

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

---

**INDEPENDENT AUDITOR'S REPORT  
AND  
FINANCIAL STATEMENTS**

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**Years Ended  
September 30, 2013 and 2012**

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Years Ended September 30, 2013 and 2012

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CERTIFIED PUBLIC ACCOUNTANT

**SAIPAN**

Family Building, Suite 201  
PMB 297 Box 10000  
Saipan, MP 96950  
Tel Nos. (670) 233-1837/0456  
Fax No. (670) 233-8214

**GUAM**

Reflection Center, Suite 204  
P.O. Box 12734  
Tamuning, GU 96931  
Tel Nos. (671) 472-2680/2687  
Fax No. (671) 472-2686

**PALAU**

PIDC Apartment No. 11  
P.O. Box 1266  
Koror, PW 96940  
Tel No. (680) 488-8615  
Fax No. (680) 488-8616

**INDEPENDENT AUDITOR'S REPORT**

To the Board of Directors  
Commonwealth Utilities Corporation

**Report on the Financial Statements**

I have audited the accompanying financial statements of the Commonwealth Utilities Corporation, a component unit of the Commonwealth of the Northern Mariana Islands Government, as of and for the years ended September 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Commonwealth Utilities Corporation's basic financial statements as listed in the table of contents.

***Management's Responsibility for the Financial Statements***

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

***Auditor's Responsibility***

My responsibility is to express opinions on these financial statements based on my audits. I conducted my audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that I plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, I express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinions.

**Opinion**

In my opinion, such financial statements present fairly, in all material respects, the financial position of the Commonwealth Utilities Corporation as of September 30, 2013 and 2012, and the changes in net position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

**Emphasis of Matter**

As described in Note 2 to the financial statements, in 2013, the Commonwealth Utilities Corporation adopted new accounting guidance, GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* and GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The prior year financial statements have been restated to comply with the reporting requirements of this pronouncement. My opinion is not modified with respect to this matter.

**Other Matters**

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion on pages 4 through 18 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. I have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to my inquiries, the basic financial statements, and other knowledge I obtained during my audit of the basic financial statements. I do not express an opinion or provide any assurance on the information because the limited procedures do not provide me with sufficient evidence to express an opinion or provide any assurance.

*Other Information*

My audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Commonwealth Utilities Corporation's basic financial statements. The Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis is presented for purposes of additional analysis and is not a required part of the basic financial statements. The Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements.

The Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis and the Schedule of Expenditures of Federal Awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In my opinion, the Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis and the Schedule of Expenditures of Federal Awards are fairly stated in all material respects in relation to the basic financial statements as a whole.

**Other Reporting Required by Government Auditing Standards**

In accordance with *Government Auditing Standards*, I have also issued my report dated October 20, 2014, on my consideration of the Commonwealth Utilities Corporation's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Commonwealth Utilities Corporation's internal control over financial reporting and compliance.

Handwritten signature in cursive script that reads "J. Scott Magliari & Company".

Saipan, Commonwealth of the Northern Mariana Islands  
October 20, 2014

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

MANAGEMENT'S DISCUSSION & ANALYSIS  
September 30, 2013

This discussion and analysis of the Commonwealth Utilities Corporation's (CUC) financial performance provides an overview of CUC's activities for the fiscal year ended September 30, 2013 with comparisons to prior fiscal years ended September 30, 2012 and 2011. We encourage readers to consider the information presented here in conjunction with the financial statements, related notes and supplementary information (pages 19 through 50).

**FINANCIAL HIGHLIGHTS**

- Total assets at September 30, 2013, were \$133,331,804, an increase of \$68,073 or 0.1% compared to \$133,263,731 in 2012, which increased by \$3,303,655 or 2.5% compared to \$129,960,076 in 2011. The increase in 2013 is primarily due to the increase in regulatory cost for future recovery-fuel (the cost of fuel not yet fully recovered by CUC in the form of "levelized energy adjustment clause" (LEAC) rate adjustments) by \$1,340,482 offset by the decrease in capital assets due to annual depreciation.
- Total liabilities at September 30, 2013, were \$41,738,141, a decrease of \$2,568,878 or 5.8% from \$44,307,019 in 2012, which increased by \$5,963,633 or 15.6% from \$38,343,386 in 2011. The increase in 2013 is primarily due to a decrease in accounts payable which is related to the lower operating expenses in 2013 compared to 2012.
- Total net operating revenues for fiscal year 2013 were \$91,101,421, a \$4,835,580 or 5.0% decrease from \$95,937,001 in 2012, which increased by \$3,656,309 or 4.0%, when compared to fiscal year 2011. The decreased revenue in 2013 is primarily attributable to the \$2,548,864 or 21.3% decrease in water revenues and \$1,854,470 or 90.1% decrease in other revenues.
- Total operating expenses for fiscal year 2013 were \$99,946,854, a decrease of \$3,710,222 or 3.6% from \$103,657,076 in 2012, which increased by \$2,297,341 or 2.3% when compared to \$101,359,735 in fiscal year 2011. The decrease in operating expenses in 2013 is the result of the \$3,672,406 or 5.5% decrease in production fuel and \$3,097,900 or 80.4% decrease in other production, offset by the \$736,370 or 4.4% increase in general and administrative expenses and \$2,672,151 or 43.2% increase in maintenance expenses.
- In fiscal year 2013, CUC received \$11,489,591 in capital contributions and federal awards compared to \$10,407,616 in fiscal year 2012 and \$13,983,886 in fiscal year 2011.

**COMMONWEALTH UTILITIES CORPORATION**  
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MANAGEMENT'S DISCUSSION & ANALYSIS  
September 30, 2013

**OVERVIEW OF THE FINANCIAL STATEMENTS**

The Financial Section of this report presents the CUC's financial statements as two components: basic financial statements, and notes to the financial statements. It also includes supplemental information.

*Basic Financial Statements*

The *Statements of Net Position* presents information on assets and deferred outflows of resources, and liabilities and deferred inflows of resources with the difference between them presented as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of CUC is improving or deteriorating.

The *Statements of Activities and Changes in Net Position* reports how net position has changed during the year. It compares related operating revenues and operating expenses connected with the CUC's principal business of providing power, water and sewer services. Operating expenses include the cost of direct services to customers, administrative expenses, contracted services and depreciation on capital assets. All other revenues and expenses are reported as non-operating.

The *Statements of Cash Flows* reports inflows and outflows of cash, classified into four major categories:

- Cash flows from operating activities include transactions and events reported as components of operating income in the Statement of Revenues, Expenses and Changes in Net Position.
- Cash flows from non-capital financing activities include operating grant proceeds.
- Cash flows from capital and related financing activities include the borrowing and repayment (principal and interest) of capital-related debt, the acquisition and construction of capital assets, and the proceeds of capital grants and contributions.
- Cash flows from investing activities include proceeds from sale of investments, receipt of interest and changes in the fair value of investments subject to reporting as cash equivalents. Outflows in this category include the purchase of investments.

*Notes to the Financial Statements*

Various notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements and are found immediately following the financial statements to which they refer.

*Other Information*

This report also presents certain supplementary information concerning CUC's Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis (see pages 49 through 50).

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MANAGEMENT'S DISCUSSION & ANALYSIS  
September 30, 2013

**ANALYSIS OF BASIC FINANCIAL STATEMENTS**

**Condensed Statements of Net Position**

	2013	2012	Increase (Decrease)	Percentage Change
Current and other assets	\$ 46,292,693	\$ 45,136,526	\$ 1,156,167	2.6%
Capital assets, net	87,039,111	88,127,205	(1,088,094)	-1.2%
Total assets	133,331,804	133,263,731	68,073	0.1%
Deferred outflows of resources	-	-	-	-
Current and other liabilities	27,854,091	25,995,914	1,858,177	7.1%
Noncurrent liabilities	13,884,050	18,311,105	(4,427,055)	-24.2%
Total liabilities	41,738,141	44,307,019	(2,568,878)	-5.8%
Deferred inflows of resources	3,400,000	3,400,000	-	0.0%
Net investment in capital assets	87,039,111	85,883,593	1,155,518	1.3%
Restricted	45,165,364	45,093,415	71,949	0.2%
Deficit	(44,010,812)	(45,420,296)	1,409,484	-3.1%
Net position	\$ 88,193,663	\$ 85,556,712	\$ 2,636,951	3.1%

	2012	2011	Increase (Decrease)	Percentage Change
Current and other assets	\$ 45,136,526	\$ 42,160,878	\$ 2,975,648	7.1%
Capital assets, net	88,127,205	87,799,198	328,007	0.4%
Total assets	133,263,731	129,960,076	3,303,655	2.5%
Deferred outflows of resources	-	-	-	-
Current and other liabilities	25,995,914	28,808,229	(2,812,315)	-9.8%
Noncurrent liabilities	18,311,105	9,535,157	8,775,948	92.0%
Total liabilities	44,307,019	38,343,386	5,963,633	15.6%
Deferred inflows of resources	3,400,000	3,400,000	-	0.0%
Net investment in capital assets	85,883,593	82,116,575	3,767,018	4.6%
Restricted	45,093,415	45,320,917	(227,502)	-0.5%
Deficit	(45,420,296)	(35,820,802)	(9,599,494)	26.8%
Net position	\$ 85,556,712	\$ 91,616,690	\$ (6,059,978)	-6.6%



**COMMONWEALTH UTILITIES CORPORATION**  
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MANAGEMENT'S DISCUSSION & ANALYSIS  
September 30, 2013

Highlights of events affecting assets, liabilities, deferred inflows and net position follows.

During fiscal year 2013, total assets increased by \$68,073 or 0.1%. Significant changes in account balances were:

- o Current and other assets which consists primarily of cash and cash equivalents, accounts and notes receivable from utility, regulatory cost for future recovery and inventory increased by \$1,156,167 or 2.6%.
- o Cash and cash equivalents increased by \$3,652,858 primarily due to the decrease in operating expenses in 2013. CUC was successful in its efforts to fully fund the customer security deposit.
- o Accounts receivable net of allowance for uncollectible amounts decreased by \$3,275,412 or 20.8%, primarily attributable to an increase in the allowance for uncollectible amounts. In prior years CUC provided allowance for uncollectible for accounts receivable over 75 days old. In fiscal year 2013, CUC begun providing an allowance for accounts over 60 days past due.
- o Other assets decreased by \$743,150, primarily due to the receipt of off-island purchases of parts and supplies for on-going maintenance programs which were prepaid in 2012.
- o Regulatory cost for future recovery increased by \$1,340,482 due to LEAC rates consistently lower than actual cost of fuel purchases.
- o Changes in capital assets are discussed in a separate section of this MD&A.

Total liabilities decreased by \$2,568,878 or 5.8% in 2013. Significant changes in account balances were as follows:

- o Current liabilities which consists primarily of accounts payable, customer deposits, due to primary government, current maturities of long-term debt and related interest and dividend payable, increased \$2,275,738 or 7.1%.
- o Accounts payable and accrued expenses decreased by \$745,685 or 7.8% due to the decrease in operating expenses in 2013.
- o Customer deposits which consists of customer account credit balances, and security deposits which consist of the mandatory deposit upon opening accounts with CUC increased by \$443,330 or 4.3%.
- o Current maturities of long term-debt increased by \$683,786 or 12.7%. CUC did not make any payments or offset of payment to its loans payable to the Commonwealth Ports Authority in 2013.

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MANAGEMENT'S DISCUSSION & ANALYSIS  
September 30, 2013

- o Noncurrent liabilities which consists primarily of long term debt - net of current maturities to Pacific Marine Industrial Corporation (PMIC) and Commonwealth Ports Authority (CPA) and retirement contributions payable. The amount decrease by \$4,844,616 or 38.9% due to the payment of the PMIC payable.

**Condensed Statements of Activities and Change in Net Position**

	2013	2012	Change	
			Amount	Percentage
Operating revenues, net	\$ 91,101,421	\$ 95,937,001	\$ (4,835,580)	-5.0%
Operating expenses	99,946,854	103,657,076	(3,710,222)	-3.6%
Loss from operations	(8,845,433)	(7,720,075)	(1,125,358)	14.6%
Nonoperating revenues(expenses), net	(1,347,689)	(1,129,275)	(218,414)	19.3%
Change in recovery of fuel costs	1,340,482	3,182,803	(1,842,321)	-57.9%
Net loss before capital contributions and federal grants	(8,852,640)	(5,666,547)	(3,186,093)	56.2%
Capital contributions and federal grants	11,489,591	10,407,616	1,081,975	10.4%
Change in net position before extraordinary items	2,636,951	4,741,069	(2,104,118)	-44.4%
Contract termination loss	-	(7,401,047)	7,401,047	-100.0%
Net position, beginning	85,556,712	88,216,690	(2,659,978)	-3.0%
Net position, ending	\$ 88,193,663	\$ 85,556,712	\$ 2,636,951	3.1%

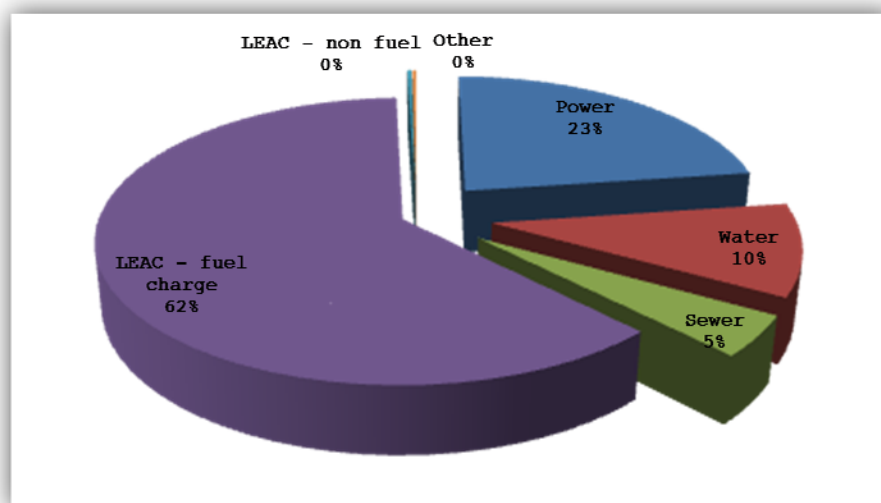
	2012	2011	Change	
			Amount	Percentage
Operating revenues, net	\$ 95,937,001	\$ 92,280,692	\$ 3,656,309	4.0%
Operating expenses	103,657,076	101,359,735	2,297,341	2.3%
Loss from operations	(7,720,075)	(9,079,043)	1,358,968	-15.0%
Nonoperating revenues(expenses), net	(1,129,275)	(2,083,958)	954,683	-45.8%
Change in recovery of fuel costs	3,182,803	(1,332,881)	4,515,684	-338.8%
Net loss before capital contributions and federal grants	(5,666,547)	(12,495,882)	6,829,335	-54.7%
Capital contributions and federal grants	10,407,616	13,983,886	(3,576,270)	-25.6%
Change in net position before extraordinary items	4,741,069	1,488,004	3,253,065	
Contract termination loss	(7,401,047)	-	(7,401,047)	0.0%
Net position, beginning	88,216,690	86,728,686	1,488,004	1.7%
Net position, ending	\$ 85,556,712	\$ 88,216,690	\$ (2,659,978)	-3.0%

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

MANAGEMENT'S DISCUSSION & ANALYSIS  
September 30, 2013

**Operating Revenues**

	2013	2012	2011
Power	\$ 20,768,693	\$ 19,402,752	\$ 15,609,742
Water	9,416,257	11,965,121	9,246,714
Sewer	4,106,125	4,723,893	3,365,104
LEAC - fuel charge	56,358,422	57,453,172	61,837,636
LEAC - non fuel	248,780	334,449	764,070
Other	203,144	2,057,614	1,457,426
<b>Total</b>	<b>\$ 91,101,421</b>	<b>\$ 95,937,001</b>	<b>\$ 92,280,692</b>



In 2013, operating revenues decreased by \$4,835,580 or 5.0% when compared to revenues in 2012, which increased by \$3,656,309 or 4.0% when compared to revenues in 2011.

- Power revenues (excluding LEAC) increased by \$1,365,941 or 7.0% compared to 2012. This is primarily due to the full year impact of the base rate increase approved by the Commonwealth Public Utilities Commission (CPUC) effective February 27, 2012.
- Revenues from LEAC charges decreased by \$1,180,419 or 2.0% compared to 2012. This is the result of LEAC charges set at a level below corresponding fuel costs, per a CPUC Order issued in January 2013. The order reduces the LEAC rate from \$0.31212 to \$0.29751 for the period January 7, 2013 to March 4, 2013. The rate was subsequently changed to \$0.31878 beginning March 5, 2013.
- Sewer revenues decreased by \$617,768 or 13.1% compared to 2012 due to improved customer metering.
- Water revenues decreased by \$2,548,864 or 21.3% compared to 2012 due primarily to offsetting of bad debt for accounts over 60 days past due.

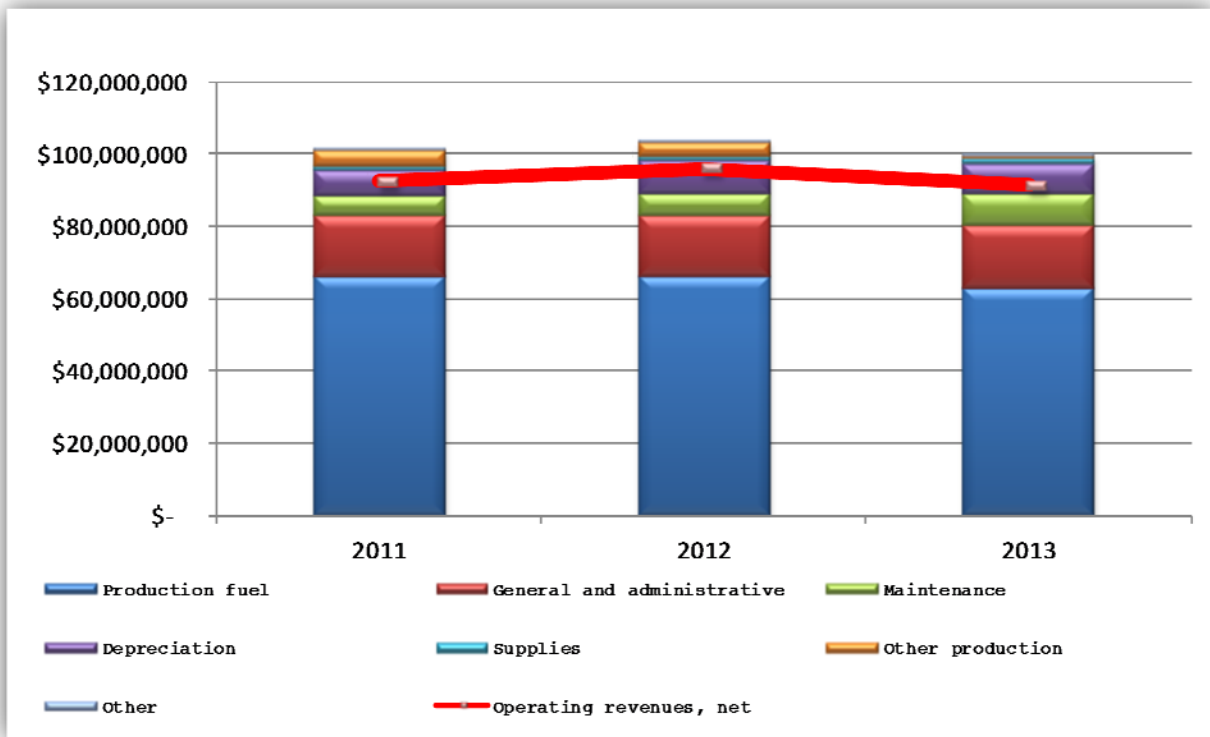
**COMMONWEALTH UTILITIES CORPORATION**  
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MANAGEMENT'S DISCUSSION & ANALYSIS  
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**Operating Expenses**

	2013	2012	2011
Production fuel	\$ 62,570,609	\$ 66,243,015	\$ 65,888,384
General and administrative	17,446,385	16,710,015	16,887,282
Maintenance	8,856,541	6,184,390	5,438,558
Depreciation	8,333,369	8,993,041	7,026,445
Supplies	1,365,318	1,265,772	1,229,359
Other production	754,975	3,852,875	4,535,037
Other	619,657	407,968	354,670
	<u>\$ 99,946,854</u>	<u>\$ 103,657,076</u>	<u>\$ 101,359,735</u>

The graph below shows the relationship of the total operating expenses (stacked bar graph) and the total operating revenues (line graph).



In 2013, total operating expenses of \$99,946,854 exceeded operating revenues of \$91,101,421 by \$8,845,433 or 9.7%.

**COMMONWEALTH UTILITIES CORPORATION**  
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MANAGEMENT'S DISCUSSION & ANALYSIS  
September 30, 2013

Highlights of events affecting operating expenses follow:

In 2013, production fuel costs totaled \$62,570,609, a decrease of \$3,672,406 (5.5%) when compared to 2012, which increased by \$354,631 (0.5%) when compared to 2011. Production fuel is the single largest expense of CUC, accounting for 63% of operating expenses in 2013, 64% for 2012 and 65% for 2011.

In 2013, general and administrative expenses, which are primarily personnel costs and related benefits, increased by \$736,370 (4.4%) when compared to 2012, which decreased by \$177,267 (1%) when compared to 2011.

Other production expenses decreased by \$3,097,900 or 80.4% in 2013 primarily due to the cancellation of the PMIC power purchase agreement.

**Capital Assets**

At September 30, 2013, CUC had \$87,039,111 invested in capital assets, net of depreciation where applicable, including electric plant, water plant, sewer plant, administrative equipment and construction in progress.

	2013	2012	2011
Utility plant in service:			
Electric plant	\$ 128,881,452	\$ 132,337,219	\$ 130,656,131
Water plant	67,805,784	70,858,321	62,897,977
Sewer plant	45,730,511	45,839,881	42,693,604
Administrative equipment	3,667,746	5,074,344	4,623,164
	246,085,493	254,109,765	240,870,876
Accumulated depreciation	(173,685,835)	(178,157,250)	(169,242,051)
Depreciable assets, net	72,399,658	75,952,515	71,628,825
Construction work-in progress	14,639,453	12,174,690	16,170,373
Capital assets, net	\$ 87,039,111	\$ 88,127,205	\$ 87,799,198

For additional information regarding capital asset activity, refer to Note 8 in the accompanying Notes to the Financial Statements.

**COMMONWEALTH UTILITIES CORPORATION**  
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MANAGEMENT'S DISCUSSION & ANALYSIS  
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**Capital Contributions and Federal Awards**

CUC received capital contributions and federal awards of \$11,489,591 in fiscal year 2013, which is \$1,081,975 (10.4%) more than the level of support received in fiscal year 2012.

The capital contributions and federal awards, are as follows:

	2013		2012		2011	
	Amount	%	Amount	%	Amount	%
Federal	\$ 11,489,591	100.0	\$ 10,407,616	100.0	\$ 13,975,408	99.9
Local	-	-	-	-	8,478	0.1
Total	<u>\$ 11,489,591</u>	<u>100.0</u>	<u>\$ 10,407,616</u>	<u>100.0</u>	<u>\$ 13,983,886</u>	<u>100.0</u>

The following is a summary of the CUC's major capital expenditures for 2013:

Federal Assistance

*Direct Grants*

During fiscal year 2013, the U.S. Environmental Protection Agency (EPA) provided \$4,787,913 for the upgrade of sewer and water systems and related equipment.

*Passed-through Grants*

The CNMI government, as a pass-through agency, provided \$3,055,186 of Covenant 702 funds received from the U.S. Department of the Interior for the Saipan Power Plant Improvement and upgrade of sewer and water systems and related equipment for fiscal year 2013. CUC also received through the CNMI Department of Public Works \$3,109,357 of the Energy Efficiency and Conservation Block Grant which was used to fund major engine overhauls and \$777,700 of the State Energy Program Fund to replace street lights with more energy efficient LED lighting fixtures.

**COMMONWEALTH UTILITIES CORPORATION**  
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MANAGEMENT'S DISCUSSION & ANALYSIS  
September 30, 2013

**Debt**

Long-term debt as of September 30, 2013, 2012 and 2011 are as follows:

	<u>2013</u>	<u>2012 Restated</u>	<u>2011</u>
Pacific Marine Industrial Corporation	\$ 3,902,581	\$ 7,470,468	\$ -
Commonwealth Ports Authority	<u>3,373,563</u>	<u>3,373,563</u>	<u>5,682,626</u>
	7,276,144	10,844,031	5,682,626
Current maturities	<u>(6,051,997)</u>	<u>(5,368,211)</u>	<u>(2,382,269)</u>
Long-term debt, net of current portion	<u>\$ 1,224,147</u>	<u>\$ 5,475,820</u>	<u>\$ 3,300,357</u>

The notes payable to the Commonwealth Ports Authority (CPA) as of 2012 was restated to reverse the application of utilities receivable from CPA Seaport to the payable to CPA.

For additional information regarding long-term debt activity, refer to Note 10 in the accompanying Notes to the Financial Statements.

**COMMONWEALTH UTILITIES CORPORATION**  
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MANAGEMENT'S DISCUSSION & ANALYSIS  
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**CUC ACCOMPLISHMENTS DURING FISCAL YEAR 2013**

***Power Division***

CUC Power Division Engineers and Mechanics performed several major engine rehabilitation projects, primarily funded by a grant from Energy Efficiency and Conservation Block Grant Program through the CNMI Department of Public Works - Division of Energy.

- Projects include: Major overhaul of power generation engines at Saipan Power Plant 1 (PP1); purchase and installation of new higher-efficiency turbo-chargers and new cooling radiators for the 8 engines at PP1. Engine foundations were repaired and replaced and necessary engine maintenance was accomplished on schedule. The materials for these projects were procured with grant funds, and all work was performed in-house with well trained CUC personnel.
- As a measure of the accomplishments of these projects, in 2009 PP1 was producing only 9.0 MW of electricity due to the poor condition of the failing engines. By the end of FY13, the same plant, with rebuilt engines was capable of 62 MW of production, a 688% improvement without purchasing new engines. For the average customer, it means the difference between rolling blackouts in 2009, and 24/7 electricity at their homes and businesses in FY13.

CUC Power Division on Rota also achieved improved service due in part to several grant-funded projects. Grants assigned to CUC by the Governor's CIP Office from the Dept. of Interior Office of Insular Areas (DOI-OIA) funded multi-million dollar Capital Improvement Projects (CIP) on the island of Rota.

- Accomplishments include: The complete overhaul of the Mitsui power generator on Rota, improving the reliability of power to the island, and improving the fuel efficiency.
- The power transmission system was upgraded to a higher voltage, creating better reliability and efficiency. New transformers, two bucket trucks and all necessary materials for the project were procured with grant funds and work was accomplished in house with well trained CUC personnel.
- Also funded by DOI-OIA, all of the diesel fuel storage tanks at the Rota power plant were inspected, tested, and repaired. This resulted in the tanks passing the stringent American Petroleum Institute (API) inspection process and subsequently, the approval by US-EPA as part of Stipulated Order #2.
  - A Renewable Energy Integration Study (funded by ARRA-SEP) was accomplished. The study documents the strengths and weaknesses of the CUC Saipan transmission grid and provides guidance on the percentage of renewable energy systems that can be added to the grid without harming the system. This study now supplies accurate grid data for a project developing a much broader master plan for CNMI power sources and distribution in the future (Integrated Resource Plan).



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All three islands of CNMI benefited from the conversion of 2,792 street lights from the outdated and inefficient High Pressure Sodium fixtures to the much more efficient LED lighting fixtures. This project was funded by ARRA-SEP grants through the CNMI Division of Energy. It is estimated that the new fixtures conserve more than \$550,000 annually.

FY13 saw notable improvements in the CUC Power Division toward providing reliable and safe energy to all of the inhabitants of the CNMI, while strides were made toward compliance with Federal Stipulated Order #2.

***Water & Wastewater Division***

CUC Water and Wastewater Division experienced many improvements during FY13. From FY11 – FY13, CUC received \$34,149,404 in grant funding from US-EPA for the purpose of renovating infrastructure and improving the capability of CUC to comply with the Clean Water Act and the Safe Drinking Water Act of the USA. FY13 saw good progress in identifying, designing, procuring and accomplishing the construction of priority projects. Projects are identified by in-house operations personnel and most projects are then designed by and construction management done by in-house CUC engineering staff. Twenty six infrastructure construction projects were underway by the end of FY 2013, with several being completed, including:

- The Agingan Point Wastewater Treatment Plant Rehabilitation Project. This project completely rehabilitated the aging treatment plant, resulting in energy efficiency, improved treatment of wastes before discharge, and improved compliance with the Clean Water Act.
- The Sadog Tasi Wastewater Treatment Plant Rehabilitation Project had similar accomplishments with the completion of the project.
- Other projects making good progress during the year include: Several waterline, fire hydrant, and valve replacement projects; an extensive sewer line replacement project; lift station rehabilitation; leak detection and repair; and an island-wide water meter replacement project.
- Wastewater operations personnel utilized a new EPA-funded Vacuum Truck to clean the majority of sewer lines on Saipan, as well as utilizing a state of the art camera to scope problem areas to determine the cause and location of blockages that can lead to sewer overflows and spills.
- Water operations personnel spent untold man-hours performing leak detection on the water distribution system using state of the art equipment purchased with US-EPA grant funds. The resulting conservation of water resulted in a year with improved water supplies to customers, with 94% receiving 24 hour per day water service (compared to 50% in 2010), and no major water rationing during the 2013 dry season.

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***Customer Service, Accounting, and Administration***

CUC Customer Service/Accounting and Administration continued working on improvements during FY13. Accomplishments include:

- Conversion from outdated billing and information system (IT Software), to a new, sophisticated, multi-functional system. The new system provides improved integration with the new CUC accounting system, quicker and better documented replies to customer complaints and calls for repairs, as well as more accurate billings and real-time access to all customer account information at the customer service center.
- CUCgov.org website was vastly improved and enhanced during FY13. The required "Water Quality/Consumer Confidence Report" was issued primarily using the website, saving postage. Regulatory matters, reports of outages, and other beneficial information for customers are available online. New efficient "Pay by Phone" and "Online Payment" options were implemented (due to new software functions).
- Customer Call Center and improved phone services provided customers with 24/7 single-point of contact access to CUC departments.
- Tablet devices with wireless connection to the new software system and to customer service enabled electronic dispatching of traceable work orders to field personnel. This has reduced the delays in providing customer service, and virtually eliminated errors in billings, and customer accounts due to misplaced paperwork, etc.
- The new Financial Management and Reporting Systems were implemented during FY13 with subsequent improvements to the CUC accounting department.
- In July of 2013, CUC filed a request with the Commonwealth Public Utilities Commission ("CPUC") to adjust its base water, wastewater, and electric rates on July 11, 2013. These increases, if granted, will become effective Q1 – FY14. CUC asked that our lowest income customers receive significant additional credit to save them money on their bills and to limit the impact of the proposed rate adjustment. The Water & Wastewater portion of the petition was withdrawn until a later time.

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September 30, 2013

**SUMMARY CONCLUSION REGARDING FY 2013 AND OUTLOOK FOR FY 2014**

While CUC had many successes in 2013, including system improvements, reliability and customer services, improvements can only continue if we recover what it costs to provide these services. Many of the improvement projects were financed by federal grants, rather than by rate payers. Such reliance on federal financial assistance is not sustainable due to future funding uncertainties. Looking forward, the greatest challenge facing the utility is the ballooning size of past-due and delinquent accounts, with the utility's three largest customers falling further and further in arrears with their accounts. We only have to look back a few short years, to the 2008-2009 timeframe, when a lack of financial investment in system maintenance brought forth by fiscal crisis resulted in rolling brown-outs, sewerage overflows, and regular drinking water boil-order notices. While CUC has been successful in improving the overall quality of services, the continued lack of reinvestment into the utility will increase the chances of again experiencing system failures.

Nevertheless, the outlook for 2014 accomplishments includes:

- o Establishment of a Board of Directors.
- o Negotiated long-term fuel purchase contract.
- o Contract for design of an "Integrated Resource Plan & Energy Supply Analysis" to provide a 20 year 'Master Plan' for power generation and transmission. (Funded by DOI-OIA grant)
- o Beginning of construction to drill for a Geothermal Resource Assessment on Saipan. (Funded by DOI-OIA grant)
- o Improved customer services by further utilizing website capabilities, translation service for foreign speaking customers, and further training of personnel.
- o Construction of a new buried fuel pipeline from the Mobil facilities at the docks, to Power Plants #1 & #2, in compliance with Stipulated Order #2. (SO2) (Funded by grants from DOI-OIA)
- o Construction of a new fuel storage tank at PP1 in compliance with SO2. (Funded by DOI-OIA grants)
- o Identification of further water and wastewater infrastructure projects, with design and engineering of solutions, and the procurement of contractors to achieve timely completion of such projects. (Funded by US-EPA grant).
- o Completion of a Water/Wastewater 20 year Master Plan to provide long range guidance regarding the infrastructure needs & solutions over next two decades.
- o Further leak detection and repairs, resulting in conservation of water and subsequent energy savings. (Partially funded by US-EPA and Bureau of Reclamation grants)

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- Building on 2013 successes in sewer line and lift station cleaning and rehabilitation to ensure safe and effective collection and transmission of wastewater to treatment plants.
- Progressive compliance with both Stipulated Orders regarding compliance with the Clean Water Act and Safe Drinking Water Act.
- Procurement and installation of 1,500 pre-pay electric meters that wirelessly communicate real-time information to both the consumer and the utility.
- Expand policies to encourage individuals to implement energy conservation and use of renewable energy sources at their homes and businesses, reducing dependence on fossil fuels.
- Expand the use of GPS mapping and resource maintenance/control systems to more accurately record the location of all major components of the power distribution system, as well as the water and wastewater infrastructure.
- Maintain the operation of the power generation system in spite of lack of funds, and the challenge of hiring skilled mechanics and engineers caused in part by immigration restrictions.
- Continued focus on personnel training in all areas involved in the safe and efficient delivery of utility services to the CNMI.

**REQUESTS FOR INFORMATION**

This financial report is designed to provide our citizens, taxpayers, customers and creditors with a general overview of the CUC's finances and to demonstrate accountability for the funds it manages. Please direct any questions about this report or requests for additional information about CUC's finances to:

Commonwealth Utilities Corporation  
Attn: Chief Financial Officer  
PO Box 501220  
Saipan, MP 96950

Or, call (670) 235-7025 through 7032.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Statements of Net Position  
September 30, 2013 and 2012

	2013	2012 Restated
<u>ASSETS</u>		
Current assets		
Current unrestricted assets		
Cash and cash equivalents	\$ 7,695,023	\$ 4,042,165
Accounts receivable - utility, net	12,450,227	15,725,639
Due from grantor agencies	116,347	24,596
Inventory, net	9,191,557	9,196,262
Regulatory cost for future recovery - fuel	4,597,480	3,256,998
Notes receivable, net	335,373	166,098
Other assets, net	1,402,462	2,145,612
Total current unrestricted assets	35,788,469	34,557,370
Current restricted assets		
Cash and cash equivalents	10,399,000	9,194,457
Total current assets	46,187,469	43,751,827
Noncurrent assets		
Notes receivable, net of current portion	105,224	1,384,699
Capital assets		
Utility plant in service		
Electric plant	128,881,452	132,337,219
Water plant	67,805,784	70,858,321
Sewer plant	45,730,511	45,839,881
Administrative equipment	3,667,746	5,074,344
	246,085,493	254,109,765
Accumulated depreciation	(173,685,835)	(178,157,250)
Net utility plant and administrative equipment	72,399,658	75,952,515
Construction in progress	14,639,453	12,174,690
Total capital assets	87,039,111	88,127,205
Total noncurrent assets	87,144,335	89,511,904
<b>TOTAL ASSETS</b>	<b>133,331,804</b>	<b>133,263,731</b>

See accompanying notes to financial statements.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Statements of Net Position, Continued  
September 30, 2013 and 2012

	2013	2012 Restated
<u>LIABILITIES</u>		
Current liabilities		
Unrestricted current liabilities		
Accounts payable and accrued liabilities	\$ 8,851,108	\$ 9,596,793
Customer deposits	1,185,182	1,091,039
Compensated absences	384,963	100,498
Current maturities of long-term debt	6,051,997	5,368,211
Dividends payable	1,260,000	180,000
Interest payable	555,636	443,355
	18,288,886	16,779,896
Restricted current liabilities		
Security deposits, including accrued interest	9,565,205	9,216,018
	27,854,091	25,995,914
Noncurrent liabilities		
Long-term debt, net of current maturities	1,224,147	5,475,820
Due to primary government	6,279,843	5,862,282
Retirement contributions payable	3,388,379	3,475,980
Dividends payable	2,340,000	2,520,000
Advances from CNMI Government	107,296	107,296
Compensated absences	544,385	869,727
	13,884,050	18,311,105
	41,738,141	44,307,019
<u>DEFERRED INFLOWS</u>		
Rate stabilization (Public Law 16-7)	3,400,000	3,400,000
	3,400,000	3,400,000
<u>NET POSITION</u>		
Net investment in capital assets	87,039,111	85,883,593
Restricted for:		
Regulatory expenses	165,364	93,415
Preferred stocks	45,000,000	45,000,000
Unrestricted	(44,010,812)	(45,420,296)
	\$ 88,193,663	\$ 85,556,712

See accompanying notes to financial statements.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Statements of Revenues, Expenses and Changes in Net Position  
For the Years Ended September 30, 2013 and 2012

	2013	2012 Restated
Operating revenues, net		
Power	\$ 20,768,693	\$ 19,402,752
Water	9,416,257	11,965,121
Sewer	4,106,125	4,723,893
LEAC - fuel charge	56,358,422	57,453,172
LEAC - non fuel	248,780	334,449
Other	203,144	2,057,614
Net operating revenues	91,101,421	95,937,001
Operating expenses		
Production fuel	62,570,609	66,243,015
General and administrative	17,446,385	16,710,015
Maintenance	8,856,541	6,184,390
Depreciation	8,333,369	8,993,041
Supplies	1,365,318	1,265,772
Other production	754,975	3,852,875
Other	619,657	407,968
Total operating expenses	99,946,854	103,657,076
Loss from operations	(8,845,433)	(7,720,075)
Non-operating revenues (expenses)		
Interest income	403,042	656,645
Miscellaneous income	303,236	421,062
Regulatory assessments	(172,985)	(561,951)
Settlement expense	(23,760)	(116,000)
Contribution to the CNMI government	(417,561)	(362,275)
Interest and distribution expense	(1,439,661)	(1,166,756)
Total non-operating revenues (expenses), net	(1,347,689)	(1,129,275)
Loss before change in recovery of fuel costs	(10,193,122)	(8,849,350)
Change in recovery of fuel costs	1,340,482	3,182,803
Net loss before capital contributions and federal grants	(8,852,640)	(5,666,547)
Capital contributions and federal grants	11,489,591	10,407,616
Change in net position before extraordinary items	2,636,951	4,741,069
Contract termination expense	-	(7,401,047)
Change in net position	2,636,951	(2,659,978)
Net position, beginning	85,556,712	88,216,690
Net position, ending	\$ 88,193,663	\$ 85,556,712

See accompanying notes to financial statements.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Statements of Cash Flows  
For the Years Ended September 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Cash received from customers	\$ 96,666,988	\$ 98,305,092
Cash payments to suppliers for goods and services	(82,205,779)	(85,835,727)
Cash payments to employees for services	(9,777,119)	(10,167,137)
Net cash provided by operating activities	4,684,090	2,302,228
Cash flows from noncapital financing activities:		
Interest paid on outstanding debt	(427,380)	(48,841)
Principal repayment of debt	(3,567,887)	(118,412)
Net cash used for noncapital financing activities	(3,995,267)	(167,253)
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(7,245,275)	(9,321,048)
Capital contributions received	11,397,840	10,382,853
Net cash provided by capital and related financing activities	4,152,565	1,061,805
Cash flows from investing activities:		
Interest income	16,013	15,023
Net cash provided by investing activities	16,013	15,023
Net change in cash and cash equivalents	4,857,401	3,211,803
Cash and cash equivalents at beginning of year	13,236,622	10,024,819
Cash and cash equivalents at end of year	\$ 18,094,023	\$ 13,236,622
Cash and cash equivalents	\$ 7,695,023	\$ 4,042,165
Restricted cash and cash equivalents	10,399,000	9,194,457
	\$ 18,094,023	\$ 13,236,622

See accompanying notes to financial statements.



**COMMONWEALTH UTILITIES CORPORATION**  
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Statements of Cash Flows, Continued  
For the Years Ended September 30, 2013 and 2012

	2013	2012
Reconciliation of loss from operations to net cash provided by operating activities:		
Loss from operations	\$ (8,845,433)	\$ (7,720,075)
Adjustments to reconcile loss from operations to net cash used for operating activities:		
Depreciation	8,333,369	8,993,041
Provision for bad debts	11,747,212	3,493,169
Miscellaneous income	303,236	421,062
Regulatory assessments	(172,985)	(561,951)
Settlement expense	(23,760)	(116,000)
(Increase) decrease in assets:		
Accounts receivable - utility	(6,911,860)	(4,511,175)
Inventory	4,705	1,121,089
Notes receivable	7,409	-
Other assets	673,030	1,682,226
Increase (decrease) in liabilities:		
Accounts payable and accrued liabilities	(745,685)	133,154
Customer deposits	94,143	(631,116)
Compensated absences	(40,877)	78,711
Security deposits including accrued interest	349,187	102,982
Retirement contributions payable	(87,601)	(182,889)
Net cash provided by operating activities	\$ 4,684,090	\$ 2,302,228
Noncash financing and investing activities		
Offsetting of CPA loans payable with CUC utilities receivable:		
Decrease in loans payable	\$ -	\$ (2,309,063)
Decrease in utilities receivable	-	(2,309,063)
	\$ -	\$ -
Termination of long-term power purchase agreement:		
Increase in long-term debt	\$ -	\$ 8,375,916
Increase in capital assets	-	(368,296)
Decrease in accounts payable	-	(606,573)
Noncash non-operating loss	-	(7,401,047)
	\$ -	\$ -

See accompanying notes to financial statements.

**COMMONWEALTH UTILITIES CORPORATION**  
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Notes to Financial Statements  
September 30, 2013 and 2012

(1) Organization

The Commonwealth Utilities Corporation (CUC), a component unit of the Commonwealth of the Northern Mariana Islands (CNMI) Government, was established as a Public Corporation by CNMI Public Law 4-47, as amended by Public Law 5-47, effective October 1, 1985 codified as Chapter 1 of Division 8 of Title 4 of the Commonwealth Code, and began operations on October 1, 1987.

Chapter 1 of Division 8 of Title 4 of the Commonwealth Code was repealed and re-enacted by Section 10 of Public Law 16-17.

CUC was given responsibility for supervising the construction, maintenance, operations, and regulation of electric, water and sewage services, provided however, that whenever feasible, CUC shall contract with private businesses to assume its duties with respect to one or more of these divisions. CUC was also designated the responsibility to establish rates, meter, bill and collect fees in a fair and rational manner from all customers of utility services in order for CUC to become financially independent of appropriations by the CNMI Legislature.

(2) Summary of Significant Accounting Policies

*Measurement Focus, Basis of Accounting and Basis of Presentation*

CUC maintains proprietary fund to account for its operations. Proprietary funds are accounted for using the "economic resources" measurement focus and the accrual basis of accounting. Accordingly, all assets, deferred outflows of resources, liabilities (whether current or noncurrent), and deferred inflows of resources are included on the *Statement of Net Position*.

The *Statement of Activities and Changes in Net Position* presents increases (revenues) and decreases (expenses) in total net position. Under the accrual basis of accounting, revenues are recognized in the period in which they are earned while expenses are recognized in the period in which the liability is incurred, regardless of the timing of related cash flows.

Operating revenues in the proprietary funds are those revenues that are generated from the primary operations of the fund. All other revenues are reported as non-operating revenues. Operating expenses are those expenses that are essential to the primary operations of the fund. All other expenses are reported as non-operating expenses.

**COMMONWEALTH UTILITIES CORPORATION**  
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Notes to Financial Statements  
September 30, 2013 and 2012

(2) Summary of Significant Accounting Policies, Continued

*Adopted Pronouncements*

In November 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34*. The objective of this Statement is to improve financial reporting for a governmental financial reporting entity. The requirements of Statement No. 14, *The Financial Reporting Entity*, and the related financial reporting requirements of Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Statements. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2012. Earlier application is encouraged.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The objective of this Statement is to incorporate into the GASB’s authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

1. Financial Accounting Standards Board (FASB) Statements and Interpretations
2. Accounting Principles Board Opinions
3. Accounting Research Bulletins of the American Institute of Certified Public Accountants’ (AICPA) Committee on Accounting Procedures

Hereinafter, these pronouncements collectively are referred to as the “FASB and AICPA pronouncements.” The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011. Earlier application is encouraged. The provisions of this Statement generally are required to be applied retroactively for all periods presented. The prior year financial statements have been restated to comply with requirement of this update.

In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. The requirements of this Statement will improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government’s net position. It alleviates uncertainty about reporting those financial statement elements by providing guidance where none previously existed. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2011. Earlier application is encouraged. The prior year financial statements have been restated to comply with requirement of this update.

**COMMONWEALTH UTILITIES CORPORATION**  
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Notes to Financial Statements  
September 30, 2013 and 2012

(2) Summary of Significant Accounting Policies, Continued

*Recent Pronouncements*

In March 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25*; and Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*. The requirements of these Statements will improve the decision-usefulness of information in employer and governmental nonemployer contributing entity financial reports and will enhance its value for assessing accountability and interperiod equity by requiring recognition of the entire net pension liability and a more comprehensive measure of pension expense. Decision-usefulness and accountability also will be enhanced through new note disclosures and required supplementary information. These Statements are effective for fiscal years beginning after June 15, 2014.

Management of CUC has not evaluated the effect of these pronouncements on the financial statements of CUC.

*Budgets*

In accordance with CNMI Public Law 3-68, *Planning and Budgeting Act of 1983*, CUC submits annual budgets to the CNMI Office of the Governor but is not legally required to adopt a budget since CUC is financially independent of appropriations by the CNMI Legislature.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Notes to Financial Statements  
September 30, 2013 and 2012

(2) Summary of Significant Accounting Policies, Continued

*Cash and Cash Equivalents*

For purposes of the Statements of Net Position and Cash Flows, cash and cash equivalents are defined as cash on-hand, cash in checking and savings accounts, and short-term time certificates of deposit with a maturity date within three months of the date acquired. Time certificates of deposit with original dates greater than ninety days are separately classified on the Statements of Net Position .

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

- Category 1 Deposits that are federally insured or collateralized with securities held by CUC or its agent in CUC's name;
- Category 2 Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in CUC's name; or
- Category 3 Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in CUC's name and non-collateralized deposits.

GASB Statement No. 40 amended GASB Statement No. 3 to eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, CUC'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 in the depositor government's name or held by the pledging financial institution but not in the depositor government's name. CUC does not have a deposit policy for custodial credit risk.

At September 30, 2013 and 2012, cash and cash equivalents were \$18,094,023 and \$13,236,622, respectively, and the corresponding bank balances were \$18,106,069 and \$13,079,327, respectively. Of the bank balance amounts, \$18,071,258 and \$13,037,177, respectively, were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. Bank deposits in the amount of \$17,796,241 and \$11,089,045 were in excess of FDIC insurable limits insured as of September 30, 2013 and 2012, respectively. CUC also has deposits of \$34,811 in 2013 and \$42,150 in 2012 in an uninsured financial institution.

CUC's deposits in excess of FDIC insured limits are collateralized by securities in the financial institutions name.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Notes to Financial Statements  
September 30, 2013 and 2012

(2) Summary of Significant Accounting Policies, Continued

*Restricted Cash and Cash Equivalents*

The restricted cash and cash equivalents of \$10,399,000 and \$9,194,457 at September 30, 2013 and 2012, respectively, pertains to customer deposits, of which, \$7,500,000 in 2013 and 2012 is held as security pursuant to a standby letter of credit obtained from a financial institution.

*Accounts Receivable and Allowance for Uncollectible Accounts*

Accounts receivable are classified as current assets and are reported net of an allowance for uncollectible amounts.

CUC provides utility services to customers within the CNMI and bills for these services on a monthly basis. The accumulated provision for uncollectible accounts is stated at an amount which management represents will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts and prior collection experience. The allowance is established through a provision for bad debts charged to expense. Current policy is to provide one hundred percent (100%) of account balances greater than sixty (60) days old effective in fiscal year 2013. Prior allowances were based on account balances greater than seventy-five (75) days old.

*Inventory*

Fuel and lubes inventory are valued at the lower of cost (first-in, first-out) or market (net realizable value). Materials and supplies inventory is valued at average cost.

Inventory balances at September 30, 2013 and 2012 are as follows:

	2013	2012	
Fuel and lubes	\$ 2,054,390	\$ 1,628,855	
Materials and supplies	7,834,292	8,264,532	
	9,888,682	9,893,387	
Allowance for obsolescence	(697,125)	(697,125)	
Inventory, net	\$ 9,191,557	\$ 9,196,262	

*Fuel Oil Costs*

Fuel oil costs increase or decrease billings to customers based on price changes in fuel oil purchased by CUC. Under or over recovery of fuel oil cost is recorded as deferred fuel cost asset or liability, respectively, in the accompanying Statement of Net Position, and is recovered in or deducted from future billings to customers based on the amendments to Part 24 of the Electric Service Regulations of the CUC adopted on July 20, 2006. Electric fuel rates are computed monthly.

**COMMONWEALTH UTILITIES CORPORATION**  
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(2) Summary of Significant Accounting Policies, Continued

*Fuel Oil Costs, Continued*

Any difference between the actual fuel costs and the electric fuel rate is accumulated in a deferred account and subject to annual reconciliation. No interest is charged or paid on any under or over recovery balance in the deferred account.

On April 2, 2009, the Commonwealth Public Utilities Commission (CPUC), adopted a "levelized energy adjustment clause" rate or LEAC rate of \$0.20147 per kWh which was effective from April 3, 2009 until September 30, 2009. On September 3, 2009, CPUC adopted to extend the effective date of the rate structure until ordered otherwise by the CPUC.

Subsequent approved LEAC rates are as follows:

<u>Effective Dates</u>	<u>Rate</u>
October 1, 2009 to June 1, 2010	\$0.24446
June 2, 2010 to January 12, 2011	\$0.24446
January 13, 2011 to April 15, 2011	\$0.28125
April 16, 2011 to November 19, 2011	\$0.34426
November 20, 2011 to January 27, 2012	\$0.30791
January 28, 2012 to April 8, 2012	\$0.30550
April 9, 2012 to June 4, 2012	\$0.32910
June 5, 2012 to July 5, 2012	\$0.29569
July 6, 2012 to August 2, 2012	\$0.26373
August 3, 2012 to September 5, 2012	\$0.28168
September 6, 2012 to January 6, 2013	\$0.31212
January 7, 2013 to March 4, 2013	\$0.29751
March 5, 2013	\$0.31878

The regulatory cost for future recovery at September 30, 2013 and 2012 is as follows:

	<u>2013</u>	<u>2012</u>
At beginning of year	\$ 3,256,998	\$ 74,195
Change in recovery of fuel costs	<u>1,340,482</u>	<u>3,182,803</u>
At end of year	<u>\$ 4,597,480</u>	<u>\$ 3,256,998</u>

**COMMONWEALTH UTILITIES CORPORATION**  
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(2) Summary of Significant Accounting Policies, Continued

*Capital Assets and Depreciation*

Capital assets consist of utility plant (including infrastructure), administrative equipment and construction-in-progress. Capital assets are stated at original cost, where costs are available, less accumulated depreciation. Depreciation is provided on the straight-line method based on the estimated useful lives of the respective assets, which range from 3 to 20 years. The cost of additions and replacements are capitalized. Repairs and maintenance are charged to expense as incurred. Retirements, sales and disposals are recorded by removing the cost and accumulated depreciation from the asset and accumulated depreciation accounts with any resulting gain or loss reflected in non-operating revenues (expenses) in the Statements of Revenues, Expenses and Changes in Net Position. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the fair value is less than the carrying amount of the asset, a loss is recognized for the difference.

Current policy is to capitalize items in excess of \$1,000. The costs of acquisition and construction of equipment and facilities are recorded as construction-in-progress until such assets are completed and placed in service, at which time the CUC commences recording depreciation expense. CUC capitalizes interest cost on borrowings incurred during the new construction or upgrade of qualifying assets. Capitalized interest is added to the cost of the underlying assets and is amortized over the estimated useful lives of the assets. There was no capitalized interest for the fiscal years ending September 30, 2013 and 2012.

*Compensated Absences*

Compensated absences are accrued and reported as a liability in the period earned. Annual leave to be paid out within the next fiscal year is accrued and is reported as a current liability. The liability at September 30, 2013 and 2012 is as follows:

	2013	2012
Total compensated absences, beginning of year	\$ 970,225	\$ 668,635
Vacation earned	351,980	678,659
Vacation used	(392,857)	(377,069)
Total compensated absences, end of year	929,348	970,225
Current portion	(384,963)	(100,498)
Compensated absences – noncurrent	\$ 544,385	\$ 869,727

No liability is recorded for non-vesting accumulating rights to receive sick leave benefits. An employee cannot carry over to the following calendar year accumulated annual leave in excess of three hundred sixty (360) hours. However, any annual leave accumulated in excess of 360 hours as of the end of the calendar year can be converted to sick leave on the last day of the calendar year.



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(2) Summary of Significant Accounting Policies, Continued

*Prioritization and Use of Available Resources*

When both restricted and unrestricted resources are available for use, it is CUC's policy to use restricted resources first, then unrestricted resources as they are needed, unless there are legal documents or contracts that prohibit doing this, therefore, using other available revenues to fund these ongoing expenditures.

*Retirement Plan – Defined Benefit Plan*

CUC contributes to the Northern Mariana Islands Retirement Fund (NMIRF), a defined benefit, cost-sharing multi-employer pension plan established and administered by the CNMI. NMIRF provides retirement, security and other benefits to employees of the CNMI government and CNMI agencies, instrumentalities and public corporations, and to their spouses and dependents. Benefits are based on the average annual salary over the term of credited service. Generally, benefits vest after three years of credited service. For early retirement, 10 years of vesting service is required and members must be at least 52 years of age. Members who retire at or after age 60, or with 25 years of vesting service, are entitled to retirement benefits. CNMI Public Law 6-17, "the Northern Mariana Islands Retirement Fund Act of 1988", is the authority under which benefit provisions are established.

Based on the actuarial valuation as of October 1, 2010 issued in October 2012, the actuarially determined contribution rate for the fiscal year ended September 30, 2010 was 72.7215% of covered payroll.

The established statutory rates at September 30, 2013 and 2012 were 72.7215% and 60.8686% of covered payroll, respectively.

In fiscal year 2013 and 2012, CUC's management adopted to follow the 30% employer contribution rate which the CNMI Superior Court ordered CUC to pay the NMIRF as one of the Intervenors to Civil Action No. 06-0367.

Required contributions and the percentage actually contributed for the current year and for the preceding three years are as follows:

<u>Fiscal Year</u>	<u>Required Contribution</u>	<u>Percentage of Covered Payroll</u>	<u>Actual Contribution</u>	<u>Percentage of Required Contributions Contributed</u>
2013	\$255,492	30.0000%	\$255,492	100%
2012	\$1,409,678	30.0000%	\$1,409,678	100%
2011	\$1,811,516	37.3909%	\$1,668,688	92%

NMIRF issues a publicly available financial report that includes financial statements and required supplementary information for the Plan. That report may be obtained by writing to the Northern Mariana Islands Retirement Fund, P.O. Box 501247, Saipan, MP, 96950-1247.

**COMMONWEALTH UTILITIES CORPORATION**  
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September 30, 2013 and 2012

(2) Summary of Significant Accounting Policies, Continued

*Other Postemployment Benefits*

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*, requires employers to record other postemployment benefits (OPEB) expense for their contractually required contributions to the OPEB plan. CUC has complied with GASB 45 by recording OPEB expense based on the statutory determined contribution rate of NMIRF. CUC's OPEB liability is incorporated into the contribution amount. It is the understanding of the management of CUC that the statutory determined contribution rate of NMIRF incorporates both the pension liability and the OPEB liability.

*Retirement Plan – Defined Contribution Plan*

The Defined Contribution Plan (DC Plan) is a multi-employer pension plan of the CNMI Government and shall be the single retirement program for all new employees whose employment commences on or after January 1, 2007.

Existing Class I members of the Defined Benefit Plan with less than 10 years of service credit could, upon written election, voluntarily and irrevocably elect membership in the DC Plan. This option expired and is no longer available.

CUC's contributions to the DC Plan for the years ended September 30, 2013, 2012 and 2011 are as follows:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Employee contributions	\$ 439,205	\$ 530,047	\$ 368,891
Employer contributions	<u>162,815</u>	<u>212,019</u>	<u>142,828</u>
	<u>\$ 602,020</u>	<u>\$ 742,066</u>	<u>\$ 511,719</u>

*Medical and Life Insurance Benefits*

In addition to providing pension benefits, the CNMI Government also ensures that employees are provided medical and life insurance benefits. The CNMI Government created the Group Health and Life Insurance Trust Fund (GHLITF), held in trust and administered by the Northern Mariana Islands Retirement Fund (NMIRF). CUC contributes to the Group Health and Life Insurance program. This is open to active employees who work at least 20 hours per week and retired CNMI government employees who retire as a result of length of service, disability or age, as well as their dependents. Health and life insurance coverage are provided by private carriers through the GHLITF. Employee deductions are made through payroll or pension benefit withholdings.

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(2) Summary of Significant Accounting Policies, Continued

*Revenue and Expense Recognition*

CUC defines operating revenues as revenue generated from power, water and sewer sales and services. Operating expenses are costs incidental to the generation of operating revenues. Revenues and expenses not meeting the above definitions are classified as non-operating revenues and expenses.

Power, water and sewer sales are recorded as billed to customers on a monthly cycle billing basis. At the end of each month, unbilled revenues are accrued for each cycle based on the subsequent cycle billing. Unbilled receivables included in current earnings at September 30, 2013 and 2012 are \$3,581,447 and \$6,858,994, respectively.

*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.

*Contingencies*

Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to CUC but which will only be resolved when one or more future events occur or fail to occur. CUC's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against CUC or unasserted claims that may result in such proceedings, CUC's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in CUC's financial statements. If the assessment indicates that a potentially material loss contingency is not probable, but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee would be disclosed.

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(3) Accounts Receivable – Utility

Account receivable – utility as of September 30, 2013 and 2012 summarized by location and customer classification are as follows:

By Location

	2013	2012
Saipan		
Commercial	\$ 6,181,799	\$ 4,697,885
Residential	11,113,312	8,222,248
Government	17,132,045	11,143,570
	34,427,156	24,063,703
Tinian		
Commercial	988,681	806,539
Residential	201,001	243,714
Government	424,975	705,018
	1,614,657	1,755,271
Rota		
Commercial	114,385	121,510
Residential	150,174	282,627
Government	1,657,157	1,163,982
	1,921,716	1,568,119
Total billed	37,963,529	27,387,093
Unbilled	3,581,447	6,858,994
	\$ 41,544,976	\$ 34,246,087

By Customer Classification

	2013	2012
Billed		
Commercial	\$ 7,284,865	\$ 5,625,934
Residential	11,464,487	8,748,589
Government	19,214,177	13,012,570
Unbilled	3,581,447	6,858,994
	41,544,976	34,246,087
Allowance for uncollectible accounts	(29,094,749)	(18,520,448)
Accounts receivable – utility, net	\$ 12,450,227	\$ 15,725,639

The 2012 accounts receivable balance was restated to reflect the reversal of the application of accounts receivable from the Commonwealth Ports Authority (CPA) to the CUC debt to CPA.

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(4) Allowance for Uncollectible Accounts

Changes in allowance for uncollectible accounts for the years ended September 30, 2013 and 2012 are as follows:

	2013	2012
Total allowance, beginning of year	\$ 19,251,221	\$ 19,250,392
Provision for uncollectible accounts	11,747,212	3,493,169
Accounts written-off	(1,126,819)	(3,492,340)
Total allowance, end of year	\$ 29,871,614	\$ 19,251,221
Accounts receivable - utility (Note 3)	\$ 29,094,749	\$ 18,520,448
Notes receivable (Note 5)	157,752	181,780
Others assets (Note 6)	619,113	548,993
Total allowance, end of year	\$ 29,871,614	\$ 19,251,221

(5) Notes Receivable

CUC allows customers to settle their outstanding utilities through issuance of promissory notes with terms ranging from 6 months to 10 years at an interest rate of 12% per annum. A summary of the outstanding notes receivable as of September 30, 2013 and 2012 is as follows:

	2013	2012
Current portion, net of allowance of \$157,752 in 2013 and \$181,780 in 2012	\$ 335,373	\$ 166,098
Noncurrent	105,224	1,384,699
	\$ 440,597	\$ 1,550,797

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(6) Other Assets

Other assets as of September 30, 2013 and 2012 consist of the following:

	<u>2013</u>	<u>2012</u>
Prepayments	\$ 1,030,172	\$ 1,903,123
Temporary facility	53,319	137,943
Employee advances and travel advances	12,443	26,256
Other receivables, net of allowance of \$619,113 in 2013 and \$548,993 in 2012	306,528	78,290
Other assets, net	<u>\$ 1,402,462</u>	<u>\$ 2,145,612</u>

(7) Due from (to) Grantor Agencies

CUC is a recipient of direct federal awards and sub-recipient of federal grants received by the CNMI central government from various U.S. federal agencies. CUC records grants-in-aid for construction or acquisition of facilities and equipment as contributions. Excess grant disbursements over receipts are recognized as due from grantor agencies until funds are received in accordance with grant terms and conditions.

Changes in the due from (to) grantor agencies account for the years ended September 30, 2013 and 2012 are as follows:

	<u>2013</u>	<u>2012</u>
Balance at beginning of year	\$ 24,596	\$ (167)
Adjustments	670	-
Deductions - cash receipts from grantor agencies	(11,681,831)	(10,382,853)
Additions - program outlays	<u>11,772,912</u>	<u>10,407,616</u>
Balance at end of year	<u>\$ 116,347</u>	<u>\$ 24,596</u>

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(8) Capital Assets

A summary of the changes in capital assets activity for the years ended September 30, 2013 and 2012 is as follows:

	Estimated Useful Lives	Balance at October 1, 2012	Acquisitions	Disposals	Adjustments/ Transfers	Balance at September 30, 2013
Utility plant in service						
Electric plant	20 years	\$132,337,219	\$ 560,532	\$ (238,637)	\$ (3,777,662)	\$128,881,452
Water plant	20 years	70,858,321	182,371	(102,928)	(3,131,980)	67,805,784
Sewer plant	20 years	45,839,881	476,288	-	(585,658)	45,730,511
Administrative equipment	3-5 years	<u>5,074,344</u>	<u>1,227,295</u>	<u>(124,600)</u>	<u>(2,509,293)</u>	<u>3,667,746</u>
		254,109,765	2,446,486	(466,165)	(10,004,593)	246,085,493
Accumulated depreciation		<u>(178,157,250)</u>	<u>(8,333,369)</u>	<u>466,165</u>	<u>12,338,619</u>	<u>(173,685,835)</u>
Depreciable assets, net		75,952,515	(5,886,883)	-	2,334,026	72,399,658
Construction work-in-progress		<u>12,174,690</u>	<u>4,798,789</u>	<u>-</u>	<u>(2,334,026)</u>	<u>14,639,453</u>
Capital assets, net		<u>\$ 88,127,205</u>	<u>\$ (1,088,094)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 87,039,111</u>

	Estimated Useful Lives	Balance at October 1, 2011	Acquisitions	Disposals	Adjustments/ Transfers	Balance at September 30, 2012
Utility plant in service						
Electric plant	20 years	\$130,656,131	\$ 1,473,974	\$ (158,932)	\$ 366,046	\$132,337,219
Water plant	20 years	62,897,977	2,830,486	-	5,129,858	70,858,321
Sewer plant	20 years	42,693,604	174,654	-	2,971,623	45,839,881
Administrative equipment	3-5 years	<u>4,623,164</u>	<u>388,360</u>	<u>(16,151)</u>	<u>78,971</u>	<u>5,074,344</u>
		240,870,876	4,867,474	(175,083)	8,546,498	254,109,765
Accumulated depreciation		<u>(169,242,051)</u>	<u>(8,993,041)</u>	<u>77,842</u>	<u>-</u>	<u>(178,157,250)</u>
Depreciable assets, net		71,628,825	(4,125,567)	(97,241)	8,546,498	75,952,515
Construction work-in-progress		<u>16,170,373</u>	<u>4,453,574</u>	<u>-</u>	<u>(8,449,257)</u>	<u>12,174,690</u>
Capital assets, net		<u>\$ 87,799,198</u>	<u>\$ 328,007</u>	<u>\$ (97,241)</u>	<u>\$ 97,241</u>	<u>\$ 88,127,205</u>

Included in utility plant in service adjustments/transfers for fiscal years ended September 30, 2013 and 2012 are completed projects transferred from construction work-in-progress to utility plant in service of \$2,334,026 and \$8,449,257, respectively.

Depreciation expense for the years ended September 30, 2013 and 2012 is \$8,333,369 and \$8,993,041, respectively.

CUC entered into several construction contracts during fiscal year 2013 for improvements, rehabilitation and replacement of facilities, and other capital projects. As of September 30, 2013, CUC had outstanding construction contracts totaling \$4,644,065 that will be financed from operating funds and federal awards.

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(9) Security Deposits

Pursuant to 4 CMC § 8143, as amended by Public Law 16-17, CUC shall collect one month security deposits per residential customer account. Such deposits shall be placed in an interest earning trust fund and shall not be used for any other purpose.

Summarized below is the summary of security deposits including accrued interest as of September 30, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Electric	\$ 8,307,367	\$ 8,149,651
Water	594,680	501,438
Sewer	<u>121,059</u>	<u>64,019</u>
Total security deposits	9,023,106	8,715,108
Accrued interest on security deposits	<u>542,099</u>	<u>500,910</u>
Security deposits, including interest	<u>\$ 9,565,205</u>	<u>\$ 9,216,018</u>
Security deposits, including interest	\$ 9,565,205	\$ 9,216,018
Restricted cash	<u>10,399,000</u>	<u>9,194,457</u>
Accumulated security deposits used to purchase fuel (Excess restricted cash over liability)	<u>\$ (833,795)</u>	<u>\$ 21,561</u>

Of CUC's restricted cash, \$7,500,000 as of September 30, 2013 and 2012, is held as security pursuant to a letter of credit obtained from a financial institution to secure a \$7,500,000 credit limit for fuel purchases. Pursuant to Public Law 16-2, CUC was to return the restricted cash used to purchase fuel by fiscal year 2011. CUC is in default of this provision of the law as of September 30, 2012 and became fully compliant by September 30, 2013.



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(10) Long-term Debt

Long-term debt at September 30, 2013 and 2012 is as follows:

	2013	2012
Pacific Marine Industrial Corporation (PMIC)	\$ 3,902,581	\$ 7,470,468
Commonwealth Ports Authority (CPA)	3,373,563	3,373,563
	7,276,144	10,844,031
Current maturities	(6,051,997)	(5,368,211)
Long-term debt, net of current portion	\$ 1,224,147	\$ 5,475,820

Interest expense on long-term debt for the years ended September 30, 2013 and 2012 was \$539,661 and \$314,881, respectively, and is presented as a component of interest expense in the accompanying Statements of Revenues, Expenses and Changes in Net Position.

Changes in long-term debt for the fiscal years ended September 30, 2013 and 2012 are as follows:

	Balance at October 1, 2012	Additions	Repayments	Non-Cash Change	Balance at September 30, 2013
CPA	\$ 3,373,563	\$ -	\$ -	\$ -	\$ 3,373,563
PMIC	7,470,468	-	(3,567,887)	-	3,902,581
Total	\$ 10,844,031	\$ -	\$ (3,567,887)	\$ -	\$ 7,276,144
	Balance at October 1, 2011	Additions	Repayments	Non-Cash Change	Balance at September 30, 2012
CPA	\$ 5,682,626	\$ -	\$ (2,309,063)	\$ -	\$ 3,373,563
PMIC	-	8,375,916	(905,448)	-	7,470,468
Total	\$ 5,682,626	\$ 8,375,916	\$ (3,214,511)	\$ -	\$ 10,844,031

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(10) Long-term Debt, Continued

A summary of CUC's loans payable to CPA at September 30, 2013 and 2012 is as follows:

	<u>2013</u>	<u>2012</u>
Loan payable to CPA, a component unit of the CNMI Government, principal of \$3,385,131, interest at 6.25% per annum, with a maturity date of October 31, 2017. Principal and interest payments are due in monthly payments of \$38,008.	\$ 3,373,563	\$ 3,373,563
Current portion	<u>(2,149,416)</u>	<u>(1,800,323)</u>
Long-term debt, net of current portion	<u>\$ 1,224,147</u>	<u>\$ 1,573,240</u>

Future repayment commitments of principal and interest are as follows:

<u>Years ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2014	\$ 2,149,416	\$ 555,636	\$2,705,052
2015	371,547	84,552	456,099
2016	395,446	60,653	456,099
2017	420,882	35,217	456,099
2018	<u>36,272</u>	<u>1,736</u>	<u>38,008</u>
	<u>\$ 3,373,563</u>	<u>\$ 737,794</u>	<u>\$4,111,357</u>

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(10) Long-term Debt, Continued

*Pacific Marine Industrial Corporation (PMIC)*

On Sept 23, 1996, CUC entered into a Power Purchase Agreement (PPA) with Pacific Marine and Industrial Corporation (PMIC).

After several contract amendments and renewal, in June 2012 CUC and PMIC agreed to terminate the PPA beginning July 2012 with 4 years and one month (49 months) remaining on the contract. CUC Power Plant 1 power generation is sufficient to provide power to the island without purchasing power from PMIC through Power Plant 4.

An analysis by CUC Management of the contract termination follows:

Remaining commitment			
Monthly minimum payment		\$	331,000
Remaining term (in months)			<u>          x 49</u>
			16,219,000
Termination cost payable in 27 months	\$		8,375,916
Assets transferred to CUC		<u>(974,869)</u>	
Contract termination expense			<u>7,401,047</u>
Savings		<u>\$</u>	<u>8,817,953</u>

As a result of the contract termination, CUC recognized a loan payable to PMIC with a principal balance of \$8,375,916 and bearing interest at 9% per annum. Principal and interest payments are due in monthly payments of \$341,286. The loan balance as of September 30, 2013 and 2012 is \$3,902,581 and \$7,470,468, respectively. Future repayment commitments of principal and interest are as follows:

<u>Year ending</u> <u>September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2014	\$ 3,902,581	\$ 192,856	\$ 4,095,437

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(11) Due to Primary Government

Public Law 9-68, enacted on October 19, 1995, requires government agencies to pay the CNMI Treasurer an amount not less than the greater of 1% of its total operations budget from sources other than legislative appropriations or pursuant to any other formula, which the CNMI Office of the Public Auditor (OPA) and the agency may agree, to fund the OPA. At September 30, 2013 and 2012, CUC recognized an outstanding payable to the CNMI Government in the amount of \$6,279,843 and \$5,862,282, respectively. CUC accrued OPA fees of \$417,561 in 2013 and \$362,274 in 2012. OPA asserts that CUC owes the CNMI government OPA fees of approximately \$9 million as of September 30, 2013 based on 1% of CUC's operations budget including fuel costs. CUC's management and OPA have initiated negotiations to reconcile CUC's payable to the CNMI Government for OPA fees; however, no settlement agreement has been formalized as of September 30, 2013. CUC and OPA have differing opinions whether fuel costs should be included in the operations budget which should be used as the basis for the OPA Fee. CUC intends to seek assistance from the CNMI Legislature to resolve this issue. CUC has not made any remittance for OPA fees since fiscal year 2003.

On September 26, 2011, the Appropriations and Budget Authority Act of 2012 (Public Law 17-55) was signed into law. Section 601 of Public Law 17-55 authorizes the CNMI Secretary of Finance to deduct the 1% due to the OPA from the CUC from monthly utility costs of the government. No application of payments were made as of September 30, 2013.

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September 30, 2013 and 2012

(12) Preferred Stocks Issued to Commonwealth Development Authority

On October 2, 2008, Public Law 16-17 or the Commonwealth Utilities Corporation Act of 2008 authorized CUC to issue shares of cumulative, non-convertible, non-transferable preferred stock valued at \$45,000,000 to CDA. CUC and CDA may provide by written agreement, subject to the terms and conditions of a Memorandum of Agreement (MOA), such terms and conditions being incorporated herein by reference, for the following:

- (1) Guaranteed annual dividends fixed and payable as agreed;
- (2) Buy-back provisions;
- (3) Default provisions;
- (4) Preferred shareholder rights; and
- (5) Consistent with Commonwealth law, such other rights and remedies as are typically found in shareholder and stock purchase agreements.

On May 7, 2009, the MOA was signed by officials of CUC and CDA. The MOA was subsequently approved by the Commonwealth Public Utilities Commission.

Pursuant to the terms of the MOA, the dividend payments for the first three years after issuance of the stocks are to be amortized and interest free over a 15-year period. Although the preferred stock certificates have not been physically issued, CUC is of the opinion that CDA has constructive receipt of the preferred shares through the execution of the MOA. Dividends payable as of September 30, 2013 and 2012 amounted to \$3,600,000 and \$2,700,000, respectively. CUC is in default of its \$900,000 dividend payment for 2013 and the \$180,000 amortization of deferred dividends.

Future payments of the deferred dividends payable and unpaid dividends are as follows:

<u>Years Ending</u> <u>September 30,</u>	
2014	\$ 1,260,000
2015	180,000
2016	180,000
2017	180,000
2018	180,000
2019 to 2023	900,000
2024 to 2027	<u>720,000</u>
	<u>\$ 3,600,000</u>

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Notes to Financial Statements  
September 30, 2013 and 2012

(13) Risk Management

The CNMI government is a self-insured entity. The government has limited its general liability to individuals to \$100,000 by statute. For this reason the government does not maintain any insurance on its buildings or employees. As an autonomous agency, CUC is not required to follow the CNMI government's policy of self-insurance and may insure some of its assets.

CUC 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. CUC currently does not maintain insurance coverage with respect to its inventory and utility plant. In the event of a loss, CUC will be self-insured for the entire amount. CUC currently reports all of its risk management activities as incurred. No provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

CUC, however, requires performance bonds on all its construction projects.

(14) Commitments and Contingencies

Commitments

At September 30, 2013, CUC had commitments of \$4,644,065 for construction, purchases of inventory, and acquisition of property and equipment, all of which are expected to be incurred in 2014.

Contingencies

*Litigation and Potential Claims*

CUC is subject to various claims and legal proceedings covering a wide range of matters that arise in the ordinary course of its operations, including customer disputes.

CUC is a defendant in a class action lawsuit, Superior Court Civil Case No. 09-0410, wherein CUC is alleged to have overcharged its customers from July 22, 2006 to October 24, 2006. The damages sought include a refund of approximately \$4.2 million, in addition to related punitive damages and attorney fees. While the lawsuit was proceeding, the Legislature enacted Public Law 17-3 which sought to clarify the intent of prior Public Laws enabling the Commonwealth Public Utilities Commission (CPUC). The law amends Section 8122 of the Commonwealth Code to give the Executive Director of CUC the power and authority to set rates as of January 27, 2006 and continue until the CPUC's first order setting rates. The second motion to dismiss has now been fully briefed by the parties, including the CNMI, and two former CUC Executive Directors, both represented by the CNMI Attorney General's Office, and was argued on January 19, 2011. CUC believes that it should not be liable for further rate refunds or damages as alleged in this case, and is defending vigorously. If CUC does not prevail, the potential loss could be upward of \$10 million. CUC believes that, with the passage of PL 17-3, which provides that its rate was "legal" during the time period in question, it has a much stronger chance of prevailing and getting these claims dismissed.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Notes to Financial Statements  
September 30, 2013 and 2012

(14) Commitments and Contingencies, Continued

Contingencies, Continued

*Litigation and Potential Claims, Continued*

As of December 2011, the original Judge assigned to this case recused himself, and the matter has been assigned to another Judge who took it under advertisement on the record on December 29, 2011. CUC has since put this matter on for status conference but has not received further information or decision on this matter to date.

No provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

There were also other threatened litigation and claims filed against CUC by Contractors but no formal cases have been filed.

*Federal Questioned Costs*

CUC participates in a number of federally assisted grant programs funded by the United States of America Federal government. These programs are subject to financial and compliance audits to ascertain if federal laws and regulations have been followed. There were no accumulated questioned costs as of September 30, 2013 and 2012.

*Public Law 18-19 Public School System Water and Waste Water Rate*

Pursuant to Public Law 18-19, CUC should charge the Public School System (PSS) the commercial rate for water and waste water. CUC may recover the decrease in water and waste water rates from other CUC customers paying the government rate for water and waste water but CUC may not increase the residential and commercial rates to recover the PSS rate reduction.

Furthermore, Public Law 18-19 states that any late fees or penalties that have been assessed to PSS shall be waived for fiscal year 2013 and any fees that have been collected from PSS in fiscal 2012 and thereafter shall be credited or used to offset PSS utility expenditures in fiscal year 2012, 2013 and 2014.

On September 30, 2014, the CNMI Attorney General issued Legal Opinion Number 2014-02 which concluded that Public Law 18-19 does not require the review and approval of the Commonwealth Public Utilities Commission prior to CUC putting the commercial rate for PSS into effect. CUC intends to comply with this Opinion. However, because of the substantial financial impact of the law on CUC, it is also considering challenging the law in Court.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Notes to Financial Statements  
September 30, 2013 and 2012

(14) Commitments and Contingencies, Continued

Contingencies, Continued

*Stipulated Orders*

The U.S. Environmental Protection Agency (EPA) sought to force CUC and the CNMI Government to comply with various regulations and requirements. To date there have been two primary stipulated orders.

Stipulated Order One is intended to ensure that CUC's wastewater and drinking water systems achieve compliance with the Clean Water Act (CWA) and Safe Drinking Water Act (SDWA). The major components of Stipulated Order One are:

1. The reformation of CUC's management, finances and operations;
2. The development of a wastewater and drinking water Master Plan; and
3. The construction of wastewater infrastructure.

CUC is also required to take steps to comply with National Pollution Discharge Elimination System permits and compliance orders, comply with drinking water standards, and to eliminate spills from the wastewater system.

Stipulated Order Two is intended to ensure that CUC's power plant facilities achieve compliance with the CWA. These requirements include requiring CUC to eliminate oil spills, implement appropriate spill prevention measures, implement effective inspection procedures for its oil storage facilities, provide containment for oil storage facilities and prepare appropriate operating plans.

Fines and penalties related to these Stipulated Orders have accrued to over \$40 million, but have not been charged, with the exception of \$29,000 and \$140,000 which were paid by CUC to the United States Department of Justice on January 2010 and July 2010, respectively. Just recently, on September 26, 2014, another Stipulated Order was entered into under which the United States and EPA waived all Stipulated Order Two penalties which have accrued as of September 25, 2014.

The parties appeared for status conferences and signed further stipulations dated August 12, 2010, in which CUC has agreed to specific performance dates for required projects. On the status conference on December 9, 2010, CUC had met its deadlines on 31 out of 33 discrete deliverables, and had made substantial progress on the balance. Pursuant to the March 22, 2011 status conference stipulation, the parties agreed to further deadlines for meter change-outs and the pipeline project. The Federal District Court has expressed its satisfaction with CUC's progress on the water metering project. There have been three major projects of the highest priority to the Federal District Court: the Pipeline, Tank 102, and the Rota Tanks. CUC completed the Rota Tanks in late December, 2012. Tank 102 is progressing with an expected completion date by early 2015. The Pipeline design is stalled based on CUC's termination of the primary contractor.



**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Notes to Financial Statements  
September 30, 2013 and 2012

(14) Commitments and Contingencies, Continued

Contingencies, Continued

The project will resume under the direction of an Engineering and Environmental Management Company pursuant to the provisions of the Stipulated Order entered on September 26, 2014. As further penalties and fines are contingent on CUC's performance under both Stipulated Orders One and Two, and as EPA has not at this time chosen to attempt to collect on the majority of the penalties and fines, it is very difficult to determine future liabilities, therefore, CUC has not accrued any liability in the accompanying Statements Net Position.

Other Matters

In August 2012, the then CNMI Governor and Attorney General signed a 25-year power purchase agreement (PPA) with a private company granting exclusive right to develop a diesel-generated electric power plant on Saipan for a total guaranteed price of \$190 million. A taxpayer lawsuit was filed in the Superior Court for the purpose of challenging the PPA. CUC is a named Defendant in the case. CUC filed a motion detailing the problems and illegalities with the agreement arguing that the PPA is void ab initio, per an Attorney General Opinion. On February 4, 2014, The Superior Court entered a decision declaring the PPA void ab initio. Accordingly, it appears that liability for CUC will not be an issue. However, there is not yet a final judgment and so there is a possibility of appeal to the CNMI Supreme Court.

SDLLC sued CUC in the US District Court for breach of contract and equitable reimbursement for the PPA at issue in the Superior Court action above. CUC brought a motion to dismiss which was granted by an Order of June 24, 2014, wherein the District Court found exceptional circumstances weighed in favor of abstention and dismissed the complaint with prejudice. SDLLC has appealed this decision to the Ninth Circuit Court of Appeals.

(15) Liability for Estimated Environmental Remediation Costs

CUC is involved in environmental remediation and ongoing compliance as discussed in Note 14.

On March 10, 2011, CUC received an order from the U.S. EPA, which requires CUC to perform cleanup activities of Power Plants 1 and 2, pursuant to the National Oil and Hazardous Substances Pollution Contingency Plan, which appears at Title 40, CFR Part 300 and paragraphs 12 and 14 of Stipulated Order Two for Preliminary Injunctive Relief. CUC and EPA estimate the cost of remedial activities to range from \$1 million to \$2 million. The accompanying financial statements have not been restated to include accrual of these remedial activities.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Notes to Financial Statements  
September 30, 2013 and 2012

(16) Economic Dependency

CUC is dependent on third-party equipment manufacturers, distributors, and dealers for the supply of parts for the utility plants. CUC is dependent on the ability of its suppliers to provide products on a timely basis and on favorable pricing terms. The loss of certain principal suppliers or a significant reduction in product availability from principal suppliers could have a material adverse effect on CUC. CUC believes that its relationships with its suppliers are satisfactory and have not experienced any significant delays due to its major suppliers.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Supplementary Information  
Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis  
For the Year Ended September 30, 2013

	Power	Water	Sewer	Administrative and General	Internal Revenues and Expenses	Total
Operating revenues, net:						
Governmental	\$ 5,738,340	\$ 4,147,245	\$ 2,454,238	\$ -	\$ (1,801,864)	\$ 10,537,959
Commercial	11,629,599	1,260,297	1,196,913	-	-	14,086,809
Residential	5,202,618	4,008,715	454,974	-	-	9,666,307
Subtotal	<u>22,570,557</u>	<u>9,416,257</u>	<u>4,106,125</u>	-	(1,801,864)	34,291,075
LEAC - Fuel charge	61,230,127	-	-	-	(4,871,705)	56,358,422
LEAC - Non fuel	248,780	-	-	-	-	248,780
Other	146,067	56,757	320	-	-	203,144
Net operating revenues	<u>84,195,531</u>	<u>9,473,014</u>	<u>4,106,445</u>	-	(6,673,569)	91,101,421
Operating expenses:						
Production fuel	62,570,609	-	-	-	-	62,570,609
General and administrative	6,757,340	3,732,900	1,679,705	5,276,440	-	17,446,385
Maintenance	7,081,946	834,826	884,716	55,053	-	8,856,541
Depreciation	2,415,637	3,702,088	2,003,516	212,128	-	8,333,369
Supplies	350,114	657,026	38,050	320,128	-	1,365,318
Other production	849,485	4,954,094	1,360,637	264,328	(6,673,569)	754,975
Other	-	-	-	619,657	-	619,657
Total operating expenses	<u>80,025,131</u>	<u>13,880,934</u>	<u>5,966,624</u>	<u>6,747,734</u>	<u>(6,673,569)</u>	<u>99,946,854</u>
Earnings (loss) from operations before allocation of common cost	4,170,400	(4,407,920)	(1,860,179)	(6,747,734)	-	(8,845,433)
Allocation of common costs	<u>(4,163,552)</u>	<u>(1,755,800)</u>	<u>(828,382)</u>	<u>6,747,734</u>	-	-
Earnings (loss) from operations	<u>\$ 6,848</u>	<u>\$ (6,163,720)</u>	<u>\$ (2,688,561)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (8,845,433)</u>

See accompanying notes to financial statements.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Supplementary Information  
Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis  
For the Year Ended September 30, 2013

	<u>Power</u>	<u>Water</u>	<u>Sewer</u>	<u>Administrative and General</u>	<u>Internal Revenues and Expenses</u>	<u>Total</u>
Earnings (loss) from operations	\$ 6,848	\$ (6,163,720)	\$ (2,688,561)	\$ -	\$ -	\$ (8,845,433)
Non-operating revenues (expenses):						
Interest income	260,497	123,890	18,655	-	-	403,042
Miscellaneous income	249,424	22,219	31,593	-	-	303,236
Regulatory assessments	(121,440)	(23,069)	(28,476)	-	-	(172,985)
Settlement expense	(12,260)	(11,500)	-	-	-	(23,760)
Contribution to the CNMI government	(200,779)	(140,343)	(76,439)	-	-	(417,561)
Interest and distribution expense	(1,427,598)	-	(12,063)	-	-	(1,439,661)
Total non-operating revenues (expenses), net	(1,252,156)	(28,803)	(66,730)	-	-	(1,347,689)
Loss before change in recovery of fuel c	(1,245,308)	(6,192,523)	(2,755,291)	-	-	(10,193,122)
Change in recovery of fuel costs	1,340,482	-	-	-	-	1,340,482
Net earnings (loss) before capital contributions and federal grants	95,174	(6,192,523)	(2,755,291)	-	-	(8,852,640)
Capital contributions and federal grants	6,414,571	2,837,145	2,237,875	-	-	11,489,591
Change in net position	<u>\$ 6,509,745</u>	<u>\$ (3,355,378)</u>	<u>\$ (517,416)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,636,951</u>

See accompanying notes to financial statements.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

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**INDEPENDENT AUDITOR'S REPORTS  
ON INTERNAL CONTROL  
AND ON COMPLIANCE**

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**Years Ended  
September 30, 2013 and 2012**



CERTIFIED PUBLIC ACCOUNTANT

**SAIPAN**

Family Building, Suite 201  
PMB 297 Box 10000  
Saipan, MP 96950  
Tel Nos. (670) 233-1837/0456  
Fax No. (670) 233-8214

**GUAM**

Reflection Center, Suite 204  
P.O. Box 12734  
Tamuning, GU 96931  
Tel Nos. (671) 472-2680/2687  
Fax No. (671) 472-2686

**PALAU**

PIDC Apartment No. 11  
P.O. Box 1266  
Koror, PW 96940  
Tel No. (680) 488-8615  
Fax No. (680) 488-8616

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL  
OVER FINANCIAL REPORTING AND ON COMPLIANCE  
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS  
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Board of Directors  
Commonwealth Utilities Corporation

I 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 Commonwealth Utilities Corporation (CUC), as of and for the year ended September 30, 2013, and the related notes to the financial statements, which collectively comprise CUC's basic financial statements and have issued my report thereon dated October 20, 2014.

**Internal Control Over Financial Reporting**

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

My consideration of internal control was for the limited purpose described in the preceding paragraph 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. However, as described in the accompanying schedule of findings and questioned costs, I identified certain deficiencies in internal control that I consider to be material weaknesses and significant deficiencies.

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. I consider the deficiencies described in Finding Nos. 2013-01 to 2013-04 in the accompanying schedule of findings and questioned costs to be material weaknesses.

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. I consider the deficiencies described in Finding Nos. 2013-05 to 2013-07 in the accompanying schedule of findings and questioned costs to be significant deficiencies.

#### **Compliance and Other Matters**


As part of obtaining reasonable assurance about whether CUC's financial statements are free from material misstatement, I 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 my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as Finding Nos. 2013-08 to 2013-11.

#### **CUC's Response to Findings**

CUC's response to the findings identified in my audit is described in the accompanying schedule of findings and questioned costs. CUC's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, I express no opinion on it.

#### **Purpose of this Report**

The purpose of this report is solely to describe the scope of my 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.

  
Saipan, Commonwealth of the Northern Mariana Islands  
October 20, 2014



CERTIFIED PUBLIC ACCOUNTANT

**SAIPAN**

Family Building, Suite 201  
PMB 297 Box 10000  
Saipan, MP 96950  
Tel Nos. (670) 233-1837/0456  
Fax No. (670) 233-8214

**GUAM**

Reflection Center, Suite 204  
P.O. Box 12734  
Tamuning, GU 96931  
Tel Nos. (671) 472-2680/2687  
Fax No. (671) 472-2686

**PALAU**

PIDC Apartment No. 11  
P.O. Box 1266  
Koror, PW 96940  
Tel No. (680) 488-8615  
Fax No. (680) 488-8616

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM  
AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133**

To the Board of Directors  
Commonwealth Utilities Corporation

**Report on Compliance for Each Major Federal Program**

I have audited CUC's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of CUC's major federal programs for the year ended September 30, 2013. CUC's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

***Management's Responsibility***

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

***Auditor's Responsibility***

My responsibility is to express an opinion on compliance for each of CUC's major federal programs based on my audit of the types of compliance requirements referred to above. I conducted my audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that I plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about CUC's compliance with those requirements and performing such other procedures as I considered necessary in the circumstances.

I believe that my audit provides a reasonable basis for my opinion on compliance for each major federal program. However, my audit does not provide a legal determination of CUC's compliance.



### **Opinion on Each Major Federal Program**

In my opinion, CUC, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2013.

### **Report on Internal Control Over Compliance**

Management of CUC is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing my audit of compliance, I considered CUC's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, I do not express an opinion on the effectiveness of CUC's internal control over compliance.

My consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, I identified certain deficiencies in internal control over compliance that I consider to be material weaknesses and significant deficiencies.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. I consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as Finding No. 2013-12 to be material weaknesses.

*A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

CUC's response to the internal control over compliance findings identified in my audit is described in the accompanying schedule of findings and questioned costs. CUC's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, I express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

*J. Scott Magliari & Company*  
Saipan, Commonwealth of the Northern Mariana Islands  
October 20, 2014

**COMMONWEALTH UTILITIES CORPORATION**  
Schedule of Expenditures of Federal Awards

Year Ended September 30, 2013

Federal Grantor/ Pass Through Grantor/ Program or Cluster Title	Federal CFDA Number	Federal Expenditures
U.S. Environmental Protection Agency		
Direct Programs:		
Environmental Protection Consolidated Grants for the Insular Areas - Program Support	66.600	<u>\$ 4,787,913</u> *
Subtotal Direct Programs		<u>4,787,913</u>
Indirect Program:		
Passed-through the CNMI Division of Environmental Quality ARRA - State Clean Diesel Grant Program	66.040	<u>42,756</u>
Subtotal U.S. Environmental Protection Agency		<u>4,830,669</u>
U.S. Department of Energy		
Indirect Program:		
Passed-through the CNMI Department of Public Works ARRA - State Energy Program - Replacement of Street Lamps	81.041	777,700 *
ARRA - Energy Efficiency and Conservation Block Grant Program (EECBG)	81.128	<u>3,109,357</u> *
Subtotal U.S. Department of Energy		<u>3,887,057</u>
U.S. Department of the Interior		
Indirect Programs:		
Passed-through the CNMI Government		
Sadog Tasi Wastewater Treatment Plant Rehabilitation	15.875	97,935
Rehabilitation of Agingan Wastewater Treatment Facilities	15.875	45,504
Grant for Stipulated Order No. 2	15.875	466,056
New Fuel Tank at Power Plant I	15.875	286,280
Rota Generation Improvements	15.875	21,496
Tank System Integrity and Cleanout Plan	15.875	118,675
Replacement of 8" Petroleum Pipeline	15.875	979,391
Professional Services Assistance	15.875	108,166
IT System Upgrade	15.875	439,123
Emergency Assistance for Power Generation and Power Distribution system	15.875	<u>492,560</u>
Subtotal U.S. Department of the Interior		<u>3,055,186</u> *
Total Federal Programs		<u>\$ 11,772,912</u>
Percentage of Federal Programs expenditures tested		<u>74%</u>

\* Denotes major programs

See accompanying notes to Schedule of Expenditure of Federal Awards.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Notes to Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2013

(1) Scope of Audit

The Commonwealth Utilities Corporation (CUC) was established as a Public Corporation by the Commonwealth of the Northern Mariana Islands (CNMI) Public Law 4-47, effective October 1, 1985. CUC was given responsibility for supervising the construction, maintenance operations, and regulation of all utility services, including power, sewage, refuse collections and water, provided however, that, whenever feasible, CUC shall contract for private businesses to assume its duties with respect to one or more of its divisions. CUC was also designated with the responsibility to establish rates, meter, and bill and collect fees in a fair and rational manner from all customers of utility services in order for CUC to become financially independent of appropriations by the Commonwealth Legislature. All projects of CUC that are funded either directly by U.S. federal agencies through the CNMI or indirectly as loans from the Commonwealth Development Authority (CDA), the U.S. Environmental Protection Agency and the U.S. Department of Agriculture are included in the scope of the OMB Circular A-133 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as CUC's cognizant agency for the Single Audit.

A. Programs Subject to Single Audit

All of the programs presented in the Schedule of Expenditures of Federal Awards are subject to the Single Audit. U.S. Federal Covenant funds received as loans from CDA and funds received from the U.S. Department of Agriculture as loans are also subject to the Single Audit.

(2) Summary of Significant Accounting Policies

A. Basis of Accounting

For purposes of this report, certain accounting procedures were followed, which help illustrate the authorizations and expenditures of the individual programs. The Schedule of Expenditures of Federal Awards is prepared on the accrual basis of accounting. All authorizations represent the total allotment or grant awards received. All expenses and capital outlays are reported as expenditures.

Any federal funds expended in excess of federal funds received are recorded as a receivable from the grantor agency and any federal funds received in excess of federal funds expended are recorded as a payable to the grantor agency.

B. Indirect Cost Allocation

For fiscal year 2013, CUC had no indirect cost agreement with grantor agencies.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Notes to Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2013

C. Matching Requirements

In allocating project expenditures between the federal share and the local share, a percentage is used based upon local matching requirements, unless funds are specifically identified to a certain phase of the project.

D. American Recovery and Reinvestment Act of 2009 (ARRA)

In February 2009, the Federal Government enacted the American Recovery and Reinvestment Act of 2009 (ARRA). As of September 30, 2013, CUC's grant award notification and expenditures included ARRA funded programs as follows:

<u>CFDA Number - Program</u>	<u>Grant Amount</u>	<u>Fiscal Year 2013 Expenditures</u>
81.128 ARRA - Energy Efficiency and Conservation Block Grant Program	\$ 4,456,000	\$ 3,109,357
81.041 ARRA - State Energy Program	777,700	777,700
66.040 ARRA - State Clean Diesel Grant Program	70,678	42,756
	<u>\$ 5,304,378</u>	<u>\$ 3,929,813</u>

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

**SECTION I – SUMMARY OF AUDITOR’S RESULTS**

Financial Statements

Type of auditor’s report issued: Unmodified

Internal control over financial reporting:

- Material weakness(es) identified?   X   yes        no
- Significant deficiency(ies) identified that are not considered to be material weaknesses?   X   yes        none reported

Noncompliance material to financial statements noted?   X   yes        no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified?   X   yes        no
- Significant deficiency(ies) identified that are not considered to be material weaknesses?        yes   X   none reported

Type of auditor’s report issued on compliance for major federal programs: Unmodified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?        yes   X   no

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

Identification of Major Programs:

<u>CFDA No.</u>	<u>Description</u>
15.875	Economic, Social, and Political Development of the Territories
66.600	Environmental Protection Consolidated Grants Support
81.128	ARRA – Energy Efficiency and Conservation Block Grant Program (EECBG)
81.041	ARRA – State Energy Program – Replacement of Street Lamps

Dollar threshold used to distinguish between Type A and Type B programs:

\$ 353,187

Auditee qualified as low-risk auditee

yes     no

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

**Finding No. 2013-01 Bank Reconciliations**

**Criteria:**

Pursuant to 34 CFR PART 80 – Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments, §80.20 (b)(3), Internal Control, an effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

In line with this, preparation of monthly reconciliations of cash accounts should be performed on a timely basis and should be properly supported.

**Condition:**

Monthly account reconciliations were not timely prepared for all bank accounts during fiscal year 2013.

**Cause:**

During fiscal year ended September 30, 2013, CUC implemented new Billing and Collection Software and Financial Accounting Software. The integration between the two programs resulted in postings in the cash general ledger of lump-sum amounts that could not be easily traced to the bank statements and from the collection report for the Billing and Collection Software. CUC's accounting department had to request a customized report from the software provider to enable the identification of deposits posted in the general ledger.

**Effect:**

Although the cash accounts as of September 30, 2013 were reconciled, interim financial reports may have been misstated for the effects of the un-reconciled bank balances. Financial decisions involving cash could be based on inaccurate information and may have negative consequences. Furthermore, fraud, theft and errors could exist and not be detected.

**Recommendation:**

Implementing new software is not an easy endeavor; CUC should have maintained parallel runs of the old and new systems to ensure that financial reporting is timely and accurate.

CUC should ensure bank reconciliations are timely prepared and reviewed.



**COMMONWEALTH UTILITIES CORPORATION**  
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Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

**Finding No. 2013-02 Reconciliation of Customer Accounts Subsidiary Ledgers to the General Ledger Accounts**

**Criteria:**

Controls should be in place to ensure that all customer billings, collections and adjustments are properly carried forward from the Billings and Collections Software to the Financial Accounting Software.

**Condition:**

For every customer account in the Billings and Collections software general ledger accounts were assigned to each transaction such as billing, customer adjustments and collection. The software provider designed an interface to upload the transactions to the general ledger. This procedure aims to seamlessly record the transactions from the subsidiary ledgers (which are maintained in the Billings and Collections software) to the general ledger accounts in the Financial Accounting Software. Having this computerized internal control in place, CUC did not conduct monthly reconciliation of the subsidiary ledgers to the general ledger balances. Account reconciliation was only prepared at year-end and such reconciliation disclosed several discrepancies.

**Cause:**

CUC relied on the computerized controls. Furthermore, the accounting department was not significantly involved in the design and implementation of the Billing and Collection Software from which the significant volume of financial information is generated.

**Effect:**

Although the account receivable balances as of September 30, 2013 were reconciled, interim financial reports may have been misstated for the effects of the unreconciled balances. Financial decisions involving receivable, such as provision for uncollectible accounts, could be based on inaccurate information and may have negative consequences. Furthermore, fraud, theft and errors could exist and not be detected.

**Recommendation:**

In order to make the financial reports generated by the accounting system as meaningful as possible, CUC should reconcile the general ledger accounts for accounts receivable on a monthly basis. A benefit of monthly reconciliations is that errors do not accumulate but can be identified and attributed to a particular period, which makes it easier to perform future reconciliations.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

**Finding No. 2013-03 Reconciliation of Vendor Accounts Subsidiary Ledgers to the General Ledger Accounts**

**Criteria:**

Controls should be in place to ensure that all vendor invoices, prepayments, payments and adjustments are properly posted in the subsidiary ledger and general ledger.

**Condition:**

Year-end reconciliation of the vendor payable detailed aging to the accounts payable general ledger accounts revealed material discrepancies. The vendor module of the Financial Accounting Software was not fully utilized to properly record prepayments and accruals.

**Cause:**

CUC accounting personnel posted transactions to the new Financial Accounting Software the way they are accustomed to do using the old software. They were not properly trained for the different built-in internal controls in the new software.

**Effect:**

Although the accounts payable balances as of September 30, 2013 were reconciled, interim financial reports may have been misstated for the effects of the un-reconciled balances. Furthermore, fraud, theft and errors could exist and not be detected.

**Recommendation:**

CUC should train the users of the Financial Accounting Software to fully utilize the modules to maximize the benefit of the built-in computerized internal controls. Furthermore, monthly reconciliations should be prepared. In order to make the financial reports generated by the accounting system as meaningful as possible, CUC should reconcile the general ledger accounts for accounts payable on a monthly basis. A benefit of monthly reconciliations is that errors do not accumulate but can be identified and attributed to a particular period, which makes it easier to perform future reconciliations.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

**Finding No. 2013-04 Use of Journal Entries**

**Criteria:**

Journal entries should be used to post unusual and nonrecurring transactions into the general ledger.

**Condition:**

CUC posted over 1,200 journal entries, excluding the automatic journal entries posted by the integration of the software used.

**Cause:**

The modules of the Microsoft GP software were not fully utilized resulting to numerous journal entries.

**Effect:**

Utilization of numerous journal entries makes it difficult to reconcile general ledger balances to supporting documents and subsidiary ledgers. Improper financial information may be processed and not be easily detected.

**Recommendation:**

CUC should train the users of the Financial Accounting Software to fully utilize the modules to prevent excessive use of journal entries.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

**Finding No. 2013-05 Accrual of Liabilities**

**Criteria:**

Expenses and related liabilities should be recorded when incurred.

**Conditions:**

The following liabilities and related expenses were not timely recorded:

<u>Invoice Date</u>	<u>Check Number</u>	<u>Check Date</u>	<u>Unrecorded Liabilities</u>
07/16/2013 and 09/16/2013	646	10/21/2013	\$ 77,984.79
08/13/2013, 09/02/2013, 09/16/2013, and 09/26/2013	645	10/21/2013	136,317.44
09/06/2013, 09/09/2013, and 09/19/2013	95813	11/7/2013	88,675.13
			<u>\$ 302,977.36</u>

For 98 vouchers with an aggregate amount of \$60,238.33, the related expenses were recorded twice. First, when the vendor invoices were recorded and again when the accountant generated a posted manual journal entries to accrue unrecorded liabilities.

**Cause:**

This is due to insufficient training of the proper use of the new Financial Accounting Software and the reports generated by the system. Furthermore, CUC Accounting department staff had voluminous work backlogs that caused them to post transactions in haste, thus overlooking the dates on the invoices.

**Effect:**

Although the accounts payable balances as of September 30, 2013 were reconciled, interim financial reports may have been misstated.

**Recommendation:**

Due care should be exercised in reviewing reports, specially with newly designed reports, to minimize errors in summarizing entries for adjustments.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

**Finding No. 2013-06 Negative Balances in the Aging of Accounts Receivable**

**Criteria:**

Collections received should be applied to specific billings.

**Condition:**

The aged listing of accounts receivable as of September 30, 2013 included negative balances totaling \$1,185,182.

**Cause:**

The negative balances pertain to advance payments received from customers and security deposits posted as payments. CUC has not established internal control policies and procedures to review and monitor credit balances within the aged listing of accounts receivable.

**Effect:**

The accounts receivable balance is understated by the amount of overpayment.

**Prior Year Status:**

Similar conditions were cited in Finding Nos. 2012-02, 2011-03, 2010-06 and 2009-14 in prior year audits.

**Recommendation:**

Accounts receivable with credit balances should be reviewed periodically. Management should ensure that a separate listing of such credit balances be generated, reviewed and adjusted on a monthly basis. For month-end and year-end financial statement reporting, these negative balances should be reclassified and reported as customer deposits or security deposits. The new Billing and Collection Software is able to summarize such credit balance into customer deposit and advance payments, hence CUC should utilize this to issue refunds for deposits in excess of mandatory deposits and properly apply advances to the appropriate subsequent billings.

**COMMONWEALTH UTILITIES CORPORATION**  
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Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

**Finding No. 2013-07 Provision for Uncollectible Accounts**

**Criteria:**

Pursuant to CUC policies, an allowance for uncollectible accounts shall be provided for customer accounts over 75 day past due.

**Condition:**

CUC Billing and Collection Software was configured to age receivable from customers in increments of 30 days, hence the report is unable to generate a summary of customer receivables over 75 days past due.

CUC used the balance over 60 days as the basis for recording the provision for uncollectible accounts.

For the year ended September 30, 2013, the allowance for uncollectible accounts increased to \$29,094,749 from \$18,520,448 at September 30, 2012. CUC is unable to determine how much of the \$10,574,301 increase in allowance is attributable to the declining credit quality of CUC customer receivables or to the change in accounting estimate.

**Cause:**

CUC was limited by the Billing and Collection Software's customer receivable aging configuration.

**Effect:**

CUC uses the rate of uncollectibility as a factor in rate setting. The shorter period used as the basis for providing allowance for uncollectible accounts could result in artificially increasing the provision for bad debts which would be used in making subsequent rate-setting decisions

**Recommendation:**

CUC should consult its software provider whether or not the aging of customer receivables could be configured to comply with CUC policy.

If CUC believes that the current aging is the more accurate basis for estimating uncollectible accounts, CUC should update its policies accordingly.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

**COMPLIANCE AND OTHER MATTERS**

**Finding No. 2013-08 Procurement**

**Criteria:**

Pursuant to CUC Procurement Regulations §50-50-201, unless otherwise authorized by law or by regulation, all CUC contracts shall be awarded by competitive sealed bidding, except as provided in:

- (a) § 50-50-210 (Small Purchases);
- (b) § 50-50-215 (Sole Source Procurement);
- (c) § 50-50-220 (Emergency Procurement);
- (d) § 50-50-225 (Competitive Sealed Proposals);
- (e) § 50-50-230 (Professional Services);
- (f) § 50-50-305 (Architect-Engineer Services)

**Condition:**

The Executive Director issued a memorandum authorizing the procurement of materials and parts utilizing a request for quotation instead of competitive sealed bidding.

The following contracts were procured using request for quotation:

<u>Contract No.</u>	<u>Amount</u>
CUC-PG-13-C024	\$ 131,544
CUC-PG-12-C045	517,356
CUC-PG-12-C046	309,960
CUC-PG-12-C044	684,504
CUC-PG-13-C035	135,070
CUC-PG-13-C037	109,400
CUC-PG-12-C029	137,714
CUC-PG-12-C030	100,908
CUC-PG-12-C032	109,400
CUC-PG-12-C047	467,597
CUC-PG-12-C048	318,940
CUC-PG-12-C050	263,679
CUC-PG-13-C036	<u>582,300</u>
	<u>\$ 3,868,372</u>

**COMMONWEALTH UTILITIES CORPORATION**  
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Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

**COMPLIANCE AND OTHER MATTERS**

**Finding No. 2013-08 Procurement, Continued**

**Effect:**

CUC did not comply with its Procurement Regulations.

**Cause:**

The contracts procured through a request for quotation are for routine repair materials and parts for CUC facilities and plants that have very specific requirements that can often only be provided by the suppliers of the equipment for which the parts reordered are to be used. Oftentimes these suppliers are off-island and would not be monitoring CUC's request for competitive sealed bidding unless CUC sent them a copy of the request. Furthermore, these suppliers often are reluctant in responding the request for competitive sealed bidding due to the volume of documentation required to be considered responsive bidders.

**Recommendation:**

CUC should consider updating its Procurement Regulations to include purchase of routine repair materials and parts as an exception to §50-50-201.

Also CUC may designate these suppliers as sole source suppliers and will comply with the CUC's Sole Source Procurement, §50-50-215 of CUC's Procurement Regulation. Furthermore, CUC should consider including a provision for cost analysis in its Sole Source Procurement regulation. Such provision will document CUC's consideration that the cost provided by the sole source vendor is not excessively priced.



**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

**COMPLIANCE AND OTHER MATTERS**

**Finding 2013-09 Memorandum of Agreement (MOA) with CDA**

**Criteria:**

Pursuant to the MOA between CUC and the Commonwealth Development Authority (CDA), the preferred stocks interest in CUC guarantees annual dividends fixed at two percent (2%) of the total aggregate value of the preferred stock interest, payable quarterly in advance. Dividend payments for the first three years are to be deferred and amortized over a fifteen (15) year period interest-free with the first incremental payment being due simultaneously with the first dividend payment for the fourth year. The guaranteed annual dividend payments shall be deposited into a revolving fund account for the financing of additional revenue producing capital development projects. Interest earned on the revolving fund account before such funds are expended are to be treated as capital development funds and become part of said revolving fund account as principal.

**Condition:**

Outstanding deferred dividends payable as of September 30, 2013 amounted to \$2,700,000. CUC has not established a revolving fund pursuant to the terms of the MOA. In addition to the deferred dividends payable, CUC also has not remitted to CDA the \$900,000 dividend for the year ended September 30, 2013.

**Cause:**

CUC has no other available funding source to fund the revolving fund.

**Effect:**

CUC is not in compliance with the terms of the MOA.

**Prior Year Status:**

Similar conditions were cited in Finding Nos. 2012-06 and 2011-07 in prior years audits.

**Recommendation:**

CUC should ensure compliance with the terms of the MOA to ensure that CUC is able to pay the dividends accrued and due. Unless other funding sources are identified, rate increases might be required to fund the ongoing dividends.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

**COMPLIANCE AND OTHER MATTERS**

**Finding 2013-10 Payroll Processing**

**Criteria:**

Employees should be paid pursuant to signed employment contracts and/or an approved notice of personnel action.

**Conditions:**

The rates used in calculating the following payroll were different than the approved Notice of Personnel Action (NOPA) provided to me:

<u>Employee Number</u>	<u>Pay Period</u>	<u>Payment Date</u>	<u>Rate Used</u>	<u>Rate on NOPA</u>	<u>Effectivity</u>	<u>Remarks</u>
10242	04.21-05.04	5/15/2013	6.21	7.28	4/9/2012	
149	04.21-05.04	5/15/2013	17.21	19.23	5/24/2012	
9942	04.21-05.04	5/15/2013	5.55	9.21	11/3/2013	Previous NOPA not provided
10309	06.16-06.29	7/11/2013	5.55	7.69	9/26/2013	Previous NOPA not provided
10371	06.16-06.29	7/11/2013	5.55	6.05	8/19/2013	Previous NOPA not provided
5982	06.16-06.29	7/11/2013	21.36	19.95	3/17/2012	
4245	07.14-07.27	8/7/2013	7.27	8.77	9/11/2013	Previous NOPA not provided

**Cause:**

In some cases, the rate in the payroll system is not timely updated for the most current NOPA. On others, not all the NOPA effective for the fiscal year ended September 30, 2013 were provided to me.

**Effect:**

Although the misstatement does not materially misstate CUC's financial statements, the salaries and wages paid to certain employees might be misstated due to the difference in rates used against the documented Notices of Personnel Action.

**Recommendation:**

The Human Resources Department should ensure that all changes in employee status and/or rates are documented on either properly executed employment contracts or notices of personnel action. Furthermore, they should ensure that each employee timely updates their Form W-4, Employee's Withholding Allowance Certificate and such information is updated on the system used to calculate payroll.

**COMMONWEALTH UTILITIES CORPORATION**  
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Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

**COMPLIANCE AND OTHER MATTERS**

**Finding 2013-11 Interest on Security Deposit Refunds**

**Criteria:**

Pursuant to Public Law 16-17 §8143(b), all residential security deposit refunds shall be paid within thirty (30) days after disconnection of utilities with earned interest.

**Condition:**

CUC has not yet established procedures for calculating interest accrued on customer deposits, and has not paid interest of security deposits refunded to customers.

**Cause:**

CUC has not yet established procedures for calculating interest accrued on customer deposits.

**Effect:**

CUC is not in compliance with the provision of Public Law 16-17.

**Recommendation:**

CUC should explore whether or not the new Billing and Collection software is able to keep track of security deposits and calculate interest on these accounts to ensure compliance with Public Law 16-17.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

**INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB A-133**

**Finding 2013-12 Procurement**

**CFDA 81.128**

**ARRA - Energy Efficiency and Conservation Block Grant Program**

**Criteria:**

Pursuant to the *Uniform Administrative Requirements for Grants and Cooperative Agreements to States and Local Government, Subpart C, 97.36* (a) States, and Governmental subrecipients of States, will use the same State policies and procedures used for procurements from non-Federal funds. They also must ensure that every purchase order or other contract includes any clauses required by Federal statutes and executive orders and their implementing regulations.

Pursuant to CUC Procurement Regulations §50-50-201, unless otherwise authorized by law or by regulation, all CUC contracts shall be awarded by competitive sealed bidding, except as provided in:

- (a) § 50-50-210 (Small Purchases);
- (b) § 50-50-215 (Sole Source Procurement);
- (c) § 50-50-220 (Emergency Procurement);
- (d) § 50-50-225 (Competitive Sealed Proposals);
- (e) § 50-50-230 (Professional Services);
- (f) § 50-50-305 (Architect-Engineer Services)

**Condition:**

The Executive Director issued a memorandum authorizing the procurement of materials and parts utilizing a request for quotation instead of competitive sealed bidding.

Of the contracts listed in Finding No. 2013-08, CUC-PG-12-C045 for \$517,356 and CUC-PG-12-C046 for \$309,960 were funded by the EECBG.

**Cause:**

The contracts procured through a request for quotation are for routine repair materials and parts for CUC facilities and plants that have very specific requirements that can often only be provided by the suppliers of the equipment for which the parts reordered are to be used. Oftentimes these suppliers are off-island and would not be monitoring CUC's request for competitive sealed bidding unless CUC sent them a copy of the request. Furthermore, these suppliers often are reluctant to respond to the request for competitive sealed bidding due to the volume of documentation required to be considered responsive bidders.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

**INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB A-133**

**Finding 2013-12 Procurement, Continued**

CFDA 81.128

ARRA - Energy Efficiency and Conservation Block Grant Program

**Effect:**

CUC did not comply with its Procurement Regulation. No questioned cost is assessed on this finding as CUC was able to demonstrate that although the materials were not procured through Competitive Sealed Bidding, full open competition was achieved thru the request of quotation from several suppliers who have provided such material to CUC in the past.

**Recommendation:**

CUC should consider updating its Procurement Regulations to include purchase of routine repair materials and parts as an exception to §50-50-201.

Also CUC may designate these suppliers as sole source suppliers and will comply with the CUC's Sole Source Procurement, §50-50-215 of CUC's Procurement Regulation. Furthermore, CUC should consider including a provision for cost analysis in its Sole Source Procurement regulation. Such provision will document CUC's consideration that the cost provided by the sole source vendor is not overstated.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

**PRIOR YEAR FINDINGS AND QUESTIONED COSTS**

Unresolved Findings

2012-01	Customer Deposits – Liability	Resolved.
2012-02	Negative Balances in the Aging of Accounts Receivable	Unresolved. Refer to Finding 2013-06.
2012-03	Prepayments	Resolved.
2012-04	Utility Plant - Inventory	Resolved.
2012-05	Procurement - After-the-fact Ratification	Resolved.
2012-06	Memorandum of Agreement (MOA) with CDA	Unresolved. Refer to Finding 2013-09.
2012-07	Deposit of Collections	Resolved.
2012-08	Equipment and Real Property Management	Resolved.

**COMMONWEALTH UTILITIES CORPORATION**  
(A Component Unit of the CNMI Government)

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2013

**SECTION IV – PRIOR YEAR FINDINGS AND QUESTIONED COSTS**

Questioned Costs

The prior year Single Audit report on compliance with the laws and regulations noted the following costs and comments that were unresolved at September 30, 2013:

Questioned costs as previously reported	\$	-
Questioned costs for fiscal year 2013 Single Audit	_____	-
Unresolved questioned costs at September 30, 2013	\$	<u>          -</u>



# Commonwealth Utilities Corporation



October 8, 2014

Mr. Scott Magliari, Partner  
J. Scott Magliari & Company  
PMP 297 PPP Box 10000  
Saipan, MP 96950

Subject: Schedule of Findings and Questioned Costs for the year ended September 30, 2013

Dear Mr. Magliari:

Please see below CUC's responses to the findings regarding CUC FY 2013 Audit:

## **Finding 2013-01 Bank Reconciliation**

### *Condition:*

Monthly account reconciliations were not timely prepared for all bank accounts during fiscal year 2013.

### *Recommendation:*

CUC should ensure that significant internal control, such as bank reconciliations are timely prepared.

### *CUC Response:*

CUC agrees with the finding.

### *Management's Plan of Corrective Action:*

CUC obtained further customization of the Billing and Collection Software and Financial Accounting Software. CUC is now utilizing the improved customized reporting capabilities to enable accurate monthly reconciliations, with proper supporting documentation, beginning July, 2014. CUC believes this finding has been resolved during FY 2014.

## **Finding 2013-02 Reconciliation of Customer Accounts Subsidiary Ledgers to the General Ledger Accounts**

### *Condition:*

For every customer account in the Billings and Collections software general ledger accounts were assigned to each transaction such as billing, customer adjustments and collection. The software provider designed an interface to upload the transactions to the general ledger. This procedure aims to seamlessly record each transaction from the subsidiary ledgers (which are maintained in the Billings and Collections software) to the general ledger account in the Financial Accounting Software. Having this computerized internal control in place; CUC did not conduct monthly reconciliation of the subsidiary ledgers totals to the general ledger balances. Account reconciliation was only prepared at year-end and such reconciliation disclosed several discrepancies.

*CUC is an Equal Opportunity Employer*

Third Floor, Joeten Dandan Building

P.O. Box 501220 Saipan, MP 96950-1220

TEL: (670) 235-7025 to 7032 • FAX (670) 235-5131



*Recommendation:*

In order to make the financial reports generated by the accounting system as meaningful as possible, CUC should reconcile the general ledger accounts for accounts receivable on a monthly basis. A benefit of monthly reconciliations is that errors do not accumulate but can be identified and attributed to a particular period, which makes it easier to perform future reconciliations.

*CUC Response:*

CUC agrees with the finding.

*Management's Plan of Corrective Action:*

Customized financial reports were required from the new software to assist the staff in the proper reconciliation and analyses of accounts. The system programmers provided the ability to perform these custom reports beginning mid FY 2014. The CUC accounting staff is working to clear the backlogs on these analyses. Upon completion of all backlogs, CUC staff will be able to fully resolve this finding.

**Finding 2013-03 Reconciliation of Vendor Accounts Subsidiary Ledgers to the General Ledger Accounts**

*Condition:*

Year-end reconciliation of the vendor payable detailed aging to the accounts payable general ledger accounts revealed material discrepancies. The vendor module of the Financial Accounting Software was not fully utilized to properly record prepayments and accruals.

*Recommendation:*

CUC should train the users of the Financial Accounting Software to fully utilize the modules to maximize the benefit of the built-in computerized internal controls. Furthermore, monthly reconciliation should be prepared. In order to make the financial reports generated by the accounting system as meaningful as possible, CUC should reconcile the general ledger accounts for accounts payable on a monthly basis. A benefit of monthly reconciliations is that errors do not accumulate but can be identified and attributed to a particular period, which makes it easier to perform future reconciliations.

*CUC Response:*

CUC agrees with the finding.

*Management's Plan of Corrective Action:*

As with customer accounts (finding 2013-03 above), customized financial reports were required from the new software to assist the staff in the proper reconciliation and analyses of accounts. The system programmers provided the ability to perform these custom reports beginning mid FY 2014. CUC recognizes the challenges of training staff to utilize technologies and software more advanced than commonly used on our isolated islands. The CUC Accounts Payable staff continues to receive training, and to work through backlogs. Upon completion of all backlogs, CUC staff will be able to fully resolve this finding.

### **Finding 2013-04 Use of Journal Entries**

*Condition:*

CUC posted over 1,200 journal entries, excluding the automatic journal entries posted by the integration of the software used.

*Recommendation:*

CUC should train the users of the Financial Accounting Software to fully utilize the modules to prevent excessive use of journal entries.

*CUC Response:*

CUC agrees with the finding.

*Management's Plan of Corrective Action:*

CUC accounting staff continues to be trained in the use of the new software system. CUC believes this finding has been resolved as staff becomes more familiar and comfortable with and thus better utilizes the capabilities of the powerful IT accounting systems. CUC is working with the programmers to assist in correcting any errors in the initial set up.

### **Finding 2013-05 Accrual of Liabilities**

*Condition:*

The liabilities and related expenses amounting to \$302,977.36 were not timely recorded (see audit).

For 98 vouchers with aggregate amount of \$60,238.33, the related expenses were recorded twice. First, when the vendor invoices were recorded and again when the accountant generated a posted manual journal entries to accrue unrecorded liabilities.

*Recommendation:*

Due care should be exercised in reviewing reports, especially with newly designed reports, to minimize errors in summarizing entries for adjustments.

*CUC Response:*

CUC agrees with the finding.

*Management's Plan of Corrective Action:*

As with other findings caused by lack of proficiency in using the new Financial Accounting System, CUC continues to train and be trained. Staff is increasingly more familiar in preparing reports with the Financial Accounting System. The A/P Supervisor has been tasked to review and verify expenses and liabilities accrued for regular vendors. To assist with the workload, an additional Accountant has been hired to focus on federal grant related accounting matters.

### **Finding 2013-06 Negative Balances in the Aging of Accounts Receivable**

*Condition:*

The aged listing of accounts receivable as of September 20, 2013 included negative balances totaling \$1,185,182. (Collections received should be applied to specific billings.)

*Recommendation:*

Accounts receivable with credit balances should be reviewed periodically. Management should ensure that a separate listing of such credit balances be generated, reviewed and adjusted on a monthly basis. These negative balances should be reclassified and reported as customer deposits or security deposits. The new software is able to summarize such credit balance into customer deposit and advance payments, hence CUC should utilize this to issue refunds for deposits in excess of mandatory deposit and properly apply advance to the appropriate subsequent billings.

*CUC Response:*

CUC agrees with the finding.

*Management's Plan of Corrective Action:*

In fiscal year 2014, more than 2000 accounts were issued security deposit refunds. Billing, Financial Accounts and Management Sections continue to analyze accounts and issue refunds to customers.

### **Finding 2013-07 Provision for Uncollectible Accounts**

*Condition:*

CUC Billing and Collection Software was configured to age receivable from customer in increments of 30 days, hence the report is unable to generate a summary of customer receivables over 75 days past due. (Pursuant to current CUC policies, allowance for uncollectible shall be provided for customer accounts over 75 day past due.) As dictated by the software configuration, CUC used the balance over 60 days as the basis for recording the provision for uncollectible accounts.

*Recommendation:*

CUC should consult its software provider whether or not the aging of customer receivable could be configured to comply with CUC policy. If CUC believes that the current aging is the more accurate basis for estimating uncollectible accounts, CUC should update its policies accordingly.

*CUC Response:*

CUC agrees with the finding.

*Management's Plan of Corrective Action:*

CUC has implemented directives but have not updated its policies. We will bring this matter to the Board of Directors for their review and decision regarding amending current policy.

### **Finding 2013-08 Procurement**

*Condition:*

The Executive Director issued a memorandum authorizing the procurement of material and parts utilizing request for quotation instead of competitive sealed bidding.

*Recommendation:*

CUC should consider updating its Procurement Regulations to include purchase of routine repair materials and parts as an exception to §50-50-201. Also CUC may designate some suppliers as sole source suppliers (with justification) and comply with the CUC's Sole Source Procurement, §50-50-215 of CUC's Procurement Regulation. Furthermore, CUC should consider including a provision for cost analysis in its Sole Source Procurement regulation. Such provision will document CUC's consideration that the cost provided by the sole source vendor is not overstated.

*CUC Response:*

CUC agrees with the finding.

*Management's Plan of Corrective Action:*

CUC has implemented directives regarding such procurements but have not updated its written policies. We will bring this matter to the Board of Directors for their review of policy.

### **Finding 2013-09 Memorandum of Agreement with CDA**

*Condition:*

Outstanding deferred dividends payable as of September 30, 2013 amounted to \$2,700,000. CUC has not established a revolving fund pursuant to the terms of the MOA. In addition to the deferred dividends payable, CUC also have not remitted to CDA the \$900,000 dividend for the year-ended September 30, 2013.

*Cause:*

CUC has no other available funding source to fund the revolving fund. (CUC comment: Rates do not support and large uncollected accounts receivable from government customers make it impossible to fund)

*Recommendation:*

CUC should ensure compliance to the terms of the MOA to ensure that CUC is able to pay the dividends accrued and due. Unless other funding sources are identified, rate increases might be required to fund the ongoing dividends.

*CUC Response:*

CUC agrees with the finding.

*Management's Plan of Corrective Action:*

CUC will continue to petition for rate increases to include the expense and will work to collect large unpaid accounts.

### **Finding 2013-10 Payroll Processing**

*Condition:*

The rates used in calculating the following payroll were different for the approved Notice of Personnel Action (NOPA) provided to me (auditor): (cites 7 employees with pay differing from NOPA)

*Recommendation:*

The Human Resources Department should ensure that all changes in employee status and/or rates are documented on either properly execute employment contracts or notices of personnel action. Furthermore, they should ensure that each employee timely update their Form W-4, Employee's Withholding Allowance Certificate and such information is updated on the system used to calculate payroll.

*CUC Response:*

CUC agrees with the finding.

*Management's Plan of Corrective Action:*

Accounting staff has been assigned to review information set up in the Human Resource module of the software system. CUC will ensure that Notice of Personnel Actions and other pertinent documents are kept current in the employee file and in the software payroll system.

### **Finding 2013-11 Interest on Security Deposit Refunds**

*Condition:*

CUC has not yet established procedures on calculating interest accrued on customer deposits, hence have not paid interest of security deposits refunded to customers.

*Recommendation:*

CUC should explore whether or not the new Billing and Collection software is able to keep track of security deposits and calculate interest liability of these accounts and ensure compliance with Public Law 16-17.

*CUC Response:*

CUC agrees with the finding.

*Management's Plan of Corrective Action:*

The new Billing system is capable of calculating interest however we have yet to work with the programmers to set it up and fully implement procedures.

## **Finding 2013-12 Procurement**

### *Condition:*

The Executive Director issued a memorandum authorizing the procurement of material and parts utilizing request for quotation instead of competitive sealed bidding.

### *Recommendation:*

CUC should consider updating its Procurement Regulations to include purchase of routine repair materials and parts as an exception to §SO-SO-201. Also CUC may designate some suppliers as solesource suppliers (with justification) and comply with the CUC's Sole Source Procurement, §50-50-215 of CUC's Procurement Regulation. Furthermore, CUC should consider including a provision for cost analysis in its Sole Source Procurement regulation. Such provision will document CUC's consideration that the cost provided by the sole source vendor is not overstated.

### *CUC Response:*

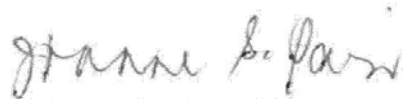
CUC agrees with the finding.

### *Management's Plan of Corrective Action:*

CUC has implemented directives regarding such procurements but have not updated its written policies. We will bring this matter to the Board of Directors for their review of policy.

Please let me know if you have any questions or comments on the above.

Sincerely,



JOANNE S. PARAISO  
Acting CFO