		
Subsidies from FSM National Government	---	21,903
Interest income, net	4,896	1,420
Net change in fair value of investments	79,801	(167,010)
Gain (loss) on disposal of capital assets	<u>100</u>	(383)
Total nonoperating revenues (expenses), net	<u>84,797</u>	(144,070)
Change in net position	<u>73,788</u>	(235,857)
Net position at beginning of year	<u>4,237,798</u>	<u>4,473,655</u>
Net position at end of year	<u>\$4,311,586</u>	<u>\$4,237,798</u>

See accompanying notes.

Kosrae Utilities Authority
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Statements of Cash Flows

	Years ended September 30,	
	<u>2023</u>	<u>2022</u>
Cashflows from operating activities:		
Cash received from customers	\$3,490,246	\$3,117,062
Cash paid to suppliers for goods and services	(2,427,216)	(2,364,230)
Cash paid to employees for services	(<u>609,498</u>)	(<u>561,635</u>)
Net cash provided by operating activities	<u>453,532</u>	<u>191,197</u>
Cashflows from investing activities:		
Increase in investments	13,649	37,328
Interest and dividends received on investments and others	<u>4,879</u>	<u>1,403</u>
Cash provided by investing activities	<u>18,528</u>	<u>38,731</u>
Cash flows from noncapital financing activities -		
Subsidies from FSM National Government	<u>---</u>	<u>21,903</u>
Cashflows from capital and related financing activities:		
Proceeds from disposal of capital assets	100	1,506
Capital expenditures for utility plant	(<u>244,935</u>)	(<u>144,783</u>)
Net cash used in capital and related financing activities	(<u>244,835</u>)	(<u>143,277</u>)
Net change in cash and cash equivalents	227,225	108,554
Cash and cash equivalents at beginning of year	<u>1,106,424</u>	<u>997,870</u>
Cash and cash equivalents at end of year	<u>\$1,333,649</u>	<u>\$1,106,424</u>

See accompanying notes.

Kosrae Utilities Authority
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Statements of Cash Flows, continued

	Years ended September 30,	
	<u>2023</u>	<u>2022</u>
Reconciliation of loss from operations to net cash provided by operating activities:		
Loss from operations	\$(11,009)	\$(91,787)
Adjustments to reconcile loss from operations to net cash provided by operating activities:		
Depreciation and amortization	318,708	325,193
Bad debt expense	981	4,599
Inventory provision	(980)	695
(Increase) decrease in assets:		
Accounts receivable	57,396	(140,548)
Prepayments	15,154	15,228
Inventories	12,524	22,539
Increase in liabilities:		
Accounts payable - fuel	33,444	42,956
Accounts payable - other	15,523	1,678
Accrued annual leave	358	7,191
Unearned revenue	13,353	354
Accrued taxes and other	(1,920)	3,099
Net cash provided by operating activities	<u>\$453,532</u>	<u>\$191,197</u>

See accompanying notes.

Kosrae Utilities Authority
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Notes to Financial Statements

Years Ended September 30, 2023 and 2022

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.

Kosrae Utilities Authority
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Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

As of September 30, 2023 and 2022, 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.

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.

Accounting 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.

Utility Plant

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.

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 certificate of deposit accounts with original maturity dates greater than three months are separately classified.

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.

Kosrae Utilities Authority
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Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Receivables

All receivables are due from government agencies, businesses and individuals located within the State of Kosrae and are interest free and uncollateralized. The allowance for uncollectible accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectability of these accounts and prior collection experience. The allowance is established through a provision for bad debts recorded against operating revenues. Bad debts are written off against the allowance on the specific identification method.

Inventory

Materials and fuel inventories are carried at the lower of cost (using the first-in first-out and the average cost method, respectively) or net realizable value.

Allowance for inventory obsolescence may be provided for inventory items with no movement for two years or as specifically identified as unusable.

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

KUA 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. KUA shall be liable for employees' contributions to the National Social Security System or other employees' benefits of the State of Kosrae or FSMNG, if any, in such manner as provided by law.

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, 2023 and 2022 is \$141,784 and \$154,472, 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, continued

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, investing and financing activities, costs and related recoveries from natural disasters, and certain other non-recurring income and costs.

Recently Adopted 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 of 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 debt 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. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. The adoption of GASB Statement No. 91 during the year ended September 30, 2023 did not have an effect on the accompanying financial statements.

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. This Statement also provides guidance for accounting and financial reporting for availability payment arrangements. The adoption of GASB Statement No. 94 during the year ended September 30, 2023 did not have an effect on the accompanying financial statements.

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. The adoption of GASB Statement No. 96 during the year ended September 30, 2023 did not result in a material effect on the accompanying financial statements.

Kosrae Utilities Authority
(A Component Unit of the State of Kosrae)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Recently Adopted Accounting Pronouncements, continued

In April 2022, GASB issued Statement No. 99, *Omnibus 2022*. This statement provides clarification guidance on several of its recent statements that addresses different accounting and financial reporting issues identified during implementation of the new standards and during the GASB's review of recent pronouncements. GASB Statement No. 99:

- Provides clarification of provisions in GASB Statement No. 87 related to the determination of the lease term, classification of a lease as a short-term lease, recognition and measurement of a lease liability and a lease asset, and identification of lease incentives. This implementation did not have a material effect on the accompanying financial statements.
- Provides clarification of provisions in GASB Statement No. 94 related to (a) the determination of the public-private and public-public partnership (PPP) term and (b) recognition and measurement of installment payments and the transfer of the underlying PPP asset. This implementation did not have a material effect on the accompanying financial statements.
- Provides clarification of provisions in GASB Statement No. 96 related to the subscription-based information technology arrangement (SBITA) term, classification of a SBITA as a short-term SBITA, and recognition and measurement of a subscription liability. This implementation did not have a material effect on the accompanying financial statements.
- Modifies accounting and reporting guidance in GASB Statement No. 53 related to termination of hedge. This implementation did not have a material effect on the accompanying financial statements.

Upcoming Accounting Pronouncements

In April 2022, GASB issued Statement No. 99, *Omnibus 2022*. This Statement contains guidance whose effective dates are in future periods:

- Modifies guidance in GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, to bring all guarantees under the same financial reporting requirements and disclosures effective for fiscal year ending September 30, 2024.
- Provides guidance on classification and reporting of derivative instruments within the scope of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, effective for fiscal year ending September 30, 2024.

Kosrae Utilities Authority
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Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Upcoming Accounting Pronouncements, continued

In June 2022, GASB issues Statement No. 100, *Accounting Changes and 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.

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 year ending September 30, 2025.

In December 2023, GASB issued Statement No. 102, *Certain Risk Disclosures*. The primary objective of this Statement is to provide users of the government financial statements with essential information about risks related to a government's vulnerabilities due to ascertain concentrations or constraints. This Statement requires a government to assess whether a concentration or constraint makes the primary government reporting unit or other reporting units that report a liability for revenue debt vulnerable to the risk of a substantial impact. Additionally, this Statement requires a government to assess whether an event or events associated with a concentration or constraint that could cause the substantial impact have occurred, have begun to occur, or are more likely than not to begin to occur within 12 months of the date the financial statements are issued. Management is evaluating the effect that this Statement, upon implementation, will have on the financial statements. GASB Statement No. 102 will be effective for fiscal year ending September 30, 2025.

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

Kosrae Utilities Authority
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Notes to Financial Statements, continued

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, 2023 and 2022, cash and cash equivalents and time certificates of deposit were \$1,503,328 and \$1,276,086, respectively, and the corresponding bank balances were \$1,564,254 and \$1,285,563, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2023 and 2022 bank deposits in the amount of \$377,800 and \$393,674, respectively, are subject to the FDIC insurance limit. 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, 2023 and 2022, investments at fair value comprise the following:

	<u>2023</u>	<u>2022</u>
Fixed income securities:		
U.S. Treasury obligations	\$204,371	\$195,236
Corporate notes	<u>131,536</u>	<u>139,779</u>
	<u>335,907</u>	<u>335,015</u>
Other Investments:		
Common equities	510,494	435,549
Real estate and tangibles	<u>---</u>	<u>9,685</u>
	<u>510,494</u>	<u>445,234</u>
	<u>\$846,401</u>	<u>\$780,249</u>

Kosrae Utilities Authority
(A Component Unit of the State of Kosrae)

Notes to Financial Statements, continued

3. Deposits and Investments, continued

B. Investments, continued

As of September 30, 2023 and 2022, the Authority's fixed income securities consist of the following:

	September 30, <u>2023</u>	Fair <u>Value</u>	Maturity 1 to 5 <u>Years</u>	Maturity 6 to 10 <u>Years</u>
U.S. Treasury obligations	Aaa	\$204,371	\$166,701	\$37,670
Corporate notes	A1	30,900	20,632	10,268
Corporate notes	A2	10,683	10,683	---
Corporate notes	A3	10,326	10,326	---
Corporate notes	Baa1	29,427	---	29,427
Corporate notes	Baa2	<u>50,200</u>	<u>40,694</u>	<u>9,506</u>
		<u>\$335,907</u>	<u>\$249,036</u>	<u>\$86,871</u>

	September 30, <u>2022</u>	Fair <u>Value</u>	Maturity 1 to 5 <u>Years</u>	Maturity 6 to 10 <u>Years</u>
U.S. Treasury obligations	Aaa	\$195,236	\$174,935	\$20,301
Corporate notes	A1	20,717	20,717	---
Corporate notes	A2	20,650	20,650	---
Corporate notes	A3	20,461	10,786	9,675
Corporate notes	Baa1	9,078	---	9,078
Corporate notes	Baa2	<u>68,873</u>	<u>50,084</u>	<u>18,789</u>
		<u>\$335,015</u>	<u>\$277,172</u>	<u>\$57,843</u>

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

Kosrae Utilities Authority
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Notes to Financial Statements, continued

3. Deposits and Investments, continued

B. Investments, continued

KUA has the following recurring fair value measurements as of September 30, 2023 and 2022:

	September 30, <u>2023</u>	<u>Fair Value Measurements Using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments by fair value level:				
Fixed income:				
U.S. Treasury obligations	\$204,371	\$ ---	\$204,371	\$ ---
Corporate notes	<u>131,536</u>	<u>---</u>	<u>131,536</u>	<u>---</u>
	<u>335,907</u>	<u>---</u>	<u>335,907</u>	<u>---</u>
Equity securities:				
U.S. equities	489,289	489,289	---	---
Non U.S. equities	<u>21,205</u>	<u>21,205</u>	<u>---</u>	<u>---</u>
	<u>510,494</u>	<u>510,494</u>	<u>---</u>	<u>---</u>
Total investments at fair value	<u>\$846,401</u>	<u>\$ 510,494</u>	<u>\$335,907</u>	<u>\$ ---</u>

	September 30, <u>2022</u>	<u>Fair Value Measurements Using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investments by fair value level:				
Fixed income:				
U.S. Treasury obligations	\$195,236	\$ ---	\$195,236	\$ ---
Corporate notes	<u>139,779</u>	<u>---</u>	<u>139,779</u>	<u>---</u>
	<u>335,015</u>	<u>---</u>	<u>335,015</u>	<u>---</u>
Equity securities:				
U.S. equities	426,667	426,667	---	---
Non U.S. equities	<u>8,882</u>	<u>8,882</u>	<u>---</u>	<u>---</u>
	<u>435,549</u>	<u>435,549</u>	<u>---</u>	<u>---</u>
Real estate and tangibles	<u>9,685</u>	<u>9,685</u>	<u>---</u>	<u>---</u>
Total investments at fair value	<u>\$780,249</u>	<u>\$ 445,234</u>	<u>\$335,015</u>	<u>\$ ---</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
(A Component Unit of the State of Kosrae)

Notes to Financial Statements, continued

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, 2023 and 2022.

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, 2023 and 2022, 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, 2023 and 2022, are summarized as follows:

	<u>2023</u>	<u>2022</u>
Utility:		
Commercial	\$ 75,540	\$ 96,542
Residential	88,370	75,850
Government	65,339	71,098
Fuel adjustment charge	<u>18,220</u>	<u>72,309</u>
	<u>247,469</u>	<u>315,799</u>
Travel advances	14,376	515
Other	<u>49,885</u>	<u>52,389</u>
	311,730	368,703
Less allowance for doubtful accounts	(70,028)	(68,624)
	<u>\$241,702</u>	<u>\$300,079</u>

Kosrae Utilities Authority
(A Component Unit of the State of Kosrae)

Notes to Financial Statements, continued

5. Inventory

Inventory at September 30, 2023 and 2022, are summarized as follows:

	<u>2023</u>	<u>2022</u>
Parts and supplies	\$542,537	\$524,513
Fuel	<u>78,439</u>	<u>108,987</u>
	620,976	633,500
Less allowance for inventory obsolescence	<u>(282,488)</u>	<u>(283,468)</u>
	<u>\$338,488</u>	<u>\$350,032</u>

6. Utility Plant

Capital asset activity for the years ended September 30, 2023 and 2022 is as follows:

	Estimated Useful Lives	Balance at October 1, 2022	Transfers and Additions	Transfers and Deletions	Balance at September 30, 2023
<u>Depreciable assets:</u>					
Production plant	5 to 40 years	\$ 3,872,273	\$ 95,381	\$(188,717)	\$ 3,778,937
Distribution plant	5 to 30 years	6,843,853	66,489	(154,159)	6,756,183
General plant	3 to 20 years	<u>668,448</u>	<u>37,302</u>	<u>(27,239)</u>	<u>678,511</u>
Total electric plant in service		11,384,574	199,172	(370,115)	11,213,631
Less accumulated depreciation		<u>(9,892,230)</u>	<u>(318,708)</u>	<u>370,115</u>	<u>(9,840,823)</u>
		1,492,344	(119,536)	---	1,372,808
<u>Non-depreciable assets:</u>					
Construction work-in-progress		<u>71,840</u>	<u>50,532</u>	<u>(4,769)</u>	<u>117,603</u>
Electric plant in service, net		<u>\$ 1,564,184</u>	<u>\$(69,004)</u>	<u>\$(4,769)</u>	<u>\$ 1,490,411</u>
	Estimated Useful Lives	Balance at October 1, 2021	Transfers and Additions	Transfers and Deletions	Balance at September 30, 2022
<u>Depreciable assets:</u>					
Production plant	5 to 40 years	\$ 3,874,173	\$ 850	\$(2,750)	\$ 3,872,273
Distribution plant	5 to 30 years	6,735,726	114,925	(6,798)	6,843,853
General plant	3 to 20 years	<u>659,491</u>	<u>32,692</u>	<u>(23,735)</u>	<u>668,448</u>
Total electric plant in service		11,269,390	148,467	(33,283)	11,384,574
Less accumulated depreciation		<u>(9,598,431)</u>	<u>(325,193)</u>	<u>31,394</u>	<u>(9,892,230)</u>
		1,670,959	(176,726)	(1,889)	1,492,344
<u>Non-depreciable assets:</u>					
Construction work-in-progress		<u>75,524</u>	<u>---</u>	<u>(3,684)</u>	<u>71,840</u>
Electric plant in service, net		<u>\$ 1,746,483</u>	<u>\$(176,726)</u>	<u>\$(5,573)</u>	<u>\$ 1,564,184</u>

Kosrae Utilities Authority
(A Component Unit of the State of Kosrae)

Notes to Financial Statements, continued

7. Commitments

Net position at September 30, 2023 and 2022 has been appropriated in the amounts of \$2,816,919 and \$2,716,919, respectively, for repair and maintenance and capital improvement projects. This process will continue in fiscal year 2024 with a total of \$25,000 being further appropriated on a quarterly basis from net position for this purpose.

8. 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.

9. Retirement Plan

KUA administers a defined contribution retirement plan (the Plan) covering all employees with at least one year of service. 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, 2023 and 2022 was \$4,324 and \$3,580, respectively, which were equal to the employer contributions required by the Plan. At September 30, 2023 and 2022, Plan assets were \$118,410 and \$114,857, respectively, with corresponding cash balances of \$115,246 and \$104,234, respectively.

Although the Plan does not accumulate assets in a trust where Plan assets are legally protected from the creditors of KUA and the plan administrator, KUA has concluded that the activities of the Plan are not fiduciary activities of KUA as the participants have the right to direct the exchange and the right to direct the employment of the Plan assets.

10. 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. Virtually 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.

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*

Management and the Board of Directors
Kosrae Utilities Authority

We have audited, in accordance with auditing standards generally accepted in the United States 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 Utilities Authority (the Authority), which comprise the statement of net position as of September 30, 2023, and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated July 17, 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) as a basis for designing 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 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 or significant deficiencies may exist that were not identified.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of 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 financial statements. 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.

Ernst + Young LLP

July 17, 2024