

COMMONWEALTH HEALTHCARE CORPORATION
(A COMPONENT UNIT OF THE COMMONWEALTH
OF THE NORTHERN MARIANA ISLANDS)

REPORT ON THE AUDIT OF FINANCIAL
STATEMENTS IN ACCORDANCE
WITH OMB CIRCULAR A-133

YEAR ENDED SEPTEMBER 30, 2014

COMMONWEALTH HEALTHCARE CORPORATION
(A COMPONENT UNIT OF THE COMMONWEALTH
OF THE NORTHERN MARIANA ISLANDS)

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2014 AND 2013

INDEPENDENT AUDITORS' REPORT

Ms. Esther L. Muna
Chief Executive Officer
Commonwealth Healthcare Corporation:

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the Commonwealth Healthcare Corporation (CHCC), a component unit of the Commonwealth of the Northern Mariana Islands (CNMI), which comprise the statements of net position as of September 30, 2014 and 2013, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Basis for Disclaimer of Opinion

CHCC did not conduct a physical inventory of its capital assets during the years ended September 30, 2014 and 2013. In addition, capital asset additions totaling \$894,238 and \$1,287,134 were expensed during the years ended September 30, 2014 and 2013, respectively. Accounting principles generally accepted in the United States of America require capital assets to be capitalized and depreciated.

We were unable to determine the propriety of receivables, inventories, due to/from CNMI, accounts payable, due to related parties, accrued payroll, accrued taxes and other liabilities and related revenues, expenses and nonoperating income (expense) as of and for the years ended September 30, 2014 and 2013 as CHCC could not substantiate general ledger balances due to inadequacies in accounting records. CHCC received and recorded a litigation settlement of \$1,779,237 at September 30, 2013. We were unable to determine the propriety of the settlement as the settlement agreement or other relevant data was not made available.

In addition, grant award documents for the Electronic Health Record incentive award were not available. We were unable to evaluate and assess compliance, if any, with grant requirements and federal rules and regulations at September 30, 2013.

Disclaimer of Opinion

Because of the significance of the matters discussed in the "Basis for Disclaimer of Opinion" paragraphs, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying financial statements.

Emphasis-of-Matters

Going Concern

The accompanying financial statements have been prepared assuming that CHCC will continue as a going concern. As discussed in note 9 to the financial statements, CHCC has incurred recurring losses and negative cash flows from operations that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in note 9. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Correction of an Error

As discussed in note 10 to the financial statements, the beginning restricted net position has been restated for the correction of an error.

Our opinion is not modified with respect to these matters.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 6 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 engagement to audit the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 15, 2015 on our consideration of CHCC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering CHCC's internal control over financial reporting and compliance.

Deloitte & Touche LLC

September 15, 2015



Commonwealth Healthcare Corporation

Commonwealth of the Northern Mariana Islands
1 Lower Navy Hill Road Navy Hill, Saipan, MP 96950



MANAGEMENT'S DISCUSSION AND ANALYSIS Year Ended September 30, 2014

INTRODUCTION

The Management's Discussion and Analysis (MD&A) of the Commonwealth Healthcare Corporation (CHCC) will serve as an overview of the audited financial statements of CHCC for fiscal year 2014. The information contained in the MD&A has been prepared by management and should be considered in conjunction with the financial statements and notes which follow this section. Fiscal years 2013 and 2012 comparative information have been included where appropriate.

FINANCIAL HIGHLIGHTS

- CHCC'S net position increased from \$(1,651,343) in fiscal year 2013 to \$35,972,699 in fiscal year 2014 due to capital contributions of \$39,916,090 from the Commonwealth of the Northern Mariana Islands (CNMI) government and a decrease in bad debts recorded from \$14,706,505 in fiscal year 2013 to \$9,434,557 in fiscal year 2014. CHCC's net position decreased from \$198,735 in fiscal year 2012 to \$(1,651,343) in fiscal year 2013.
- CHCC recorded capital assets of \$39,916,090 transferred from the CNMI at September 30, 2014. CHCC expensed machinery, office equipment, furniture and fixtures of \$894,238, \$1,287,134 and \$115,907 at September 30, 2014, 2013 and 2012, respectively, which will be capitalized in fiscal year 2015.
- CHCC's total assets increased from \$19,239,829 in fiscal year 2013 to \$64,608,791 in fiscal year 2014 and from \$16,639,817 in fiscal year 2012 to \$19,239,829 in fiscal year 2013. Total assets are composed of cash, receivables, advances, due from CNMI, inventories and capital assets, net of accumulated depreciation.
- CHCC's total liabilities increased from \$20,891,172 in fiscal year 2013 to \$28,636,092 in fiscal year 2014 and from \$16,441,082 in fiscal year 2012 to \$20,891,172 in fiscal year 2013.
- CHCC's operating revenues increased from \$29,608,622 in fiscal year 2013 to \$38,508,072 in fiscal year 2014 and decreased from \$29,651,097 in fiscal year 2012 to \$29,608,622 in fiscal year 2013.
- CHCC's operating expenses increased from \$35,221,811 in fiscal year 2013 to \$42,592,687 in fiscal year 2014 and from \$34,075,575 in fiscal year 2012 to \$35,221,811 in fiscal year 2013.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Governmental Accounting Standards Board (GASB) requires the presentation of an MD&A and basic financial statements. The basic financial statements consist of a statement of net position, a statement of revenues, expenses and changes in net position, a statement of cash flows and notes to the financial statements.

MD&A

The MD&A is a narrative section that introduces the basic financial statements. It should give readers an objective, easily understood and readable analysis of CHCC's financial performance for the year.

Statement of Net Position

The Statement of Net Position presents information similar to a balance sheet. It reflects CHCC's assets, liabilities and the resources remaining after liabilities are satisfied. The statement is an indicator of overall financial condition.

Statement of Revenues, Expenses and Changes in Net Position

The Statement of Revenues, Expenses and Changes in Net Position is the operating statement for CHCC utilizing the accrual basis of accounting.

A summary of the Statements of Net Position and the Statements of Revenues, Expenses and Changes in Net Position is presented below:

Statements of Net Position

Assets	2014	2013 (As Restated)	2012
Current assets	\$ 24,692,701	\$ 19,239,829	\$ 16,639,817
Capital assets, net of accumulated depreciation	<u>39,916,090</u>	<u>-</u>	<u>-</u>
Total assets	\$ <u>64,608,791</u>	\$ <u>19,239,829</u>	\$ <u>16,639,817</u>
Liabilities and Net Position			
Liabilities:			
Current liabilities	\$ <u>28,636,092</u>	\$ <u>20,891,172</u>	\$ <u>16,441,082</u>
Total liabilities	<u>28,636,092</u>	<u>20,891,172</u>	<u>16,441,082</u>
Net position:			
Net investment in capital assets	39,916,090	-	-
Restricted	1,432,312	779,237	-
Unrestricted	<u>(5,375,703)</u>	<u>(2,430,580)</u>	<u>198,735</u>
Total net position	<u>35,972,699</u>	<u>(1,651,343)</u>	<u>198,735</u>
Total liabilities and net position	\$ <u>64,608,791</u>	\$ <u>19,239,829</u>	\$ <u>16,639,817</u>

OVERVIEW OF THE FINANCIAL STATEMENTS, CONTINUED

Statements of Revenues, Expenses and Changes in Net Position

	2014	2013	2012
Operating revenues	\$ 38,508,072	\$ 29,608,622	\$ 29,651,097
Operating expenses	<u>42,592,687</u>	<u>35,221,811</u>	<u>34,075,575</u>
Operating loss	(4,084,615)	(5,613,189)	(4,424,478)
Nonoperating income (expense), net	<u>1,792,567</u>	<u>3,763,111</u>	<u>4,623,213</u>
Loss before capital contributions	(2,292,048)	(1,850,078)	198,735
Capital contributions	<u>39,916,090</u>	<u>-</u>	<u>-</u>
Change in net position	37,624,042	(1,850,078)	198,735
Net position at beginning of year	<u>(1,651,343)</u>	<u>198,735</u>	<u>-</u>
Net position at end of year	\$ <u>35,972,699</u>	\$ <u>(1,651,343)</u>	\$ <u>198,735</u>

Statements of Cash Flows

	2014	2013	2012
Cash flows from operating activities	\$ (4,622,022)	\$ (6,493,623)	\$ (976,668)
Cash flows from financing activities	<u>1,792,567</u>	<u>3,434,456</u>	<u>7,951,868</u>
Net (decrease) increase in cash	(2,829,455)	(3,059,167)	6,975,200
Cash at beginning of year	<u>3,916,033</u>	<u>6,975,200</u>	<u>-</u>
Cash at end of year	\$ <u>1,086,578</u>	\$ <u>3,916,033</u>	\$ <u>6,975,200</u>

CHCC'S ANALYSIS AND FINANCIAL CONDITION

At the end of fiscal years 2014, 2013 and 2012, CHCC had total assets of \$64,608,791, \$19,239,829 and \$16,639,817, respectively, comprised of cash, receivables, net of allowance for doubtful accounts, advances, due from CNMI, inventories of medical and pharmaceutical supplies and contributed capital assets from the CNMI government.

Current liabilities arise from obligations to CHCC's suppliers/vendors for operations, retirement contributions and taxes.

Notes payable arise from the Marianas Public Land Trust lines of credit of \$3,000,000 as of September 30, 2014 and 2013, respectively, and \$3,328,655 as of September 30, 2012. See note 4 to the financial statements for more detailed information on CHCC's notes payable to a related party.

Major expenses for CHCC are wages and salaries, utilities, employee benefits and medical supplies.

CHCC'S ANALYSIS AND FINANCIAL CONDITION, CONTINUED

Considering the level of funding that CHCC receives from the CNMI government, it will continue to face financial challenges despite great improvements in the collection of receivables compared to previous years. CHCC commits to strive and improve its healthcare system and to make its patient's experience the best quality care in the CNMI.

CHCC's implementation of its Business and Strategic Plan continues to address and improve the current state of health in the CNMI.

Capital Assets

At September 30, 2014 and 2013, CHCC had \$39,916,090 and \$-0-, respectively, invested in capital assets. This represents a net increase of 100% during fiscal year 2014 due to the transfer of capital assets from the CNMI. See notes 2 and 3 to the financial statements for more detailed information on CHCC's capital assets.

CHALLENGES AND ACCOMPLISHMENTS

Over the year, CHCC continues to face challenges but has also made accomplishments:

- a. CHCC will continue to attempt to hire a permanent Chief Financial Officer to fully address its overall financial condition.
- b. CHCC will continue to address and eliminate Medicare findings and citations.
- c. We have sufficient physicians at CHCC.
- d. CHCC will explore the hiring of nurses through manpower agencies.
- e. CHCC will continue implementation of the Electronic Health Record system in Tinian and Rota to improve its billing process and increase revenue collection.

ECONOMIC OUTLOOK

CHCC has experienced many challenges but anticipates and envisions more improvements as there is more that needs to be done. CHCC's challenges are currently being addressed and handled distinctively.

The Management's Discussion and Analysis for the year ended September 30, 2013 is set forth in CHCC's report on the audit of financial statements, which is dated February 24, 2015. That Discussion and Analysis explains the major factors impacting the 2013 financial statements and can be viewed at the Office of the Public Auditor's website at www.opacnmi.com.

CONTACTING CHCC'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, patients and stakeholders a general overview of CHCC's finances and demonstrate its stewardship and accountability with public funds that it collects and its proper usage. If you have any questions about this report or need additional information, please contact CHCC's Chief Executive Officer or its Acting Chief Financial Officer at 234-8950, Monday through Friday, 8:00 am to 5:00 pm, except on recognized CNMI government holidays.

COMMONWEALTH HEALTHCARE CORPORATION

Statements of Net Position
September 30, 2014 and 2013

<u>ASSETS</u>	<u>2014</u>	<u>2013</u> <u>(As Restated)</u>
Current assets:		
Cash	\$ 1,086,578	\$ 3,916,033
Receivables:		
Patient	19,386,190	65,516,083
Third party insurers	12,436,259	78,936,015
Medicare	7,386,218	7,141,889
Medicaid	3,640,664	76,994,907
Other	141,170	42,050
	<u>42,990,501</u>	<u>228,630,944</u>
Less allowance for doubtful accounts	<u>(24,141,067)</u>	<u>(217,813,527)</u>
Total receivables, net	<u>18,849,434</u>	<u>10,817,417</u>
Advances	<u>362,953</u>	<u>-</u>
Due from CNMI	<u>2,037,221</u>	<u>2,066,439</u>
Inventories	<u>2,356,515</u>	<u>2,439,940</u>
Total current assets	<u>24,692,701</u>	<u>19,239,829</u>
Capital assets, net of accumulated depreciation	<u>39,916,090</u>	<u>-</u>
Total assets	<u>\$ 64,608,791</u>	<u>\$ 19,239,829</u>
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Notes payable to a related party	\$ 3,000,000	\$ 3,000,000
Accounts payable	5,582,711	2,013,960
Due to related parties	15,569,966	12,717,753
Accrued payroll	938,328	995,134
Accrued taxes and other liabilities	3,052,309	1,030,184
Unearned revenue	492,778	1,134,141
Total liabilities	<u>28,636,092</u>	<u>20,891,172</u>
Commitments and contingencies		
Net position:		
Net investment in capital assets	39,916,090	-
Restricted	1,432,312	779,237
Unrestricted	<u>(5,375,703)</u>	<u>(2,430,580)</u>
Total net position	<u>35,972,699</u>	<u>(1,651,343)</u>
	<u>\$ 64,608,791</u>	<u>\$ 19,239,829</u>

See accompanying notes to financial statements.

COMMONWEALTH HEALTHCARE CORPORATION

Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Operating revenues:		
Hospital services	\$ 47,675,810	\$ 44,221,146
Other revenue	266,819	88,481
Contributions	-	5,500
	<u>47,942,629</u>	<u>44,315,127</u>
Bad debts	<u>(9,434,557)</u>	<u>(14,706,505)</u>
Total operating revenues, net	<u>38,508,072</u>	<u>29,608,622</u>
Operating expenses:		
Wages and salaries	20,480,124	16,771,660
Supplies	5,846,323	3,403,285
Utilities	5,710,570	5,766,767
Employee benefits	3,710,364	3,981,060
Professional services	1,931,104	1,666,499
Repair and maintenance	673,093	674,550
Cleaning services	509,932	545,975
Machinery and equipment	275,053	1,266,725
Recruitment/repatriation	267,955	261,234
Food items	211,839	169,775
Travel	201,659	180,164
Fuel and lubricants	155,516	129,106
Communications	142,260	171,664
Printing and photocopying	83,313	85,795
Freight and handling	73,486	68,395
Building improvements	62,671	1,544
Rentals	52,787	10,247
Licenses and fees	45,341	48,501
Office equipment	16,783	18,865
Furniture and fixtures	529	-
Miscellaneous	2,141,985	-
Total operating expenses	<u>42,592,687</u>	<u>35,221,811</u>
Operating loss	<u>(4,084,615)</u>	<u>(5,613,189)</u>
Nonoperating income (expense):		
Federal grant contributions	12,742,223	1,048,144
CNMI appropriation	1,208,675	1,152,913
Settlements	-	1,779,237
Interest expense	(177,779)	(217,183)
Federal grant expenses	<u>(11,980,552)</u>	<u>-</u>
Total nonoperating income (expense), net	<u>1,792,567</u>	<u>3,763,111</u>
Loss before capital contributions	<u>(2,292,048)</u>	<u>(1,850,078)</u>
Capital contributions	<u>39,916,090</u>	<u>-</u>
Change in net position	<u>37,624,042</u>	<u>(1,850,078)</u>
Net position at beginning of year	<u>(1,651,343)</u>	<u>198,735</u>
Net position at end of year	<u>\$ 35,972,699</u>	<u>\$ (1,651,343)</u>

See accompanying notes to financial statements.

COMMONWEALTH HEALTHCARE CORPORATION

Statements of Cash Flows
Years Ended September 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Cash received from customers	\$ 29,863,908	\$ 27,163,272
Cash payments to suppliers for goods and services	(10,238,636)	(12,775,313)
Cash payments to employees for services	<u>(24,247,294)</u>	<u>(20,881,582)</u>
Net cash used for operating activities	<u>(4,622,022)</u>	<u>(6,493,623)</u>
Cash flows from financing activities:		
Cash received from the CNMI	1,208,675	1,152,913
Federal and other contributions received	12,742,223	1,048,144
Payments made under federal programs	(11,980,552)	-
Settlements	-	1,779,237
Proceeds from notes payable	3,000,000	3,000,000
Payment of notes payable	(3,000,000)	(3,328,655)
Interest paid on notes payable	<u>(177,779)</u>	<u>(217,183)</u>
Net cash provided by financing activities	<u>1,792,567</u>	<u>3,434,456</u>
Net decrease in cash	(2,829,455)	(3,059,167)
Cash at beginning of year	<u>3,916,033</u>	<u>6,975,200</u>
Cash at end of year	<u>\$ 1,086,578</u>	<u>\$ 3,916,033</u>
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	\$ (4,084,615)	\$ (5,613,189)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Bad debts	9,434,557	14,706,505
(Increase) decrease in assets:		
Receivables:		
General	(17,367,454)	(16,178,005)
Other	(99,120)	(41,552)
Advances	(362,953)	-
Due from CNMI	29,218	(2,066,439)
Inventories	83,425	(2,079,688)
Increase (decrease) in liabilities:		
Accounts payable	3,568,751	(68,506)
Due to related parties	2,852,213	5,120,413
Accrued payroll	(56,806)	(128,862)
Accrued taxes and other liabilities	2,022,125	(1,278,441)
Unearned revenue	<u>(641,363)</u>	<u>1,134,141</u>
Net cash used for operating activities	<u>\$ (4,622,022)</u>	<u>\$ (6,493,623)</u>

Supplemental disclosure of noncash transactions:

During the year ended September 30, 2014, CHCC recorded the following noncash transactions as a result of the transfer of capital assets from the CNMI:

	<u>2014</u>	<u>2013</u>
Noncash increase in capital assets	\$ 39,916,090	\$ -
Noncash increase in capital contributions	<u>(39,916,090)</u>	<u>-</u>
	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to financial statements.

COMMONWEALTH HEALTHCARE CORPORATION

Notes to Financial Statements
September 30, 2014 and 2013

(1) Organization and Purpose

The Commonwealth Healthcare Corporation (CHCC) is responsible for providing healthcare services in the Commonwealth of the Northern Mariana Islands (CNMI), and was created through CNMI Public Law 16-51. CHCC is governed by a Chief Executive Officer (CEO) who governs the operations of CHCC in a manner that furthers its purposes. A seven-member Board of Trustees, three of which are ex officio voting members consisting of the CEO, the Director of Medical Affairs and a U.S. citizen selected from CHCC's non-physician healthcare professionals and the remaining four appointed by the Governor with the advice and consent of the Senate, acts in an advisory role to the CEO.

(2) Summary of Significant Accounting Policies

The accounting policies of CHCC conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities, specifically proprietary funds. CHCC utilizes the flow of economic resources measurement focus. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Basis of Accounting

All proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of this fund are included on the statements of net position. Proprietary fund operating statements present increases (e.g. revenues) and decreases (e.g. expenses) in net position. The accrual basis of accounting is utilized for proprietary funds. Under this method, revenues are recorded when earned and expenses recorded at the time liabilities are incurred.

Budgets

In accordance with Public Law 3-68, the Planning and Budgeting Act of 1983, CHCC is required to submit annual budgets to the CNMI Office of the Governor.

Concentrations of Credit Risk

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

Taxes

Per Public Law 16-51, Section 2811, CHCC is exempt from the Northern Marianas Territorial Income Tax. Therefore, no provision has been made for gross receipts or income taxes in the accompanying financial statements.

COMMONWEALTH HEALTHCARE CORPORATION

Notes to Financial Statements
September 30, 2014 and 2013

(2) Summary of Significant Accounting Policies, Continued

Cash

For purposes of the statements of net position and cash flows, CHCC considers all cash held in demand accounts to be cash. At September 30, 2014 and 2013, total cash was \$1,086,578 and \$3,916,033, respectively, and the corresponding bank balances were \$1,579,261 and \$4,461,108, respectively. All bank balances are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. CNMI law does not require component unit funds to be collateralized and thus CHCC's funds, in excess of FDIC insurance, are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

Patient Accounts Receivable

Accounts receivable for services provided to patients covered under the Medicare and Medicaid programs, privately sponsored managed care programs for which payment is made based on terms defined under formal contracts, and other payers (including self-pay) are recorded at their estimated realizable values based on CHCC's standard fees. A provision for uncollectible accounts is based on management's evaluation of the collectability of current accounts and historical trends. Finance charges or interest is not accrued for past due accounts.

Management believes there are no significant credit risks associated with receivables from government programs. Receivables from managed care programs and others are from various payers who are subject to differing economic conditions. They do not represent any concentrated credit risk to CHCC. Management continually monitors and adjusts the estimated allowances for contractual adjustments and uncollectible accounts.

Allowance for Doubtful Accounts

The allowance for doubtful accounts is stated at an amount that management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectability of these accounts and prior collection experience. The allowance is established through an allowance for doubtful accounts charged to bad debts expense. Bad debts are written-off against the allowance based on the specific identification method. At September 30, 2014, CHCC wrote-off accounts receivable of \$203,107,017. CHCC recorded bad debts of \$9,434,557 and \$14,706,505 during the years ended September 30, 2014 and 2013, respectively.

Inventories

Inventories are stated at the lower of cost or market using the first-in/first-out (FIFO) method.

COMMONWEALTH HEALTHCARE CORPORATION

Notes to Financial Statements
September 30, 2014 and 2013

(2) Summary of Significant Accounting Policies, Continued

Capital Assets

In accordance with CNMI Public Law 16-51, the CNMI is required to transfer all real properties owned by the CNMI Department of Public Health, and all other real and personal property used exclusively for the functions and duties assumed by CHCC, to CHCC. During the year ended September 30, 2014, the CNMI transferred capital assets totaling \$65,868,991 and related accumulated depreciation of \$25,952,901 to CHCC. CHCC has adopted a policy to capitalize items with costs in excess of \$2,500.

Unearned Revenue

Unearned revenue is recognized when cash, receivables or other assets are recorded prior to being earned. Unearned revenue of \$492,778 and \$1,134,141 as of September 30, 2014 and 2013, respectively, relates to advances received from the CNMI Government for the Electronic Health Record incentive program.

Retirement Plan

CHCC contributed to the Northern Mariana Islands Retirement Fund's (NMIRF) defined benefit plan (DB Plan), a cost-sharing, multiple-employer plan established and now administered by the CNMI. CHCC also contributes to a defined contribution plan (DC Plan).

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 portion to the employee's defined account shall continue with respect to employees who do not terminate membership in the DB Plan. All but nine active CHCC employees voluntarily terminated membership in the DB Plan and CHCC contributed \$183,094 and \$254,398 to the DB Plan during the years ended September 30, 2014 and 2013, respectively.

COMMONWEALTH HEALTHCARE CORPORATION

Notes to Financial Statements
September 30, 2014 and 2013

(2) Summary of Significant Accounting Policies, Continued

Retirement Plan, Continued

For the years ended September 30, 2014 and 2013, CHCC contributed social security benefits of \$1,302,829 and \$1,017,297, respectively.

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. CHCC is required to contribute to each member's individual account an amount equal to 4% of the member's compensation. CHCC's recorded DC contributions for the years ended September 30, 2014 and 2013 were \$402,996 and \$236,877, respectively.

Members of the DC Plan, who have completed five years of government service, have a vested balance of 100% of both member and employer contributions plus any earnings thereon.

Net Position

CHCC's net position is classified as follows:

- Invested in capital assets: capital assets, net of accumulated depreciation.
- Restricted: net position subject to externally imposed stipulations that can be fulfilled by actions pursuant to those stipulations or that expire by the passage of time. A restricted net position of \$1,432,312 and \$779,237 is recorded at September 30, 2014 and 2013, respectively, based on the differential between recorded restricted receipts and restricted expenses.
- Unrestricted: net position that is not subject to externally imposed stipulations.

Compensated Absences

The accumulated vacation leave liability as of September 30, 2014 and 2013 amounted to \$2,403,117 and \$1,659,713, which management has elected not to record at September 30, 2014 and 2013, respectively.

Operating and Non-Operating Revenue and Expenses

CHCC considers revenues and costs that are directly related to patient and other healthcare operations and exchange transactions to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as non-operating. Revenues are recorded net of contractual adjustments of \$8,307,292 and \$15,467,734 for the years ended September 30, 2014 and 2013, respectively.

COMMONWEALTH HEALTHCARE CORPORATION

Notes to Financial Statements
September 30, 2014 and 2013

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

During the year ended September 30, 2014, CHCC implemented the following pronouncements:

- GASB Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The implementation of this statement did not have a material effect on the accompanying financial statements.

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Statement 68 will require CHCC to recognize a net pension liability based on the percentage of the actuarial present value of projected benefit payments allocated to CHCC by the Northern Mariana Islands Settlement Fund (the Settlement Fund). The Settlement Fund has not communicated amounts to CHCC which may be material and will be recorded on October 1, 2014. The implementation of this statement may have a material effect on the financial statements of CHCC and may require a restatement disclosure upon implementation.

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*, which improves accounting and financial reporting for state and local governments' combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. A disposal of government operations can occur through a transfer to another government or a sale. The provisions in Statement 69 are effective for fiscal years beginning after December 15, 2013. Management has not yet determined the effect of implementation of this statement on the financial statements of CHCC.

COMMONWEALTH HEALTHCARE CORPORATION

Notes to Financial Statements
September 30, 2014 and 2013

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*, which addresses an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. The provisions in Statement 71 are effective for fiscal years beginning after June 15, 2014. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CHCC.

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.

Reclassifications

Certain 2013 balances in the accompanying financial statements have been reclassified to conform to the 2014 presentation.

(3) Capital Assets

Capital asset balances consist of the following as of September 30, 2014 and 2013:

	<u>Estimated Useful Lives</u>	<u>Balance October 1, 2013</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance September 30, 2014</u>
Assets not being depreciated:					
Construction in progress		\$ -	\$ 2,156,816	\$ -	\$ 2,156,816
Capital assets being depreciated:					
Building	15 - 50 years	-	34,275,607	-	34,275,607
Machinery and equipment	5 - 10 years	-	3,483,667	-	3,483,667
		-	37,759,274	-	37,759,274
Less accumulated depreciation		-	-	-	-
Total capital assets being depreciated		-	37,759,274	-	37,759,274
Total capital assets, net		\$ -	\$ 39,916,090	\$ -	\$ 39,916,090

COMMONWEALTH HEALTHCARE CORPORATION

Notes to Financial Statements
September 30, 2014 and 2013

(3) Capital Assets, Continued

On November 18, 2013, CHCC was advised that properties deeded to CHCC from the CNMI in January 2012 may revert to the CNMI and to the Department of Public Lands. The two properties deeded are located adjacent to the hospital and are currently encumbered by CHCC's loan with MPLT. The primary reason for this change is to increase the properties' earning potential. Management has not yet determined the effect of this change on the accompanying financial statements; however, the property has not been recorded due to the incomplete status of the transfer document between CHCC and the CNMI.

(4) Notes Payable to a Related Party

	<u>2014</u>	<u>2013</u>
Note payable to the Marianas Public Land Trust (MPLT), bearing interest at 7% per annum, due over a one-year term, beginning on March 12, 2013. The note is collateralized by CHCC's accounts receivable, future distributable income in fiscal year 2014 and CHCC's real properties for CHCC's operational and bridge capital pursuant to CNMI Public Law No. 17-76. The note was paid in full on April 9, 2014.	\$ -	\$ 3,000,000
Note payable to MPLT, bearing interest at 7% per annum, due on June 4, 2015. The note is collateralized by future distributable income in fiscal year 2015 and CHCC's real properties for CHCC's operational and bridge capital pursuant to CNMI Public Law No. 17-76.	<u>3,000,000</u>	<u>-</u>
	<u>\$ 3,000,000</u>	<u>\$ 3,000,000</u>

(5) Risk Management

CNMI Public Law 16-51 established CHCC as a public corporation with certain limitations on liability provided by the CNMI Government Liability Act (GLA) and immunity from seizure of its property to pay judgment debts. CHCC employees are covered by CNMI Public Law 15-22, which amended the GLA, which provides that employees who have been personally sued for actions taken within the scope of their employment may have the government substituted as the defendant and the employee dismissed from the suit. CHCC is "self-insured" meaning it has no insurance coverage. When a malpractice action is filed naming an individual health care provider who works for the government as a defendant, Public Law 15-22 requires that the health care provider be dismissed from the lawsuit, and the government substituted as the defendant, upon certification by the CNMI Attorney General that the provider was acting within the scope of his or her employment at the time of the alleged negligence. Public Law 15-22 operates to substitute the CNMI government, not CHCC, as the defendant in place of the individual CHCC employee. Public Law 16-51 is clear that CHCC is a CNMI government corporation covered by the immunities reserved to the government under the GLA. The GLA provides that judgments against CNMI public corporations are treated as judgments against the CNMI for the purpose of enforcement and payment. A judgment against CHCC may only be paid upon a specific appropriation by the CNMI Legislature for that purpose. Absent an appropriation by the legislature, CHCC is prohibited from paying a judgment rendered against it.

COMMONWEALTH HEALTHCARE CORPORATION

Notes to Financial Statements
September 30, 2014 and 2013

(5) Risk Management, Continued

CHCC will report all of its risk management activities, if and when such occurs. Claims expenditures and liabilities will be reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Losses, if reported, would include an estimate of claims that have been incurred but not reported. No losses as a result of these risks have occurred or have been reported within the last two years.

(6) Related Party Transactions

Total related party transactions for the years ended September 30, 2014 and 2013, and the related receivable and payable balances, are as follows:

	2014			
	Revenues and Other Contributions	Expenses	Payables	Receivables
Commonwealth Utilities Corporation	\$ -	\$ 5,837,899	\$ 11,185,488	\$ -
CNMI Government	<u>1,208,675</u>	<u>359,421</u>	<u>4,384,478</u>	<u>2,037,221</u>
	<u>\$ 1,208,675</u>	<u>\$ 6,197,320</u>	<u>\$ 15,569,966</u>	<u>\$ 2,037,221</u>
	2013			
	Revenues and Other Contributions	Expenses	Payables	Receivables
Commonwealth Utilities Corporation	\$ -	\$ 5,766,767	\$ 8,996,577	\$ -
CNMI Government	1,152,913	402,939	788,270	2,066,439
Northern Mariana Islands Retirement Fund	<u>-</u>	<u>253,729</u>	<u>2,932,906</u>	<u>-</u>
	<u>\$ 1,152,913</u>	<u>\$ 6,423,435</u>	<u>\$ 12,717,753</u>	<u>\$ 2,066,439</u>

Notes payable to MPLT aggregate \$3,000,000 at September 30, 2014 and 2013. Related interest expense for the years ended September 30, 2014 and 2013 amounted to \$177,779 and \$217,183, respectively.

CHCC recorded contributions of \$1,208,675 and \$1,152,913 from the CNMI during the years ended September 30, 2014 and 2013, respectively. Due from CNMI of \$2,037,221 and \$2,066,439 relates to unreconciled amounts at September 30, 2014 and 2013, respectively. Due to the CNMI relates to the 1% Public Auditor fee of \$1,147,691 and \$788,270 at September 30, 2014 and 2013, respectively. Due to CNMI also includes \$3,236,787 related to CHCC's contribution to the DB Plan (see note 8).

(7) Commitments

CHCC leases a portion of its office space, located on the second floor of the Commonwealth Health Center. The lease agreement provides for an annual rental of \$79,500 during the term of the lease. Total lease income for the years ended September 30, 2014 and 2013 is \$79,500 and \$72,575, respectively. Minimum future lease income is as follows:

COMMONWEALTH HEALTHCARE CORPORATION

Notes to Financial Statements
September 30, 2014 and 2013

(7) Commitments, Continued

<u>Year ending September 30,</u>	<u>Minimum Lease Income Due</u>
2015	\$ 79,500
2016	79,500
2017	<u>13,250</u>
	\$ <u>172,250</u>

CHCC engages in various contracts to sustain hospital operations. Future contract commitments for the year ended September 30, 2015 are \$773,555.

(8) Contingencies

At September 30, 2014 and 2013, CHCC recorded outstanding Medicare withholdings of \$680,646 and \$217,512, respectively. The related interest and penalties for late submission and payment of Medicare withholdings have not been determined and, accordingly, is not recorded at September 30, 2014 and 2013, respectively. CHCC management does not consider the related interest and penalties material to the financial statements.

At September 30, 2013, CHCC recorded outstanding withholding taxes (Chapter 2 local tax and Chapter 7 NMTIT) of \$665,083. The related interest and penalties for late submission and payment of withholding taxes have not been determined and, accordingly, was not recorded at September 30, 2014 and 2013.

CHCC participates in a number of federally assisted grant programs funded by the United States Government. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of \$653,621 have been set forth in CHCC's Single Audit Report for the year ended September 30, 2014. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

In April 2012, a court order was issued by the CNMI Superior Court authorizing autonomous agencies to remit employer contributions of 30% of covered payroll to NMIRF. On September 30, 2013, the United States District Court for the Northern Mariana Islands approved a Settlement agreement in a Class Action Settlement (Settlement), between a retiree (individually and on behalf of similarly-situated persons) and the CNMI, NMIRF and others. The Settlement includes the creation of the Settlement Fund to accept the transfer of NMIRF assets, receive annual contributions and payments by the CNMI and to carry out the consent judgment entered by the District Court. Further, Section 8.1 of the Settlement assigns the CNMI the rights to collect deficient employer contributions and related costs as of August 6, 2013 from autonomous agencies.

COMMONWEALTH HEALTHCARE CORPORATION

Notes to Financial Statements September 30, 2014 and 2013

(8) Contingencies, Continued

At September 30, 2014 and 2013, CHCC recorded outstanding and deficient employer contributions due to the CNMI of \$3,236,787 and \$2,932,906, respectively. The amount confirmed by the CNMI was \$6,842,972 (inclusive of interest totaling \$174,483) resulting in a variance of \$3,606,185 and \$3,910,066 at September 30, 2014 and 2013, respectively. An assessment of the outstanding and deficient employer contributions has not been determined and, accordingly, employer contributions of \$3,606,185 and \$3,910,066 are not reflected in the accompanying financial statements at September 30, 2014 and 2013, respectively.

(9) Going Concern

CHCC incurred operating losses of \$4,084,615 and \$5,613,189 and negative cash flows from operations of \$4,622,022 and \$6,493,623 for the years ended September 30, 2014 and 2013, respectively. CHCC recorded bad debts of \$9,434,557 and \$14,706,505 for the fiscal years ended September 30, 2014 and 2013, respectively. At September 30, 2014 and 2013, delinquent utility charges excluding penalties due to the Commonwealth Utilities Corporation (CUC) amounted to \$11,185,488 and \$8,996,577, respectively. At September 30, 2014, total penalties and late charges assessed by CUC amounted to \$1,864,433. CHCC has not recorded the penalties due at September 30, 2014. On May 21, 2014 the CNMI Superior Court issued a temporary restraining order (TRO) and preliminary injunction prohibiting CUC from disconnecting any utility services provided to CHCC. On June 2, 2014, the Superior Court ordered CHCC to make timely payments of monthly billings, exclusive of interest or penalties, and determine non-essential meters to be terminated.

CHCC management has taken the following actions and measures to address losses and negative cash flows from operations:

- Continue evaluation of the fee structure to determine if changes/adjustments are necessary;
- Continued evaluation of the billing system and collection processes to determine changes to be made;
- Enhancement of the personnel structure and invest in staff and expansion;
- Implementation of the business and strategic plan; and
- Develop plans for alternative revenue generating methods.

CHCC is dependent on the CNMI Government to provide additional funding for operations.

(10) Restatement

Management has determined that the restricted net position at September 30, 2013 was understated by \$779,237 and has corrected this error in the accompanying financial statements:

	<u>As Previously Reported</u>	<u>As Restated</u>
Net position, restricted	\$ -	\$ 779,237

COMMONWEALTH HEALTHCARE CORPORATION

Notes to Financial Statements
September 30, 2014 and 2013

(11) Subsequent Event

On March 19, 2015, the Superior Court found CHCC to be in contempt of the court's orders issued on June 2, 2014 and January 20, 2015 and ordered sanctions subject to conditions stipulated in the order. The court further orders CHCC to pay its monthly billings to CUC, subject to any negotiation between the parties. On April 10, 2015, CHCC filed an amended motion to dismiss the case or grant judgement to CHCC.