

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

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**INDEPENDENT AUDITORS' REPORT  
AND  
FINANCIAL STATEMENTS**

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**Years Ended  
September 30, 2017 and 2016**

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

Years Ended September 30, 2017 and 2016

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**INDEPENDENT AUDITORS' REPORT**

To the Board of Directors  
Commonwealth Utilities Corporation

***Report on the Financial Statements***

We 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 year ended September 30, 2017 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.

***Auditors' Responsibility***

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the 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, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Commonwealth Utilities Corporation as of September 30, 2017, and the changes in net position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

### ***Other Matters***

#### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 19 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. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

#### ***Other Information***

Our 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 Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, 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 our 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*, we have also issued our report dated October 15, 2018, on our consideration of the Commonwealth Utilities Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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.

A handwritten signature in black ink, reading "Benigno C. Magliani". The signature is written in a cursive, flowing style.

Saipan, Commonwealth of the Northern Mariana Islands  
October 15, 2018

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

**MANAGEMENT'S DISCUSSION & ANALYSIS**  
September 30, 2017

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, 2017 with comparisons to the prior fiscal year ended September 30, 2016. We encourage readers to consider the information presented here in conjunction with the financial statements, related notes and supplementary information (pages 20 through 54).

	<u>2017</u>	<u>2016</u>	<u>\$ Change</u>	<u>% Change</u>
<b>Assets</b>				
Current unrestricted assets	\$ 57,314,253	\$ 43,137,445	\$ 14,176,808	32.9%
Current restricted assets	10,404,546	5,935,495	4,469,051	75.3%
Noncurrent assets	34,766	86,128	(51,362)	-59.6%
Capital assets, net	<u>103,843,693</u>	<u>92,636,641</u>	<u>11,207,052</u>	12.1%
	<u>\$ 171,597,258</u>	<u>\$ 141,795,709</u>	<u>\$ 29,801,549</u>	21.0%
Current liabilities	\$ 26,154,040	\$ 26,091,603	\$ 62,437	0.2%
Noncurrent liabilities	27,136,730	27,555,438	(418,708)	-1.5%
Deferred inflows	640,342	340,768	299,574	87.9%
Net position	<u>117,666,146</u>	<u>87,807,900</u>	<u>29,858,246</u>	34.0%
	<u>\$ 171,597,258</u>	<u>\$ 141,795,709</u>	<u>\$ 29,801,549</u>	21.0%
<b>Revenues, Expenses and Changes in Net Position</b>				
Operating revenues	\$ 95,534,409	\$ 66,779,476	\$ 28,754,933	43.1%
Operating expenses	<u>89,121,255</u>	<u>80,312,279</u>	<u>8,808,976</u>	11.0%
Earnings (loss) from operations	<u>6,413,154</u>	<u>(13,532,803)</u>	<u>19,945,957</u>	
Capital contributions	23,713,013	19,412,082	4,300,931	22.2%
Nonoperating revenues (expenses)	276,457	(442,752)	719,209	-162.4%
Change in recovery of fuel costs	<u>(544,378)</u>	<u>2,957,526</u>	<u>(3,501,904)</u>	-118.4%
Total nonoperating revenues (expenses), net	<u>23,445,092</u>	<u>21,926,856</u>	<u>1,518,236</u>	
Change in net position	<u>\$ 29,858,246</u>	<u>\$ 8,394,053</u>	<u>\$ 21,464,193</u>	255.7%

For the year ended September 30, 2017, CUC has earnings from operations of about \$6.4 million as compared to a loss of about \$13.5 million for the year ended September 30, 2016.

During the year ended September 30, 2017, CUC operating revenues increased overall by \$28.8million or 43% when compared to revenues for the year ended September 30, 2016. Operating expenses also increased by \$8.8 million or 11%.

# COMMONWEALTH UTILITIES CORPORATION

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## MANAGEMENT'S DISCUSSION & ANALYSIS

September 30, 2017

### 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* present 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 Revenues, Expenses and Changes in Net Position* report how net position has changed during the year. It compares related operating revenues and operating expenses connected with 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* report 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.

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### *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 53 through 54).

## ANALYSIS OF BASIC FINANCIAL STATEMENTS

### *Condensed Statements of Revenues, Expenses and Change in Net Position*

	<u>2017</u>	<u>2016</u>
Operating revenues, net	\$ 88,705,401	\$ 60,659,474
Operating expenses	<u>82,292,247</u>	<u>74,192,277</u>
Earnings (loss) from operations	6,413,154	(13,532,803)
Nonoperating revenues (expenses), net	276,457	(442,752)
Change in recovery of fuel costs	<u>(544,378)</u>	<u>2,957,526</u>
Net earnings (loss) before capital contributions and federal grants	6,145,233	(11,018,029)
Capital contributions and federal grants	<u>23,713,013</u>	<u>19,412,082</u>
Change in net position	29,858,246	8,394,053
Net position, beginning	<u>87,807,900</u>	<u>79,413,847</u>
Net position, ending	<u>\$ 117,666,146</u>	<u>\$ 87,807,900</u>

CUC's earnings from its operations at the end of fiscal year 2017 is \$6.4 million.



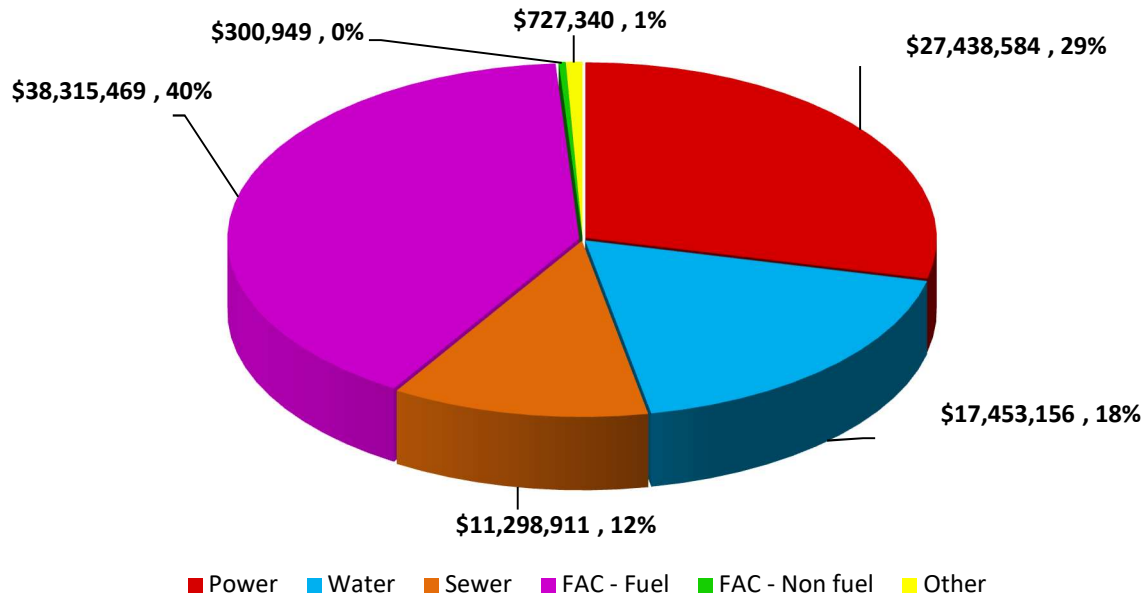
**COMMONWEALTH UTILITIES CORPORATION**  
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MANAGEMENT'S DISCUSSION & ANALYSIS  
September 30, 2017

**Financial Highlights**

**Operating Revenues**

	2017	2016	\$ Change	% Change
Power	\$ 27,438,584	\$ 22,526,098	\$ 4,912,486	21.8%
Water	17,453,156	11,601,231	5,851,925	50.4%
Sewer	11,298,911	5,285,008	6,013,903	113.8%
FAC - Fuel	38,315,469	26,446,491	11,868,978	44.9%
FAC - Non fuel	300,949	257,767	43,182	16.8%
Other	727,340	662,881	64,459	9.7%
<b>Total</b>	<b>\$ 95,534,409</b>	<b>\$ 66,779,476</b>	<b>\$ 28,754,933</b>	<b>43.1%</b>

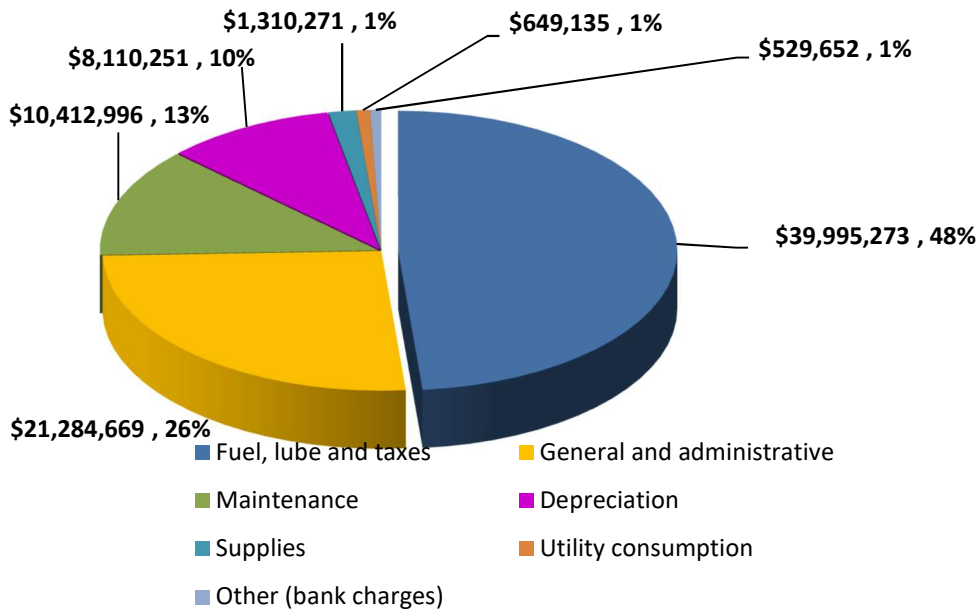


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**MANAGEMENT'S DISCUSSION & ANALYSIS**  
September 30, 2017

**Operating Expenses**

	2017	2016	\$ Change	% Change
Fuel, lube and taxes	\$ 39,995,273	\$ 31,211,044	\$ 8,784,229	28.1%
General and administrative	21,284,669	22,635,971	(1,351,302)	-6.0%
Maintenance	10,412,996	10,049,779	363,217	3.6%
Depreciation	8,110,251	7,327,567	782,684	10.7%
Supplies	1,310,271	1,775,852	(465,581)	-26.2%
Utility consumption	649,135	738,565	(89,430)	-12.1%
Other (bank charges)	529,652	453,499	76,153	16.8%
<b>Total</b>	<b>\$ 82,292,247</b>	<b>\$ 74,192,277</b>	<b>\$ 8,099,970</b>	<b>10.9%</b>



CUC determine that there were effects of the disaster on its financial statements and is fully engaged with FEMA for most of the authorized requests for reimbursement. CUC performed a physical count of all fixed assets and inventories and compare them to the accounting records of CUC for completeness and accuracy. Furthermore, CUC maintains and perform the full valuation of its fixed assets and inventories. CUC expanded its financial software capabilities to include the Fixed Asset Module of the GP system.

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September 30, 2017

### Capital Assets

At September 30, 2017, CUC had \$103,843,693 invested in capital assets, net of depreciation where applicable, including electric plant, water plant, sewer plant, administrative equipment and construction in progress.

	<u>2017</u>	<u>2016</u>
Utility plant in service		
Electric plant	\$ 147,485,242	\$ 137,226,701
Water plant	74,365,783	70,341,946
Sewer plant	51,880,772	50,581,548
Administrative equipment	<u>3,980,428</u>	<u>3,586,825</u>
	277,712,225	261,737,020
Accumulated depreciation	<u>(200,087,618)</u>	<u>(191,977,366)</u>
Depreciable assets, net	77,624,607	69,759,654
Construction work-in progress	<u>26,219,086</u>	<u>22,876,987</u>
Capital assets, net	<u>\$ 103,843,693</u>	<u>\$ 92,636,641</u>

For additional information regarding capital asset activity, refer to Note 8 in the accompanying notes to the financial statements.

### Debt

Long-term debt as of September 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Commonwealth Ports Authority	\$ 3,385,131	\$ 3,348,256
Current maturities	<u>(3,385,131)</u>	<u>(3,014,922)</u>
Long-term debt, net of current portion	<u>\$ -</u>	<u>\$ 333,334</u>

For additional information regarding long-term debt activity, refer to Note 10 in the accompanying notes to the financial statements.

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## MANAGEMENT'S DISCUSSION & ANALYSIS

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### EXECUTIVE OVERVIEW AND OUTLOOK

The Commonwealth Utilities Corporation (“CUC”) is an independent, governmentally owned corporation that operates outside the annual legislative budget and follows comparable but separate policies and procedures of the CNMI for human resource activity and procurement of material and capital assets. The current Corporate structure was established in 2009 by Legislative action and we have been operating under that formation ever since.

In 2009, the Environmental Protection Agency (“EPA”) sued CUC for failure to meet federal regulatory mandates at that time, insufficient funding of operations, a lack of management structure, and no plan for the future. The Federal Court, Region IX, adopted Stipulated Order 1 (SO1) in order to identify specific requirements, organizational structure, preparation of a master plan for water and sewer for all three islands of Saipan, Rota and Tinian, performance of a comprehensive hydraulic assessment of the water and wastewater distribution and collection systems and the adoption of a comprehensive list of priority projects that were to be followed in order to build and develop a baseline of capital improvements that would raise the quality of life on the islands.

At the same time, Stipulated Order 2 was also adopted for Power Generation which focused on improving the fuel delivery systems, tankage, spill barriers and installation of new oil/water separators.

CUC has come a long way from 2009. Maintenance, at that time, on the power plant engines were not keeping up, water distribution was subject to significant leaks and tanks were not holding water, and wastewater collection was 70% or more asbestos pipe that had already reached its useful life and the two treatment plants were in a poor state of condition and needed rehabilitation.

Today, Power Generation (PG) is following a maintenance schedule for all of its engines with priority given to the larger engines in PP1. PG has lost a good number of its mechanics due to the CW and H1B downsizing that played out over the last year. The US Congress passed and the President signed legislation to support the addition of 8,000 new CW’s that will increase available workers to 13,000. The law stipulates that the CNMI lose 1,300 per year over 10 years as it must focus on building up local trades groups and hotel and restaurant employees to replace these CW workers as they gradually leave the work force.

With the impact of Typhoon Soudelor in August of 2015, CUC was heavily impacted with wind and rain damage to the Transmission and Distribution (“T&D”) power lines and downed poles, water wells and distribution infrastructure were impacted with the loss of power when the generating plants were shut down for three weeks but power to the island wasn’t available for 5 months. The wastewater treatment plants and lift stations were impaired by lack of resident power at the plants but the lift stations were back on line fairly quickly.

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Following Soudelor, CUC and the CNMI has come back strong. In early 2016, Best Sunshine Inc. ("BSI") came in and negotiated a single casino license and that was the beginning of significant development across the island. Over the next two years, CUC saw 40% growth in sales and customer demand for services.

### **EPA Investment**

Over the course of nine years, EPA has invested upwards of \$80 million in CUC facilities, infrastructure, planning documents, and structural needs including policies and procedures updates, standard operating procedures ("SOP's"), flow charts, and so on. The success of that investment to date, has realized water loss is falling dramatically, water transmission mains have been upsized to carry added capacity to improve supply, pressure reducing valves have been added to control water breakage due to varying pressure gradients on hilly terrain, storage tanks have been expanded and now built with concrete to gain a 100 year asset that is not affected by earthquakes, and a multi-year master plan for the three islands that provides a possible plan of action that will be updated as conditions change on the islands.

An additional \$20 million has just been approved for the SO1 and SO2 capital programs which have already been identified for capital investment to continue replacing storage tanks, lift station updates, introduction of Supervisory Control and Data Acquisition (SCADA) for remote monitoring and control, continued investment in pipeline replacement, meter change outs and testing to assure accuracy, and plans to rehab Agingan WWTP and replace Sadog Tasi WWTP.

### **Strategic Planning**

CUC senior management has been working with senior division heads to create a strategic planning document for 2019 through 2024. This is only the beginning. It needs to be expanded for an additional five years in order to extends the vision of what CUC is planning to achieve over a ten year period.

The draft Strategic Plan has identified a large number of initiatives that all need to be done if we are to build what is termed a "Utility of Today." Many of the topics under immediate consideration are:

- Update of Rules and Regulations
- Purchase and implementation of a computerized maintenance management system
- Replace Engine No 8 and possibly No 4 if the cost of funding is reasonable and a funding decision can be approved within available local funds.
- Decision to maintain the existing power facilities or replace them with new base load generators if a financial analysis supports this concept.
- Complete the hiring of an HR Manager, Public Information Officer, new senior management legal counsel, new IT Manager, new Fats, Oils and Grease (FOG) Engineer Technician, and Real Estate Manager.

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- Complete the training of the T&D lineman to be Journeyman Linemen recognized by the Dept. of Labor.
- Implement the installation of Prepay electric meters on both Tinian and Rota to reduce labor demands.
- Complete the rehabilitation of Agingan WWTP and the addition of new preliminary treatment and grit removal, solids system rehab and the rebuild of the central planetary drive of the clarifier.
- Complete the preparation of a grant application for the complete rebuild, rehabilitation of Sadog Tasi WWTP which is in serious condition of failure and will be subject to the greatest amount of growth needing wastewater treatment.
- Water main replacement island-wide along with a leak detection study to assure that CUC is eliminating and reducing its water loss statistic.
- Achieve a non-revenue water condition that demonstrates a less than 40% loss rate within two years.
- Completing the water hardening project funded by FEMA by August 2019.

### Discussion of Division Results

#### Administration

The current senior management team was brand new to leadership on the island beginning in early 2016 with the appointment of the Executive Director (ED). The ED came from Power Generation and began the process of cleaning up administrative and operational issues following Typhoon Soudelor and some that were pre-existing. Finance was in a shambles and the leadership team was held together by the ED until the DED, CFO, and the Manager of Water and Wastewater were hired and began work around November 1 and January 29th, 2017 for the latter hire. The HR Manager also returned about the same time from a 9 month long sabbatical while running for office on Saipan. The progress made from that time forward has been dramatic:

- There is clearly a new administrative structure with new business policies in place, new HR protocols and procedures have been implemented,
- Financial accountability for accounting staff is being raised with specific expectations being reviewed,
- New monthly reporting expectations for the Board of Directors,
- New accountabilities of field staff to sign out daily equipment requirements and return in similar condition or replacement is charged to their paycheck,
- Vehicle tracking system is operating and being used,
- Zero tolerance policy with regard to drug use has been implemented which is to CUC's benefit especially with its focus on safety,
- New budget process has been implemented in 2018 for the 2019 budget,
- The warehouse is now being used as an inventory exchange and reorder facility to help reduce RV and improve project and work order costing.

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These are only some of the systems that have begun to change with the new management team. The driver of this effort is multi-faceted but embedded in the management's interest in focusing on the customer, the consumer. At the same time, management is focused on building a Utility of Today, a structure built on the basis of achieving successful change, cost containment, improved response times, improved communication, and improved customer experience.

### **Power Generation ("PG")**

PG is the driving force of the CNMI economy. Without power, the island's expansion would come to a screeching halt. This is the reason CUC has placed such a high priority on operating and maintaining these engines. The engines at PP1 are on average 40 years old and they have been running continuously approximately 24 years. The engines do not benefit from automation and SCADA technology such that the PG team runs a manual facility that requires a well-trained, coordinated, documented, safety conscious and knowledgeable organization.

Island-wide power outages occur several times a year, either by a typhoon or tropical depression event or by a faulty in the power system. PG provides 45 MW's of power on a daily basis with 10.4 MW's in reserve. CUC is concerned about the current reserve capacity which barely reaches industry standard of having a 20% reserve and this is due primarily to the age of the engines. PG realizes that at the present time, the value of maintaining the current engines remains high yet at the same time the level of risk of potential failure also continues to rise.

PG is presently advertising to replace Engine #8 and potentially Engine #4 if funds are available. At a minimum the addition of 10 MW of new generation capacity will add the reserve capacity we need to meet planned new energy demand coming on line in early 2020. With a second engine of the same size, this would maintain the level of reserve capacity PG needs and would also take the pressure off the oldest engines to assure maintenance is performed to keep them running with minimal interruptions.

At the same time, CUC management is evaluating the question of building a new power plant or maintaining the existing plant with additional replacement engines to take the oldest and more maintenance prone engines out of service. A study is due in shortly to offer a perspective of what taking either road would entail in terms of price, long-term cost savings, and potential to fund a loan, possible rate increases and so on.

**Power Transmission and Distribution ("T&D")** T&D is seen the greatest amount of improvement due to the hardening that has been done to approximately 900 power poles following Typhoon Soudelor where FEMA reimbursed the expense of installing concrete reinforced poles across the island of Saipan and are now helping Rota following the recent Typhoon Mangkhut with an additional 90 concrete poles.

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Organizationally, T&D is working well preparing every year for the next Typhoon event by trimming trees, shrubs, and other landscaping to minimize the potential of anything falling or blowing into power lines and transformers. Senior management knows that there is still work to be done performing regular scheduled maintenance to cut outs, power arrestors, cross arms and so on to assure they will function as they are designed to do.

T&D staff is very professional and understand the importance of safety, team spirit, communication, fitting out their assignments effectively, bring the right tools, and need for job costing on every work order. They recently started coursework for a three year linesman training program that requires 23,000 hours of on the job experience. If they accumulate the work hours and complete the in-class training, then they will qualify for certification as a Journeyman which is one of the highest credentials to achieve in this work discipline.

### **Water Operations**

The Water division, in the past year and one half, has morphed into becoming a viable, well disciplined, and certification oriented group that is seeing the value of working hard for an organization that is working to support the current work staff team building efforts being pushed by the Water Manager. The crews are now signing out tools and critical equipment which must be brought back in good working condition or they are charged from their paycheck to replace it item damaged beyond normal wear and tear or lost. The Division has also been acquiring more large equipment items so that they can perform more of the physical repairs themselves including road repaving work.

Presently, Water operations has been benefitting from a high percentage of the \$40 million of infrastructure investment funded by EPA on improvements completed through 2018. There is an additional \$20 million of new EPA grant funds that have been received and will be invested in new water assets (i.e., storage tanks, transmission and distribution pipeline replacements, new saddles and service connections, valves and pressure reducing valves. The work done over the past nine years has given the island of Saipan access to 24 hour water for the first time in its history. Storage tanks are remaining full at an 80 to 90 percent level where before or more than 4 months ago, tanks were not able to remain filled or rose to only 25% of capacity. This is now allowing Water operations to turn off wells because tanks have been overflowing. With the wells off, this allows the pumps and motors to be maintained, the wells can relax and potentially this relaxation can improved water quality and reduced chlorides as the lens layer potentially expands.



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Water has also been affected with Perfluorooctanoic (PFOA) and Perfluorooctanesulfonic (PFOS) contaminants that were introduced through firefighting foam used at the airport training academy on Saipan. That material is an unregulated health advisory hazard which required CUC to shut down eight (8) wells that test positive for these contaminants. The airport well field has always been one of the best producing on the island and even though the wells are down this can have a positive improvement on the lens layer as well. Plans are in place to install GAC (granular activated carbon) treatment systems which absorbs the PFOA's and PFOS's from the water. The Engineering division of Water and Wastewater designed the larger GAC systems to handle all the flow from the 46 wells in the Isley Field system. Three of those wells are dedicated to different areas and individual treatment units will be installed with them.

Overall, there has been a significant reduction in water leaks from all over the island of Saipan due to the full time pressurization of the water transmission and distribution system maintaining an average of 38 PSI with all tanks are full and on-line. Reducing the incidents of water hammer has been the key to the majority of the problems.

### **Wastewater Operations**

Wastewater has the lowest profile of any of CUC's service areas. It's essentially out of sight and out of mind until there is a spill or the treatment plant is upset and odors develops as the treatment process is deprived of oxygen. Wastewater represents approximately 41 percent of the number of water customer accounts. It benefits from collecting waste flows from the various hotels and resorts in order to supplement the small number of residential and commercial customers who are registered and connected for treatment.

Wastewater will be affected greatly by the expanding footprint of new hotels and resorts that have been permitted for development over the next five years. However, there are several problems that need to be addressed in the short-term if the Wastewater Division expects to be prepared and/or ready to receive the doubling of flows that they presently collect. The specific areas of immediate concern include:

- 1) Inflow and infiltration ("I&I") into the sanitary collection system needs to be addressed. These essentially clean water flows provide no nutrients to the waste stream and as a result dilute the concentration of the sanitary portion essentially starving the mixed liquor that is the biological process required to treat the pathogens and organic solids in the waste stream. Treating clean water is expensive and robs valuable capacity from collection mains and treatment plant. This is also the cause of sanitary sewer overflows that occur at various locations all over the island of Saipan where old sewer mains have begun to unseal pipe connections, crack due to vibrations, age and heat.

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The primary solution is to continue replacing sewer mains with the oldest asbestos concrete pipe being done and the old clay pipe found all over Garapan. CUC has funded and plans to procure a new Ques Truck which is a televised remote camera system that works using a caterpillar type mobile unit to roll through various sized sewer mains to camera and record every square inch of main and then plot the results on a GIS application as a data layer that can be used for identifying hot spots for future grouting repair work and/or planned replacement of the main. The recordings can also validate which properties are connected to the line and are using the line. The plans are to acquire a new grouting vehicle in 2020 that is pulled behind the Ques truck and will perform the grouting automatically from the recorded cracks, leaks, breaks and so on that are recorded.

2) The update of sewer lift stations needs to be completed before these projected new resort flows come on line. This will assure that there is enough pumping capacity at the site to carry high anticipated flows and to have the latest VFD equipment installed to assure a soft start to the pumps which minimizes damage and strain to the seating bolts and pipe lines. Between 2020 and 2025, CUC will begin pushing SCADA to each of the stations that have already been prepared with SCADA connectivity so that remote monitoring and control can be implemented to reduce labor obligations to each station.

3) The Agingan and Sadog Tasi WWTP's need updates.

1. Agingan is in better shape, however, recent events that required the clarifier to be rebuilt, the planetary drive replaced, the swing arm reconstructed with additional steel beam support, and the squeegee arm at the base that pushes settled solids on the bottom into two pipes for removal to a sludge thickening and drying facility, require CUC to review its condition and to determine if it is ready for additional and higher flows. CUC already has plans and funding to install a new headworks with static-screening and an auger compactor to remove grit, gravel, wood, rocks, bricks and other debris that in the past had been allowed to flow right into the secondary clarifiers. This material damages the rack arms and pump impellers and builds up on the edges of the process units such that valuable capacity is lost.

2. Sadog Tasi is in worst shape and needs a major rehabilitation effort done to it if not a full replacement. The central clarifier unit is also out of service and is being drained for determining the degree of damage. The drive unit is out; the lower rack arms need additional bracing arm to carry the weight of the arm, the catwalk is highly corroded and may need to be replaced. There are funds set aside from EPA, CUC funds and Public Law funds to repair these immediate problems. At the same time, a new headworks element will be added to Sadog Tasi similar to Agingan for the same reasons. Also, new solids handling unit is funded and will be replacing the old and failing screen filter press with a new turbine system.

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### **Rota, Power and Water**

Rota is blessed with an abundant water supply developed by the Japanese back in the 40's. Water is supplied from a spring filled cave high in the hills and runs by gravity feed to the bulk of the island residents who are customers. The current water tank, Sinapalo a 0.5 MG tank, is to be torn down and is planned for design in 2020 as a concrete tank and will be relocated to a higher elevation to improve hydraulic pressures to all known homestead sites under consideration for development. The main water supply line from the Main Cave is above ground and runs for two miles to the current Sinapalo storage tank that is metal glass. Plans are also to rehab the three wells that are near the CUC office close to the airport in order to provide a backup source incase anything happens to the Main Cave supply.

The power supply systems on the island are provided with Caterpillar and Cummins diesel engines. At present, there is plenty of excess power available. However, the 450 KW Cummins diesel was recently damaged and a new motor is being acquired to repair the damaged engine. At the same time, CUC will be installing "exciter" elements to the Cummins to improve efficiency and provide enhanced power to the grid.

Rota recently was hit with Typhoon Mangkhut and approximately 90 power poles came down and power was lost for a week's time. CUC power T&D staff were air lifted down and several trucks, equipment and new poles were sent by barge to Rota to help with the rebuilding of the power transmission system. Final repairs were completed in two weeks' time.

### **Tinian, Power and Water**

Tinian is blessed with both abundant water and excess power supplies and there are plans developing to add three more homesteads to the island which would further require power, water and potentially sewer service connections along with roads and storm sewers. The Maui II well head needs rehabilitation and its four series of pumps rehabbed or replaced which are already being done. The ventilation fan for the backup generator needs to be repaired to improve air exchange to reduce heat build-up when the engine is running. During the last Typhoon Mangkhut, despite losing the backup generator for a short time, the water system did not lose pressure and water was available throughout the storm period.

With regard to power, CUC contracts with Telesource to provide power generation and distribution services to the customer. Telesource has 20 MW of power available, however, this past year the average energy consumption for the island was approximately 2 MW. The power plant is in excellent condition because despite the age of the plant, the engines have hardly been run such that they might be considered still relatively young with respect to run time. During Typhoon Mangkhut, there were no loss of power poles, only a few downed power lines and connections to customers.

There are several major developments under consideration at the moment on Tinian:

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1. Forward Diversion Unit of DOD is finalizing negotiations with Tinian Local Delegation to construct a new taxi way, parking area and jet fuel tank. The DOD currently holds long-term control of the Northern portion of the island with plans to perform jungle style training and other activities. Their advance team has spoken with CUC about possible plans they may have and other services they might be considering and we have let them know we are available so long as they are willing to tie in to CUC for service.

2. The three homesteads mentioned earlier are Marpo, Makpo and West San Jose. The Local Tinian Delegation is also including in their discussion the addition of sewer services to properties on Tinian since there is a “green” organic version that is modular available for them to consider. The system also offers the option to incorporate reuse for irrigation purposes, surface water recharge or recharging to the aquifer.

3. The new casino and Ferry Terminal on Tinian may be required to provide sewer service for their facility because of the size of the property and a septic system would not be adequate in soils that close to the beach. This potential may benefit San Jose village which has voiced interest by the Local Tinian Delegation in considering adding a sewer collection system and treatment process for the benefit of that area. They would be considering the same “green” system introduced to them by CUC.

### **Financial Statement of Fiscal Budget**

The financial condition of all three divisions, Power, Water and Wastewater is improving gradually each year. For example, the 2017 budget totaled \$86 million whereas 2019 totals \$122 million. This represents a significant strengthening in revenue that will support the very real growth that is going on primarily in power first and ultimately water and sewer. Federal grants have been and will continue to be the primary driver of infrastructure rehabilitation for the short-term with more moneys being added each year from CUC revenues to support capital reinvestment in projects and rolling stock. With the planned startup of new developments as new as January 2020, the need to prepare for growth will become just that much more important as CUC streamlines to support expansion of services.

Using the 2017, 2018 and 2019 Approved Budgets for a three year running comparison, the commitment of rate generated cash funds from CUC has been growing in support of capital reinvestment needs for water and wastewater. This has been a complaint EPA has had with CUC’s annual budget commitment which is a limited level of support towards the maintenance of their grant funded projects. Power is unique in that it is the earliest beneficiary of development and demand and PG understands the importance of spending to meet power demand. There is \$12 million dedicated to a new Engine 8 in 2018. This will now need to be pushed forward to 2019 to cover the expenditure since the contract will be let in 2019. CUC is not ignoring its obligation but adding gradually towards supporting operational and capital needs.

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	<b>Water Debt Svc &amp; Cap Outlay Budget</b>	<b>% Increase</b>	<b>Wastewater Debt Svc &amp; Cap Outlay Budget</b>	<b>% Increase</b>
2017 Funding	\$1,402,305		\$295,176	
2018 Funding	2,116,902	151%	311,118	5%
2019 Funding	3,578,383	169%	1,059,973	341%

It has always been CUC’s plan to add to its commitment for long term sustainability, however, revenues are gradually improving for water and wastewater as less money is spent on lost production and more on generating sales. CUC has also populated its warehouse with a one-time annual supply order such that in the future replacement parts and equipment will be set on a minimum quantity setting which will trigger an automatic reorder with adequate lead time to restock before the current supply is depleted. This is the beginning of our asset management strategy.

CUC continues to strive to achieve the desired state of an efficient organization led by technological advances in utility delivery services to the people of 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) 664-4282.

**COMMONWEALTH UTILITIES CORPORATION**  
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Statements of Net Position  
September 30, 2017 and 2016

	2017	2016 (as restated)
<b><u>ASSETS</u></b>		
Current assets:		
Current unrestricted assets		
Cash and cash equivalents	\$ 22,541,265	\$ 8,648,737
Accounts receivable - utility, net	10,577,906	6,628,159
Due from grantor agencies	5,007,907	6,234,426
Inventory, net	9,796,984	11,431,894
Unbilled fuel cost recovery	7,745,942	8,290,320
Notes receivable, net	123,180	90,833
Other assets, net	1,521,069	1,813,076
Total current unrestricted assets	57,314,253	43,137,445
Current restricted assets:		
Cash and cash equivalents	10,404,546	5,935,495
Total current assets	67,718,799	49,072,940
Noncurrent assets:		
Notes receivable, net of current portion	34,766	86,128
Capital assets:		
Utility plant in service:		
Electric plant	147,485,242	137,226,701
Water plant	74,365,783	70,341,946
Sewer plant	51,880,772	50,581,548
Administrative equipment	3,980,428	3,586,825
	277,712,225	261,737,020
Accumulated depreciation	(200,087,618)	(191,977,366)
Net utility plant and administrative equipment	77,624,607	69,759,654
Construction in progress	26,219,086	22,876,987
Total capital assets	103,843,693	92,636,641
Total noncurrent assets	103,878,459	92,722,769
<b>TOTAL ASSETS</b>	<b>\$ 171,597,258</b>	<b>\$ 141,795,709</b>

See accompanying notes to financial statements.

**COMMONWEALTH UTILITIES CORPORATION**  
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Statements of Net Position, Continued  
September 30, 2017 and 2016

	2017	2016 (as restated)
<b><u>LIABILITIES</u></b>		
Current liabilities:		
Unrestricted current liabilities:		
Accounts payable and accrued liabilities	\$ 8,735,763	\$ 4,582,390
Compensated absences	1,030,574	1,094,126
Current maturities of long-term debt	3,385,131	3,014,922
Dividends payable	-	4,500,000
Interest payable	1,067,184	957,640
Total unrestricted current liabilities	14,218,652	14,149,078
Restricted current liabilities:		
Security deposits, including accrued interest	11,935,388	11,942,525
Total current liabilities	26,154,040	26,091,603
Noncurrent liabilities:		
Long-term debt, net of current maturities	-	333,334
Due to primary government	7,981,211	7,477,505
Retirement contributions payable	3,452,169	3,429,267
Unearned fuel purchase obligation rebate	3,343,301	3,931,316
Unearned revenue	618,816	718,857
Payable others	9,941,233	9,865,159
Dividends payable	1,800,000	1,800,000
Total noncurrent liabilities	27,136,730	27,555,438
<b>TOTAL LIABILITIES</b>	<b>53,290,770</b>	<b>53,647,041</b>
<b><u>DEFERRED INFLOWS</u></b>		
Rate stabilization (Public Law 16-7)	640,342	340,768
<b>TOTAL DEFERRED INFLOWS</b>	<b>640,342</b>	<b>340,768</b>
<b><u>NET POSITION</u></b>		
Net investment in capital assets	103,843,693	92,636,641
Restricted for:		
Preferred stocks	45,000,000	45,000,000
Unrestricted	(31,177,547)	(49,828,741)
<b>NET POSITION</b>	<b>\$ 117,666,146</b>	<b>\$ 87,807,900</b>

See accompanying notes to financial statements.

**COMMONWEALTH UTILITIES CORPORATION**

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Statements of Revenues, Expenses and Changes in Net Position  
For the Years Ended September 30, 2017 and 2016

	<u>2017</u>	<u>2016</u> (as restated)
Operating revenues:		
Power	\$ 27,438,584	\$ 22,526,098
Water	17,453,156	11,601,231
Sewer	11,298,911	5,285,008
FAC - Fuel charge	38,315,469	26,446,491
FAC - Non fuel	300,949	257,767
Other	727,340	662,881
	<u>95,534,409</u>	<u>66,779,476</u>
Provision for uncollectible accounts	<u>(6,829,008)</u>	<u>(6,120,002)</u>
Net operating revenues	<u>88,705,401</u>	<u>60,659,474</u>
Operating expenses:		
Fuel, lube and taxes	39,995,273	31,211,044
General and administrative	21,284,669	22,635,971
Maintenance	10,412,996	10,049,779
Depreciation	8,110,251	7,327,567
Supplies	1,310,271	1,775,852
Utility consumption	649,135	738,565
Other (bank charges)	529,652	453,499
	<u>82,292,247</u>	<u>74,192,277</u>
Earnings (loss) from operations, carried forward	<u>\$ 6,413,154</u>	<u>\$ (13,532,803)</u>

See accompanying notes to financial statements.



**COMMONWEALTH UTILITIES CORPORATION**

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Statements of Revenues, Expenses and Changes in Net Position, Continued  
For the Years Ended September 30, 2017 and 2016

	<u>2017</u>	<u>2016</u> (as restated)
Earnings (loss) from operations, brought forward	\$ 6,413,154	\$ (13,532,803)
Non-operating revenues (expenses):		
Interest income	544,159	380,450
Miscellaneous income	387,198	92,107
Amortization of fuel purchase obligation rebate	1,100,000	1,100,000
Regulatory assessments	4,661	(370,904)
Settlement income (expense)	97,403	(51,807)
Contribution to OPA	(503,708)	(428,427)
Interest and distribution expense	<u>(1,353,256)</u>	<u>(1,164,171)</u>
Total non-operating revenues (expenses), net	<u>276,457</u>	<u>(442,752)</u>
Earnings (loss) before change in recovery of fuel costs	6,689,611	(13,975,555)
Change in recovery of fuel costs	<u>(544,378)</u>	<u>2,957,526</u>
Net earnings (loss) before capital contributions and federal grants	6,145,233	(11,018,029)
Capital contributions and federal grants	<u>23,713,013</u>	<u>19,412,082</u>
Change in net position	29,858,246	8,394,053
Net position, beginning	<u>87,807,900</u>	<u>79,413,847</u>
Net position, ending	<u>\$ 117,666,146</u>	<u>\$ 87,807,900</u>

See accompanying notes to financial statements.

**COMMONWEALTH UTILITIES CORPORATION**  
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Statements of Cash Flows  
For the Years Ended September 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Cash received from customers	\$ 85,512,512	\$ 61,369,356
Cash payments to suppliers for goods and services	(52,184,306)	(58,771,720)
Cash payments to employees for services	<u>(14,378,312)</u>	<u>(14,577,650)</u>
Net cash provided by (used for) operating activities	<u>18,949,894</u>	<u>(11,980,014)</u>
Cash flows from noncapital financing activities:		
Dividend payments	(5,580,000)	-
Interest paid on outstanding debt	(163,712)	(129,676)
Principal repayment of debt	<u>(466,832)</u>	<u>(453,735)</u>
Net cash used for noncapital financing activities	<u>(6,210,544)</u>	<u>(583,411)</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(19,317,303)	(15,888,213)
Capital contributions received	<u>24,939,532</u>	<u>15,610,223</u>
Net cash provided by (used for) capital and related financing activities	<u>5,622,229</u>	<u>(277,990)</u>
Net change in cash and cash equivalents	18,361,579	(12,841,415)
Cash and cash equivalents at beginning of year	<u>14,584,232</u>	<u>27,425,647</u>
Cash and cash equivalents at end of year	<u>\$ 32,945,811</u>	<u>\$ 14,584,232</u>
Cash and cash equivalents	\$ 22,541,265	\$ 8,648,737
Restricted cash and cash equivalents	<u>10,404,546</u>	<u>5,935,495</u>
	<u>\$ 32,945,811</u>	<u>\$ 14,584,232</u>

See accompanying notes to financial statements.

**COMMONWEALTH UTILITIES CORPORATION**  
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Statements of Cash Flows, Continued  
For the Years Ended September 30, 2017 and 2016

	2017	2016
Reconciliation of earnings (loss) from operations to net cash provided by (used for) operating activities:		
Earnings (loss) from operations	\$ 6,413,154	\$ (13,532,803)
Adjustments to reconcile loss from operations to net cash provided by (used for) operating activities:		
Depreciation	8,110,251	7,327,567
Provision for bad debts	6,829,008	6,120,002
Interest income/late charges	544,159	380,450
Miscellaneous income	387,198	92,107
Marketing assistance program	1,100,000	1,100,000
Regulatory assessments	4,661	(370,904)
Settlement income (expense)	97,403	(51,807)
(Increase) decrease in assets:		
Accounts receivable - utility	(10,778,755)	(7,048,493)
Inventory	1,634,910	(2,047,077)
Notes receivable	19,015	34,650
Other assets	292,007	42,068
Increase (decrease) in liabilities:		
Accounts payable and accrued liabilities	4,153,372	(1,810,072)
Compensated absences	(63,552)	-
Security deposits including accrued interest	(7,137)	858,589
Unearned revenue - BSI voucher	(100,041)	(1,499,701)
Unearned fuel purchase obligation rebate	(588,015)	(1,100,000)
Rate stabilization	299,574	(1,326,499)
Payable others	76,074	836,706
Due to primary government	503,706	-
Retirement contributions payable	22,902	15,203
	\$ 18,949,894	\$ (11,980,014)
Net cash provided by (used for) operating activities		

See accompanying notes to financial statements.

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Notes to Financial Statements  
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(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. CUC is governed by a board of directors appointed for terms of four years by the Governor of the CNMI with the advice and consent of the Senate.

(2) Summary of Significant Accounting Policies

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

CUC maintains a 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 *Statements of Revenues, Expenses and Changes in Net Position* present 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.

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Notes to Financial Statements  
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(2) Summary of Significant Accounting Policies

*New Accounting Standards*

In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its capital assets should recognize a liability based on the guidance in this Statement. The provisions in Statement No. 83 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this Statement will have a material effect on the financial statements.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities for all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities. The provisions in Statement No. 84 are effective for fiscal years beginning after December 15, 2018.

In March 2017, GASB issued Statement No. 85, *Omnibus 2017*, which addresses a variety of topics including related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits). The provisions in Statement No. 85 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this Statement will have a material effect on the financial statements.

In May 2017, GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*, the primary objective of which is to improve the consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources-resources other than proceeds of refunding debt-are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance. The provisions in Statement No. 85 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this Statement will have a material effect on the financial statements.

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Notes to Financial Statements  
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(2) Summary of Significant Accounting Policies, Continued

*New Accounting Standards, Continued*

In June 2017, GASB issued Statement No. 87, *Leases*, which increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use-lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether the implementation of this Statement will have a material effect on the financial statements.

In April 2018, GASB issued Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements*, the primary objective of which is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. The provisions in Statement No. 88 are effective for fiscal years beginning after June 15, 2018. Management has yet to determine whether the implementation of this Statement will have a material effect on the financial statements.

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*, which establishes accounting requirements for interest cost incurred before the end of a construction period. Such interest cost includes all interest that previously was accounted for in accordance with the requirements of paragraphs 5-22 of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which are superseded by this Statement. This Statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund. The provisions in Statement No. 89 are effective for fiscal years beginning after December 15, 2019. The requirements of this Statement should be applied prospectively. Management has yet to determine whether the implementation of this Statement will have a material effect on the financial statements.

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Notes to Financial Statements  
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(2) Summary of Significant Accounting Policies, Continued

*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 and is required to adopt a budget, however CUC is financially independent of appropriations by the CNMI Legislature.

*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. 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, 2017 and 2016, cash and cash equivalents were \$32,945,811 and \$14,584,232, respectively, and the corresponding bank balances were \$35,018,189 and \$15,608,306, respectively. Of the bank balance amounts, \$34,975,899 and \$15,388,697, respectively, were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. Bank deposits in the amount of \$34,595,425 and \$15,060,253 were in excess of FDIC insurable limits as of September 30, 2017 and 2016, respectively. CUC has deposits of \$41,009 in 2017 and \$218,271 in 2016 in Bank of Saipan, which is not FDIC insured. Bank of Saipan accepts customer payments for CUC. These collections are periodically transferred to CUC's FDIC insured bank accounts. CUC's deposits in excess of FDIC insured limits are collateralized by securities in the financial institution's name.

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(2) Summary of Significant Accounting Policies, Continued

*Restricted Cash and Cash Equivalents*

The restricted cash and cash equivalents of \$10,404,546 at September 30, 2017 and \$5,935,495 at September 30, 2016, pertain to customer deposits.

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 collectability 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.

*Investments*

CUC reports investments at fair value and categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles.

Investments classified as level 1. Fixed income and equity securities classified in level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities.

Investments classified as level 2. Fixed income and equity securities classified in level 2 are valued using observable inputs including quoted prices for similar securities and interest rates.

Investments classified as level 3. Private equity, real assets, and other investments classified in level 3 are valued using discounted cash flow or market comparable techniques.

At September 30, 2017 and 2016, CUC did not have any investments subject to the fair value hierarchy.



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(2) Summary of Significant Accounting Policies, Continued

*Inventory*

Fuel and lubes inventory are valued at the weighted average valuation method. Materials and supplies inventory is valued at average cost.

Inventory balances at September 30, 2017 and 2016 are as follows:

	2017	2016
Fuel and lubes	\$ 1,404,373	\$ 1,332,503
Materials and supplies	9,085,514	10,792,294
 Total	 10,489,887	 12,124,797
Allowance for obsolescence	(692,903)	(692,903)
 Inventory, net	 \$ 9,796,984	 \$ 11,431,894

*Fuel Costs*

CUC's fuel purchases are based on Means of Platts Singapore (MOPS) monthly pricing. Fuel cost increases or decreases billed to customers are based on price changes in fuel purchased by CUC. Under or over recovery of fuel cost is recorded as a 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. The Fuel Adjustment Charge (FAC) rates are computed monthly based on MOPS.

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

In its May 11, 2015 meeting, CPUC approved to change the LEAC tariff to Fuel Adjustment Charge (FAC). It also authorized on an interim basis through the next regulatory session, to adjust the fuel adjustment charge, in the event the MOPS monthly pricing to CUC equals or exceeds a 4.5% differential in the average per gallon cost of fuel used in the calculation of the then current FAC. In such event, CUC shall change the FAC rate to reflect the higher/lower MOPS price and shall promptly provide calculations and supporting work papers to the Commission. This change shall be calculated on the basis of the ratio of the then current monthly MOPS pricing to the average per gallon cost of fuel used in the calculation of the current FAC rate.

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(2) Summary of Significant Accounting Policies, Continued

*Fuel Costs, continued*

Subsequent approved FAC rates for 2017 and 2016 are as follows:

Effective Dates	Rate
September 1, 2016 to October 31, 2016	\$ 0.13232
November 1, 2016 to November 30, 2016	\$ 0.15063
December 1, 2016 to December 31, 2016	\$ 0.14323
January 1, 2017 to January 31, 2017	\$ 0.15512
February 1, 2017 to May 31, 2017	\$ 0.16381
June 1, 2017 to June 30, 2017	\$ 0.15330
July 1, 2017 to August 31, 2017	\$ 0.14605
September 1, 2017 to September 30, 2017	\$ 0.15917

The unbilled fuel cost recovery at September 30, 2017 and 2016 is as follows:

	2017	2016
At beginning of year	\$ 8,290,320	\$ 5,332,794
Change in recovery of fuel costs	(544,378)	2,957,526
At end of year	\$ 7,745,942	\$ 8,290,320

*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 25 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.

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(2) Summary of Significant Accounting Policies, Continued

*Capital Assets and Depreciation, continued*

CUC's current policy is to capitalize items in excess of \$5,000. 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 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, 2017 and 2016.

*Compensated Absences*

Compensated absences are accrued and reported as a liability in the period earned.

The liability at September 30, 2017 and 2016 is as follows:

	2017	2016
Total compensated absences, beginning of year	\$ 1,094,126	\$ 913,633
Annual leave earned	769,641	897,345
Annual leave used	(833,193)	(716,852)
Total compensated absences, end of year	\$ 1,030,574	\$ 1,094,126

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.

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

*Net Position*

Net position represents the residual interest in CUC's assets after liabilities while net deficit represents the excess of liabilities over assets. Net position consists of three sections: invested in capital assets, net of related debt; restricted regulatory expenses and preferred stocks; and unrestricted. Net position invested in capital assets, net of debt includes capital assets, restricted and unrestricted, net of accumulated depreciation, reduced by outstanding debt net of debt service reserve.

Net position is reported as restricted when constraints are imposed by third parties or enabling legislation. CUC's restricted net position as of September 30, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
CDA Preferred Stock	<u>\$ 45,000,000</u>	<u>\$ 45,000,000</u>

*Prioritization and Use of Available Resources*

When both restricted and unrestricted resources are available for use, it is CUC's policy to use unrestricted resources first, then restricted 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*

CUC contributes to the Northern Mariana Islands Retirement Fund's (the Fund) defined benefit plan (DB Plan) and defined contribution plan (DC Plan), a cost sharing, and multi-employer plan (the Plan) established and now administered by the CNMI. On September 30, 2013, the DB Plan was transferred to the Northern Mariana Islands Settlement Fund (NMISF).

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(2) Summary of Significant Accounting Policies, Continued

*Retirement Plan, continued*

On August 30, 2012, Public Law 17-79 was enacted to amend Title I of the Commonwealth Code to include the intent of the CNMI to participate in the retirement insurance system established by Title II of the U.S. Federal Insurance Contributions Act (FICA) and for participation to be extended to elected officials, employees, political subdivisions and instrumentalities of the CNMI. On September 11, 2012 Public Law 17-82 CNMI Pension Reform Recovery Act of 2012 was enacted. Unless specifically exempted or authorized by federal law, Public Law 17-82 provides for mandatory membership of CNMI Government employees and elected officials in the U.S. Social Security system and authorizes employees, who elect to, to buy quarters of service in the U.S. Social Security system from contributions made to the DB Plan. In addition, Public Law 17-82 provides active and inactive DB Plan members the option to voluntarily terminate membership in the DB Plan, withdraw or roll over contributions to the DC Plan and to participate in the U.S. Social Security system without termination of employment or penalty. Further, Public Law 17-82 allows the CNMI Government to continue remitting its 4% employer contribution to the DC Plan unless the employee ceases to contribute its employee share.

On March 11, 2013, Public Law 18-02 was enacted to amend Public Law 17-82 to clarify those provisions necessary to expedite the refunds and to prevent any further frustration of the process. Included in the public law is the amendment of Section 203(a) of Title 1, Division 8, Part 3, which states that the government obligation to withhold and remit the employee's defined account shall continue with respect to employees who do not terminate membership in the DB Plan.

*Defined Contribution Plan (DC Plan)*

On June 16, 2006, Public Law No. 15-13 was enacted which created the DC Plan, a multi-employer pension plan and is the single retirement program for all employees whose first time CNMI government employment commences on or after January 1, 2007. Each member of the DC Plan is required to contribute to the member's individual account an amount equal to 10% of the member's compensation. CUC is required to contribute to each member's individual account an amount equal to 4% of the member's compensation. The DC Plan by its nature is fully funded on a current basis from employer and member contributions. Members of the DC Plan, who have completed five years of government service, have a vested balance of 100% of both member and employer contribution plus any earnings thereon. With the passage of Public Law 17-82 in September 11, 2013, the membership to the DC Plan became voluntary.

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(2) Summary of Significant Accounting Policies, Continued

*Defined Contribution Plan (DC Plan), continued*

CUC's aggregate contributions to the Retirement Fund for the years ended September 30, 2017, 2016 and 2015 were \$370,704, \$412,343 and \$410,346, respectively.

The amount CUC recognized as payable to the Retirement Fund prior to the creation of the Settlement Fund totaled \$3,452,169 and \$3,429,267 as of September 30, 2017 and 2016, respectively.

*Medical and Life Insurance Benefits*

In addition to providing pension benefits, the CNMI Government also ensures that employees are provided with medical and life insurance benefits. The CNMI Government created the Group Health and Life Insurance Trust Fund ("Trust Fund"), 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 to retired CNMI Government employees who retire as a result of length of service, disability or age, as well as their dependents. Life insurance coverage is to be provided by a private carrier. Contributions from employees and employers are based on rates as determined by NMIRF Board of Trustees. Employee deductions are made through payroll withholdings.

*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, 2017 and 2016 are \$5,468,286 and \$2,938,966, 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.

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(2) Summary of Significant Accounting Policies, Continued

*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.

**COMMONWEALTH UTILITIES CORPORATION**  
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(3) Accounts Receivable – Utility

Account receivable – utility as of September 30, 2017 and 2016 summarized by location and customer classification are as follows:

	<u>2017</u>	<u>2016</u>
By Location		
Saipan		
Commercial	\$ 6,574,912	\$ 5,752,575
Residential	9,633,507	9,324,516
Government	<u>37,888,081</u>	<u>29,854,623</u>
	<u>54,096,500</u>	<u>44,931,714</u>
Tinian		
Commercial	\$ 1,885,323	\$ 1,883,470
Residential	312,682	314,799
Government	<u>1,763,387</u>	<u>1,349,037</u>
	<u>3,961,392</u>	<u>3,547,306</u>
Rota		
Commercial	\$ 172,597	\$ 156,817
Residential	190,761	198,799
Government	<u>1,124,749</u>	<u>2,563,857</u>
	<u>1,488,107</u>	<u>2,919,473</u>
Total billed	59,545,999	51,398,493
Unbilled	<u>5,468,286</u>	<u>2,938,966</u>
	<u>\$ 65,014,285</u>	<u>\$ 54,337,459</u>



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(3) Accounts Receivable – Utility, Continued

By Customer Classification

	2017	2016
Billed		
Commercial	\$ 8,632,832	\$ 7,792,863
Residential	10,136,950	9,838,113
Government	40,776,217	33,767,517
Unbilled	5,468,286	2,938,966
	65,014,285	54,337,459
Allowance for uncollectible accounts	(54,436,379)	(47,709,300)
	\$ 10,577,906	\$ 6,628,159

(4) Allowance for Uncollectible Accounts

Changes in allowance for uncollectible accounts for the years ended September 30, 2017 and 2016 are as follows:

	2017	2016
Total allowance, beginning of year	\$ 48,414,608	\$ 43,942,801
Provision for uncollectible accounts	6,829,009	4,475,604
Bad debts recovery	-	1,641,845
Accounts written-off	-	(1,645,642)
Total allowance, end of year	\$ 55,243,617	\$ 48,414,608
Accounts receivable - utility (Note 3)	\$ 54,436,379	\$ 47,709,300
Notes receivable (Note 5)	85,791	86,195
Other receivables (Note 6)	721,447	619,113
Total allowance, end of year	\$ 55,243,617	\$ 48,414,608

**COMMONWEALTH UTILITIES CORPORATION**  
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Notes to Financial Statements  
September 30, 2017 and 2016

(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, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Current portion, net of allowance of \$70,574	\$ 123,180	\$ 90,833
Noncurrent portion, net of allowance of \$15,217	<u>34,766</u>	<u>86,128</u>
Long-term notes receivable, net of current portion	<u>\$ 157,946</u>	<u>\$ 176,961</u>

(6) Other Current Assets

Other assets as of September 30, 2017 and 2016 consist of the following:

	<u>2017</u>	<u>2016</u>
Prepayments	\$ 1,294,298	\$ 1,500,600
Temporary facility	104,412	103,751
Employee advances and travel advances	12,490	17,197
Other receivables, net of allowance of \$721,447	<u>109,869</u>	<u>191,528</u>
	<u>\$ 1,521,069</u>	<u>\$ 1,813,076</u>

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(7) Due from 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 capital contributions. 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 grantor agencies account for the years ended September 30, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Balance at beginning of year	\$ 6,234,426	\$ 2,442,567
Deductions - cash receipts from grantors	(14,475,520)	(8,464,544)
Additions - program outlays	<u>13,249,001</u>	<u>12,256,403</u>
Balance at end of year	<u>\$ 5,007,907</u>	<u>\$ 6,234,426</u>

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**(8) Capital Assets**

A summary of the changes in capital assets for the years ended September 30, 2017 and 2016 is as follows:

	<b>Estimated Useful Lives</b>	<b>Balance at October 1, 2016</b>	<b>Additions</b>	<b>Disposals</b>	<b>Adjustments/ Transfers</b>	<b>Balance at September 30, 2017</b>
Utility plant in service						
Electric plant	25 years	\$ 137,226,701	\$ 9,815,035	\$ -	\$ 443,506	\$ 147,485,242
Water plant	25 years	70,341,946	269,376	-	3,754,461	74,365,783
Sewer plant	25 years	50,581,548	637,166	-	662,058	51,880,772
Administrative equipment	3-5 years	3,586,825	133,873	-	259,730	3,980,428
		261,737,020	10,855,450	-	5,119,755	277,712,225
Accumulated depreciation		(191,977,366)	(8,110,252)	-	-	(200,087,618)
Depreciable assets, net		69,759,654	2,745,198	-	5,119,755	77,624,607
Construction work-in progress		22,876,987	9,146,841	-	(5,804,742)	26,219,086
Capital assets, net		\$ 92,636,641	\$ 11,892,039	\$ -	\$ (684,987)	\$ 103,843,693
	<b>Estimated Useful Lives</b>	<b>Balance at October 1, 2015</b>	<b>Additions</b>	<b>Disposals</b>	<b>Adjustments/ Transfers</b>	<b>Balance at September 30, 2016</b>
Utility plant in service						
Electric plant	25 years	\$ 129,528,547	\$ 3,003,224	\$ (1,168,602)	\$ 5,863,532	\$ 137,226,701
Water plant	25 years	68,764,005	149,553	(385,031)	1,813,419	70,341,946
Sewer plant	25 years	50,234,999	26,853	(263,653)	583,349	50,581,548
Administrative equipment	3-5 years	3,895,897	178,382	(487,454)	-	3,586,825
		252,423,448	3,358,012	(2,304,740)	8,260,300	261,737,020
Accumulated depreciation		(187,581,639)	(6,961,730)	2,566,003	-	(191,977,366)
Depreciable assets, net		64,841,809	(3,603,718)	261,263	8,260,300	69,759,654
Construction work-in progress		19,234,190	11,904,489	(1,392)	(8,260,300)	22,876,987
Capital assets, net		\$ 84,075,999	\$ 8,300,771	\$ 259,871	\$ -	\$ 92,636,641

Included in utility plant in service adjustments/transfers for fiscal years ended September 30, 2017 and 2016 are completed projects transferred from construction work-in-progress to utility plant in service of \$5,119,755, and \$8,260,300, respectively.

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(8) Capital Assets, Continued

Depreciation expense for the years ended September 30, 2017 and 2016 is \$8,110,251 and \$7,327,567, respectively.

CUC entered into several construction contracts during fiscal years 2017 and 2016 for improvements, rehabilitation and replacement of facilities, and other capital projects. As of September 30, 2017, CUC had outstanding construction contracts totaling \$7,466,265 that will be financed from operating funds and federal awards.

(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 bearing 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, 2017 and 2016:

	2017	2016
Electric	\$ 10,491,729	\$ 10,415,455
Water	678,288	758,612
Sewer	207,976	223,073
Total security deposits	11,377,993	11,397,140
Accrued interest on security deposits	557,395	545,385
Security deposits, including interest	11,935,388	11,942,525
Security deposits, including interest	11,935,388	11,942,525
Restricted cash	10,404,546	5,935,495
Accumulated security deposits used for operating expenditures	\$ 1,530,842	\$ 6,007,030

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(10) Long-term Debt

Long-term debt at September 30, 2017 and 2016 is as follows:

	2017	2016
Commonwealth Ports Authority	\$ 3,385,131	\$ 3,348,256
Current maturities	(3,385,131)	(3,014,922)
At end of year	\$ -	\$ 333,334

Interest expense on long-term debt for the years ended September 30, 2017 and 2016 was \$273,256 and \$264,171, respectively, and is presented as a component of interest and distribution 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, 2017 and 2016 are as follows:

	Balance at October 1, 2016	Acquisitions	Transfers	Balance at September 30, 2017
Commonwealth Ports Authority	\$ 3,348,256	\$ 36,875	\$ -	\$ 3,385,131

	Balance at October 1, 2015	Acquisitions	Transfers	Balance at September 30, 2016
Commonwealth Ports Authority	\$ 3,373,563	\$ -	\$ (25,307)	\$ 3,348,256

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Notes to Financial Statements  
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(10) Long-term Debt, Continued

A summary of CUC's loans payable to CPA at September 30, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Loan payable to Commonwealth Ports Authority, 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 is due in monthly payments of \$38,008.	\$ 3,385,131	\$ 3,348,256
Current maturities	(3,385,131)	(3,014,922)
Long-term debt, net of current portion	\$ -	\$ 333,334

(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, 2017 and 2016, CUC recognized an outstanding payable to the CNMI Government in the amount of \$7,981,212 and \$7,477,505, respectively. CUC accrued OPA fees of \$503,708 in 2017 and \$428,427 in 2016. CUC owes the CNMI government OPA fees of approximately \$9 million as of September 30, 2014 based on 1% of CUC's operations budget excluding 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, 2017.

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 CUC from the monthly utility costs of the government. No application of payments were made as of September 30, 2017.

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September 30, 2017 and 2016

(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.

On August 17, 2016, CUC entered into an agreement with CDA for the total amount of unpaid dividend payments owed to CDA and agreed to a dividend of \$4,320,000 for the year ended September 30, 2016. The agreement states that CUC will make quarterly dividend payments of \$270,000 beginning October 1, 2016, as required by the preferred stock agreement, which represents the full amount of the quarterly dividend due. Dividends payable as of September 30, 2017 and 2016 amounted to \$1,800,000 and \$6,300,000, respectively.



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

Notes to Financial Statements  
September 30, 2017 and 2016

(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 does, however, require performance bonds on all of its construction projects.

(14) Commitments and Contingencies

Commitments

At September 30, 2017, CUC had commitments of \$7,466,265 for construction, purchases of inventory, and acquisition of property and equipment, all of which are expected to be incurred in 2018.

Lease Commitments

CUC entered into a lease agreement for office space in Joeten Dandan Building for a term of five years commencing in December 2016 and expiring in December 2021. The annual lease payment is \$166,605.

CUC also entered into a lease agreement for lease of office/warehouse space for Power Division in Saipan commencing in December 2015 and expiring in June 2018. In June 2018, the lease was renewed for another two years and will expire in June 2020. The annual lease payment is \$94,848.

CUC also entered into a lease agreement for office space in Rota for a term of six years commencing in December 2012 and expiring in December 2018. The annual lease payment is \$15,600.

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

Notes to Financial Statements  
September 30, 2017 and 2016

(14) Commitments and Contingencies, Continued

*Lease Commitments, continued*

Future lease payments are as follows:

Years ending September 30, 2018	\$	294,837
2019		306,849
2020		257,501
2021		166,605
2022		<u>34,708</u>
		<u>\$ 1,060,500</u>

Rent expense totaled \$277,485 in 2017 and \$253,740 in 2016.

Contingencies

*Federal Funded Programs*

CUC participates in a number of federally assisted grant programs funded by the United States of America 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, 2017 and 2016.

*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.

No provision for any liability that may result upon resolution of these matters has been made in the accompanying financial statements, however there are pending cases under litigation.

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

Notes to Financial Statements  
September 30, 2017 and 2016

(14) Commitments and Contingencies, Continued

*Stipulated Orders*

The U.S. Environmental Protection Agency (EPA) brought suit against CUC and the CNMI Government alleging a failure to comply with various regulations and requirements related to the Safe Drinking Water Act (“SDWA”) and the Federal Water Pollution Control Act (“FWPCA”). To date there have been two primary stipulated orders entered as a result of this action.

Stipulated Order One is intended to ensure that CUC’s wastewater and drinking water systems achieve compliance with the SDWA and the FWPCA. The major components of Stipulated Order One are:

1. The reformation of CUC’s management, finances and operations;
2. 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 Clean Water Act (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.

In FY2017, the SO2 projects will continue under the direction of the Court's appointed Engineering and Environmental Management Company (EEMC) Gilbane Federal pursuant to the provisions of the Stipulated Order entered on September 26, 2014. Any further penalties which may be assessed are related to CUC's performance under both Stipulated Orders 1 and 2.

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

Notes to Financial Statements  
September 30, 2017 and 2016

(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. On April 26, 2017, CUC received an assessment to pay United States Coast Guard for reimbursement of the costs incurred in CUC Power Plants 1 and 2 oil discharge pollution removal in the amount of \$7,809,537. The accompanying financial statements have recorded the accrual of these remedial activities. These assessments are still outstanding.

On October 27, 2011, EPA contacted CUC regarding release or threatened release of hazardous substance connected with the Rota Power Plant located in Songsong Village, Rota (the Site). As a current owner and operator of the Rota Power Plant, EPA believes that CUC may be liable pursuant to Section 107(a) of the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), as amended, 42 U.S.C. 9607(a), for response costs incurred to address environmental contamination at the Site. By letter dated November 3, 2011, CUC indicated that it lacked the financial ability to perform an immediate cleanup of hazardous substances and requested EPA's assistance in performing such a cleanup. EPA has incurred at least \$2,131,696 in costs related to the Site as of January 31, 2016. The accompanying financial statements have been restated to include accrual of these response costs activities. These assessments are still outstanding.

(16) Economic Dependency

CUC is dependent on various equipment manufacturers, distributors, and dealers for the supply of parts for the utility plants and suppliers of fuel and lube. 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)

Notes to Financial Statements  
September 30, 2017 and 2016

(17) Restatement

The Net Position as of September 30, 2016 has been restated to reflect the prior years' accrual of the United States Environmental Protection Agency (EPA) costs incurred in the cleanup of the Rota Power Plant in the amount of \$2,131,696.

The following is a summary of the restatement for the year ending September 30, 2016:

Net position, beginning, as previously reported	\$ 89,939,596
Restatement	<u>(2,131,696)</u>
Net position, beginning, as restated	<u>\$ 87,807,900</u>

The effect of the CUC's previously issued 2016 financial statements are summarized as follows:

Statement of Net Position

	<u>Previously Reported</u>	<u>Increase (Decrease)</u>	<u>As Restated</u>
Current Assets	\$ 49,072,940	\$ -	\$ 49,072,940
Noncurrent assets	<u>92,722,769</u>	<u>-</u>	<u>92,722,769</u>
Total assets	141,795,709	-	141,795,709
Current liabilities	(26,091,603)	-	(26,091,603)
Noncurrent liabilities	(25,423,742)	(2,131,696)	(27,555,438)
Deferred inflows	<u>(340,768)</u>	<u>-</u>	<u>(340,768)</u>
Net position	<u>\$ 89,939,596</u>	<u>\$ (2,131,696)</u>	<u>\$ 87,807,900</u>

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

Notes to Financial Statements  
September 30, 2017 and 2016

(17) Restatement, Continued

Statement of Revenues, Expenses and Changes in Net Position:

	<u>Previously Reported</u>	<u>Increase (Decrease)</u>	<u>As Restated</u>
Net operating revenues	\$ 60,659,474	\$ -	\$ 60,659,474
Operating expenses	(74,192,277)	-	(74,192,277)
Non-operating revenues (expenses)	(442,752)	-	(442,752)
Change in recovery of fuel costs	2,957,526	-	2,957,526
Capital contributions and federal grants	<u>19,412,082</u>	<u>-</u>	<u>19,412,082</u>
Change in net position	8,394,053	-	8,394,053
Net position at beginning of the year	<u>81,545,543</u>	<u>(2,131,696)</u>	<u>79,413,847</u>
Net position at end of the year	<u>\$ 89,939,596</u>	<u>\$ (2,131,696)</u>	<u>\$87,807,900</u>

(18) Reclassifications

Certain reclassifications have been made to the prior year's financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported statement of revenues, expenses and changes in net position.

**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, 2017

	Power	Water	Sewer	Administrative and General	Elimination	Total
Operating revenues:						
Governmental	\$ 7,210,587	\$ 9,051,464	\$ 9,052,031	\$ -	\$ (1,841,287)	\$ 23,472,795
Commercial	14,914,432	2,933,640	1,723,758	-	-	19,571,830
Residential	<u>7,154,852</u>	<u>5,468,052</u>	<u>523,122</u>	-	-	<u>13,146,026</u>
Subtotal	29,279,871	17,453,156	11,298,911	-	(1,841,287)	56,190,651
FAC - Fuel charge	40,539,651	-	-	-	(2,224,182)	38,315,469
FAC - Non fuel	300,949	-	-	-	-	300,949
Other	<u>642,641</u>	<u>84,699</u>	-	-	-	<u>727,340</u>
	70,763,112	17,537,855	11,298,911	-	(4,065,469)	95,534,409
Bad debts	<u>(1,053,335)</u>	<u>(2,630,496)</u>	<u>(3,145,177)</u>	-	-	<u>(6,829,008)</u>
Net operating revenues	<u>69,709,777</u>	<u>14,907,359</u>	<u>8,153,734</u>	-	<u>(4,065,469)</u>	<u>88,705,401</u>
Operating expenses:						
Fuel, lube and taxes	39,995,273	-	-	-	-	39,995,273
General and administrative	8,086,224	4,124,739	1,890,325	7,183,381	-	21,284,669
Maintenance	7,211,350	2,365,082	763,584	72,980	-	10,412,996
Depreciation	3,441,643	2,361,083	1,869,402	438,123	-	8,110,251
Supplies	482,541	375,098	114,968	337,664	-	1,310,271
Utility consumption	704,989	2,923,478	849,164	236,973	(4,065,469)	649,135
Other (bank charges)	-	-	-	529,652	-	529,652
Total operating expenses	<u>59,922,020</u>	<u>12,149,480</u>	<u>5,487,443</u>	<u>8,798,773</u>	<u>(4,065,469)</u>	<u>82,292,247</u>
Earnings from operations before allocation of common cost	9,787,757	2,757,879	2,666,291	(8,798,773)	-	6,413,154
Allocation of common costs	<u>(5,528,079)</u>	<u>(2,082,902)</u>	<u>(1,187,792)</u>	<u>8,798,773</u>	-	-
Earnings from operations	<u>\$ 4,259,678</u>	<u>\$ 674,977</u>	<u>\$ 1,478,499</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 6,413,154</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, 2017

	Power	Water	Sewer	Administrative and General	Elimination	Total
Earnings from operations	\$ 4,259,678	\$ 674,977	\$ 1,478,499	\$ -	\$ -	\$ 6,413,154
Non-operating revenues (expenses):						
Interest income	267,758	149,951	126,450	-	-	544,159
Miscellaneous income	341,720	23,658	21,820	-	-	387,198
Amortization of marketing assistance	1,100,000	-	-	-	-	1,100,000
Regulatory assessments	4,661	-	-	-	-	4,661
Settlement income	73,190	15,652	8,561	-	-	97,403
Contribution to the CNMI government	(251,909)	(191,659)	(60,140)	-	-	(503,708)
Interest and distribution expense	(1,353,256)	-	-	-	-	(1,353,256)
Total non-operating revenues (expenses), net	<u>182,164</u>	<u>(2,398)</u>	<u>96,691</u>	<u>-</u>	<u>-</u>	<u>276,457</u>
Earnings before change in recovery of fuel costs	4,441,842	672,579	1,575,190	-	-	6,689,611
Change in recovery of fuel costs	<u>(544,378)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(544,378)</u>
Net earnings before capital contributions and federal grants	3,897,464	672,579	1,575,190	-	-	6,145,233
Capital contributions and federal grants	<u>10,619,671</u>	<u>9,552,557</u>	<u>3,540,785</u>	<u>-</u>	<u>-</u>	<u>23,713,013</u>
Change in net position	<u>\$ 14,517,135</u>	<u>\$ 10,225,136</u>	<u>\$ 5,115,975</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 29,858,246</u>

See accompanying notes to financial statements.



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

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**UNIFORM GUIDANCE REPORTS**

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**For The Year Ended September 30, 2017**

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

To the Board of Directors  
Commonwealth Utilities Corporation

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Commonwealth Utilities Corporation (CUC), which comprise the statement of financial position as of September 30, 2017, and the related statements of revenues, expenses, and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 15, 2018.

***Internal Control Over Financial Reporting***

In planning and performing our audit of the financial statements, we 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 our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of CUC's internal control. Accordingly, we do not express an opinion on the effectiveness of CUC's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph 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 have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs as Finding Nos. 2017-001 and 2017-003 that we consider to be significant deficiencies.

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

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

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

CUC's response to the findings identified in our 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, we express no opinion on it.

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

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



Saipan, Commonwealth of the Northern Mariana Islands  
October 15, 2018

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE  
FOR EACH MAJOR PROGRAM AND  
ON INTERNAL CONTROL OVER COMPLIANCE  
REQUIRED BY THE *UNIFORM GUIDANCE***

To the Board of Directors  
Commonwealth Utilities Corporation

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

We have audited Commonwealth Utilities Corporation (CUC's) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of CUC's major federal programs for the year ended September 30, 2017. 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 federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

***Auditors' Responsibility***

Our responsibility is to express an opinion on compliance for each of CUC's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our 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 the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we 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 we considered necessary in the circumstances.

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

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

In our 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, 2017.

### **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 our audit of compliance, we 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 the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of CUC's internal control over compliance.

*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. *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.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be a material weaknesses. However, material weaknesses may exist that have not been identified.

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 the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.



Saipan, Commonwealth of the Northern Mariana Islands  
October 15, 2018

Commonwealth Utilities Corporation  
Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2017

Federal Grantor/ Pass Through Grantor/ Program Title	Federal CFDA Number/ Grantor ID No./ Pass Through Grantor's Number	Program or Award Amount	Receivable from Grantor (Deferred) Revenue at September 30, 2016	Cash Receipts	Expenditures	Receivable (Deferred) Revenue) from Grantor at September 30, 2017
<u>U.S. Environmental Protection Agency</u>						
Direct Program:						
Consolidated Environmental Program	66.600/-M-00T33711	\$ 40,912,704	\$ 366,969	\$ 8,343,288	\$ 12,392,297	\$ 4,415,978
Consolidated Environmental Program	66.600/-M-00T33715	8,219,700	-	223,555	324,233	100,678
Consolidated Environmental Program	66.600/-M-00T33717	4,910,000	-	-	-	-
Subtotal		<u>54,042,404</u>	<u>366,969</u>	<u>8,566,843</u>	<u>12,716,530</u>	<u>4,516,656</u>
<u>U.S. Department of the Interior</u>						
<u>Direct Program</u>						
USGS	15.875/OMIP CUC 2006 -1	12,500	(12,500)	-	-	(12,500)
Bureau of Reclamation:						
Water Loss Reduction and Energy Savings	15.507/R13AP80017	294,967	7,219	23,936	62,272	45,555
Passed through the Government of the CNMI:						
<u>Federal Portion</u>						
Geothermal Energy	15.875/CNMI-CIP-2011-3	1,260,000	-	-	-	-
Geothermal Energy	15.875/CNMI-EIC-2011-1	500,000	-	-	-	-
Sadog Tasi Wastewater Treatment Plant Rehabilitation	15.875/CNMI-CIP-2010-2	1,000,000	-	-	-	-
Stipulated Order #2	15.875/CNMI-CIP-2010-3	4,050,000	(3)	-	-	(3)
New Fuel Tank at PP1 (Tank 102)	15.875/CNMI-CIP-2013-1	350,000	-	-	-	-
Tank System Integrity and Cleanou Plan-(Rota Tanks, SpnTank103)	15.875/CNMI-CIP-2012-8	232,000	-	-	-	-
Replacement of 8" Petroleum Pipeline	15.875/CNMI-CIP-2011-2	2,154,000	-	-	-	-
Add'l Funding for Replacement of 8" Petroleum Pipeline	15.875/CNMI-CIP-2012-7	800,000	-	-	-	-
Add'l Funding for Replacement of 8" Petroleum Pipeline	15.875/CNMI-CIP-2013-3	1,025,000	-	-	-	-
Add'l Funding for Replacement of 8" Petroleum Pipeline	15.875/CNMI-CIP-2013-6	725,000	-	-	-	-
Add'l Funding for Replacement of 8" Petroleum Pipeline	15.875/CNMI-CIP-2014-2	733,253	-	-	-	-
Integrated Resource Plan	15.875/CNMI-EIC-2013-1	500,000	-	12,000	12,000	-
Prepaid Meters	15.875/CNMI-EIC-2013-2	622,000	-	-	-	-
Economic Development Administration:						
Design of Lower Base Sewer System - EDA Share	11.300/EDA -07-79-07008	200,000	90,144	90,144	-	-
Design of Lower Base Sewer System - CNMI/OIA Share	11.300/EDA -07-79-07008	-	30,048	30,048	-	-
Subtotal Federal Portion		<u>14,458,720</u>	<u>114,908</u>	<u>156,128</u>	<u>74,272</u>	<u>33,052</u>
Federal Emergency Management Administration						
Typhoon Soudelor Claims	97.036/FEMA-DR-4235-MP	-	5,752,550	5,752,550	458,199	458,199
		<u>\$ 68,501,124</u>	<u>\$ 6,234,426</u>	<u>\$ 14,475,520</u>	<u>\$ 13,249,001</u>	<u>\$ 5,007,907</u>

See accompanying notes to Schedule of Expenditures 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, 2017

(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), and the U.S. Environmental Protection Agency are included in the scope of the Uniform Guidance. The U.S. Department of the Interior has been designated as CUC's cognizant agency.

A. Programs Subject to Uniform Guidance

All of the programs presented in the Schedule of Expenditures of Federal Awards are subject to the Uniform Guidance.

(2) Summary of Significant Accounting Policies

For purposes of preparation of the accompanying Schedule of Expenditures of Federal Awards, certain accounting procedures were followed, which help illustrate the authorizations and expenditures of the individual programs. The accompanying Schedule of Expenditures of Federal Awards is prepared on the accrual basis of accounting and is presented in accordance with the audit requirements of Title 2 U.S. *Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). 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.

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

Notes to Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2017

(2) Summary of Significant Accounting Policies, Continued

B. Indirect Cost Allocation

For fiscal year 2017, CUC had no indirect cost agreement with grantor agencies.

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.



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

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

**SECTION I – SUMMARY OF AUDITORS’ RESULTS**

*Financial Statements*

Type of auditors’ report issued: Unmodified

Internal control over financial reporting:

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

Noncompliance material to financial statements  
noted?       yes     no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified?       yes     no
  
- Significant deficiency(ies) identified  
that are not considered to be material  
weaknesses?       yes     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 2 CFR § 200.516 (a)?       yes     no

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

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

**SECTION I – SUMMARY OF AUDITORS’ RESULTS, Continued**

*Federal Awards*

Identification of Major Programs:

CFDA No.	Description	Federal Expenditures
66.600	Environmental Protection Consolidated Grants Support	\$ <u>12,716,530</u>
	Total major program expenditures	\$ <u>12,716,530</u>
	Total federal expenditures	\$ <u>13,249,001</u>
	Percentage of federal expenditures tested as major programs	<u>96%</u>

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

\$750,000

Auditee qualified as low-risk auditee

\_\_yes Xno

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

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

**SECTION II – FINANCIAL STATEMENTS FINDINGS**

**Finding No. 2017-001 Travel**

Finding type: Significant Deficiency in Internal Control

Criteria:

Pursuant to CUC's Travel policy:

- a. The traveler is responsible to prepare and submit a travel voucher within 15 working days after the completion of travel.
- b. Trip reports should be as detailed as possible to provide information as to the actual activities covered by the trip.

Condition:

- a. For 9 or 23% of 40 travel authorizations selected, the Travel Voucher (TV) was submitted late; 7 or 17% were not dated; 9 or 23% was missing boarding pass, 1 or 3% was not liquidated, 1 or 3% of excess amount disbursed was not refunded by traveler.
- b. For 17 or 42% of 40 travel authorizations selected, the trip reports were not submitted together with the TV.

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

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

**SECTION II – FINANCIAL STATEMENTS FINDINGS**

**Finding No. 2017-001 Travel, Continued**

Cause:

The cause of the above conditions is the lack of adherence to established policies and procedures regarding the liquidation of travel advance.

Effect:

CUC is not in compliance with its travel policies and procedures.

Prior Year Status:

A similar condition was reported in the prior year audit as Finding 2016-001.

Recommendation:

CUC should adhere to its travel policy to ensure that all travelers comply with the policy.

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

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

**SECTION II – FINANCIAL STATEMENTS FINDINGS**

**Finding 2017-002 Human Resources**

Finding type: Significant deficiency in Internal Control

Criteria:

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

Condition:

Based on results of testing of personnel records, the following were noted:

- a. For 1 or 1% of 90 personnel records selected for testing, the 201 file was not provided for review for:

<b>Employee Number</b>	<b>Pay period</b>	<b>Payment Date</b>	<b>Rate Used</b>	<b>Remarks</b>
78	12/11/16-12/24/16	1/6/2017	\$ 22.24	No files found

- b. For 20 or 22% of 90 personnel records selected for testing, the rate used in calculating the payroll was not supported by an approved Notice of Personnel Action (NOPA) on the following:

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

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

**SECTION II – FINANCIAL STATEMENTS FINDINGS**

**Finding 2017-002 Human Resources, Continued**

Employee Number	Pay period	Payment Date	Rate Used	NOPA Rate	Effectivity	Remarks
1806	12/11/16-12/24/16	1/6/2017	\$ 19.27	\$ 18.15	2/8/2015	No updated NOPA to reflect rate change
9957	12/11/16-12/24/16	1/6/2017	\$ 10.01	\$ 9.64	11/4/2012	No updated NOPA to reflect rate change
10031	12/11/16-12/24/16	1/6/2017	\$ 26.92	\$ 26.44	2/8/2015	No updated NOPA to reflect rate change
10104	12/11/16-12/24/16	1/6/2017	\$ 35.09	\$ 33.17	2/8/2015	HR did not have a copy on file but obtained a copy from Payroll Dept. for the auditor
10112	8/20/17-9/02/17	9/15/2017	\$ 12.70	\$ 11.81	2/8/2015	Memo from Executive Director dated 7/3/17 to pay large number of employees for Hazardous, On Call and Longevity pay. NOPA was prepared on 8/2/17 but was not signed by Officials per memo dated 1/4/18. Documents are with HR as of 8/10/18
10138	8/20/17-9/02/17	9/15/2017	\$ 10.94	\$ 10.18	2/8/2015	Memo from Executive Director dated 7/3/17 to pay large number of employees for Hazardous, On Call and Longevity pay. NOPA was prepared on 8/2/17 but was not signed by Officials per memo dated 1/4/18. Documents are with HR as of 8/10/18
10246	4/16/17-4/29/17	5/12/2017	\$ 10.01	\$ 7.69	11/4/2012	No updated NOPA to reflect rate change
10262	4/16/17-4/29/17	5/12/2017	\$ 10.01	\$ 7.69	11/4/2012	No updated NOPA to reflect rate change
10266	4/16/17-4/29/17	5/12/2017	\$ 10.01	\$ 7.69	11/4/2012	No updated NOPA to reflect rate change
10307	8/20/17-9/02/17	9/15/2017	\$ 9.48	\$ 9.03	2/8/2015	Memo from Executive Director dated 7/3/17 to pay large number of employees for Hazardous, On Call and Longevity pay. NOPA was prepared on 8/2/17 but was not signed by Officials per memo dated 1/4/18. Documents are with HR as of 8/10/18
10323	8/20/17-9/02/17	9/15/2017	\$ 10.51	\$ 10.01		Memo from Executive Director dated 7/3/17 to pay large number of employees for Hazardous, On Call and Longevity pay. NOPA was prepared on 8/2/17 but was not signed by Officials per memo dated 1/4/18. Documents are with HR as of 8/10/18
10347	12/11/16-12/24/16	1/6/2017	\$ 10.64	\$ 9.21	10/4/2013	No updated NOPA to reflect rate change
10348	4/16/17-4/29/17	5/12/2017	\$ 11.58	\$ 10.18	2/8/2015	No updated NOPA to reflect rate change
10368	8/20/17-9/02/17	9/15/2017	\$ 12.16	\$ 11.58	2/8/2015	No updated NOPA to reflect rate change
10399	8/20/17-9/02/17	9/15/2017	\$ 9.48	\$ 9.03	2/8/2015	Memo from Executive Director dated 7/3/17 to pay large number of employees for Hazardous, On Call and Longevity pay. NOPA was prepared on 8/2/17 but was not signed by Officials per memo dated 1/4/18. Documents are with HR as of 8/10/18
10417	8/20/17-9/02/17	9/15/2017	\$ 10.51	\$ 7.00	7/30/2012	No updated NOPA to reflect rate change
10450	8/20/17-9/02/17	9/15/2017	\$ 20.23	\$ 19.27	2/8/2015	No updated NOPA to reflect rate change
10625	8/20/17-9/02/17	9/15/2017	\$ 10.21	\$ 10.01	5/29/2017	No updated NOPA to reflect rate change
10625	8/20/17-9/02/17	9/15/2017	\$ 10.21	\$ 10.01	5/29/2017	No updated NOPA to reflect rate change
37357	4/16/17-4/29/17	5/12/2017	\$ 11.58	\$ 8.31	11/8/2010	No updated NOPA to reflect rate change

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

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

**SECTION II – FINANCIAL STATEMENTS FINDINGS**

**Finding 2017-002 Human Resources, Continued**

Cause:

The NOPA's subject for testing effective for the fiscal year ended September 30, 2017 were not provided to the auditor by the human resources department. CUC did not adhere to policies and procedures for the maintenance of Human Resources files.

Effect:

CUC is not in compliance with its regulations and there could be misstatements of payroll expenses. Potential fraud could exist and not be detected.

Prior Year Status:

A similar condition was reported in the prior year audit as Finding 2016-002.

Recommendation:

CUC should ensure that all employees have valid contracts, and that the Human Resources Department maintains and updates the files periodically.

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

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

**SECTION II – FINANCIAL STATEMENTS FINDINGS**

**Finding 2017-003 Payroll processing**

Finding type: Significant deficiency in Internal Control

Criteria:

Employees should be paid overtime wages pursuant to an approval of responsible official.

Condition:

For sixteen (16) or 17% of 90 employees selected for testing, the appropriate supervisor's signature was missing in the flextime/overtime request and authorization form.

Cause:

CUC's appropriate supervisor did not sign or approve the flextime/overtime request and authorization form.

Effect:

CUC is not in compliance with its regulations and there could be misstatements of payroll expenses. Potential fraud could exist and not be detected.

Recommendation:

CUC should ensure that all overtime forms are properly approved and signed.



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

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

**SECTION III – FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS**

There were no federal awards audit findings and questioned costs for fiscal year ending September 30, 2017.

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

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

**PRIOR YEAR FINDINGS AND QUESTIONED COSTS**

<u>Finding</u>	<u>Subject Matter</u>	<u>Current Year Status</u>
2013-10	Payroll processing	Unresolved. Refer to Finding 2014-009, 2015-005, 2016-002, 2016-003
2014-009	Payroll processing	Unresolved. Refer to Finding 2015-005 2016-002, 2016-003
2015-004	Travel	Unresolved. Refer to Finding 2016-001
2015-005	Payroll processing	Unresolved. Refer to Finding 2014-009, 2016-002, 2016-003
2015-006	Fixed assets	Corrective action taken
2015-008	Equipment and Real Property Management	Corrective action taken
2016-001	Travel	Unresolved. Refer to Finding 2017-001
2016-002	Payroll processing	Unresolved. Refer to Finding 2014-009, 2017-002
2016-003	Payroll processing	Unresolved. Refer to Finding 2014-009, 2017-003
2016-004	Fixed assets	Corrective action taken
2016-005	Equipment and Real Property Management	Corrective action taken

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

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

**SECTION IV – PRIOR YEAR AUDIT 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, 2017:

Questioned costs as previously reported	\$ -
Questioned costs for fiscal year 2017 Single Audit	<u>-</u>
Unresolved questioned costs at September 30, 2017	<u>\$ -</u>



# Commonwealth Utilities Corporation



October 15, 2018

Mr. David Burger, Partner  
Burger Comer Magliari  
P.O. Box 504053  
Saipan, MP 96950

Subject: Schedule of Findings and Questioned Costs for the year ended September 30, 2017

Dear Mr. Burger:

Please see below CUC's responses to the findings regarding CUC FY 2017 Audit:

## **Finding No. 2017-001 Travel**

### *Condition:*

- a. For 9 or 23% of 40 travel authorizations selected, the Travel Voucher (TV) was submitted late; 7 or 17% were not dated; 9 or 23% was missing boarding pass, 1 or 3% was not liquidated, 1 or 3% of excess amount disbursed was not refunded by traveler.
- b. For 17 or 42% of 40 travel authorizations selected, the trip reports were not submitted together with the TV.

### *Recommendation:*

CUC should adhere to its travel policy to ensure that all travelers comply with the policy.

### *CUC Response:*

CUC agrees with the finding.

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

CUC Travel Section will ensure that all inter-island travel and International Travel trip report should be submitted on a timely manner, travel documentations that are required to be submitted 15 days from return of travel. Travel Section will advise employee by email and courtesy phone call with submission of travel voucher and trip report. Missing boarding passes; employees would have to request from the airlines a duplicate copy of boarding passes. Travel Checklist will be given to every employee when picking up check from AP section and acknowledge by the employee.

**Finding No. 2017-002 Human Resources**

*Condition:*

Based on results of testing of personnel records, the following were noted:

- a. For 1 or 1% of 90 personnel records selected for testing, the 201 file was not provided for review for:

<b>Employee Number</b>	<b>Pay period</b>	<b>Payment Date</b>	<b>Rate Used</b>	<b>Remarks</b>
78	12/11/16-12/24/16	1/6/2017	\$ 22.24	No files found

**Finding No. 2017-002 Human Resources**

*Condition, continued:*

b. For 20 or 22% of 90 personnel records selected for testing, the rate used in calculating the payroll was not supported by an approved Notice of Personnel Action (NOPA) on the following:

Employee Number	Pay period	Payment Date	Rate Used	NOPA Rate	Effectivity	Remarks
1806	12/11/16-12/24/16	1/6/2017	\$ 19.27	\$ 18.15	2/8/2015	No updated NOPA to reflect rate change
9957	12/11/16-12/24/16	1/6/2017	\$ 10.01	\$ 9.64	11/4/2012	No updated NOPA to reflect rate change
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10104	12/11/16-12/24/16	1/6/2017	\$ 35.09	\$ 33.17	2/8/2015	HR did not have a copy on file but obtained a copy from Payroll Dept. for the auditor
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10399	8/20/17-9/02/17	9/15/2017	\$ 9.48	\$ 9.03	2/8/2015	Memo from Executive Director dated 7/3/17 to pay large number of employees for Hazardous, On Call and Longevity pay. NOPA was prepared on 8/2/17 but was not signed by Officials per memo dated 1/4/18. Documents are with HR as of 8/10/18
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10625	8/20/17-9/02/17	9/15/2017	\$ 10.21	\$ 10.01	5/29/2017	No updated NOPA to reflect rate change
10625	8/20/17-9/02/17	9/15/2017	\$ 10.21	\$ 10.01	5/29/2017	No updated NOPA to reflect rate change
37357	4/16/17-4/29/17	5/12/2017	\$ 11.58	\$ 8.31	11/8/2010	No updated NOPA to reflect rate change

*Recommendation:*

CUC should ensure that all employees have valid contracts, and that the Human Resources Department maintains and updates the files periodically.

*CUC Response:*

CUC agrees with the finding.

*Management's Corrective Action Plan:*

The Human Resources Department (HR) will ensure that all Personnel Actions are filed accordingly. All NOPAs will be reviewed by the HR Manager and Chief of Administration. HR will also coordinate with Payroll to ensure the rates are correct and updated. HR will ensure that Personnel Files (201) are filed properly and accounted for. HR will conduct quarterly review of all records to avoid discrepancies. HR will create a checklist to ensure all requirements are met.

**Finding No. 2017-003 Payroll**

*Condition:*

For eleven (11) or 12% of 90 employees selected for testing, the appropriate supervisor's signature was missing in the flextime/overtime request and authorization form.

*Recommendation:*

CUC should ensure that all overtime forms are properly approved and signed.

*CUC Response:*

CUC agrees with the finding.

*Management's Corrective Action Plan:*

Payroll personnel will ensure that Flextime / Overtime Request forms are completely signed before processing the employee's payroll. Payroll personnel will require division timekeepers to have the Flextime / Overtime Request forms completely signed before submitting it to payroll. Payroll will create a checklist to ensure all requirements are met.

Sincerely,

*//SIGNED//*

ANTONIO B. CASTRO  
Chief Financial Officer