

COMMONWEALTH UTILITIES CORPORATION

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

YEAR ENDED SEPTEMBER 30, 1999

COMMONWEALTH UTILITIES CORPORATION

FINANCIAL STATEMENTS  
AND  
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 1999 AND 1998



## INDEPENDENT AUDITORS' REPORT

Board of Directors  
Commonwealth Utilities Corporation:

We have audited the accompanying balance sheets of the Commonwealth Utilities Corporation (CUC), a component unit of the Commonwealth of the Northern Mariana Islands (CNMI), as of September 30, 1999 and 1998, and the related statements of earnings and deficit and cash flows for the years then ended. These financial statements are the responsibility of CUC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraph, 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Because of inadequacies in the accounting records and internal control, we were unable to determine that utility receivables, inventory, due from grantor agencies, utility plant, accounts payable and contributed capital were fairly stated as of September 30, 1999 and 1998. Furthermore, in our judgment, the balance of utility receivables, inventory, due from grantor agencies, utility plant, accounts payable and contributed capital materially affect the determination of results of operations and cash flows for the years ended September 30, 1999 and 1998.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had the propriety of utility receivables, inventory, due from grantor agencies, utility plant, accounts payable and contributed capital and their effect on the results of operations and cash flows, been determinable, such financial statements present fairly, in all material respects, the financial position of CUC as of September 30, 1999 and 1998, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Statement of Revenues and Expenses on a Divisional Basis for the year ended September 30, 1999 (page 17) is presented for purposes of additional analysis and is not a required part of the basic financial statements of CUC. This statement is the responsibility of the management of CUC. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, except as discussed in the third paragraph above, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 1, 2000, on our consideration of CUC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

*Deloitte & Touche*

March 1, 2000

## COMMONWEALTH UTILITIES CORPORATION

Balance Sheets  
September 30, 1999 and 1998

ASSETS

	<u>1999</u>	<u>1998</u> <u>(As Restated)</u>
Utility plant:		
Electric plant	\$ 101,457,487	\$ 90,289,795
Water plant	44,712,562	43,366,054
Sewer plant	16,627,845	16,531,191
Administrative equipment	3,709,394	3,436,380
Construction work in progress	<u>22,923,754</u>	<u>18,400,833</u>
	189,431,042	172,024,253
Less accumulated provision for depreciation	<u>(72,154,747)</u>	<u>(65,391,603)</u>
Net utility plant	<u>117,276,295</u>	<u>106,632,650</u>
Current assets:		
Cash and cash equivalents	<u>9,315,758</u>	<u>5,040,684</u>
Accounts receivable:		
Utility	20,791,911	13,742,133
Other	<u>1,633,124</u>	<u>1,926,192</u>
	22,425,035	15,668,325
Less accumulated provision for uncollectible accounts	<u>(4,635,163)</u>	<u>(4,055,769)</u>
Net accounts receivable	<u>17,789,872</u>	<u>11,612,556</u>
Inventory, less allowance for obsolete inventory of \$1,159,467 in 1999 and 1998	<u>9,387,283</u>	<u>6,797,954</u>
Due from grantor agencies	<u>790,826</u>	<u>471,135</u>
Total current assets	<u>37,283,739</u>	<u>23,922,329</u>
Restricted assets:		
Cash and cash equivalents	<u>5,174,782</u>	<u>6,330,905</u>
	<u>\$ 159,734,816</u>	<u>\$ 136,885,884</u>

See accompanying notes to financial statements.

## COMMONWEALTH UTILITIES CORPORATION

Balance Sheets, Continued  
September 30, 1999 and 1998

CAPITALIZATION AND LIABILITIES

	<u>1999</u>	<u>1998</u> (As Restated)
Capitalization (deficiency):		
Contributed capital	\$ 55,164,263	\$ 52,152,993
Deficit	<u>(32,053,662)</u>	<u>(35,165,160)</u>
Total capitalization	<u>23,110,601</u>	<u>16,987,833</u>
Commitments and contingencies		
Long-term debt:		
Notes payable less current maturities	9,306,865	329,944
Loan payable less current maturities	<u>363,203</u>	<u>397,633</u>
	<u>9,670,068</u>	<u>727,577</u>
Current liabilities:		
Current maturities of long-term debt	62,036,316	64,266,330
Accounts payable	7,474,262	5,114,515
Accrued liabilities	1,276,282	996,494
Accrued payroll	449,833	542,181
Customer deposits	7,120,347	6,921,921
Payable to CNMI Office of the Public Auditor	2,158,854	1,549,489
Interest payable	<u>46,438,253</u>	<u>39,779,544</u>
Total current liabilities	<u>126,954,147</u>	<u>119,170,474</u>
	<u>\$ 159,734,816</u>	<u>\$ 136,885,884</u>

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

Statements of Earnings and Deficit  
Years Ended September 30, 1999 and 1998

	<u>1999</u>	<u>1998</u>
Operating revenues:		
Power	\$ 54,592,641	\$ 52,721,128
Water	7,060,230	7,435,411
Sewer	2,073,597	1,992,669
Franchise income	558,160	673,973
Other	<u>501,727</u>	<u>873,435</u>
Total operating revenues	<u>64,786,355</u>	<u>63,696,616</u>
Operating expenses:		
General and administrative	17,557,100	17,443,161
Production fuel	17,452,854	19,714,437
Maintenance	9,245,029	6,235,089
Depreciation	6,746,939	6,859,446
Other production	2,967,842	2,535,395
Supplies	763,029	541,037
Bad debts	321,062	467,071
Other	<u>136,138</u>	<u>82,173</u>
Total operating expenses	<u>55,189,993</u>	<u>53,877,809</u>
Earnings from operations	<u>9,596,362</u>	<u>9,818,807</u>
Nonoperating revenues (expenses):		
Interest income	633,082	430,559
Federal grant income	52,470	614,413
Foreign exchange gain	97	157,754
Interest expense	(7,800,229)	(6,563,168)
CNMI Office of the Public Auditor funding	<u>(664,365)</u>	<u>(624,745)</u>
Total nonoperating revenues (expenses), net	<u>(7,778,945)</u>	<u>(5,985,187)</u>
Net earnings	1,817,417	3,833,620
Add depreciation on fixed assets acquired by grants and contributions externally restricted for capital acquisitions and construction that reduces contributed capital	<u>1,294,081</u>	<u>2,387,452</u>
Decrease in deficit	3,111,498	6,221,072
Deficit at beginning of year	<u>(35,165,160)</u>	<u>(41,386,232)</u>
Deficit at end of year	\$ <u>(32,053,662)</u>	\$ <u>(35,165,160)</u>

See accompanying notes to financial statements.

## COMMONWEALTH UTILITIES CORPORATION

Statements of Cash Flows  
Years Ended September 30, 1999 and 1998

	<u>1999</u>	<u>1998</u> <u>(As Restated)</u>
Cash flows from operating activities:		
Earnings from operations	\$ 9,596,362	\$ 9,818,807
Adjustments to reconcile earnings from operations to net cash provided by operating activities:		
Depreciation	6,746,939	6,859,446
Bad debts	321,062	467,071
(Increase) decrease in assets:		
Accounts receivable:		
Utility	(6,871,328)	(3,173,714)
Other	372,950	456,563
Inventory	(2,589,329)	(25,237)
Increase (decrease) in liabilities:		
Accounts payable	2,359,747	(3,315,877)
Accrued liabilities	279,788	162,098
Accrued payroll	(92,348)	21,773
Customer deposits	<u>198,426</u>	<u>583,714</u>
Net cash provided by operating activities	<u>10,322,269</u>	<u>11,854,644</u>
Cash flows from noncapital financing activities:		
Payments to CNMI Office of the Public Auditor	(55,000)	(60,000)
Operating grants received	<u>52,470</u>	<u>614,413</u>
Net cash (used for) provided by noncapital financing activities	<u>(2,530)</u>	<u>554,413</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(17,390,584)	(10,716,135)
Capital contributions	4,305,351	7,875,219
Proceeds from issuance of debt	9,959,000	5,000,000
Principal repayment of debt	(3,246,426)	(9,219,466)
Interest paid on outstanding debt	(1,141,520)	(434,258)
Net disbursements for capital grants	(319,691)	(177,841)
Decrease (increase) in restricted assets	<u>1,156,123</u>	<u>(6,330,905)</u>
Net cash used for capital and related financing activities	<u>(6,677,747)</u>	<u>(14,003,386)</u>
Cash flows from investing activities:		
Interest received on time certificates of deposit	<u>633,082</u>	<u>430,559</u>
Net cash provided by investing activities	<u>633,082</u>	<u>430,559</u>
Net increase (decrease) in cash and cash equivalents	4,275,074	(1,163,770)
Cash and cash equivalents at beginning of year	<u>5,040,684</u>	<u>6,204,454</u>
Cash and cash equivalents at end of year	\$ <u>9,315,758</u>	\$ <u>5,040,684</u>

See accompanying notes to financial statements.



# COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 1999 and 1998

## (1) Organization

The Commonwealth Utilities Corporation (CUC), a component unit of the Commonwealth of the Northern Mariana Islands (CNMI), was established as a Public Corporation by CNMI Public Law 4-47, as amended by Public Law 5-47, effective October 1, 1985, and began operations on October 1, 1987. CUC was given responsibility for supervising the construction, maintenance, operations, and regulation of all utility services, including power, sewage, refuse collection, telephone, cable television, and water, provided however, that whenever feasible, CUC shall contract for 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 nine-member Board of Directors, appointed for terms of four years by the Governor of the CNMI.

Public Law 4-47 effected transfer to CUC of identifiable assets, liabilities, operations, and unexpended capital improvement funding allocations formerly administered directly by the CNMI Department of Public Works.

## (2) Summary of Significant Accounting Policies

The accounting policies of CUC conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. CUC has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

### 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 disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources, measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included on the balance sheets. Fund equity (i.e., net assets) is segregated into contributed capital and deficit components. Proprietary fund operating statements present increases and decreases in net total assets.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 1999 and 1998

(2) Summary of Significant Accounting Policies, Continued

Basis of Accounting, Continued

The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. Revenues 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 most recent cycle billing.

Budgets

In accordance with CNMI Public Law 3-68, the Planning and Budgeting Act of 1983, CUC submits annual budgets to the CNMI Office of the Governor.

Cash and Cash Equivalents

For purposes of the balance sheets and the statements of cash flows, cash and cash equivalents and restricted 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. At September 30, 1999 and 1998, CUC's cash and cash equivalents are substantially with federally insured banks. CNMI law does not require government agency funds to be collateralized in excess of Federal Depository Insurance Corporation (FDIC) limits; therefore, any amounts in excess of these limits are uncollateralized. FDIC insurance aggregated \$200,000 and \$229,000 at September 30, 1999 and 1998, respectively.

Short-term time certificates of deposit amounting to \$5,174,782 and \$2,762,914 as of September 30, 1999 and 1998 represent customer deposits and, accordingly, are classified as restricted in the accompanying financial statements.

Receivables and Allowance for Doubtful Accounts

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 believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts and prior collection experience. The allowance is established through a provision for bad debts charged to expense.

Inventory

Inventories of fuel are valued at the lower of cost (first-in, first-out) or market (net realizable value). Inventories of supplies and materials are valued at average cost.

Utility Plant and Depreciation

Utility plant are stated at cost, where available. Cost of certain utility plant transferred from the CNMI Department of Public Works, is based on contract amounts to construct certain utility plant. Depreciation is calculated on the straight-line method based on the estimated useful lives of the respective assets.

# COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 1999 and 1998

## (2) Summary of Significant Accounting Policies, Continued

### Utility Plant and Depreciation, Continued

CUC follows the accounting principle generally accepted in the United States of America of recording grants-in-aid for the construction or acquisition of facilities and equipment as contributions. Under this principle, depreciation applicable to contributed assets is recorded as a reduction against the related contribution and depreciation applicable to non-contributed assets is recorded as a charge against income.

### Capitalization of Interest

CUC capitalizes interest in order to recognize all costs associated with non-contributed construction projects based on CUC's weighted average borrowing rate. During the years ended September 30, 1999 and 1998, eligible interest expense was not considered significant and consequently no interest has been capitalized.

### Fund Equity

Contributed capital is recorded initially through receipt of capital grants. Depreciation expense for capital assets acquired with capital grants is recorded as a reduction of contributed capital.

### Retirement Plan

CUC contributes to the Northern Mariana Islands Retirement Fund (the Fund), a cost-sharing multiple employer defined benefit pension plan administered by the CNMI. The Fund provides retirement, security and other benefits to employees, and their spouses and dependents of the CNMI Government and CNMI agencies, instrumentalities, and public corporations. CNMI Public Law 6-17, the Northern Mariana Retirement Fund Act of 1988, assigns the authority to establish and amend benefit provisions to the Fund's Board of Trustees. The Fund issues a publicly available financial report that includes financial statements and required supplementary information for the Fund. That report may be obtained by writing to the Northern Mariana Islands Retirement Fund, P.O. Box 501247, Saipan, MP, 96950-1247.

Plan members are required to contribute 6.5% and 9.0% of their annual covered salary for Class I and Class II members, respectively, and CUC is required to contribute at an actuarially determined rate. The current rate is 26.4% of annual covered payroll. The contribution requirements of plan members and CUC are established and may be amended by the Fund's Board of Trustees. CUC's contributions to the Fund for the years ended September 30, 1999, 1998 and 1997 were \$2,619,860, \$2,622,676, and \$2,269,411, respectively, equal to the required contributions for each year.

### Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and liability as the benefits accrue to employees. No liability is recorded for nonvesting accumulating rights to receive sick pay benefits. The sick pay benefit liability as of September 30, 1999 and 1998, was approximately \$1,700,000 and \$697,000, respectively.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 1999 and 1998

(2) Summary of Significant Accounting Policies, Continued

Franchise Income

Franchise income is received from a local telecommunications company for the right to provide telecommunication services within the CNMI.

Reclassification

Certain 1998 balances in the accompanying financial statements have been reclassified to conform to the 1999 presentation.

(3) Due From Grantor Agencies

CUC is a subrecipient of federal grants received by the CNMI from various U.S. federal agencies. CUC follows the accounting principle generally accepted in the United States of America of recording grants-in-aid for construction or acquisition of facilities and equipment as contributions. Excess grant disbursements over receipts are recognized as due from grantor agencies until funds are received in accordance with grant terms and conditions.

Changes in the due from grantor agencies accounts for the years ended September 30, 1999 and 1998, are as follows:

	1999	1998 (As Restated)
Balance at beginning of year	\$ 471,135	\$ 275,393
Deductions - cash receipts from grantor agencies	(4,231,570)	(5,957,964)
Additions - program outlays	<u>4,551,261</u>	<u>6,153,706</u>
Balance at end of year	\$ <u>790,826</u>	\$ <u>471,135</u>

(4) Utility Plant

Utility plant at September 30, 1999 and 1998, consists of the following:

	Estimated Useful Lives	1999		
		Contributed	Non- Contributed	Total
Utility plant:				
Electric plant	20 years	\$ 18,794,163	\$ 82,663,324	\$ 101,457,487
Water plant	20 years	23,419,142	21,293,420	44,712,562
Sewer plant	20 years	16,212,197	415,648	16,627,845
Administrative equipment	3-5 years	<u>342,027</u>	<u>3,367,367</u>	<u>3,709,394</u>
		58,767,529	107,739,759	166,507,288
Less accumulated provision for depreciation		<u>(23,843,199)</u>	<u>(48,311,548)</u>	<u>(72,154,747)</u>
		34,924,330	59,428,211	94,352,541
Construction work in progress		<u>20,239,933</u>	<u>2,683,821</u>	<u>22,923,754</u>
		\$ <u>55,164,263</u>	\$ <u>62,112,032</u>	\$ <u>117,276,295</u>

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 1999 and 1998

(4) Utility Plant, Continued

	Estimated Useful Lives	1998		
		Contributed	Non- Contributed	Total
Utility plant:				
Electric plant	20 years	\$ 18,794,163	\$ 71,495,632	\$ 90,289,795
Water plant	20 years	21,621,596	21,744,458	43,366,054
Sewer plant	20 years	16,202,187	329,004	16,531,191
Administrative equipment	3-5 years	<u>230,950</u>	<u>3,205,430</u>	<u>3,436,380</u>
		56,848,896	96,774,524	153,623,420
Less accumulated provision for depreciation		<u>(21,774,288)</u>	<u>(43,617,315)</u>	<u>(65,391,603)</u>
		35,074,608	53,157,209	88,231,817
Construction work in progress		<u>17,078,385</u>	<u>1,322,448</u>	<u>18,400,833</u>
		\$ <u>52,152,993</u>	\$ <u>54,479,657</u>	\$ <u>106,632,650</u>

(5) Notes Payable

A schedule of CUC's long-term debt as of September 30, 1999 and 1998, is as follows:

	1999	1998
Promissory note payable to the Commonwealth Development Authority (CDA), a component unit of the CNMI. Principal amount available to \$30,000,000, interest at 7% per annum, with a maturity date of February 17, 2013. Principal and interest payments are due in quarterly payments of \$658,469.	\$ 30,000,000	\$ 30,000,000
Promissory note payable to CDA. Principal amount available to \$16,135,650, interest at 5% per annum, with a maturity date of January 12, 2014. Principal and interest payments are due in quarterly payments of \$359,514.	16,068,750	16,068,750
Promissory note payable to CDA. Principal amount available to \$5,500,000, interest at 7% per annum, with a maturity date of January 30, 2000. Principal and interest payments are due in quarterly payments of \$276,471.	5,500,000	5,500,000
Promissory note payable to CDA. Principal amount available to \$10,000,000 and interest at 7% per annum. Principal and interest payments are due in monthly payments of \$58,509. No promissory agreement related to this note has been signed.	10,000,000	10,000,000
Note payable to bank, due September 25, 1999 in monthly installments of \$156,250 including interest at 6.031% per annum, collateralized by time certificates of deposit.	-	1,897,664

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 1999 and 1998

(5) Notes Payable, Continued

	<u>1999</u>	<u>1998</u>
Note payable to bank, due November 24, 1999 in monthly installments of \$111,400 inclusive of interest at the prevailing TCD interest rate plus 1% (6.3% at September 30, 1999), collateralized by a time certificate of deposit, security interest on all inventory, receivables, furniture, fixtures and equipment and first position assignment of a specified group of CUC's receivables for utility services.	-	1,097,417
Note payable to contractor, due February 1, 2009 in monthly installments of \$180,000 plus interest, collateralized by property, plant and equipment situated in Tinian.	<u>9,740,001</u>	<u>-</u>
	71,308,751	64,563,831
Less amounts due within one year	<u>62,001,886</u>	<u>64,233,887</u>
Long-term portion of notes payable	<u>\$ 9,306,865</u>	<u>\$ 329,944</u>

At September 30, 1999 and 1998, and subsequent to that date, CUC was in default of repayment terms of all notes payable to CDA. In accordance with the associated loan agreements, in the event of default, CDA may accelerate all remaining amounts due. Thus, \$61,568,750 at September 30, 1999 and 1998, associated with the notes payable to CDA along with interest payable on these notes of \$46,291,453 and \$39,382,343 as at September 30, 1999 and 1998, respectively, has been classified as current liabilities within the accompanying financial statements.

On February 1, 1999, a contractor substantially completed the construction of a 10 Megawatt Power Plant on the island of Tinian. CUC is making monthly installments on the guaranteed price of the contract. CUC may, without penalty, discharge the entire outstanding balance of the guaranteed price by paying a discounted amount equal to the adjusted guaranteed price as follows:

<u>Period</u>	<u>Amount</u>
End of year 3	\$ 9,783,000
End of year 4	\$ 8,821,000
End of year 5	\$ 7,750,000
End of year 6	\$ 6,540,000
End of year 7	\$ 5,200,000
End of year 8	\$ 3,900,000

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 1999 and 1998

(5) Notes Payable, Continued

Future repayment commitments of principal and interest are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>
2000	\$ 62,001,886	\$ 48,018,315
2001	518,308	1,641,692
2002	620,225	1,539,774
2003	742,183	1,417,817
2004	888,122	1,271,878
Subsequent years	<u>6,538,027</u>	<u>3,001,974</u>
	<u>\$ 71,308,751</u>	<u>\$ 56,891,450</u>

(6) Loan Payable

On June 29, 1988, the CNMI executed a loan contract with the United States Department of Agriculture, Farmers Home Administration in the amount of \$1,033,400. The loan contract bears interest at 6-1/8% per annum with repayments due on January 1 beginning in 1989 and continuing through 2008. Proceeds of the loan are to be used for the acquisition and construction of improvements and replacements to the Saipan Water System, which is administered by CUC. CUC is required to deposit all water system revenue and funds it receives through the "Covenant to Establish a CNMI in Political Union With the United States of America (the Covenant)" into a water system revenue fund to provide for repayment of the loan. As of September 30, 1999 and 1998, CUC had not established the required water system revenue fund but has established separate general ledger accounts to summarize water system revenues and Covenant funds. It is CUC's intention to repay the loan from these sources and management is of the opinion that its process of accounting for water system revenues and Covenant funds is in compliance with the intent of the loan agreement.

The following summarizes this loan payable as of September 30, 1999 and 1998:

	<u>1999</u>	<u>1998</u>
Loan payable to the U.S. Department of Agriculture with repayments due on January 1, beginning in 1989 through 2008, bearing interest at 6-1/8% per annum.	\$ 397,633	\$ 430,076
Less current portion	<u>34,430</u>	<u>32,443</u>
Long-term loan payable	<u>\$ 363,203</u>	<u>\$ 397,633</u>

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 1999 and 1998

(6) Loan Payable, Continued

Future repayment commitments of principal and interest are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>
2000	\$ 34,430	\$ 24,355
2001	36,539	22,246
2002	38,777	20,008
2003	41,152	17,633
2004	43,672	15,112
Subsequent years	<u>203,063</u>	<u>32,012</u>
	<u>\$ 397,633</u>	<u>\$ 131,366</u>

(7) CNMI Office of the Public Auditor Funding

Public Law 9-66, enacted October 19, 1995, requires government agencies to pay the Commonwealth 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 Public Auditor and the agency may agree, to fund the Office of the Public Auditor (OPA). At September 30, 1999 and 1998, CUC had an outstanding payable to OPA in the amount of \$2,158,854 and \$1,549,489, respectively.

(8) Contributed Capital

Contributed capital was derived from the following sources as of September 30, 1999 and 1998:

	<u>1999</u>	<u>1998</u>
Commonwealth of the Northern Mariana Islands	\$ 33,448,417	\$ 32,482,432
U.S. Department of the Interior	25,132,979	22,751,324
U.S. Environmental Protection Agency	6,853,117	6,297,038
Developer Contributions	6,054,514	6,044,564
U.S. Department of Commerce	4,484,718	3,289,950
U.S. Department of Agriculture	2,608,012	2,608,012
U.S. Federal Emergency Management Agency	<u>425,705</u>	<u>453,961</u>
	79,007,462	73,927,281
Less depreciation of contributed assets	<u>(23,843,199)</u>	<u>(21,774,288)</u>
	<u>\$ 55,164,263</u>	<u>\$ 52,152,993</u>

During the year ended September 30, 1999, CUC extended the estimated useful life of its waterline distribution system on the island of Rota. The effect of this change in accounting estimate increased contributed capital and decreased accumulated depreciation by approximately \$816,755.



# COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 1999 and 1998

## (9) Commitments and Contingencies

### Commitments

CUC has entered into a binding commitment to borrow \$89,000,000 from CDA for proposed capital improvement projects. As of September 30, 1999 and 1998, CUC had entered into promissory note agreements for \$30,000,000, \$16,135,650, and \$5,500,000 against the \$89 million as described in note 5.

On June 10, 1997, CUC entered into an agreement with a contractor for the construction, maintenance and operation, and transfer of ownership of a 10 Megawatt Power Plant on the island of Tinian. The agreement is for a guaranteed price of \$9,959,000 inclusive of interest of \$11,641,000 payable over ten years in equal monthly installments. During this period, the contractor will maintain and operate the power plant and be paid operation, production and maintenance fees in addition to the guaranteed price. The power plant will be turned over to CUC at the end of the ten year period from the date of substantial completion. On December 13, 1998, CUC executed a change order to expand the 10 Megawatt Power Plant to 30 Megawatts. Such expansion is to be fulfilled within the ten year period as stated in the original agreement.

CUC has entered into a contract for generator refurbishment for \$2,880,499. At September 30, 1999, \$1,000,087 is committed for future work under this contract.

### Contingencies

CUC entered into certain memorandums of understanding (MOUs) with developers who paid CUC sewer connection fees in excess of that required by CUC's regulations. To the extent that CUC has not complied with obligations imposed on it by the MOUs (i.e., depositing the contributions in a special fund, making accountings, and spending the contributions for specified capital improvement projects), developers could consider CUC to have breached the terms of the MOUs. The maximum amount that CUC could be required to expend pursuant to the MOUs is \$3,027,951.

CUC is a defendant in several legal cases involving customers, employees and outside parties for which the potential liability relating to such claims cannot presently be determined.

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.

## (10) Going Concern

CUC has working capital deficiencies of \$89,670,408 and \$95,248,145 as at September 30, 1999 and 1998, respectively, and deficits of \$32,053,662 and \$35,165,160 as of those dates, respectively. The results of operations to date are consistent with management's budget estimates. Management of CUC perceives that an increase of future operating revenues will result by decreasing line losses, expanding metering and increasing generation and distribution capacities to meet the magnitude of forecasted development.

COMMONWEALTH UTILITIES CORPORATION

Notes to Financial Statements  
September 30, 1999 and 1998

(11) Restatement

During the year ended September 30, 1999, CUC determined that certain receivables from grantors at September 30, 1998 were recorded in error. CUC has restated September 30, 1998 balances by reducing receivables from grantor and accounts payable by \$1,032,419.

COMMONWEALTH UTILITIES CORPORATION

Statement of Revenues and Expenses on a Divisional Basis  
Year Ended September 30, 1999

	Power	Water	Sewer	Administrative and General	Internal Revenues and Expenses (1)	Total
Operating revenues:						
Governmental:						
CNMI Government	\$ 5,851,658	\$ 2,062,806	\$ 965,874	\$ -	\$ -	\$ 8,880,338
CNMI agencies	4,436,707	924,639	424,350	-	(2,281,614)	3,504,082
Total governmental	10,288,365	2,987,445	1,390,224	-	(2,281,614)	12,384,420
Commercial	32,528,368	2,166,180	612,555	-	-	35,307,103
Residential	13,962,710	2,782,937	103,450	-	-	16,849,097
Grants and contributions	402,835	1,463	166	-	-	404,464
Miscellaneous	(308,023)	(877,795)	(32,798)	558,160	-	(660,456)
Other	-	-	-	501,727	-	501,727
Total operating revenues	56,874,255	7,060,230	2,073,597	1,059,887	(2,281,614)	64,786,355
Operating expenses:						
General and administrative	6,661,374	2,883,682	1,074,430	6,937,614	-	17,557,100
Production fuel	17,452,854	-	-	-	-	17,452,854
Maintenance	6,743,180	938,527	456,863	1,106,459	-	9,245,029
Depreciation	4,856,273	1,178,226	427,795	284,645	-	6,746,939
Other production	2,744,504	1,829,729	626,141	49,082	(2,281,614)	2,967,842
Bad debts	-	-	-	321,062	-	321,062
Supplies	242,827	144,003	376,199	-	-	763,029
Other	-	-	-	136,138	-	136,138
Total operating expenses	38,701,012	6,974,167	2,961,428	8,835,000	(2,281,614)	55,189,993
Earnings (loss) from operations	18,173,243	86,063	(887,831)	(7,775,113)	-	9,596,362
Nonoperating revenues (expenses):						
Interest income	-	-	-	633,082	-	633,082
Federal grant income	-	-	-	52,470	-	52,470
Foreign exchange gain	97	-	-	-	-	97
Interest expense	(6,969,819)	(830,410)	-	-	-	(7,800,229)
CNMI Office of the Public Auditor funding	-	-	-	(664,365)	-	(664,365)
Total nonoperating revenues (expenses), net	(6,969,722)	(830,410)	-	21,187	-	(7,778,945)
Net earnings (loss) by division	\$ 11,203,521	\$ (744,347)	\$ (887,831)	\$ (7,753,926)	\$ -	\$ 1,817,417

(1) The Water and Sewer Divisions recognize an expense for power supplied by the Power Division to operate their facilities. The Power division recognizes internal revenue for the corresponding amount.

See accompanying independent auditors' report.

COMMONWEALTH UTILITIES CORPORATION

INDEPENDENT AUDITORS' REPORTS ON  
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 1999

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON  
INTERNAL CONTROL OVER FINANCIAL REPORTING BASED  
UPON THE AUDIT PERFORMED IN ACCORDANCE  
WITH GOVERNMENT AUDITING STANDARDS

Board of Directors  
Commonwealth Utilities Corporation:

We have audited the financial statements of the Commonwealth Utilities Corporation (CUC), as of and for the year ended September 30, 1999, and have issued our report thereon dated March 1, 2000, which was qualified due to our inability to determine the propriety of utility receivables, due from grantor agencies, inventory, utility plant, accounts payable, contributed capital, revenues and expenses. Except as described in the preceding sentence, we conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether CUC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 that are required to be reported under *Government Auditing Standards*. We also noted one immaterial instance of noncompliance, which we have reported to management of the CUC in a separate letter dated March 1, 2000.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered CUC's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect CUC's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs (pages 10 through 28) as Findings 99-1 through 99-18.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider Findings 99-1, 99-2, 99-6, 99-7, 99-8, 99-10, 99-11, 99-12, 99-13, 99-15 and 99-17 to be material weaknesses. We also noted other matters involving the internal control over financial reporting, which we have reported to management of the CUC in a separate letter dated March 1, 2000.

This report is intended for the information of the management of CUC, the Board of Directors, the cognizant audit and other federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*DeBelle & Jorche*

March 1, 2000



INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND  
INTERNAL CONTROL OVER COMPLIANCE APPLICABLE  
TO EACH MAJOR FEDERAL AWARD PROGRAM AND ON  
THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Board of Directors  
Commonwealth Utilities Corporation:

Compliance

We have audited the compliance of the Commonwealth Utilities Corporation (CUC) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal programs for the year ended September 30, 1999. CUC's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 10 through 28). Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal programs is the responsibility of CUC's management. Our responsibility is to express an opinion on CUC's compliance based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that 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. Our audit does not provide a legal determination on CUC's compliance with those requirements.

In our opinion, CUC complied, in all material respects, with the requirements referred to above that are applicable to its major federal programs for the year ended September 30, 1999.

Internal Control Over Compliance

The management of CUC is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered CUC's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

#### Schedule of Expenditures of Federal Awards

We have audited the financial statements of CUC as of and for the year ended September 30, 1999, and have issued our report thereon dated March 1, 2000, which was qualified due to our inability to determine the propriety of utility receivables, inventory, due from grantor agencies, utility plant, accounts payable, contributed capital, revenues and expenses. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards (pages 6 and 7) is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. This schedule is the responsibility of the management of CUC. Such information has been subjected to the auditing procedures applied in our audit of the financial statements and, in our opinion, except as described in the aforementioned report, is fairly stated, in all material respects, when considered in relation to the financial statements taken as a whole.

This report is intended for the information of the management of CUC, the Board of Directors, the cognizant audit and other federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Deville & Touche*

March 1, 2000



COMMONWEALTH UTILITIES CORPORATION

Schedule of Programs Selected for Audit in  
 Accordance with OMB Circular A-133  
 Year Ended September 30, 1999

The following list specifies grants selected for detailed compliance testing in accordance with applicable A-133 requirements.

<u>Original Grantor</u>	<u>CFDA #</u>	<u>Description</u>	<u>Amount of Expenditures</u>
U.S. Department of Commerce	11.300	Waterline Project	\$ 378,013
U.S. Department of the Interior	15.875	Capital Development Projects	<u>3,347,580</u>
		Total program expenditures tested (1)	\$ <u>3,725,593</u>
		Total federal program expenditures	\$ <u>4,551,261</u>
		% of total federal program expenditures tested	<u>82%</u>

- (1) In addition, proceeds of the loan funds described in notes 3A and 3B to the Schedule of Expenditures of Federal Awards, totaling \$61,966,383, were tested for detailed compliance in accordance with A-133 requirements.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Expenditures of Federal Awards  
Year Ended September 30, 1999

Federal Grantor/ Pass Through Grantor/ Program Title	Federal CFDA Number/ Grantor ID No./ Pass Through Grantor's Number	CNMI Cost Center	Program or Award Amount	Receivable (Deferred Revenue) from Grantor at October 1, 1998 (As Restated Note 4)	Cash Receipt FY99	Expen- ditures FY99	Receivable (Deferred Revenue) from Grantor at September 30, 1999
<u>U.S. Environmental Protection Agency</u>							
Direct Program:							
San Roque/Tanapag Sewer Collection	66.418/ C690001-050/-	-	\$ 1,273,300	\$ 256,374	\$ -	\$ -	\$ 256,374
Beach Road Sewer System	11.300/-/-	-	2,839,443	46,312	660,906	736,036	121,442
Passed through the CNMI Dept. of Public Works:							
Construction	66.418/-/-	3307	39,350	807	-	-	807
Waste Water, Agingan Waste Water Treatment Plant and Saipan Pump Station Renovation	66.418/ C690001-030/-	3346	1,228,881	93,445	-	-	93,445
Rota Water Cave TL	66.418/ 07-01-02901/-	3347	743,250	50,094	-	-	50,094
Rota Wast Water TS	66.418/ C690002-010/-	3348	1,120,115	222,336	-	-	222,336
Sadog Tasi Sewage Treatment Plant	66.418/ C690001-04-0/-	3352	1,252,732	193,229	-	-	193,229
CK, Sus, Kag SV Water	66.418/-/-	3363	-	219	-	-	219
Subtotal CFDA #66.418			8,497,071	862,816	660,906	736,036	937,946
<u>U.S. Department of the Interior</u>							
Passed through the Government of the CNMI:							
<u>Federal Portion</u>							
Water and Power Projects Upgrade Feeder 4	15.875/-/-	-	-	(398,111)	-	-	(398,111)
Kagman III Homestead Waterline	15.875/-/-	5804	1,407,543	-	41,670	41,670	-
Oleai Waterline	15.875/-/-	4910	1,722,550	-	268,132	268,132	-
Isley/San Vicente Waterline	15.875/-/-	4912	439,800	-	75,681	75,681	-
Tatachog/Songsong Waterline	15.875/-/-	4932	741,393	-	285,594	285,594	-
Electric Power Transmission Substations	15.875/-/-	4938	513,100	-	277,083	277,083	-
Sinapalu-Dugi Waterline	15.875/-/-	4901	4,005,637	-	188,987	188,987	-
Tinian 1.5MW Generator	15.875/-/-	4909	366,548	138,812	-	-	138,812
Precinct II Distribution Upgrade	15.875/-/-	4987	376,078	177,576	122,904	122,904	177,576
Design & Construction San Jose Waterline Replacement	15.875/-/-	5804	1,200,000	-	342,976	342,976	-
Sinapalu-Chugai Waterline	15.875/-/-	4936	1,158,509	-	283,961	283,961	-
Y2K Remediation	15.875/-/-	4939	479,008	-	383,590	383,590	-
Subtotal Federal Portion		19875Y	126,800	-	-	111,077	111,077
Subtotal Federal Portion			12,536,966	(81,723)	2,270,578	2,381,655	29,354
<u>Local Matching Portion</u>							
Upgrade Feeder 4	15.875/-/-	5804	512,707	-	27,780	27,780	-
Kagman III Homestead Waterline	15.875/-/-	4910	627,450	-	97,668	97,668	-
Oleai Waterline	15.875/-/-	4912	160,200	-	27,567	27,567	-
Isley/San Vicente Waterline	15.875/-/-	4932	270,057	-	104,030	104,030	-
Tatachog/Songsong Waterline	15.875/-/-	4938	186,900	-	100,929	100,929	-
Design & Construction Beach Road Sewer	15.875/-/-	4980	1,375,050	-	33,149	33,149	-
Carolina Heights Waterline	15.875/-/-	4712	107,328	-	-	-	-
Electric Power Transmission Substations	15.875/-/-	4901	1,458,363	-	71,146	71,146	-
Sinapalu-Dugi Waterline	15.875/-/-	4909	133,452	50,563	-	-	50,563
Tinian 1.5MW Generator	15.875/-/-	4987	136,922	63,924	44,746	44,746	63,924
Precinct II Distribution Upgrade	15.875/-/-	5804	800,000	-	215,750	215,750	-
Design & Construction San Jose Waterline Replacement	15.875/-/-	4936	422,515	-	103,435	103,435	-
Sinapalu-Chugai Waterline	15.875/-/-	4939	174,482	-	139,725	139,725	-
Subtotal Local Matching Portion			6,365,426	114,487	965,925	965,925	114,487
Subtotal CFDA #15.875			18,902,392	32,764	3,236,503	3,347,580	143,841

See accompanying notes to schedule of expenditures of federal awards.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 1999

Federal Grantor/ Pass Through Grantor/ Program Title	Federal CFDA Number/ Grantor ID No./ Pass Through Grantor's Number	CNMI Cost Center	Program or Award Amount	Receivable (Deferred Revenue) from Grantor at October 1, 1998 (As Restated Note 4)	Cash Receipt FY99	Expen- ditures FY99	Receivable (Deferred) Revenue) from Grantor at September 30, 1999
<u>U.S. Federal Emergency Management Agency</u>							
Passed through the Govern- ment of the CNMI:							
Public Assistance	83.544/-/-	-	898,000	110,968	133,002	12,500	(9,534)
Water Augmentation Program	83.544/-/-	-	1,279,500	-	-	77,132	77,132
Subtotal CFDA #83.544			2,177,500	110,968	133,002	89,632	67,598
<u>U.S. Department of Agriculture</u>							
Passed through the Govern- ment of the CNMI:							
Loan project Saipan Water	10.423/-/-	3344	-	(34,359)	-	-	(34,359)
CK/Susupe Waterline PhIII	10.423/-/-	4512	3,100,200	778,528	-	-	778,528
Kagman San Vicente Water	10.423/-/-	4511	-	1,437,585	-	-	1,437,585
Water Dist. Coll.	10.423/-/-	4513	-	(2,788,204)	-	-	(2,788,204)
Subtotal CFDA #10.423			3,100,200	(606,450)	-	-	(606,450)
<u>U.S. Department of Commerce -</u>							
<u>Economic Development Administration</u>							
Direct Program:							
Tasa Marpi Waterline	11.300/-/-	-	1,200,000	(320,130)	-	-	(320,130)
Rota Sinapalo-Tatachog Waterline	11.300/-/-	-	-	655,448	-	-	655,448
Rota Tatachog-SongSong-Teneto Ponia Waterline	11.300/-/-	-	456,998	-	384,044	378,013	(6,031)
Passed through the Government of the CNMI:							
Rota Water Cave	11.300/-/-	3362	1,200,000	(264,281)	-	-	(264,281)
Unlocated difference			-	-	(182,885)	-	182,885
Subtotal CFDA #11.300			2,856,998	71,037	201,159	378,013	247,891
			<u>\$ 35,534,161</u>	<u>\$ 471,135</u>	<u>\$ 4,231,570</u>	<u>\$ 4,551,261</u>	<u>\$ 790,826</u>

See accompanying notes to schedule of expenditures of federal awards.

# COMMONWEALTH UTILITIES CORPORATION

## Notes to Schedule of Expenditures of Federal Awards Year Ended September 30, 1999

### (1) Scope of Review

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, telephone, cable television, 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, 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 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. Department of Agriculture are included in the scope of the OMB Circular A-133 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as CUC's cognizant agency for the Single Audit.

#### A. Programs Subject to Single Audit

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

### (2) Summary of Significant Accounting Policies

#### A. Basis of Accounting

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

#### B. Indirect Cost Allocation

For fiscal year 1999, CUC had no indirect cost agreement with grantor agencies.

# COMMONWEALTH UTILITIES CORPORATION

## Notes to Schedule of Expenditures of Federal Awards, Continued Year Ended September 30, 1999

### (3) Loan Funds

#### A. United States Department of the Interior (Commonwealth Development Authority)

Through the "Agreement of the Special Representatives on Future United States Financial Assistance for the Northern Mariana Islands" (the Agreement), the United States Department of the Interior (DOI) granted to the Commonwealth of the Northern Mariana Islands (CNMI) government funds to be used for capital improvement projects. The CNMI government subgranted these funds to the Commonwealth Development Authority (CDA). These funds are to be disbursed in accordance with a seven-year strategic plan for capital improvement projects. Additionally, CDA is required to establish a revolving fund, into which repayments of principal and interest from revenue producing projects shall be deposited for financing of additional revenue producing capital development projects. As such, CDA has entered into a \$40,000,000 and a \$5,500,000 loan agreement with CUC to be used for power related projects and a \$16,135,650 loan agreement to be used for water related projects. At September 30, 1999, \$40,000,000, \$5,500,000 and \$16,068,750 of the loans had been disbursed, respectively. As these funds are not grants but loans of CUC, they are not included in the accompanying Schedule of Expenditures of Federal Awards. However, these funds were reviewed for compliance with federal requirements.

#### B. U.S. Department of Agriculture, Farmers Home Administration

On June 29, 1988 the CNMI executed a promissory note with the United States Department of Agriculture, Farmers Home Administration for \$1,033,400. The note bears interest at 6-1/8% per annum with repayments due on January 1 beginning in 1989 and through 2008. Proceeds of the loan are to be used for the acquisition and construction of improvements and replacements to the Saipan Water System, which is administered by CUC. As such, CUC is required to deposit all water system revenue and Covenant funds it receives into a water system revenue fund to provide for repayment of the loan. As of September 30, 1999, CUC had not established the required water system revenue fund.

Although CUC administers the use of the proceeds of the loan agreement, the CNMI Department of Finance provides accounting services for all related receipts and disbursements. As of September 30, 1999, the CNMI Department of Finance had disbursed the entire \$1,033,400 relating to the loan agreement. CUC has recognized the related loan payable. CUC has made repayments on the loan in accordance with the agreed-upon repayment schedule. As of September 30, 1999, the remaining balance of the loan payable is \$397,633, of which \$34,430 is classified as the current portion.

As the \$1,033,400 drawdown represents loans and not grants, this award has not been included in the accompanying Schedule of Expenditures of Federal Awards. However, the funds have been reviewed for compliance with federal requirements.

### (4) Restatement

During the year ended September 30, 1999, CUC determined that certain receivables from grantors at September 30, 1998 were recorded in error. CUC restated September 30, 1998 balances by reducing receivables from grantor and accounts payable by \$1,032,419.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs  
Year Ended September 30, 1999

**Part I - Summary of Auditor's Results**

1. The Independent Auditors' Report on the financial statements expressed a qualified opinion.
2. Reportable conditions in internal control over financial reporting were identified, some of which are considered to be material weaknesses.
3. No instance of noncompliance considered material to the financial statements was disclosed by the audit.
4. No reportable conditions in internal control over compliance with requirements applicable to major federal awards programs were identified.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed an unqualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. CUC's major programs were as follows:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
U.S. Department of Commerce	11.300
U.S. Department of the Interior	15.875

8. A threshold of \$300,000 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
9. CUC did not qualify as a low-risk audit as that term is defined in OMB Circular A-133.

**Part II - Financial Statements Findings Section**

<u>Reference Number</u>	<u>Findings</u>	<u>Refer Page #</u>	<u>Questioned Costs</u>
99-1 - 3	Revenue/Receipts	11 - 13	\$ -
99-4	Purchases/Disbursements	14	\$ -
99-5	Payroll	15	\$ -
99-6 - 7	External Financial Reporting	16 - 17	\$ -
99-8 - 10	Receivables	18 - 20	\$ -
99-11	Inventory	21	\$ -
99-12 - 15	Utility Plant	22 - 25	\$ -
99-16 - 17	Payables	26 - 27	\$ -
99-18	Debt	28	\$ -

**Part III - Federal Award Findings and Questioned Costs Section**

No findings are reported.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

**Part II - Financial Statement Findings Section**

Revenue/Receipts

Finding No. 99-1

Criteria: All revenues and receivables recorded should reflect balances considered collectible.

Condition: Investigation of long outstanding and not disconnected accounts revealed a listing prepared by the credit and collections division as of June 30, 1995, of accounts that were not to be disconnected. From this listing, twenty-six accounts totaling \$481,461 were outstanding at September 30, 1999. The explanation given for the lack of disconnection of these accounts was that these customers had CUC wells, poles, pumps, etc., on their property, and were therefore not billed for their utility usage.

Cause: The cause of the above condition is the lack of formal agreements with landowners for the use of parcels of land by CUC.

Effect: The effect of the above condition is the misstatement of accounts receivable, bad debts expense, and rental expense. Additionally, there are inequalities in the consideration paid for certain parcels of land to different landowners depending upon the value of utilities used.

Recommendation: We recommend that CUC execute formal agreements with all landowners for the use of land on which CUC has assets.

Prior Year Status: Lack of formal agreements with landowners for the use of parcels of land by CUC was reported as a finding in the audits of CUC for fiscal year 1996 through 1998.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

Revenue/Receipts

Finding No. 99-2

Criteria: Outstanding receivables should be reviewed on a regular basis to ensure that delinquent accounts are followed up and collected in a timely manner.

Condition: Specific review of long outstanding individual receivables revealed a total of \$1,173,851 in forty-five accounts which were not disconnected despite more than \$10,000 in each account being over seventy-five days outstanding. Various explanations were given to explain some of the large, long-outstanding balances. However, the majority were not supported by sufficient documentation to evidence the reasons for non-application of CUC's disconnection policy.

Additionally, out of the forty-five items tested, two accounts revealed errors in meter readings that resulted in an overstatement of receivables of \$27,222.

Cause: The cause of the above condition appears to be inadequate procedures to ensure timely follow-up and collection of balances due, disconnection of customers who have not paid on a timely basis and inaccurate meter reading.

Effect: The effect of the above condition is the increased potential for bad debts, resulting in significant losses to CUC and the misstatement of revenues and receivables.

Recommendation: We recommend that CUC implement policies and procedures to ensure the timely follow-up and collection of balances due. We also recommend that billings be accurately processed.

Prior Year Status: The inadequacy of filing and procedures to ensure timely follow-up and collection of balances due was reported as a finding in the audits of CUC for fiscal years 1994 through 1998.



COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

Revenue/Receipts

Finding No. 99-3

Criteria: Proper internal control requires cashier reports to be signed off by the preparer and reviewer indicating review.

Condition: Of twenty-five cash receipts tested, we noted five instances where either the preparer or verifier did not sign the report.

Cause: The cause of the above condition is due to the absence of signatures on the reports.

Effect: The effect of the above condition is lack of adherence to established internal controls.

Recommendation: We recommend that CUC ensure that established internal control procedures are strictly adhered to.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

Purchases/Disbursements

Finding No. 99-4

Criteria: Official purchase orders are to be approved and issued prior to receipt of goods.

Condition: From a sample of twenty-five expenditures selected, totaling \$21,891, supporting documents related to five expenditures totaling \$3,507 indicated that invoices and the receipt of goods/services were dated prior to the approval of the relevant purchase orders.

Cause: The cause of the above condition is the lack of adherence to prescribed procurement procedures.

Effect: The effect of the above condition is the potential for misspending of CUC funds as items are being ordered without the appropriate preapproval being obtained.

Recommendation: We recommend that management ensure strict adherence to procurement policies and procedures.

Prior Year Status: Lack of compliance with prescribed procurement procedures was reported as a finding in the audit of CUC for fiscal year 1998.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

Payroll

Finding No. 99-5

Criteria: All non-emergency overtime is to be pre-approved by a supervisor.

Condition: Of sixty-five payroll disbursements tested, twenty-eight employees were paid for overtime. Overtime request forms for these employees were all approved subsequent to the overtime being worked.

Cause: The cause of the above condition is the lack of adherence to prescribed policies and procedures.

Effect: The effect of the above condition is the potential for payment of unnecessary overtime.

Recommendation: We recommend that all non-emergency overtime be pre-approved and be appropriately documented.

Prior Year Status: Lack of adherence to prescribed policies and procedures regarding overtime was reported as a finding in the audits of CUC for fiscal years 1996 through 1998.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

External Financial Reporting

Finding No. 99-6

Criteria: Without an adequate system to record receivable or payable balances from or to the grantor agency, an entity cannot accurately report on the use of funding.

Condition: CUC is not reconciling receivable or payable balances from or to the grantor agency on a timely basis. CUC's Schedule of Expenditures of Federal Awards contains numerous projects with no current activity but material receivable or payable balances exist. Additionally, CUC is not reconciling expenditures of its Schedule of Expenditures of Federal Awards to increases in contributed capital.

Cause: The cause of the above condition is that management has not introduced an adequate system of reconciling receivable or payable balances or contributed capital accounts.

Effect: The effect of the above condition is that amounts due from or to the grantor agency and contributed capital accounts are misstated throughout the year.

Recommendation: We recommend that CUC implement a system whereby a receivable/payable account records all cash received from the grantor agency and records all related expenditures. The account should be reconciled on a monthly basis to the Schedule of Expenditures of Federal Awards. Additionally, we recommend that expenditures of the Schedule of Expenditures of Federal Awards be reconciled to contributed capital accounts on a timely basis.

Prior Year Status: The non-reconciliation of receivable or payable balances from or to grantor agencies and contributed capital accounts was reported as a finding in the audits of CUC for fiscal years 1990 through 1998.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

External Financial Reporting

Finding No. 99-7

Criteria: Without an adequate system for recording projects contributed by the Federal and the CNMI governments, an entity cannot accurately report funding received or properly capitalize contributions within the accounting records.

Condition: CUC does not have an adequate system for tracking all contributed assets from the Federal and CNMI governments.

Cause: The cause of the above condition is the lack of appropriate policies and procedures for the recording of contributed assets.

Effect: The effect of the above condition is the possible misstatement of contributions and utility plant.

Recommendation: We recommend that a reconciliation procedure be implemented between the records of the Federal Programs Coordinator and the Comptroller's office on a quarterly basis to ensure completeness of recording of projects in the general ledger.

Prior Year Status: Lack of appropriate policies and procedures for the recording of contributed assets was reported as a finding in the audits of CUC for fiscal years 1997 and 1998.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

Receivables

Finding No. 99-8

Criteria: Receivables in dispute with customers should be reconciled and resolved in a timely manner.

Condition: CUC's account receivable balance from the CNMI government at September 30, 1999 was \$9,938,715. The CNMI confirmation of balance due at this date indicated an amount materially different from this balance.

Cause: The cause of the above condition is that the balance due from the CNMI has not been reconciled for several years.

Effect: The effect of the above condition is that accounts receivable may be misstated.

Recommendation: We recommend that CUC reconcile the balance due from the CNMI with appropriate CNMI officials and record any necessary adjustments.

Prior Year Status: Lack of reconciliation of the balance due from the CNMI was reported as a finding in the audits of CUC for fiscal years 1995 through 1998.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

Receivables

Finding No. 99-9

Criteria: All advances should be periodically reviewed to determine if actual expenses have been incurred.

Condition: Detailed summaries of other receivables and travel advances outstanding as of September 30, 1999 were found to contain many individual items that had been recorded in these accounts and are outstanding for in excess of one year.

Cause: The cause of the above condition is the lack of periodic review of the contents of these accounts to ensure that they are reduced once the expense has been incurred.

Effect: The effect of the above condition is an overstatement of CUC's assets and an understatement of expenses at September 30, 1999. Additionally, the lack of timely follow-up of travel advances reduces the chance of full recovery for the portion of advances requiring collection from employees.

Recommendation: We recommend that all long outstanding balances included in these accounts as of September 30, 1999 be reviewed and expensed where necessary. We also recommend that these accounts be reviewed on a monthly basis.

Prior Year Status: The lack of timely follow-up of advances and prepayments was reported as a finding in the audits of CUC for fiscal years 1993 through 1998.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

Receivables

Finding No. 99-10

Criteria: Prepayments should be properly adjusted for goods/services subsequently received.

Condition: Our review of prepayment schedules indicates that adjustments were not made during the year for goods/services subsequently received. An adjustment at September 30, 1999 was proposed to reflect current year activity.

Cause: The cause of the above condition is the lack of monitoring and timely reconciliation of the account.

Effect: The effect of the above condition is the possible overstatement/understatement of other receivables and expenses.

Recommendation: We recommend that CUC establish policies and procedures to ensure other receivables are adequately monitored and reconciled on a timely basis.



COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

Inventory

Finding No. 99-11

Criteria: Final inventory summaries should reflect the number of items counted during inventory count procedures as of balance sheet date.

Condition: Our verification of items on hand as of September 30, 1999 revealed forty-one instances out of sixty-nine items tested, where the number of items counted varied from the final inventory listing, indicating that CUC has not properly recorded inventory withdrawals.

Cause: The cause of the above condition appears to be due to absence of compliance with established inventory management policies.

Effect: The effect of the above condition is a possible misstatement of inventory balances on hand as of September 30, 1999.

Recommendation: We recommend that final inventory listings reflect the quantities of items counted at balance sheet date.

Prior Year Status: Inaccuracies in the number of items counted during inventory count procedures as of balance sheet date to the final inventory listing was reported as a finding in the audits of CUC for fiscal years 1994 through 1998.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

Utility Plant

Finding No. 99-12

Criteria: Proper accounting for internal construction projects requires that all applicable material and labor costs be assigned to appropriate projects for capitalization and depreciation over the estimated useful life of the resulting asset.

Condition: A detailed listing of construction projects in progress as of September 30, 1999, was not available for our review. Additionally, similar balances in previous years are still maintained within the construction work-in-progress general ledger account, but cannot be attributed to specific projects.

Cause: The cause of the above condition is the lack of proper records maintenance.

Effect: The effect of the above condition is a possible misstatement of the value of construction-in-progress.

Recommendation: We recommend that proper construction work-in-progress records be maintained.

Prior Year Status: The lack of transfer of construction-in-progress projects to fixed assets and the related nonrecording of depreciation was reported as a finding in the audits of CUC for fiscal years 1988 through 1998.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

Utility Plant

Finding No. 99-13

Criteria: Adequate presentation and control of fixed assets is essential in preparing accurate financial statements. Additionally, unless all fixed assets are recorded, depreciation used in rate settings could be misstated.

Condition: CUC has not taken a physical inventory of fixed assets. Additionally, CUC has no registration system in place to ensure safekeeping of fixed assets.

Cause: The cause of the above condition is that no inventory of fixed assets on hand has ever been taken.

Effect: The effect of the above condition is that fixed assets and depreciation expense could be misstated. Additionally, a serious weakness in control exists over the safeguarding of fixed assets.

Recommendation: We recommend that CUC perform a physical inventory of all fixed assets on hand, agree the count with its records and make necessary adjustments. Additionally, we recommend that CUC implement a system of tagging fixed assets and perform periodic counts to ensure existence.

Prior Year Status: The lack of control over fixed assets was reported as a finding in the audits of CUC for fiscal years 1988 through 1998.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

Utility Plant

Finding No. 99-14

Criteria: Utility plant general ledger balances should be supported by a detailed fixed asset register.

Condition: As at September 30, 1999, the general ledger accounts reflected \$16,532 less than the fixed asset register.

Cause: The cause of the above condition is the lack of reconciliation procedures between the general ledger and the fixed asset register to identify timing differences.

Effect: The effect of the above condition is the misstatement of utility plant as of September 30, 1999 and depreciation expense for the year ended September 30, 1999.

Recommendation: We recommend that the fixed asset register be reconciled to the general ledger on a monthly basis.

Prior Year Status: Lack of reconciliation procedures between the general ledger and the fixed asset register to identify timing differences was reported as a finding in the audits of CUC for fiscal years 1997 and 1998.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

Utility Plant

Finding No. 99-15

Criteria: Insurance coverage protects an organization from potential material losses.

Condition: CUC has not obtained insurance for its fixed assets, construction projects or vehicles.

Cause: The cause of the above condition is the lack of an adequate policy to ensure utility plant insurance coverage.

Effect: The effect of the above condition is the possibility of material losses.

Recommendation: We recommend that CUC implement a policy with respect to required insurance coverage levels.

Prior Year Status: The lack of insurance coverage was reported as a finding in the audits of CUC for fiscal years 1989 through 1998.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

Payables

Finding No. 99-16

Criteria: Customer security deposits recorded in the general ledger should be adequately supported by utility service applications.

Condition: Out of six service applications tested totaling \$120,336, from total new security deposits of \$1,033,995, documents showing the calculation of security deposits could not be located for one account totaling \$25,165. Additionally, cash receipts for three other accounts amounting to \$71,646 could not be located.

Cause: The cause of the above condition is the lack of effective policies and procedures for service application record keeping.

Effect: The effect of the above condition is the potential for misstatement of security deposits account.

Recommendation: We recommend that CUC review its system of record keeping and establish policies and procedures to ensure that utility service applications are appropriately maintained.

Prior Year Status: The lack of effective policies and procedures for service application record keeping was reported as a finding in the audit of CUC for fiscal year 1998.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

Payables

Finding No. 99-17

Criteria: An effective system of internal control includes policies and procedures to ensure that liabilities are recorded in the appropriate fiscal year.

Condition: Our tests of subsequent disbursements determined material amounts of liabilities relating to the year ended September 30, 1999 were not recorded.

Cause: The cause of the above condition is the lack of appropriate cut-off.

Effect: The effect of the above condition is misstatements of accounts payable, expenses and construction work-in progress at September 30, 1999.

Recommendation: We recommend implementation of appropriate policies and procedures to ensure recording of all liabilities in the appropriate fiscal year.

Prior Year Status: The lack of appropriate cut-off was reported as a finding in the audit of CUC for fiscal year 1998.

COMMONWEALTH UTILITIES CORPORATION

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 1999

Debt

Finding No. 99-18

Criteria: Section 7.2 of a loan agreement with a contractor requires CUC to establish and maintain an escrow account of not less than \$360,000 as part of the security agreement.

Condition: At September 30, 1999, CUC has not established such an account.

Cause: The cause of the above condition is unknown.

Effect: The effect of the above condition is noncompliance with the loan agreement.

Recommendation: We recommend that CUC establish this account to ensure compliance with debt requirements.



COMMONWEALTH UTILITIES CORPORATION

Unresolved Prior Year Findings and Questioned Costs  
Year Ended September 30, 1999

Questioned Costs

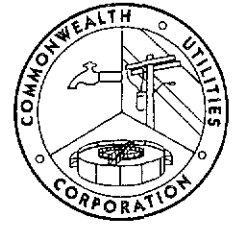
There are no unresolved questioned costs from prior year audits of CUC.

Findings

The status of unresolved prior year findings is discussed within the Schedule of Findings and Questioned Costs section of this report (pages 10 through 28).



# Commonwealth Utilities Corporation



Corrective Action Plans to Questioned Costs and Findings included in the Independent Auditors' Reports on Internal Control and Compliance for the Year Ended September 30, 1999

## **Financial Statements Findings Section**

### Revenue/Receipts

#### Finding No. 99-1

CUC agrees with the finding. CUC has forwarded all easement disputes on file to outside counsel for immediate resolution. All but two disputes (involving eight accounts) forwarded to counsel have either been resolved or is pending resolution. The unresolved dispute account holders are requesting administrative hearing to resolve their dispute. CUC has advertised for an administration hearing officer and will adhere to the customers' rights to an administrative hearing.

To prevent the occurrence of future easement claims, CUC requires all new connections to be accompanied with dedication of easement by the applicant or owners of the land. For its own in house projects, CUC has hired an easement specialist to ensure that CUC projects do not encroach private property. For those projects requiring the use of private property, CUC shall formally seek an agreement with the affected parties prior to using such properties.

### Revenue/Receipts

#### Finding No. 99-2

CUC partially agrees to the finding. While there are a few accounts that CUC is unable to explain the lack of adherence to the disconnection policy, most of the accounts are in fact accounts with long standing disputes or accounts that were in the process for adjustment.

CUC currently requires monthly reviews of accounts with disputes. A monthly status report of unresolved disputes is provided to the Director and Comptroller to ensure timely resolution. The Comptroller has been tasked to monitor and ensure that disputes are resolved in a timely manner and that accounts requiring collection action is initiated.

To ensure adherence to the disconnection and reconnection policies, Credit & Collection (C&C) is tasked to properly document the reasons for none compliance (i.e. billing, easement disputes). Documentation will require that C&C implement filing procedures to record such disputes. Customer service shall be required to properly document customer dispute and forward copies of disputes to C&C.

Revenue/Receipts

Finding No. 99-3

CUC agrees with the finding. A memorandum prepared by the Treasurer dated June 30, 2000 was sent to all cashiers and supervisors reminding them that daily cashier reports should be signed. Cashiers and their supervisors have duly acknowledged the receipt of the memorandum. To ensure compliance with the memorandum, CUC's Treasurer has been instructed to review cashier reports daily to ensure strict compliance to internal control procedures. Cashiers and supervisors not adhering to procedures will be duly warned and reprimanded (if necessary).

Purchases/Disbursements

Finding No. 99-4

CUC agrees with the finding. A majority of the violations occurred as a result of urgently required service or goods that required an immediate action of CUC. CUC, at times, is unable to obtain the necessary approval as goods or services are required outside normal working business hours.

CUC has strengthened its adherence to strictly complying with procurement procedures. In recognition of its responsibility to provide service to the public even outside normal business working hours, CUC has opened accounts with vendors who provide essential services to CUC, thus ensuring that expenditures are properly approved. These open accounts are to be used only under urgent CUC operation needs and are monitored weekly to ensure that vendors do not exceed the approved purchase orders.

In addition, CUC will advise all its vendors that no goods or services are to be delivered or received without a properly approved purchased order. Vendors providing goods or services without purchase order will take the risk associated to such acts, CUC will not take responsibility.

Payroll

Finding No. 99-5

CUC agrees with this finding. Pre-approved overtime is required to be approved by the Director or his designee not supervisors.

All managers have been reminded to comply with the overtime policy and procedures. The memorandum states that the Director will strictly enforce this policy and will not hesitate to take necessary administrative actions to ensure compliance (i.e. reprimands and demotions).

External Financial Reporting

Finding No. 99-6 and 99-7

CUC agrees with this finding. CUC has prepared the procedures below to address the two findings.

### Recording of Grants

Grants, entitlements, or shared revenues received for proprietary fund operating purposes, or that may be used for either operations or capital expenditures at the discretion of the recipient, should be recognized as "non-operating" revenues in the accounting period in which they are earned and become measurable (accrual basis). Such resources restricted for the acquisition or construction of capital assets should be recorded as contributed equity (Source: NCGAS 2 Paragraph 12).

#### Objectives:

1. To implement a system to record receivable/payable balances from/to grantor agencies.
2. To monitor all contributed assets from Federal and CNMI governments.

#### Procedures:

### New Grants

1. Grants Section forwards to Accounting copies of all the documents supporting approval of the grant.

#### Direct Grants:

- Grantor Agency's letter of approval to award
- Contract (including change orders, if any)

#### CNMI 702 CIP:

- Public Law/Appropriations/Resolutions
- DOI/OIA's Approval Letter
- Allotment Advice
- Contract (including change orders, if any)

2. Accounting opens a folder and a subsidiary ledger for each direct grant/CIP project for reference and monitoring purposes.

### Payment Processing

- A. Direct grants (CUC advances payment and requests for reimbursement from grantor)
  1. Division Manager certifies the invoice(s) or completion of work and submits payment request to Grants Section (invoice is supported by an approved purchase order and completion of work is approved by Executive Director).
  2. Grants Section processes the payment request and forwards to Accounts Payable for check preparation.
  3. Grants Section keeps a ledger of payment requests/drawdowns for each project.

4. Upon receipt of payment request from Grants, Accounts Payable cuts the check and forwards to Grants Section a copy of the check for reimbursement purposes (Note: Receivable from Grantor Agency (GL #1794) is set up).
5. Grants Section prepares necessary documents for reimbursement processing and distributes copies of the request for reimbursement to the following:
  - Executive Director
  - Accounting
  - Treasury
  - Division Manager

B. 702 CIP (DOF processes payment)

1. Division Manager certifies the invoice(s) or completion of work and submits payment request to Grants Section.
2. Grants Section processes the payment request and forwards a copy to Accounting.
3. Grants Section keeps a ledger of payment requests/drawdowns for each project.

Accounting for Grants

1. Upon receipt of the copy of payment request from Grants, Accounting performs the following procedures:

- Preparation of Journal Entries:

Direct Grants (Reimbursable Basis)

- Contributed Equity - if grant is restrictedly intended for acquisition or construction of fixed assets.
  - . Debit GL 1794 - Due from Grantor Agencies when billing statement or letter is sent to grantor agency.
  - . Credit GL 2062 - Contributions-Federal Grants.
- Non-Operating Revenue - if grant is restrictedly intended for acquisition or construction of fixed assets
  - . Debit GL 1794 - Due from Grantor Agencies when billing statement or letter is sent to grantor agency.
  - . Credit GL 7020 - Revenue-Non-Utility Operations (when processing payments to vendors that are reimbursable from grants, charge the regular expense accounts).

702 CIP

- . Debit GL 117310/139310/158310 - Construction Work-In-Progress - Power/Water/Sewer when billing statement or letter is sent to CNMI Department of Finance.
- . Credit GL 2061 - Contributions - Local Grants for the local matching share.
- . Credit GL 2062 - Contributions - Federal Grants for the Department of the Interior (DOI) Share.
- Updated of subsidiary ledgers (SL) to monitor available balance of grant by subtracting from the approved grant amount/contract amount all the drawdowns or payment requests. SL details are:
  1. PR No.
  2. Billing Date
  3. Amount
  4. Reference JV No.
  5. CNMI Share
  6. Federal Share
- Filing of documents in their individual folders for easy reference.
- 2. Treasurer/Cashier informs Accounting of any reimbursement/payment received from grantor agency.
- 3. Cashier prepares charge voucher and forwards to Accounting the yellow copy with attached supporting documents (e.g. check stub, transmittal letters, etc.). Accounting advises Cashier to use GL 1794 in posting the payment to the system.
- 4. Upon receipt of copy of charge voucher and attachments, Accounting updates the subsidiary ledger and files documents to their individual folders.

Monthly Reconciliation Procedures

Grants Section:

1. Prepares the following reports:
  - Monthly Fund Status Report for on-going CIP's (separate columns for local matching share and federal share)
  - Grant/Project Ledger showing available balance/project drawdowns
2. Forwards monthly report to the following:
  - Accounting
  - Division Managers concerned

Accounting Section:

1. Prints subsidiary ledgers for each grant/project
2. Prepares the following reports:
  - Schedule of Due from Grantor Agency as of end of the month
  - Schedule of 702 CIP's (CWIP/CNMI and Federal share)
3. Reconciles with monthly reports obtained from Grants Section
4. Reconciles general ledger figures to subsidiary ledgers.

Completed Projects Funded by Grants

1. Division Managers certifies completion of the project and approved by the Executive Director. The following documents are required by Accounting to close out a CWIP account and transfer to its proper fixed asset account:
  - Certificate of Completion
  - Final Acceptance
  - Turn-Over Certificate
2. Accounting processes closing of the CWIP and enters to the Fixed Asset system.

Receivables

Finding No. 99-8

CUC agrees with the finding. CUC will initiate discussion with CNMI Department of Finance to reconcile the outstanding receivable. When completed, the general ledger and chief accountant will prepare the appropriate adjustment. The adjustment will be subject to review and approval by the Assistant Comptroller or Comptroller.

Receivables

Finding No. 99-9

CUC agrees with the finding. On a monthly basis, CUC will review the status of employee travel and other advances and will initiate collection action on advances that are not timely liquidated or travels that have outstanding balances. To ensure that expenses are timely recorded, CUC will enforce its payroll deduction policies for travel authorizations that are not liquidated. In addition, accounting will require the Human Resources section to obtain clearance from the accounting section prior to the processing of their resignation action and immediately inform accounting of personnel who are resigning so as to allow accounting to require immediate payroll deduction for all outstanding balances.

Receivables

Finding No. 99-10

CUC agrees with the finding. To correct this finding, CUC is requiring that Accounts Payable section record and reclassify the purchases as the original invoices and the receiving report are received. In addition to this procedure, CUC will review monthly its prepayment purchases to monitor and ensure that the purchases are timely received and recorded.

Inventory

Finding No. 99-11

CUC agrees with the finding. CUC has recently hired a fixed asset/inventory accountant to implement procedures to ensure that physical counts match the final inventory listing and the withdrawal of inventory is properly recorded. In addition to the procedures to be implemented, semi-annually and annually CUC will reconcile counts against the final inventory listing to ensure proper recording of the physical counts.

Utility Plant

Finding No. 99-12

CUC agrees with the finding. CUC has been properly capitalizing labor and material charges to its internal construction projects but has been unable to timely close completed projects. Again, CUC has hired a fixed asset accountant who has been tasked to address its timeliness issue. CUC anticipates to address the backlog files issue either by seeking professional service assistant or internally or combination thereof.

Utility Plant

Finding No. 99-13

CUC partially agrees with the finding. Although we have not taken a physical inventory of fixed assets, we have a registration system in place to keep track of all our fixed assets purchases.

Acquired fixed assets are processed through our accounts payable system and are initially lodged to a fixed asset clearing account for review by our chief accountant. The clearing account is analyzed weekly and the corresponding item is assigned a property tag number and its applicable useful life. The property is then recorded in the proper account code in the fixed assets register. Monthly, the fixed asset register total is reconciled with the corresponding general ledger balance. Completed CIPs are likewise recorded in the fixed assets register monthly.

CUC is currently backlogged in closing work orders of system improvements and new customer installations. However, work order costs are initially recorded as Construction Work in Progress (CWIP). The delayed closing has caused the understatement of fixed assets and thereby affecting our financial statement.

To address CUC's lack of inventory of fixed assets and timeliness of closing work orders, CUC has announced and selected a fixed assets/inventory accountant to conduct a complete count of fixed assets and to close complete work orders. CUC plans to seek proposals from qualified firms to assist in the inventory and valuation of its fixed assets. CUC expects to complete both the inventory and close all work orders by Fiscal Year 2002.



Utility Plant

Finding No. 99-14

CUC partially agrees with the finding. Since February 1999, the Comptroller's office, accounting section, reconciled the utility plant general ledger balances to the detailed fixed asset register. The reported condition was due primarily to the auditors' adjustment, which has subsequently been recorded.

Utility Plant

Finding No. 99-15

CUC agrees with the finding. CUC currently has a fixed asset schedule that requires review and confirmation. CUC is in the process of hiring a fixed asset/inventory accountant to review and confirm this listing. Upon completion of the review, CUC will solicit insurance coverage for its fixed assets. The recommendation to insure CUC construction projects has been forwarded to the Procurement manager to prepare to incorporate into its procurement requirements. This change of policy will be presented to the board for adoption.

Payables

Finding No. 99-16

CUC partially agrees with this finding. CUC was able to locate the documents that were not made available to the auditor for review. The Chief of Administration and the Comptroller has been tasked to undertake a review of the record keeping system of CUC. Upon completing their review, they are to make recommendations needed to ensure that all CUC official documents are readily available to management and auditors.

Payables

Finding No. 99-17

CUC agrees with the finding. The policies and procedures to record payable are in place. However, without a proper procurement system, these procedures are prone to untimely recognition of expenses. Most of the findings relate to CUC's untimely recording of CWIP projects that have not been closed. CUC is revisiting its procedures in closing CWIP projects to ensure that it records its expenses (i.e. depreciation) in the proper fiscal period.

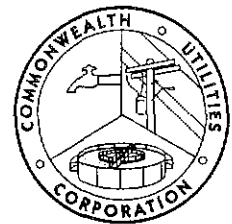
Debt

Finding No. 99-18

CUC agrees with the finding. CUC recognizes that it is bound by the contract terms and has properly set aside \$400,000 in a time certificate of deposit. CUC intends to seek a revision of the security terms with the contractor. This finding should be resolved before the end of fiscal year 2002.



# Commonwealth Utilities Corporation



## Summary of Schedule of Prior Audit Findings

Status of audit findings included in the schedule of findings and questioned costs for the year ended September 30, 1998:

### Financial Statement Findings

- Finding No. 98-1 - Corrective action was taken.
- Finding No. 98-2 - Not corrected. See corrective action plan to Finding 99-1.
- Finding No. 98-3 - Not corrected. See corrective action plan to Finding 99-2.
- Finding No. 98-4 - Corrective action was taken.
- Finding No. 98-5 - Not corrected. See corrective action plan to Finding 99-4.
- Finding No. 98-6 - Not corrected. See corrective action plan to Finding 99-5.
- Finding No. 98-7 - Not corrected. See corrective action plan to Finding 99-6.
- Finding No. 98-8 - Not corrected. See corrective action plan to Finding 99-7.
- Finding No. 98-9 - Not corrected. See corrective action plan to Finding 99-8.
- Finding No. 98-10 - Not corrected. See corrective action plan to Finding 99-9.
- Finding No. 98-11 - Not corrected. See corrective action plan to Finding 99-11.
- Finding No. 98-12 - Corrective action was taken.
- Finding No. 98-13 - Corrective action was taken.
- Finding No. 98-14 - Corrective action was taken.
- Finding No. 98-15 - Not corrected. See corrective action plan to Finding 99-12.
- Finding No. 98-16 - Not corrected. See corrective action plan to Finding 99-13.
- Finding No. 98-17 - Not corrected. See corrective action plan to Finding 99-14.
- Finding No. 98-18 - Not corrected. See corrective action plan to Finding 99-15.
- Finding No. 98-19 - Not corrected. See corrective action plan to Finding 99-16.

Federal Award Findings and Questioned Costs

Finding No. 98-20 - Not corrected. See corrective action plan to Finding 99-17.

Finding No. 98-21 - Corrective action was taken.

Finding No. 98-22 - Corrective action was taken.

Finding No. 98-23 - Corrective action was taken.

Finding No. 98-24 - Corrective action was taken.

Deloitte & Touche  
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**Deloitte  
Touche  
Tohmatsu**

August 26, 2004

Mr. Michael S. Sablan  
Public Auditor  
Office of the Public Auditor  
P.O. Box 501399  
Saipan, MP 96950-1399

Dear Mr. Sablan:

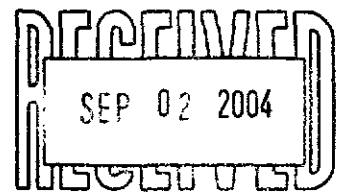
Enclosed please find six (6) bound and one (1) unbound copies of the audit of financial statements of the Commonwealth Utilities Corporation for the year ended September 30, 1999.

Please acknowledge receipt by signing and returning to us the attached copy of this letter.

Very truly yours,



Michael S. Johnson  
Managing Partner, Saipan



Received by: \_\_\_\_\_ Date: \_\_\_\_\_