

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

INDEPENDENT AUDITOR'S REPORT
AND
FINANCIAL STATEMENTS

Years Ended
September 30, 2010 and 2009

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

Years Ended September 30, 2010 and 2009

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J. Scott Magliari
& COMPANY

CERTIFIED PUBLIC ACCOUNTANT

SAIPAN OFFICE:

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

GUAM OFFICE:

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

PALAU OFFICE:

PIDC Apartment No. 11
P.O. Box 1266
Koror, PW 96940
Tel No. (680) 488-8615
Fax No. (680) 488-8616
Email: coconutrum@palaunet.com

INDEPENDENT AUDITOR'S REPORT

The Executive Director
Commonwealth Utilities Corporation

I have audited the accompanying statements of net assets (deficit) of the Commonwealth Utilities Corporation (CUC), a component unit of the Commonwealth of the Northern Mariana Islands, as of September 30, 2010 and 2009, and the related statements of revenues, expenses and changes in net assets (deficit), and of cash flows for the years then ended. These financial statements are the responsibility of CUC's management. My responsibility is to express an opinion on these financial statements based on my audits.

I conducted my audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of CUC's internal control over financial reporting. Accordingly, I express no such opinion. 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audits provide a reasonable basis for my opinion.

In my opinion, such financial statements present fairly, in all material respects, the financial position of CUC as of September 30, 2010 and 2009, and the changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis (MD&A) on pages 3 to 16 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. I have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, I did not audit this information and express no opinion on it.

My audits were conducted for the purpose of forming opinion on the CUC's basic financial statements. The Statement of Revenues, Expenses and Changes in Net Assets (Deficit) on a Divisional Basis for the year ended September 30, 2010 on pages 22 and 23 is presented for purposes of additional analysis and is not a required part of the basic financial statements. This supplemental information is the responsibility of CUC's management. The supplemental information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in my opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with the *Government Auditing Standards*, I have also issued my report dated January 31, 2011 on my consideration of CUC's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting, or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of my audits.

Handwritten signature of J. Scott Magliari & Company in cursive script.

Saipan, Commonwealth of the Northern Mariana Islands
January 31, 2011

Except for Notes 13 and 14, as to which the date is March 15, 2011

COMMONWEALTH UTILITIES CORPORATION
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MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2010

This discussion and analysis of the Commonwealth Utilities Corporation's (CUC) financial performance provides an overview of CUC's activities for the fiscal year ended September 30, 2010 with comparisons to prior fiscal years ended September 30, 2009 and 2008. We encourage readers to consider the information presented here in conjunction with the financial statements and related notes (pages 17 through 49).

FINANCIAL HIGHLIGHTS

- Total assets at September 30, 2010, were \$130.9 million, a decrease of \$547 thousand or 4% compared to 2009 which is at \$131.5 million, a decrease of \$12.5 million (8.7 percent) when compared to September 30, 2008. Most significant was a decrease in capital assets of \$2.6 million, the result of accumulated depreciation increasing \$7.8 million and Water Plant capital assets increasing \$5.1 million. Other changes of note were an increase in deferred fuel costs of \$1.4 million, a decrease in accounts and other receivables of \$1.5 million and a \$1.2 million increase in inventory.
- Total liabilities at September 30, 2010, were \$58.2 million, an increase of \$1.4 million from \$56.8 million in 2009, which decreased by \$172.1 million (75.2 percent) when compared to September 30, 2008. Significant changes include an increase in retirement contributions payable of \$1.1 million, an increase in long-term debt of \$1.4 million, and a decrease in accounts payable of \$1.9 million.
- Total net operating revenues for fiscal year 2010 were \$82.7 million, an \$8 million or 10.7 percent increase from \$74.6 million in 2009, which decreased by \$29.6 million (28.4 percent), when compared to fiscal year 2008. Other than a \$1.4 million increase in fuel charges, the most significant change was an increase of \$4.5 million in water revenues. This can be attributed to the water metering program underway at CUC.
- Total operating expenses for fiscal year 2010 were \$90.7 million, an increase of \$1.1 million or 1.3 percent from \$89.6 million in 2009, which decreased by \$27.6 million (23.5 percent) when compared to fiscal year 2008. Production fuel costs increased by \$7.4 million, while other production costs, primarily related to independent power producer contracts, decreased by \$4.3 million.
- In fiscal year 2010, CUC recognized \$5.8 million in capital contributions compared to \$8 million in fiscal year 2009 and \$6.7 million in fiscal year 2008.

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OVERVIEW OF THE FINANCIAL STATEMENTS

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

Basic Financial Statements

The *Statements of Net Assets (Deficit)* presents information on assets and liabilities, with the difference between the two reported as net assets (deficit). Changes in net assets (deficit) over time may provide an indicator as to whether the financial position of the CUC is improving or deteriorating.

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

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

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

Notes to the Financial Statements

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

Other Information

This report also presents certain supplementary information concerning CUC's Statements of Revenues, Expenses and Changes in Net Assets (Deficit) on a divisional basis (see pages 22 through 23).

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ANALYSIS OF BASIC FINANCIAL STATEMENTS

Net Assets (Deficit)

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Current assets	\$ 35,407,008	\$ 32,948,778	\$ 39,535,358
Capital assets, net	87,822,594	90,388,841	96,785,584
Restricted assets	<u>7,709,149</u>	<u>8,148,586</u>	<u>7,681,378</u>
Total Assets	<u>130,938,751</u>	<u>131,486,205</u>	<u>144,002,320</u>
Current liabilities	28,521,125	28,649,595	217,094,174
Noncurrent liabilities	<u>29,680,110</u>	<u>28,126,748</u>	<u>11,823,878</u>
Total Liabilities	<u>58,201,235</u>	<u>56,776,343</u>	<u>228,918,052</u>
Net Assets (Deficit):			
Invested in capital assets, net of related debt	59,112,862	64,742,131	34,332,591
Restricted	13,766,557	12,334,511	(2,906,585)
Unrestricted	<u>(141,903)</u>	<u>(2,366,780)</u>	<u>(116,341,738)</u>
Net Asset (Deficit)	<u>\$ 72,737,516</u>	<u>\$ 74,709,862</u>	<u>\$ (84,915,732)</u>
Operating revenues, net	\$ 82,656,150	\$ 74,643,224	\$ 104,309,697
Operating expenses	<u>90,776,591</u>	<u>89,595,883</u>	<u>117,209,039</u>
Loss from operations	(8,120,441)	(14,952,659)	(12,899,342)
Nonoperating revenues(expenses), net	(1,198,199)	552,363	(12,123,589)
Change in recovery of fuel costs	<u>1,536,048</u>	<u>(4,454,066)</u>	<u>4,170,190</u>
Net loss before capital contributions	(7,782,592)	(18,854,362)	(20,852,741)
Capital contributions	<u>5,810,246</u>	<u>7,983,367</u>	<u>6,735,990</u>
Change in net assets (deficit) before extraordinary items	(1,972,346)	(10,870,995)	(14,116,751)
Extraordinary gain	-	170,496,589	-
Net assets (deficit), beginning	<u>74,709,862</u>	<u>(84,915,732)</u>	<u>(70,798,981)</u>
Net Asset (Deficit)	<u>\$ 72,737,516</u>	<u>\$ 74,709,862</u>	<u>\$ (84,915,732)</u>

Highlights of events affecting assets, liabilities and net assets (deficit) balances follow.

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September 30, 2010

During fiscal year 2010, total assets decreased \$547,454. Significant changes in account balances were:

- Cash and equivalents increased by \$1.3 million due to the timing of payments to major suppliers and contractors.
- Accounts and other receivables decreased by \$1.5 million, primarily attributable to more aggressive collection activities.
- Inventory increased by \$1.2 million.
- Under-recovery of fuel cost shown as deferred fuel cost increased \$1.5 million. This represents the difference between actual fuel costs and electric fuel charge revenues, resulting in a net under-recovery of fuel costs of about \$1.4 million.
- Capital assets, net of accumulated depreciation, decreased by \$2.6 million due to current year depreciation expense net of current year additions.

Total liabilities increased by \$1.4 million. Significant changes in account balances were as following:

- Accounts payable decreased by \$1.9 million, primarily attributable to increased payments to vendors.
- Current maturities of long-term debt increased by \$1.2 million.
- Retirement contributions payable, increased by \$1.1 million.

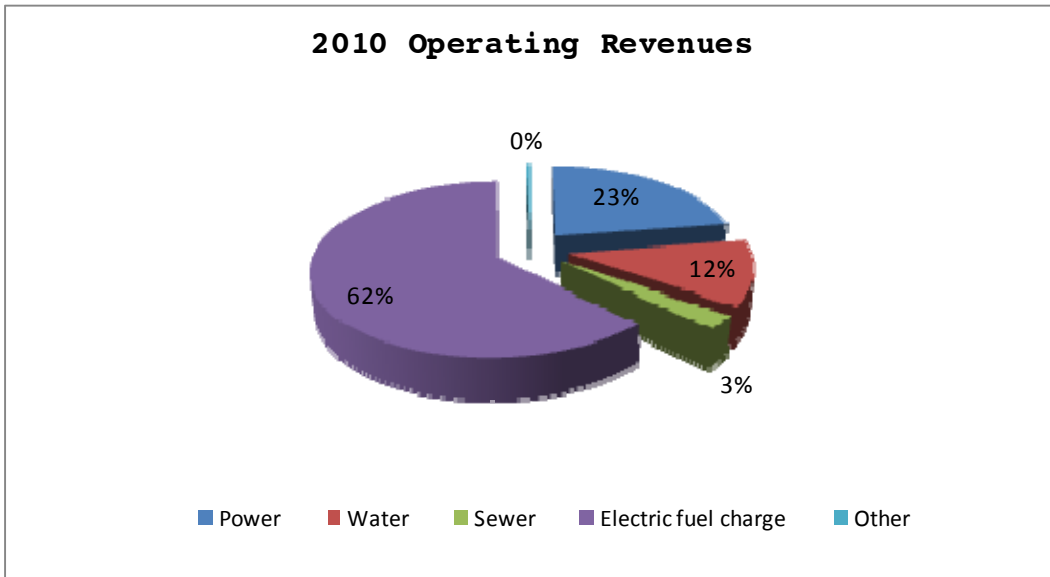
Net assets decreased \$2.0 million. This was the result of a loss of \$7.8 million for fiscal year 2010, partially offset by capital contributions of \$5.8 million.

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Operating Revenues

	2010	2009	2008
Power	\$ 19,297,284	\$ 18,299,551	\$ 22,352,803
Water	10,252,911	5,725,407	4,526,690
Sewer	2,315,113	1,274,665	1,288,263
Electric fuel charge	53,341,371	51,925,018	76,866,867
Other	377,496	206,717	757,505
Total	85,584,175	77,431,358	105,792,128
Bad debts	(2,928,025)	(2,788,134)	(1,482,431)
Operating revenues, net	<u>\$ 82,656,150</u>	<u>\$ 74,643,224</u>	<u>\$ 104,309,697</u>



In 2010, operating revenues increased by \$8.0 million (10.7 percent) when compared to revenues for 2009, which decreased by \$29.7 million (28.4 percent) when compared to 2008.

The majority of the increase was related to water revenues. In 2010, water revenues increased by \$4.5 million (78.5 percent) over 2009. Water revenues increased by \$1.2 million (26.5 percent) from 2008 to 2009. In addition, the electric fuel charge increased by \$1.4 million (2.7 percent) when compared to revenues for 2009, which decreased \$29.0 million (29.2 percent) when compared to 2008.

In 2010, sewer revenues increased by \$1.0 million (81.6 percent) when compared to revenues for 2009. Sewer charges were essentially flat from 2008 to 2009.

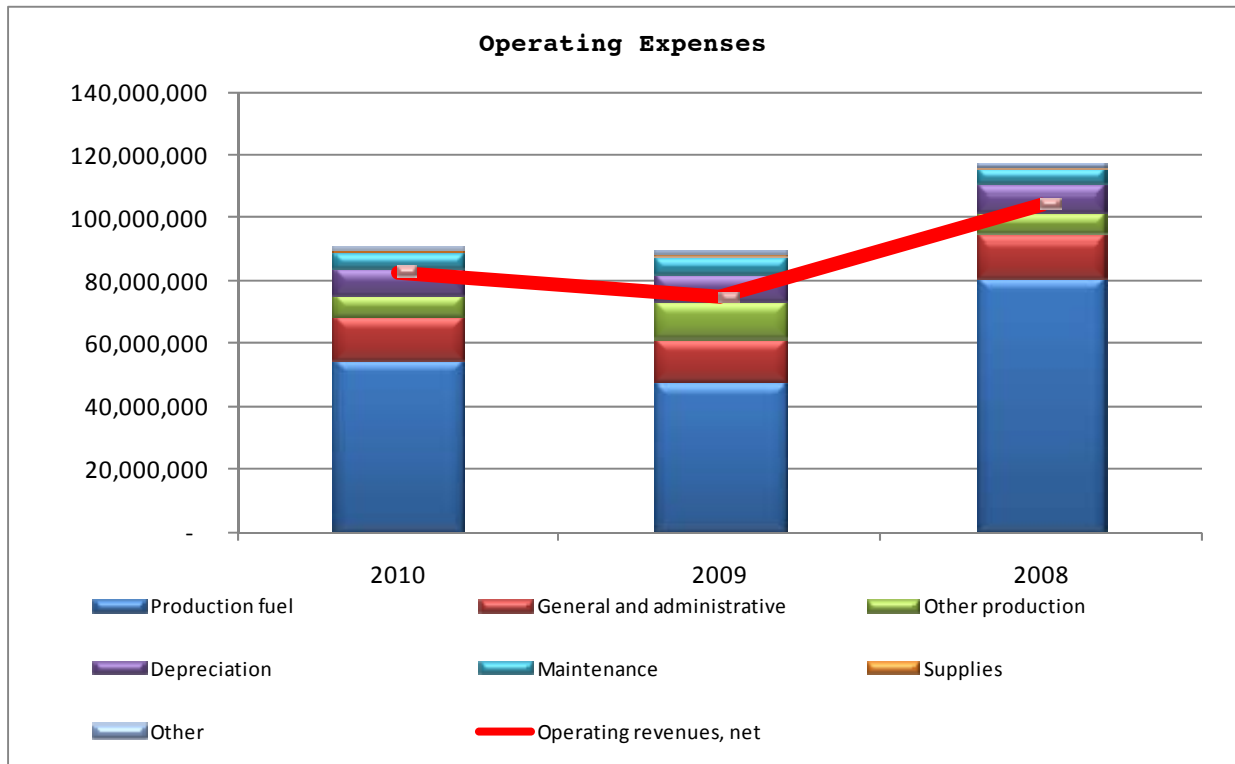
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Operating Expenses

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Production fuel	\$ 54,877,419	\$ 47,470,952	\$ 81,037,057
General and administrative	13,633,092	14,396,147	14,045,284
Depreciation	8,164,412	8,316,344	8,909,417
Other production	7,506,477	11,802,857	6,534,607
Maintenance	5,225,928	5,708,500	5,273,031
Supplies	725,217	1,104,178	464,058
Other	<u>644,046</u>	<u>796,905</u>	<u>945,585</u>
	<u>\$ 90,776,591</u>	<u>\$ 89,595,883</u>	<u>\$ 117,209,039</u>

This graph shows the total relationship of the total operating expenses (stacked bar graph) in relation to the total operating revenues (line graph).



In 2010, total operating expenses increased by \$1.2 million (1.3 percent) when compared to expenses for 2009, which decreased by \$27.6 million (23.5 percent) when compared to expenses for 2008.

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In 2010, production fuel was \$54.9 million, an increase of \$7.4 million (15.6 percent) when compared to 2009, which decreased by \$33.6 million (41.4 percent) when compared to 2008. Production fuel is the single largest expense of CUC, accounting for 60 percent of operating expenses in 2010, 53 percent for 2009 and 69.1 percent for 2008.

In 2010, maintenance expense increased by \$483,000 (8.5 percent) when compared to 2009, which increased by \$435,000 (8.3 percent) when compared to 2008.

In 2010, general and administrative expenses, which are primarily personnel costs and related benefits, decreased by \$763,000 (5.3 percent) when compared to 2009, which increased by \$351,000 (2.5 percent) when compared to 2008.

In 2010, other production expense decreased by \$4.3 million (36.4 percent) when compared to 2009, which increased by \$5.3 million (80.6 percent) when compared to 2008. The decrease is attributable to cost of the emergency generators no longer required after the catastrophic failure of the main power generators in Saipan during 2008.

In 2010, supplies and other expenses decreased by \$532,000 (30.0 percent) when compared to 2009, which increased by \$491,000 (34.8 percent) when compared to 2008.

Capital Assets

At September 30, 2010, CUC had \$87.8 million invested in capital assets, net of depreciation where applicable, including electric plant, water plant, sewer plant, administrative equipment and construction work-in progress.

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Utility plant in service			
Electric plant	\$ 128,586,476	\$ 127,763,430	\$ 127,438,647
Water plant	62,436,988	62,613,268	62,580,255
Sewer plant	42,640,713	37,585,094	37,565,848
Administrative equipment	<u>4,475,287</u>	<u>4,545,784</u>	<u>4,532,820</u>
	238,139,464	232,507,576	232,117,570
Accumulated depreciation	<u>(162,436,969)</u>	<u>(154,626,740)</u>	<u>(146,286,611)</u>
Depreciable assets, net	75,702,495	77,880,836	85,830,959
Construction work-in progress	<u>12,120,099</u>	<u>12,508,005</u>	<u>10,954,625</u>
Capital assets, net	<u>\$ 87,822,594</u>	<u>\$ 90,388,841</u>	<u>\$ 96,785,584</u>

For additional information regarding capital asset activity, refer to Note 6 in the accompanying Notes to the financial statements.

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Capital Projects

CUC incurred capital expenditures and recognized related revenue in the form of capital contributions of \$5.8 million in fiscal year 2010, which is a decrease of \$2.2 million (27.2 percent) when compared to fiscal year 2009 and an increase of \$1.2 million when compared to 2008.

The capital contributions, by source, are as follows:

	2010		2009		2008	
	Amount	%	Amount	%	Amount	%
Federal	\$ 5,810,246	100.0	\$ 7,007,294	87.8	\$ 5,140,930	76.3
Local	-	-	976,073	12.2	1,595,060	23.7
Total	<u>\$ 5,810,246</u>	<u>100.0</u>	<u>\$ 7,983,367</u>	<u>100.0</u>	<u>\$ 6,735,990</u>	<u>100.0</u>

The following is a summary of the CUC's major capital expenditures for 2010:

Federal Assistance

The U.S. Department of the Interior provided \$28,000 for sewer and wastewater system improvements.

The U.S. Environmental Protection Agency provided \$2.0 million for the upgrade of sewer and water systems and related equipment.

Local Assistance

The CNMI government, as a pass-through grant, provided \$3.8 million of Covenant 702 funds received from the U.S. Department of the Interior for the Saipan Power Plant Improvement and upgrade of sewer and water systems and related equipment.

For additional information regarding capital asset activity, refer to Note 6 in the accompanying Notes to the financial statements.

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Debt

Long-term debt as of September 30, 2010, 2009 and 2008 are as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Commonwealth Development Authority	\$ 19,579,335	\$ 18,379,268	\$ 61,568,750
Commonwealth Ports Authority	7,104,452	7,267,445	7,876,082
Marianas Public Land Trust	245,347	1,800,000	3,500,000
GPPC	<u>1,918,549</u>	<u>-</u>	<u>-</u>
	28,847,683	27,446,713	72,944,832
Current maturities	<u>(3,743,520)</u>	<u>(2,512,765)</u>	<u>(62,896,929)</u>
Long-term debt, net of current portion	<u>\$ 25,104,163</u>	<u>\$ 24,933,948</u>	<u>\$ 10,047,903</u>

For additional information regarding long-term debt activity, refer to Note 8 in the accompanying Notes to the financial statements.

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MANAGEMENT'S DISCUSSION & ANALYSIS
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ECONOMIC FACTORS

In addressing full cost recovery, it was concluded by the 1994 Metzler and Associates Management Audit (Metzler) report of CUC that:

"Today, if desired, full cost recovery could be achieved in short notice if that was the only objective. This could be done by cutting services to all but the very high profit customers. Achievement of financial solvency as a single objective will likely result in customers suffering a reduced level of service and a severe disruption to the CNMI economy. All decisions of utility impact financial or operational objectives. Full cost recovery and superior operational service must be viewed as two objectives which must be balanced together."

On September 24, 2010, the Commonwealth Public Utilities Commission (CPUC) approved its 5th Levelized Energy Adjustment Clause (LEAC) rate tariff. On January 13, 2011, the Commonwealth Public Utilities Commission (CPUC) approved an emergency interim Levelized Energy Adjustment Clause (LEAC) rate tariff, due to rapidly escalating fuel prices experienced in the first quarter of FY 2011, and expected to continue into the second quarter.

CUC has rates in place which allow for 100% full costs recovery for water and wastewater expenses. In addition CUC has begun a process to have its electric rate tariff reviewed by CPUC with new rates expected to be in place by April 2011. The electric rate tariff in April 2011 should also allow for full cost recovery of electric power expenses.

The financial and operational outlook appears to be very positive for CUC, in that significant system improvements have been undertaken and customer rates are approaching a full cost recovery level. CUC has an established platform through the CPUC to ensure that rates allow for 100% full costs recovery are effected; has power generation capacity to satisfy demand along with a sufficient reserve; has engaged utility management professionals to ensure compliance with regulatory requirements; and reinvigorated its management focus and sensitivity through the development and enhancement of systems maintenance and operational efficiency.

Compliance with Stipulated Order requirements continues to be a challenge. However, the financial, legal and operational management infrastructures are in place to see compliance of Stipulated Order requirements to its finality. For a more complete description of the Stipulated Orders, see Note 12 Commitments and Contingencies in the accompanying Notes to the financial statements.

As it stands, this balance between full cost recovery and superior operational service referred to by Metzler appears to have been achieved. However, Metzler recognizes that there are certain forces outside of CUC's control which could upset this balance or trigger a need to continually rebalance. Metzler recognizes that the economy (both internal and external) has a force beyond CUC's control. Currently, the Commonwealth of the Northern Mariana Islands (CNMI) is in the throes of an economic crisis for which will trigger the need to continually rebalance full cost recovery and the provision of superior operational service.

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CNMI Government revenues continue to decline and its ability to pay for its monthly utility expenses is in doubt for the foreseeable future. The CNMI Government monthly billings accounts for about 17% of CUC revenues. Its rates for water and wastewater are 22 times the rate paid by nongovernment customers. Despite a State of Emergency having been declared to ensure the CNMI Government's accumulated past due billings could be paid to avert a fuel resupply and system maintenance crisis; amounts owed to CUC are again at unsustainable levels.

Furtherance to its inability to pay for its utility costs, the CNMI Government's ability to pay its personnel payroll costs in the near term is also in doubt. Emergency legislation was needed to reprogram funds to ensure payroll could be met. The impact of CNMI Government's financial crisis will lead to the thousands of government employees being unable to pay their individual utility costs.

The direct and indirect impact of the CNMI Government's financial woes will undoubtedly lead to tremendous revenue losses to CUC and thus trigger the need to re-evaluate full cost recovery rates and the provision of superior operational service.

Revenue losses due to a decrease in customer base and a reduction in utility consumption may lead to increasing rates plus further revenue losses as affordability of utility services becomes an ever increasing financial burden to CUC customers dwindling economic base.

Although the financial and operational outlook appears positive, the CNMI Government's financial instability plus the affordability of services are essential for CUC to maintain its stability in balancing full cost recovery and the provision of superior operational services.

ACCOMPLISHMENTS

Water & Wastewater Divisions

- Completed sanitary survey of entire water system on Saipan in partnership with Department of Environmental Quality (DEQ) (The last one was conducted in 2006); more importantly, all noted deficiencies were corrected.
- Cleaned and disinfected 16 of 17 reservoirs in Saipan; as well as 2 in Rota and 2 in Tinian, for a total of 20.
- Continuous 24/7 water ("pressurization") increased from 60% to 70% of the population on Saipan.
- Installed 108 sample taps in the distribution system, enabling more accurate and timely water sampling.
- Twenty-one workers trained on PRV, pump repairs—sponsored by WERI, delivered by Hawaiian Engineering.

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- Designed Sadog Tasi waste treatment plant rehabilitation in-house.
- A 16 Lift Station emergency repair done in-house.
- Repaired/replaced sections of the sewer collection line that collapsed (two at San Jose, two at As Terlaje, and one at Chalan Kanoa).

Power Generation and Power Transmission & Distribution

- Stabilized and doubled available megawatt (MW) power generation capacity. Saipan January 2009: 26 MW; Saipan December 2009: 58 MW.
- Reduced 80% of feeder outage duration from typical 60-to 90 minutes to 3 minutes per trip. This was accomplished by re-energizing whole feeders within minutes of an auto-trip. This revised re-energizing procedure takes into the account that 80-to 90% of overhead distribution faults are transient in nature (short temporary faults).
- Station power no longer lost during voltage dips caused by outdoor feeder faults. Under-voltage trip function replaced by an under-voltage alarm function.
- Rescued Engine 2 at power plant even though certain experts said that a new (\$1 million) crankshaft should be purchased. Instead, the crankshaft was repaired, bringing on-line 6 MW. The engine is 34 years old with a name plate rating of 7.2 MW.
- Prepaid meters made available to CUC customers. Over 102 were installed at customer request.
- Substation transformer repairs completed at Power Plant T-2: 3 HV Bushings on T-2; improving power reliability directly to Kiya Substation, hence, the entire southern part of Saipan.
- Three hundred fifty (350) pole top pin insulators replaced with fiberglass pins, improving reliability especially at Kagman and Dandan Homesteads.
- Maintained and restored 125 streetlights towards end of 2009; improved security lighting.
- 16 linemen successfully completed Pacific Linemen Training (two year program); only ongoing apprenticeship program on-island.

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FUTURE PLANS

Power Generation

- The net-metering policy will go into effect in 2011 and is timed to usher in distributed Renewable Energy Generation (REG). Customers reeling at the high price of electricity can choose to self-generate using a renewable energy source and sell excess power to CUC.
- Prospective investors with the wherewithal to install utility size REG of over 500 kilowatts (KW) will be invited to bid to supply to the CUC grid. CUC will support the effort of bona fide companies interested in developing renewable energy in the CNMI, particularly in the areas of solar, waste gasification, geothermal and wind.
- On Saipan the existing base load plants fired by expensive diesel fuel have a remaining economic life of 7 to 10 years. CUC will start planning for replacement that has at least a 10% REG component depending on the available technology.
- The goal is to lower the cost of electricity to customers through REG or any other proven technology that is not dependent on fossil fuels, without compromising reliability of service.

Power Transmission & Distribution

- CUC will continue to promote pre-paid metering. The benefits are the conservation of energy and reduction of cost to the customer as well as improved cash management for CUC.
- Emphasis will be placed on maintenance and re-engineering in order to improve reliability; and to minimize the frequency, duration and extent of disruptions.

Water

- The goal is to increase the availability of 24/7 water on Saipan from 78% to 90% by end of 2011.
- The goal for Rota is to improve the infrastructure of the Water Caves so that the source water is protected and eligible for consideration as "ground water" rather than groundwater under the influence of surface water.
- All improvements to the water infrastructure and operations will be done with the objective and goal towards energy efficiency.

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

MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2010

Wastewater

- The goal is to rehabilitate the wastewater treatment plants at Sadog Tasi and Agingan so that National Pollutant Discharge Elimination System (NPDES) requirements are fully met for discharge of treated effluent. A corollary is to engage in a conversation with EPA on strategies and methods to lower the cost of compliance which is high for a small utility such as CUC.
- CUC will continue to rehabilitate its lift stations; ensure back up power is available; improve maintenance so that the incipient failures of the collection mains are caught in advance.
- All improvements to the wastewater infrastructure and operations will be done with the objective and goal towards energy efficiency.

Customer Service

- As the various services of the multi-service utility improve, customer expectations rise. Admittedly, CUC customer service is substandard. The plan is to improve the level of that service dramatically in 2011. The improvement is not just in the improved reliability and quality of the power or water, but of the way customers are served. A second customer outlet will be opened in 2011, in order to provide expanded customer service and payment services.

Since the installation of, and interest in, pre-paid electric meters is growing exponentially, CUC will implement a prepaid card system in 2011. These cards, similar in nature to pre-paid phone cards, will be available through distributors island-wide and will provide customers the ability to recharge their meters on a continuous 24/7 basis. An RFP will also be issued in 2011 for an enhanced billing and customer service data processing system. It is expected that this system will provide seamless integration of services, including field operations, metering, billing, customer support services, accounting, inventory, and equipment maintenance. Another goal for this new system will be to provide customers the ability to pay their utility bills on-line.

REQUESTS FOR INFORMATION

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

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

Or, call (670) 235-7025 through 7032 or email at charles_warren@cucgov.net.

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

Statements of Net Assets (Deficit)
September 30, 2010 and 2009

	2010	2009
	<u>ASSETS</u>	
Current assets		
Current unrestricted assets		
Cash and cash equivalents	\$ 3,006,820	\$ 1,743,554
Accounts receivable - utility, net	17,959,330	18,488,850
Due from grantor agencies	1,751,336	2,372,503
Inventory, net	10,200,734	9,017,836
Deferred fuel costs	1,407,076	-
Other assets, net	1,081,712	1,326,035
Total current unrestricted assets	35,407,008	32,948,778
Current restricted assets		
Cash and cash equivalents	7,709,149	8,148,586
Total current assets	43,116,157	41,097,364
Noncurrent assets		
Capital assets		
Utility plant in service		
Electric plant	128,586,476	127,763,430
Water plant	62,436,988	62,613,268
Sewer plant	42,640,713	37,585,094
Administrative equipment	4,475,287	4,545,784
	238,139,464	232,507,576
Accumulated depreciation	(162,436,969)	(154,626,740)
Net utility plant and administrative equipment	75,702,495	77,880,836
Construction in progress	12,120,099	12,508,005
Total capital assets	87,822,594	90,388,841
TOTAL ASSETS	\$ 130,938,751	\$ 131,486,205

See accompanying notes to financial statements.

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

Statements of Net Assets (Deficit), Continued
September 30, 2010 and 2009

	2010	2009
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities		
Accounts payable	\$ 8,754,128	\$ 10,667,378
Excess of electric fuel surcharge over fuel costs	-	128,972
Accrued liabilities	163,230	206,501
Compensated absences, current portion	195,513	318,876
Due to primary government	4,805,248	4,110,489
Customer deposits	10,511,904	10,634,511
Current maturities of long-term debt	3,743,520	2,512,765
Interest payable	347,582	70,103
Total current liabilities	28,521,125	28,649,595
Noncurrent liabilities		
Long-term debt, net of current maturities	25,104,163	24,933,948
Retirement contributions payable	3,882,111	2,740,055
Advances from CNMI Government	107,296	107,296
Compensated absences, less current portion	586,540	345,449
Total noncurrent liabilities	29,680,110	28,126,748
TOTAL LIABILITIES	58,201,235	56,776,343
Commitments and contingencies		
Net assets (deficit)		
Invested in capital assets, net of related debt	59,112,862	64,742,131
Restricted	13,766,557	12,334,511
Unrestricted	(141,903)	(2,366,780)
NET ASSETS (DEFICIT)	72,737,516	74,709,862
TOTAL LIABILITIES AND NET ASSETS (DEFICIT)	\$ 130,938,751	\$ 131,486,205

See accompanying notes to financial statements.

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

Statements of Revenues, Expenses and Changes in Net Assets (Deficit)
For the Years Ended September 30, 2010 and 2009

	2010	2009
Operating revenues		
Power	\$ 19,297,284	\$ 18,299,551
Water	10,252,911	5,725,407
Sewer	2,315,113	1,274,665
Electric fuel surcharge	53,341,371	51,925,018
Other	377,496	206,717
 Total	 85,584,175	 77,431,358
Bad debts	(2,928,025)	(2,788,134)
 Net operating revenues	 82,656,150	 74,643,224
 Operating expenses		
Production fuel	54,877,419	47,470,952
General and administrative	13,633,092	14,396,147
Depreciation	8,164,412	8,316,344
Other production	7,506,477	11,802,857
Maintenance	5,225,928	5,708,500
Supplies	725,217	1,104,178
Other	644,046	796,905
 Total operating expenses	 90,776,591	 89,595,883
 Loss from operations	 (8,120,441)	 (14,952,659)
 Non-operating revenues (expenses)		
CNMI Government transfers	1,554,653	1,700,000
Interest income	878,122	583,411
Miscellaneous income	206,282	89,000
Regulatory assessments	(457,206)	(395,259)
Settlement expense	(54,000)	(56,729)
Contribution to the CNMI government	(694,759)	(694,759)
Interest expense	(2,631,291)	(673,301)
 Total non-operating revenues (expenses), net	 (1,198,199)	 552,363
 Change in recovery of fuel costs	 1,536,048	 (4,454,066)
 Net loss before capital contributions	 (7,782,592)	 (18,854,362)
Capital contributions	5,810,246	7,983,367
 Change in net assets (deficit) before extraordinary items	 (1,972,346)	 (10,870,995)
Gain on debt restructuring	-	170,496,589
 Change in net assets (deficit)	 (1,972,346)	 159,625,594
Net assets (deficit), beginning	74,709,862	(84,915,732)
 Net asset, ending	 \$ 72,737,516	 \$ 74,709,862

See accompanying notes to financial statements.

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

Statements of Cash Flows
For the Years Ended September 30, 2010 and 2009

	2010	2009
Cash flows from operating activities:		
Cash received from customers	\$ 86,197,370	\$ 82,431,061
Cash payments to suppliers for goods and services	(78,596,724)	(75,281,361)
Cash payments to employees for services	<u>(8,521,074)</u>	<u>(8,020,438)</u>
Net cash used for operating activities	<u>(920,428)</u>	<u>(870,738)</u>
Cash flows from noncapital financing activities:		
Principal repayment of debt	(789,603)	(608,637)
Advances payment to primary government	<u>-</u>	<u>(59,564)</u>
Net cash used for noncapital financing activities	<u>(789,603)</u>	<u>(668,201)</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(3,621,933)	(1,919,601)
Capital contributions received	6,431,413	6,204,633
Principal repayment of debt under capital lease	-	(884,243)
Interest paid on outstanding debt	<u>(1,153,742)</u>	<u>(745,704)</u>
Net cash provided by capital and related financing activities	<u>1,655,738</u>	<u>2,655,085</u>
Cash flows from investing activities:		
Interest income	<u>878,122</u>	<u>583,411</u>
Net cash provided by investing activities	<u>878,122</u>	<u>583,411</u>
Net change in cash and cash equivalents	823,829	1,699,557
Cash and cash equivalents at beginning of year	<u>9,892,140</u>	<u>8,192,583</u>
Cash and cash equivalents at end of year	<u>\$ 10,715,969</u>	<u>\$ 9,892,140</u>
Cash and cash equivalents	\$ 3,006,820	\$ 1,743,554
Restricted cash and cash equivalents	<u>7,709,149</u>	<u>8,148,586</u>
	<u>\$ 10,715,969</u>	<u>\$ 9,892,140</u>

See accompanying notes to financial statements.

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

Statements of Cash Flows, Continued
For the Years Ended September 30, 2010 and 2009

	2010	2009
Reconciliation of loss from operations to net cash used for operating activities:		
Loss from operations	\$ (8,120,441)	\$ (14,952,659)
Adjustments to reconcile loss from operations to net cash used for operating activities:		
Depreciation	8,164,412	8,316,344
Provision for bad debts	2,928,025	2,788,134
Miscellaneous income	206,282	89,000
Regulatory assessments	(457,206)	(395,259)
Settlement expense	(54,000)	(56,729)
(Increase) decrease in assets		
Accounts receivable - utility	(2,398,505)	2,076,021
Inventory	(1,182,898)	(757,267)
Other assets	244,323	1,165,681
Increase (decrease) in liabilities		
Accounts payable	(1,913,250)	(747,399)
Accrued liabilities	(43,271)	58,154
Compensated absences	117,728	46,466
Customer deposits including accrued interest	(122,607)	46,548
Retirement contribution payable	1,142,056	1,452,227
Long-term debt	568,924	-
	<u>\$ (920,428)</u>	<u>\$ (870,738)</u>
 Noncash financing and investing activities		
Increase in capital asset and loans payable due to settlement of litigation:		
Noncash increase in capital assets	\$ 1,976,232	\$ -
Noncash increase in long term debt	(1,976,232)	-
	<u>\$ -</u>	<u>\$ -</u>
 Debt restructuring		
Decrease in interest payable	\$ -	\$ (127,307,107)
Decrease in long-term debt	-	(43,189,482)
Gain in debt restructuring	-	170,496,589
	<u>\$ -</u>	<u>\$ -</u>
 Payment of MPLT loan by appropriation from CNMI General Fund		
Decrease in loans payable	\$ (1,554,653)	\$ (1,700,000)
Non-cash non-operating revenue	1,554,653	1,700,000
	<u>\$ -</u>	<u>\$ -</u>
 Offsetting of CPA loans payable with CUC utilities receivable		
Decrease in loans payable	\$ -	\$ (608,637)
Decrease in utilities receivable	-	608,637
	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to financial statements.

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

Supplementary Information
Statement of Revenues, Expenses and Changes in Net Assets (Deficit) on a Divisional Basis
For the Year Ended September 30, 2010

	Power	Water	Sewer	Administrative and General	Internal Revenues and Expenses	Total
Operating revenues:						
Electric fuel surcharge	\$ 58,292,175	\$ -	\$ -	\$ -	\$ (4,950,804)	\$ 53,341,371
Governmental	6,041,029	3,208,470	1,028,417	-	(2,147,890)	8,130,026
Commercial	11,253,804	3,030,923	866,119	-	-	15,150,846
Residential	4,150,341	4,013,518	420,577	-	-	8,584,436
Other	334,149	39,936	3,411	-	-	377,496
Total operating revenues	80,071,498	10,292,847	2,318,524	-	(7,098,694)	85,584,175
Bad debts	-	-	-	(2,928,025)	-	(2,928,025)
Net operating revenues	80,071,498	10,292,847	2,318,524	(2,928,025)	(7,098,694)	82,656,150
Operating expenses:						
Production fuel	54,877,419	-	-	-	-	54,877,419
General and administrative	5,605,237	2,501,010	962,106	4,564,739	-	13,633,092
Depreciation	3,944,794	2,277,052	1,880,410	62,156	-	8,164,412
Other production	6,761,596	4,919,719	2,302,358	621,498	(7,098,694)	7,506,477
Maintenance	3,686,449	685,270	760,607	93,602	-	5,225,928
Supplies	187,187	347,444	56,343	134,243	-	725,217
Other	-	-	-	644,046	-	644,046
Total operating expenses	75,062,682	10,730,495	5,961,824	6,120,284	(7,098,694)	90,776,591
Earnings (loss) from operations before allocation of common cost	5,008,816	(437,648)	(3,643,300)	(9,048,309)	-	(8,120,441)
Allocation of common costs	(7,817,104)	(1,004,855)	(226,350)	9,048,309	-	-
Loss from operations	\$ (2,808,288)	\$ (1,442,503)	\$ (3,869,650)	\$ -	\$ -	\$ (8,120,441)

See accompanying notes to financial statements.

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

Supplementary Information
Statement of Revenues, Expenses and Changes in Net Assets (Deficit) on a Divisional Basis
For the Year Ended September 30, 2010

	Power	Water	Sewer	Administrative and General	Internal Revenues and Expenses	Total
Loss from operations	\$ (2,808,288)	\$ (1,442,503)	\$ (3,869,650)	\$ -	\$ -	\$ (8,120,441)
Non-operating revenues (expenses):						
Transfers from CNMI government	-	-	-	1,554,653	-	1,554,653
Interest income	758,636	97,519	21,967	-	-	878,122
Miscellaneous income	139,755	-	-	66,527	-	206,282
Regulatory assessments	(114,752)	(342,454)	-	-	-	(457,206)
Settlement expense	(54,000)	-	-	-	-	(54,000)
Contribution to the CNMI government	(600,223)	(77,156)	(17,380)	-	-	(694,759)
Interest expense	(1,321,726)	-	(1,309,565)	-	-	(2,631,291)
Total non-operating revenues (expenses), net	(1,192,310)	(322,091)	(1,304,978)	1,621,180	-	(1,198,199)
Change in recovery of fuel costs	(3,414,756)	3,311,289	1,639,515	-	-	1,536,048
Net loss before capital contributions	(7,415,354)	1,546,695	(3,535,113)	1,621,180	-	(7,782,592)
Capital contributions	2,817,073	1,097,214	1,895,959	-	-	5,810,246
Change in net assets (deficit)	\$ (4,598,281)	\$ 2,643,909	\$ (1,639,154)	\$ 1,621,180	\$ -	\$ (1,972,346)

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2010 and 2009

(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.

(2) Summary of Significant Accounting Policies

Measurement Focus, Basis of Accounting and Basis of Presentation

CUC maintains an enterprise fund to account for its operations. An enterprise fund is a proprietary fund, which is accounted for on the flow of economic resources measurements focus and uses the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. Enterprise funds are used to account for operations that are financed and operated in a manner similar to a private business enterprise, where the intent of management is to finance the costs of providing services to the public primarily through user charges.

The accompanying financial statements are presented in conformity with accounting principles generally accepted in the United States of America (GAAP). The accompanying financial statements have been prepared in accordance with the reporting model defined by Governmental Accounting Standards Board (GASB) Statement No. 34, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments, as amended by GASB Statement No. 37, Basic Financial Statements and Management's Discussion and Analysis - for State and Local Governments: Omnibus - an Amendment of GASB Statements No. 21 and No. 34, and GASB Statement No. 38, Certain Financial Statement Note Disclosures.

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

Notes to Financial Statements
September 30, 2010 and 2009

(2) Summary of Significant Accounting Policies, Continued

Accounting Standards

GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, requires that governments' proprietary activities apply all GASB pronouncements as well as pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, Financial Accounting Standards Board ("FASB") Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins. Governments are given the option whether or not to apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements. CUC has elected not to implement FASB Statements and Interpretations issued after November 30, 1989.

Recent Pronouncements

GASB Statement No. 51 – In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This Statement establishes accounting and financial reporting standards for many different types of assets that may be considered intangible assets, including easements, water rights, timber rights, patents, trademarks, and computer software. This Statement is not effective until June 30, 2010. The CUC has not determined its effect on the financial statements.

In March 2008, GASB issued Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefit*, which clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 45, *Accounting and Financial Reporting by Employers of Postemployment Benefits Other Than Pensions, for calculating the annual required contribution (ARC) adjustment*. The provisions of this Statement are effective for periods beginning after December 15, 2008. Management believes that implementation of this statement does not materially affect the financial statements of the CUC.

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

Notes to Financial Statements
September 30, 2010 and 2009

(2) Summary of Significant Accounting Policies, Continued

Recent Pronouncements, Continued

GASB Statement No. 53 - In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB Statement No. 53 is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. The provisions of this Statement are effective for periods beginning after June 15, 2009. Management believes that implementation of this statement does not materially affect the financial statements of the CUC.

In February 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The provisions of this Statement are effective for periods beginning after June 15, 2010. The effect of the implementation of this Statement on the financial statements of CUC has not been determined.

In March 2009, GASB issued Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. This Statement is to improve financial reporting by contributing to the GASB efforts to codify all generally accepted accounting principles (GAAP) for State and Local governments so that they derive from a single source. This statement is effective upon issuance. The implementation of this Statement did not have a material effect on the accompanying financial statements of the CUC.

In March 2009, GASB issued Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. This Statement incorporates accounting and financial reporting guidance previously only contained in the American Institute of Certified Public Accountants (AICPA) auditing literature into the GASB's accounting and financial reporting literature for State and Local governments, and addresses three issues from the AICPA's literature - related party transactions, going concern considerations and subsequent events. This statement is effective upon issuance. The implementation of this Statement did not have a material effect on the accompanying financial statements of the CUC.

In December 2009, the GASB issued Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*, which provides accounting and financial reporting guidance for governments that have petitioned for protection from creditors under Chapter 9 of the United States Bankruptcy Code. This statement is effective beginning after June 15, 2010, with retroactive application for all periods presented during which the government was in bankruptcy. The effect of the implementation of this Statement on the financial statements of CUC has not been determined.

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

Notes to Financial Statements
September 30, 2010 and 2009

(2) Summary of Significant Accounting Policies, Continued

Recent Pronouncements, Continued

In June 2010, GASB issued Statement No. 59, *Financial Instruments Omnibus*. The Statement updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. The Statement is effective for financial statements prepared by state and local governments for periods beginning after June 15, 2010, with earlier application encouraged. The effect of the implementation of this Statement on the financial statements of CUC has not been determined.

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

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

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

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

Budgets

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

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

Notes to Financial Statements
September 30, 2010 and 2009

(2) Summary of Significant Accounting Policies, Continued

Cash and Cash Equivalents

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

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

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

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

At September 30, 2010 and 2009, cash and cash equivalents were \$10,715,969 and \$9,892,140, respectively, and the corresponding bank balances were \$10,733,133 and \$9,812,401, respectively. Of the bank balance amounts, \$10,729,286 and 9,794,108, respectively were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. Bank deposits in the amount of 10,212,255 and \$9,538,178 were in excess of FDIC insurable limits insured as of September 30, 2010 and 2009. CUC also has deposits of \$3,847 in 2010 and \$18,293 in 2009 in an uninsured financial institution.

CNMI law does not mandate component units to require collateral for their cash deposits; therefore, deposit levels in excess of FDIC insurance are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

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

Restricted Cash and Cash Equivalents

The restricted cash and cash equivalents of \$7,709,149 and \$8,148,586 at September 30, 2010 and 2009, respectively, pertains to customer deposits, of which, \$7,500,000 in 2010 and 2009 is held as security pursuant to a standby letter of credit obtained from a financial institution.

Accounts Receivable and Allowance for Uncollectable Accounts

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

CUC provides utility services to customers within the CNMI and bills for these services on a monthly basis. The accumulated provision for uncollectible accounts is stated at an amount which management 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. Current policy is to provide one hundred percent (100%) of account balances greater than seventy-five (75) days old.

Inventory

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

Inventory as of September 30, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Fuel and lubes	\$ 1,857,666	\$ 1,000,930
Materials and supplies	<u>9,040,193</u>	<u>8,714,031</u>
	10,897,859	9,714,961
Allowance for obsolescence	<u>(697,125)</u>	<u>(697,125)</u>
Inventory, net	<u>\$ 10,200,734</u>	<u>\$ 9,017,836</u>

Fuel Oil Costs

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

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

Fuel Oil Costs, Continued

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

The residential rates established by the July 20, 2006 Amendments to Part 24 of the Electric Service Regulation of the CUC was superseded by Public Law 15-94 on October 4, 2007. Public Law 15-94 retained the provision that electric fuel rates may fluctuate depending on the actual cost of fuel; however, any proposed change to the electric charges and rates by the Commonwealth Utilities Corporation shall be reviewed and approved by the Commonwealth Public Utilities Commission before promulgation.

On May 3, 2008, Public Law 16-2 suspended the electrical charges and rates set forth in Section 2 of Public Law 15-94 until December 31, 2008. The rate structure established by the Amendments to Part 24 of the Electric Service Regulations of the CUC was reinstated; provided that this rate structure shall be superseded by a rate structure adopted by the Commonwealth Public Utilities Commission, pursuant to Public Law 15-35, as amended; provided further that the rates set forth in Public Law 15-94 shall become effective and will supersede temporary electrical charges and rates established pursuant to Public Law 16-2 upon the failure of the Commonwealth Utilities Corporation and the Public Utilities Commission to adopt an electrical rate structure on or before December 31, 2008.

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

On May 28, 2010, the LEAC rate was increased from \$0.20147 per kWh to \$0.24445 per kWh effective June 1, 2010 and should remain in place until changed by CPUC's order.

Under (over) recovery as of September 30, 2010 and 2009 were \$1,407,076 and \$(128,972), respectively. The deferred fuel cost at September 30, 2010 and 2009 are as follows:

	2010	2009
Deferred fuel cost, beginning	\$ (128,972)	\$ 4,325,094
Under (over) recovery of fuel cost	1,536,048	(4,454,066)
Deferred fuel cost, end	\$ 1,407,076	\$ (128,972)

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2010 and 2009

(2) Summary of Significant Accounting Policies, Continued

Capital Assets and Depreciation

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

Current policy is to capitalize items in excess of \$1,000. The costs of acquisition and construction of equipment and facilities are recorded as construction-in-progress until such assets are completed and placed in service, at which time the CUC commences recording depreciation expense.

Compensated Absences

Compensated absences are accrued and reported as a liability in the period earned. Annual leave to be paid out within the next fiscal year is accrued and is included in current liabilities. The liability at September 30, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Total compensated absences, beginning of year	\$ 664,325	\$ 617,859
Vacation earned	607,000	557,015
Vacation used	<u>(489,272)</u>	<u>(510,549)</u>
Total compensated absences, end of year	782,053	664,325
Current portion	<u>(195,513)</u>	<u>(318,876)</u>
Compensated absences – noncurrent	<u>\$ 586,540</u>	<u>\$ 345,449</u>

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

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

Net Assets (Deficit)

Net assets represent the residual interest in CUC's assets after liabilities while net deficit represents the excess liability over assets. Net assets (deficit) consist of three sections: invested in capital assets, net of related debt; restricted expendable and nonexpendable; and unrestricted. Net assets invested in capital assets, net of debt include capital assets, restricted and unrestricted, net of accumulated depreciation, reduced by outstanding debt net of debt service reserve. Net assets are reported as restricted when constraints are imposed by third parties or enabling legislation.

Retirement Plan – Defined Benefit Plan

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

Based on the actuarial valuation as of October 1, 2008 issued in May 2010, the actuarially determined contribution rate for the fiscal year ended September 30, 2008 was 51.0578% of covered payroll.

The established statutory rate at September 30, 2010 and 2009 was 37.3909% of covered payroll.

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

<u>Fiscal Year</u>	<u>Required Contribution</u>	<u>Percentage of Covered Payroll</u>	<u>Actual Contribution</u>	<u>Percentage of Required Contributions Contributed</u>
2010	\$2,137,963	37.3909%	\$995,907	47%
2009	\$2,479,375	37.3909%	\$1,027,148	41%
2008	\$2,698,532	36.7727%	\$1,527,316	57%
2007	\$2,895,766	36.7727%	\$2,895,766	100%
2006	\$3,136,714	36.7727%	\$3,136,714	100%

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(2) Summary of Significant Accounting Policies, Continued

Retirement Plan – Defined Contribution Plan

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

Existing Class I members of the Defined Benefit Plan with less than 10 years of service credit may, upon written election, voluntarily and irrevocably elect membership in the DC Plan. This option shall expire 12 months after enactment of legislation.

Summarized as follows are the changes in the Defined Contribution Plans from inception to September 30, 2010 and 2009.

	<u>2010</u>	<u>2009</u>
Market value, beginning of year	\$ 473,796	\$ 217,144
Employee contributions	285,535	156,173
Employer contributions	111,689	62,398
Transfers and rollovers	26,374	10,769
Withdrawals	(68,003)	(4,504)
Distributions	(3,850)	(4,155)
Earnings	4,170	7,054
Unrealized gain (loss)	56,054	29,482
Expenses	<u>(6,220)</u>	<u>(565)</u>
Market value, end of year	<u>\$ 879,545</u>	<u>\$ 473,796</u>

Medical and Life Insurance Benefits

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

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2010 and 2009

(2) Summary of Significant Accounting Policies, Continued

Revenue and Expense Recognition

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

Power, water and sewer sales are recorded as billed to customers on a monthly cycle billing basis. At the end of each month, unbilled revenues are accrued for each cycle based on the subsequent cycle billing. Unbilled receivables included in current year's earnings at September 30, 2010 and 2009 are \$10,268,375 and \$9,036,667, respectively.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Contingencies

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

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

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

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Notes to Financial Statements
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(3) Accounts Receivable – Utility

Account receivable – utility as of September 30, 2010 and 2009 summarized by location and customer classification are as follows:

By Location

	2010	2009
Saipan		
Commercial	\$ 10,626,909	\$ 11,371,375
Residential	14,363,121	11,818,534
Government	5,603,782	6,097,350
	30,593,812	29,287,259
Tinian		
Commercial	1,010,524	1,128,453
Residential	618,027	632,099
Government	497,259	655,510
	2,125,810	2,416,062
Rota		
Commercial	510,628	515,785
Residential	820,083	662,783
Government	398,922	476,044
	1,729,633	1,654,612
	\$ 34,449,255	\$ 33,357,933

By Customer Classification

	2010	2009
Commercial	\$ 12,148,061	\$ 13,015,613
Residential	15,801,231	13,113,416
Government	6,499,963	7,228,904
	34,449,255	33,357,933
Allowance for uncollectible accounts	(16,489,925)	(14,869,083)
Accounts receivable – utility, net	\$ 17,959,330	\$ 18,488,850

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Notes to Financial Statements
September 30, 2010 and 2009

(3) Accounts Receivable – Utility, Continues

Changes in allowance for uncollectible accounts for the years ended September 30, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Total allowance, beginning of year	\$ 15,884,480	\$ 14,779,347
Provision for uncollectible accounts	2,928,025	2,788,134
Accounts written-off	<u>(1,412,465)</u>	<u>(1,683,001)</u>
Total allowance, end of year	<u>\$ 17,400,040</u>	<u>\$ 15,884,480</u>
Accounts receivable - utility	\$ 16,489,925	\$ 14,869,083
Others assets	<u>910,115</u>	<u>1,015,397</u>
Total allowance, end of year	<u>\$ 17,400,040</u>	<u>\$ 15,884,480</u>

(4) Other Assets

Other assets as of September 30, 2010 and 2009 consist of the following.

	<u>2010</u>	<u>2009</u>
Prepayments	\$ 785,129	\$ 1,099,728
Notes receivable	243,901	292,727
Temporary facility	-	244,177
Others	<u>962,837</u>	<u>704,800</u>
	1,991,867	2,341,432
Allowance for uncollectible accounts	<u>(910,155)</u>	<u>(1,015,397)</u>
Other assets, net	<u>\$ 1,081,712</u>	<u>\$ 1,326,035</u>

(5) Due from Grantor Agencies

CUC is a recipient of direct federal awards and sub-recipient of federal grants received by the CNMI central government from various U.S. federal agencies. CUC 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.

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Notes to Financial Statements
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(5) Due from Grantor Agencies, Continued

Changes in the due from grantor agencies account for the years ended September 30, 2010 and 2009 are as follows:

	2010	2009
Balance at beginning of year	\$ 2,372,503	\$ 593,769
Adjustment	(76,289)	7,234
Deductions - cash receipts from grantor agencies	(6,355,125)	(6,286,145)
Additions - program outlays	5,810,247	8,057,645
Balance at end of year	\$ 1,751,336	\$ 2,372,503

(6) Capital Assets

A summary of the changes in capital assets activity for the years ended September 30, 2010 and 2009 is as follows:

	Estimated Useful Lives	Balance at October 1, 2009	Acquisitions	Disposals	Adjustments/ Transfers	Balance at September 30, 2010
Utility plant in service						
Electric plant	20 years	\$127,763,430	\$ 174,213	\$ (44,033)	\$ 692,866	\$128,586,476
Water plant	20 years	62,613,268	84,109	(235,494)	(24,895)	62,436,988
Sewer plant	20 years	37,585,094	22,498	(20,195)	5,053,316	42,640,713
Administrative equipment	3-5 years	4,545,784	39,180	(109,677)	-	4,475,287
		232,507,576	320,000	(409,399)	5,721,287	238,139,464
Accumulated depreciation		(154,626,740)	(8,164,412)	323,472	30,711	(162,436,969)
Depreciable assets, net		77,880,836	(7,844,412)	(85,927)	5,751,998	75,702,495
Construction work-in-progress		12,508,005	5,278,165	(40,561)	(5,625,510)	12,120,099
Capital assets, net		\$ 90,388,841	\$(2,566,247)	\$ (126,488)	\$ 126,488	\$ 87,822,594

	Estimated Useful Lives	Balance at October 1, 2008	Acquisitions	Disposals	Adjustments/ Transfers	Balance at September 30, 2009
Utility plant in service						
Electric plant	20 years	\$127,438,647	\$ 79,688	\$ -	\$ 245,095	\$127,763,430
Water plant	20 years	62,580,255	10,418	(2,300)	24,895	62,613,268
Sewer plant	20 years	37,565,848	3,115	(2,800)	18,931	37,585,094
Administrative equipment	3-5 years	4,532,820	18,534	(4,070)	(1,500)	4,545,784
		232,117,570	111,755	(9,170)	287,421	232,507,576
Accumulated depreciation		(146,286,611)	(8,316,344)	9,170	(32,955)	(154,626,740)
Depreciable assets, net		85,830,959	(8,204,589)	-	254,466	77,880,836
Construction work-in-progress		10,954,625	1,523,010	-	30,370	12,508,005
Capital assets, net		\$ 96,785,584	\$(6,681,579)	\$ -	\$ 284,836	\$ 90,388,841

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(6) Capital Assets, Continued

Included in utility plant in service adjustments/transfers for fiscal year ended September 30, 2010 and 2009 are completed projects transferred from construction work-in-progress to utility plant in service of \$5,746,182 and \$0, respectively.

Depreciation expense for the years ended September 30, 2010 and 2009 is \$8,164,412 and \$8,316,344, respectively.

(7) Customer Deposits

Pursuant to 4 CMC § 8143, as amended by Public Law 15-80, the CUC shall collect one month security deposits per customer account. Such deposits shall be placed in an interest earning trust fund and shall not be used for any other purpose.

On May 3, 2008, 4 CMC § 8143 as established by Public Law 15-80 was amended by Public Law 16-2, which allows CUC to use up to fifty percent (50%) of the security deposit funds to pay for its fuel expenses for fiscal year 2008 with the condition that CUC shall return the funds within three years.

Pursuant to Public Law 16-2, summarized below is the summary of customer deposits including accrued interest as of September 30, 2010 and 2009:

	2010	2009
Electric	\$ 8,203,342	\$ 8,594,694
Water	428,494	428,351
Sewer	346	286
Total customer deposits	8,632,182	9,023,331
Customer overpayments	1,536,032	1,299,625
Accrued interest on customer deposits	343,690	311,555
	<u>\$10,511,904</u>	<u>\$10,634,511</u>
	2010	2009
Customer deposits, including interest	\$10,511,904	\$10,634,511
Restricted cash	(7,709,149)	(8,148,586)
Accumulated customer deposits used in operations	<u>\$ 2,802,755</u>	<u>\$ 2,485,925</u>

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(7) Customer Deposits, Continued

CUC has not accrued an additional liability for accrued interest on customer deposits in excess of the actual interest income the restricted cash has earned. Any payments of interest in excess of the interest income of the restricted cash should be recorded in the period incurred.

Of CUC's restricted cash, \$7,500,000 as of September 30, 2010 and 2009, is held as security pursuant to a letter of credit obtained from a financial institution to secure a \$7,500,000 credit limit for fuel purchases.

(8) Noncurrent Liabilities

Changes in noncurrent liabilities at September 30, 2010 and 2009 are as follows:

	Balance 9/30/2009	Increase	Decrease	Balance 9/30/2010	Due in One Year	Noncurrent
Long-term debt						
Commonwealth Development Authority (CDA)	\$ 18,379,268	\$ 1,200,067	\$ -	\$ 19,579,335	\$ -	\$ 19,579,335
Commonwealth Ports Authority (CPA)	7,267,445	-	(162,994)	7,104,451	2,783,695	4,320,756
GPPC Construction, Inc. (GPPC)	-	1,976,232	(57,682)	1,918,550	714,478	1,204,072
Marianas Public Land Trust (MPLT)	<u>1,800,000</u>	<u>-</u>	<u>(1,554,653)</u>	<u>245,347</u>	<u>245,347</u>	<u>-</u>
	27,446,713	3,176,299	(1,775,329)	28,847,683	3,743,520	25,104,163
Retirement Contributions payable (Note 2)	2,740,055	2,137,963	(995,907)	3,882,111	-	3,882,111
Advances from CNMI Government	107,296	-	-	107,296	-	107,296
Compensated Absences (Note 2)	<u>664,325</u>	<u>607,000</u>	<u>(489,272)</u>	<u>782,053</u>	<u>195,513</u>	<u>586,540</u>
Total Noncurrent liabilities	<u>\$ 30,958,389</u>	<u>\$ 5,921,262</u>	<u>\$ (3,260,508)</u>	<u>\$ 33,619,143</u>	<u>\$ 3,939,033</u>	<u>\$ 29,680,110</u>

COMMONWEALTH UTILITIES CORPORATION
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(8) Noncurrent Liabilities, Continued

	Balance 9/30/2008	Increase	Decrease	Balance 9/30/2009	Due in One Year	Noncurrent
Long-term debt						
Commonwealth Development Authority (CDA)	\$ 61,568,750	\$ -	\$ (43,189,482)	\$ 18,379,268	\$ -	\$ 18,379,268
Commonwealth Ports Authority (CPA)	7,876,082	-	(608,637)	7,267,445	2,512,765	4,754,680
Marianas Public Land Trust (MPLT)	<u>3,500,000</u>	<u>-</u>	<u>(1,700,000)</u>	<u>1,800,000</u>	<u>-</u>	<u>1,800,000</u>
	72,944,832	-	(45,498,119)	27,446,713	2,512,765	24,933,948
Retirement Contributions payable (Note 2)	1,287,828	2,479,375	(1,027,148)	2,740,055	-	2,740,055
Advances from CNMI Government	166,860	-	(59,564)	107,296	-	107,296
Compensated Absences (Note 2)	<u>617,859</u>	<u>557,015</u>	<u>(510,549)</u>	<u>664,325</u>	<u>318,876</u>	<u>345,449</u>
Total Noncurrent liabilities	<u>\$ 75,017,379</u>	<u>\$ 3,036,390</u>	<u>\$ (47,095,380)</u>	<u>\$ 30,958,389</u>	<u>\$ 2,831,641</u>	<u>\$ 28,126,748</u>

Interest expense on long-term debt for the years ended September 30, 2010 and 2009 was \$2,631,291 and \$673,301, respectively.

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Notes to Financial Statements
September 30, 2010 and 2009

(8) Noncurrent Liabilities, Continued

Commonwealth Development Authority (CDA)

A summary of CUC's long-term payable to CDA as of September 30, 2010 and 2009 consist of the present value of Debt Security of \$45,000,000 with stated dividend payment rate of 2% per annum. However, to reflect the time value of money, the liability recorded in the financial statements reflects future payments discounted at an imputed interest rate of 6.49%.

On June 6, 2006, the Governor of the CNMI approved Public Law 15-12 which authorized CDA to waive for a sum of \$45,500,000, the amount owed by CUC, such amount being the aggregate sum of all outstanding sewer and water project loans given to CUC and referenced in the amended MOA executed in January 2004, by CUC and CDA.

Pursuant to the same amended MOA, CDA is authorized to waive any and all accrued interest owed by CUC on all outstanding loans in accordance with the terms and conditions of the amended MOA. Section 2 of the Public Law 15-12 provides that in the event that the power generation system for the CNMI is privatized and controlled by an independent power producer, fifty percent of the principal amount of \$45,500,000 shall be paid by the independent power producer to CDA.

Section 2 of the Public Law 15-12 was amended by Public Law 15-44, approved by the Governor of the CNMI on January 23, 2007. The amended section 2 provides that in the event that CUC's power division or any section thereof is privatized, fifty percent or \$22,750,000 of the principal amount of \$45,500,000 shall be rebated to the residential power consumers and the remaining fifty percent shall be waived. The said rebate shall be subject to review and approval by the Public Utilities Commission upon privatization.

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

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

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

Notes to Financial Statements
September 30, 2010 and 2009

(8) Noncurrent Liabilities, Continued

Commonwealth Development Authority (CDA), Continued

On May 7, 2009, the MOU was signed by officials of CUC and CDA. This was subsequently approved by the Commonwealth Public Utilities Corporation approved the MOU on September 3, 2009. As a result of the forgoing events, CUC recognized a gain on debt restructuring of \$170,496,589, presented as extraordinary gain in the accompanying Statements of Revenues, Expenses and Changes in Net Assets (Deficit) in fiscal year 2009.

Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Government*, does not provide for preferred stocks to be recorded as component of net assets, hence the \$45,000,000 preferred stocks issued to CDA is presented as Debt Security in the accompanying financial statements.

Pursuant to the terms of the MOU, the dividend payments for the first three years after issuance of the stocks are to be amortized, interest free over a 15 year period. The present value of the debt security was computed using imputed interest rate of 6.49% on quarterly payments or \$225,000 for 30 years with redemption of the \$45,000,000 at the end of 30 years.

Future payments to CDA are summarized as follows:

	<u>Year ending</u>	
	<u>September 30,</u>	
	2010	\$ -
	2011	-
	2012	-
	2013	1,080,000
	2014	1,080,000
	2015 - 2019	5,400,000
	2020 - 2024	5,400,000
	2025 - 2029	5,040,000
	2030 - 2034	4,500,000
	2035 - 2039	<u>49,500,000</u>
Total payments		72,000,000
Amount representing dividends		<u>(26,100,000)</u>
Face value of debt		45,900,000
Unamortized discount		<u>(26,320,665)</u>
Present value of debt		<u>\$ 19,579,335</u>

The face amount of the debt as of September 30, 2009, includes the \$900,000 deferred dividend income.

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

Notes to Financial Statements
September 30, 2010 and 2009

(8) Noncurrent Liabilities, Continued

Commonwealth Ports Authority (CPA)

A summary of CUC's loans payable CPA at September 30, 2010 and 2009 is as follows:

	<u>2010</u>	<u>2009</u>
Loan payable to CPA, a component unit of the CNMI, principal of \$3,385,131, interest at 6.25% per annum, with a maturity date of October 31, 2017. Principal and interest payments are due in monthly payments of \$38,008.	\$ 3,559,068	\$ 2,882,245
Loan payable to CPA, principal of \$4,829,895, interest at 6.25% per annum with a maturity date of October 31, 2012. Principal and interest payments are due in monthly payments of \$93,938.	<u>3,545,383</u>	<u>4,385,200</u>
Current portion	<u>7,104,451</u> <u>(2,783,695)</u>	<u>7,267,445</u> <u>(2,512,765)</u>
Long-term debt, net of current portion	<u>\$ 4,320,756</u>	<u>\$ 4,754,680</u>

Future repayment commitments of principal and interest are as follows:

<u>Year ending</u> <u>September 30,</u>	<u>Principal</u>
2011	\$2,783,695
2012	1,320,616
2013	1,129,839
2014	349,093
2015	371,547
2016-2018	<u>1,149,661</u>
	<u>\$7,104,451</u>

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2010 and 2009

(8) Noncurrent Liabilities, Continued

GPPC Construction, Inc. (GPPC)

Pursuant to a Memorandum of Understanding between CUC and GPPC signed July 26, 2010, CUC recognized a liability of \$1,976,232 for the unpaid balance for a construction contract between CUC and GPPC. The loan is payable in 25 monthly payments of \$105,000 including interest and one payment of \$95,787, commencing on August 2010 through October 2012.

Future repayment commitments of principal and interest are as follows:

<u>Year ending</u> <u>September 30,</u>	<u>Principal</u>
2011	\$ 714,478
2012	<u>1,204,071</u>
	<u>\$1,918,550</u>

Marianas Public Land Trust (MPLT)

On August 4, 2008, CUC obtained a \$3,500,000 unsecured loan bearing interest of 7% per annum. Principal and unpaid interest is due on August 4, 2011. Interest is payable in equal monthly installments on each interest payments, payment date beginning September 1, 2008.

During fiscal year ending September 30, 2010 and 2009, the CNMI government paid MPLT \$1,554,653 and \$1,700,000, respectively, of the \$3,500,000.

Future repayment commitments of principal and interest are as follows:

<u>Year ending</u> <u>September 30,</u>	<u>Principal</u>
2011	\$ 245,347

(9) Due to Primary Government

Public Law 9-66, enacted on 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 CNMI Office of the Public Auditor (OPA) and the agency may agree, to fund the OPA. At September 30, 2010 and 2009, CUC had an outstanding payable to the CNMI Government in the amount of \$4,805,248 and \$4,110,489, respectively.

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2010 and 2009

(10) Electric Fuel Charge

On October 26, 2004, CUC published proposed amendments to the Electrical Service Regulations (ESR) for a fuel surcharge. The regulation limited the fuel surcharge to a maximum of \$.035 per kilowatt hour (kwh) for the first calendar year after adoption of the regulation, but allowed for full cost recovery in subsequent calendar years. The regulation includes an exception, required by statute, limiting the annual increase for low volume users. After notices and hearings, the fuel surcharge was adopted in January 2005. The final regulation was published on February 17, 2005 and became effective by operation of law on February 28, 2005. As a result of the regulation being finalized in 2005, the \$.035 per kwh cap on the surcharge remained in effect until the end of calendar year 2005.

On July 2006, the CUC Electric Service Regulations, Part 24 Rate Schedules were amended to implement an adjustment of the utility rate structure. The amendment of the CUC Electric Service Regulations is in accordance with the recommendations and findings set forth in a comprehensive electric, sewer and wastewater rate study prepared for CUC by a consultant.

The fuel surcharge fee, made effective on February 27, 2005, as Part 24.5.8 of the CUC Electric Service Regulations, was rescinded as of the effective date of the amendments to Part 24 of the CUC Electric Service Regulations. The new utility rate, which includes an electric fuel charge, is effective beginning August 2006 utility consumption and was formally adopted on October 24, 2006.

As discussed in Note 2, several Public Laws have been passed to amend Part 24.5.8 of the CUC Electric Service Regulations.

Electric fuel surcharge for the years ended September 30, 2010 and 2009 was \$53,341,371 and \$51,925,018, respectively.

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

Notes to Financial Statements
September 30, 2010 and 2009

(11) Risk Management

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

CUC is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. CUC currently does not maintain insurance coverage with respect to its inventory and utility plant. In the event of a loss, CUC will be self insured for the entire amount. CUC currently reports all of its risk management activities as they are incurred. No provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

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

(12) Commitments and Contingencies

Commitments

On September 23, 1996, CUC entered into an agreement with a third party for the purchase of electric power and associated services. The agreement provides for a monthly minimum purchase of 7,300,000 kilowatt-hours (kwh) at \$0.033 per kwh after January 1, 1998. Additionally, the agreement provides for periodic adjustment of the prices agreed upon but not to exceed 10% of the price then in effect. The original agreement expired on July 31, 2006 and was subsequently renewed for an additional ten year period to expire on July 31, 2016.

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2010 and 2009

(12) Commitments and Contingencies, Continued

Contingencies

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

CUC is a defendant in a class action lawsuit, Superior Court Civil Case No. 09-410, wherein CUC is alleged to have overcharged its customers from July 22, 2006 to October 24, 2006. The damages sought include a refund of approximately \$4.2 million, in addition to related punitive damages and attorney fees. While the lawsuit was proceeding, the Legislature enacted Public Law 17-3 which purported to clarify the intent of prior Public Laws enabling the Commonwealth Public Utilities Commission (CPUC). The law amends Section 8122 of the Commonwealth Code to give the Executive Director of CUC the power and authority to set rates as of January 27, 2006 and continue until the CPUC's, first order setting rates. The second motion to dismiss has been fully briefed by the parties, including the CNMI, and two former CUC Executive Directors, both represented by the Attorney General's Office, and is set for oral argument on January 19, 2011. CUC believes that it should not be liable for further rate refunds or damages as alleged in this case, and is defending vigorously. If CUC does not prevail, the potential loss could be upward of \$10 million. CUC believes that, with the passage of PL 17-3, it has a greater likelihood of prevailing and having the claims dismissed. No provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

CUC is also a party to a labor related complaint with the US Department of Labor and CUC believes that it will prevail on this matter. If CUC does not prevail, the potential loss could be \$105,000. No provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

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

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

Notes to Financial Statements
September 30, 2010 and 2009

(12) Commitments and Contingencies, Continued

Contingencies, Continued

CUC participates in a number of federally assisted grant programs funded by the United States Government. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of \$1,245,922 have been set forth in CUC's Single Audit Report for the year ended September 30, 2010. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

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

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

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

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

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

Subsequent to September 30, 2008, fines and penalties related to these stipulated orders have accrued to approximately \$15 million, but have not been charged, with the exception of \$29,000 and \$140,000 which were paid by CUC to the United States Department of Justice on January 2010 and July 2010, respectively.

The parties appeared for a status conference and signed a further stipulation dated August 12, 2010, in which CUC has agreed to specific performance dates for required projects. As further penalties and fines are contingent on CUC's performance, and as EPA has not at this time chosen to attempt to collect on the majority of the penalties and fines, it is very difficult to evaluate future liabilities and CUC has not accrued any liability in the accompanying statements of net assets.

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

Notes to Financial Statements
September 30, 2010 and 2009

(13) Liability for Estimated Environmental Remediation Costs

CUC is involved in environmental remediation and ongoing compliance as discussed in Note 12. At September 30, 2010, and 2009, CUC has not estimated total remediation cost associated with these activities.

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

(14) Subsequent Event

CUC has evaluated subsequent events from September 30, 2010 through March 15, 2011, the date the financial statements were available to be issued. As discussed in Note 13, CUC received an order from EPA for pollution remediation that could cost from \$1 million to \$2 million.

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

**REPORTS ON THE AUDITS OF FINANCIAL
STATEMENTS IN ACCORDANCE WITH
OMB CIRCULAR A-133**

**Year Ended
September 30, 2010**

J. Scott Magliari
&
COMPANY

CERTIFIED PUBLIC ACCOUNTANT

SAIPAN OFFICE:

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

GUAM OFFICE:

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

PALAU OFFICE:

PIDC Apartment No. 11
P.O. Box 1266
Koror, PW 96940
Tel No. (680) 488-8615
Fax No. (680) 488-8616
Email: coconutrum@palaunet.com

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

To the Executive Director
Commonwealth Utilities Corporation

I have audited the financial statements of the Commonwealth Utilities Corporation (CUC), as of and for the year ended September 30, 2010, and have issued my report thereon dated January 31, 2011. I conducted my audit 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 of America.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered CUC's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of CUC's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of CUC's internal control over financial reporting.

My consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be *significant deficiencies* or *material weaknesses*. However, as discussed below, I identified certain deficiencies in internal control over financial reporting that I consider to be *significant deficiencies*.

A *deficiency* in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. I consider Finding Nos. 2010-2, 2010-6 and 2010-8 through 2010-11 described in the accompanying Schedule of Findings and Questioned Costs to be material weaknesses.

A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. I consider Finding Nos. 2010-1, 2010-3, 2010-5 and 2010-7 described in the accompanying Schedule of Findings and Questioned Costs to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether CUC's financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as Findings 2010-2, 2010-3 and 2010-12.

CUC's responses to the findings identified in my audit are described in the accompanying Schedule of Findings and Questioned Costs. I did not audit CUC's response and, accordingly, I express no opinion on it.

This report is intended solely for the information and use of the management of CUC, the CNMI Office of the Public Auditor, 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. However, this report is also a matter of public record.


J. Scott Magliari & Company

Saipan, Commonwealth of the Northern Mariana Islands
January 31, 2011

J. Scott Magliari
COMPANY

CERTIFIED PUBLIC ACCOUNTANT

SAIPAN OFFICE:

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

GUAM OFFICE:

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

PALAU OFFICE:

PIDC Apartment No. 11
P.O. Box 1266
Koror, PW 96940
Tel No. (680) 488-8615
Fax No. (680) 488-8616
Email: coconutrum@palaunet.com

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE
WITH REQUIREMENTS APPLICABLE TO EACH MAJOR FEDERAL AWARD PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE WITH OMB CIRCULAR A-133
AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

To the Executive Director
Commonwealth Utilities Corporation

Compliance

I have audited the compliance of Commonwealth Utilities Corporation (CUC) with the types of compliance requirements in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2010. CUC's major federal programs are identified in the Summary of Auditor's Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of CUC's management. My responsibility is to express an opinion on CUC's compliance based on my audit.

I conducted my audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that I plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about CUC's compliance with those requirements and performing such other procedures as I considered necessary in the circumstances. I believe that my audit provides a reasonable basis for my opinion. My audit does not provide a legal determination of CUC's compliance with those requirements.

As described in Findings 2010-13 through 2010-16 in the accompanying Schedule of Findings and Questioned Costs, CUC did not comply with requirements regarding reporting, and equipment and real property, that are applicable to its Construction Grants for Wastewater Treatment - ARRA (CFDA 66.418 ARRA), Capitalization Grants for Drinking Water - ARRA (CFDA 66.418 ARRA), Capitalization Grants for Drinking Water - ARRA (CFDA 66.468) and Capital Development Projects (CFDA 15.875) and compliance with such requirements is necessary, in my opinion, for CUC to comply with the requirements applicable to that program.

In my opinion, except for the noncompliance described in the preceding paragraph, CUC complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2010.

Internal Control Over Compliance

The management of CUC is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing my audit, I considered CUC's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine my auditing procedures for the purpose of expressing my opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, I do not express an opinion on the effectiveness of CUC's internal control over compliance.

My consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, I identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as Findings 2010-13 through 2010-16 to be material weaknesses.

A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. There were no deficiency noted that was not a material weakness.

Schedule of Expenditures of Federal Awards

I have audited the basic financial statements of CUC as of and for the year ended September 30, 2010, and have issued my report thereon dated January 31, 2011. My audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards on pages 55 through 58 is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of CUC. Such information has been subjected to the auditing procedures applied in the audit of the basic financial

statements and, in my opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

CUC's responses to the findings identified in my audit described in the accompanying Schedule of Findings and Questioned Costs are in a separate letter prepared by CUC's management. I did not audit CUC's response and, accordingly, I express no opinion on it.

This report is intended solely for the information and use of the management of CUC, the CNMI Office of the Public Auditor, 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. However, this report is also a matter of public record.


Saipan, Commonwealth of the Northern Mariana Islands
January 31, 2011

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

Schedule of Expenditures of Federal Awards
For the Year Ended September 30, 2010

Federal Grantor/Pass-Through Program Title	Federal CFDA Number Pass Through Grantor's Number	Receivable (Deferred Revenue) from Grantor at September 30, 2009	Receipts FY 2010	Adjustments	Expenditures FY 2010	Receivable (Deferred Revenue) from Grantor at September 30, 2010
<u>U.S. Environmental Protection Agency</u>						
Direct Programs:						
Kanat Tabla IMG Tank	66.468	\$ 33,029	\$ 186,942	\$ 5,179	\$ 148,734	\$ -
As Matus Waterwell Interconnection	66.468	54,629	90,031	-	35,402	-
Rehabilitation of Existing Slow sand Filter	66.468	<u>102,485</u>	<u>268,486</u>	-	<u>166,001</u>	-
		190,143	545,459	5,179	350,137	-
ARRA - Wastewater Treatment Construction Programs	66.418A	-	329,733	-	970,124	640,391
ARRA - Drinking Water Infrastructure	66.468A	-	457,005	-	693,740	236,735
Agingan Sewage Treatment Plant Ocean Outfall	66.418	<u>6,184</u>	<u>-</u>	<u>(6,184)</u>	<u>-</u>	<u>-</u>
Total U.S. Environmental Protection Agency		<u>196,327</u>	<u>1,332,197</u>	<u>(1,005)</u>	<u>2,014,001</u>	<u>877,126</u>
<u>U.S. Department of Homeland Security</u>						
Passed through the Government of the CNMI						
Public Assistance Grants	97.036	<u>80,388</u>	<u>105,193</u>	-	<u>51,662</u>	<u>26,857</u>
Total U.S. Department of Homeland Security		<u>80,388</u>	<u>105,193</u>	-	<u>51,662</u>	<u>26,857</u>
Balance carried forward		<u>\$ 276,715</u>	<u>\$ 1,437,390</u>	<u>\$ (1,005)</u>	<u>\$ 2,065,663</u>	<u>\$ 903,983</u>

See accompanying notes to schedule of expenditures of federal awards.

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

Schedule of Expenditures of Federal Awards
For the Year Ended September 30, 2010

Federal Grantor/Pass-Through Grantor Program Title	Federal CFDA Number Pass Through Grantor's Number	Receivable (Deferred Revenue) from Grantor at September 30, 2009	Receipts FY 2010	Adjustments	Expenditures FY 2010	Receivable (Deferred Revenue) from Grantor at September 30, 2010
Balance brought forward		\$ 276,715	\$ 1,437,390	\$ (1,005)	\$ 2,065,663	\$ 903,983
<u>U.S. Department of the Interior</u>						
<u>Direct Grant</u>						
Meter Maintenance Program	OMIP-CUC-2007-1	(13,005)	-	-	-	(13,005)
Information Technology Upgrade	OMIP-CUC-2007-2	(94,964)	-	-	-	(94,964)
Live line Tool Maintenance Improvement Program	OMIP-CUC-2007-3	52,198	52,198	-	-	-
Technical Consultant	OMIP-CUC-2006-1	(12,500)	-	-	-	(12,500)
Waste and Wastewater funding	CNMI Water/ Wastewater 2006-1	55,104	83,082	-	27,978	-
Subtotal Direct Grant		(13,167)	135,280	-	27,978	(120,469)
Passed through the Government of the CNMI:						
Renovation and rehabilitation of Saipan Power Plant	15.875	230,787	-	(74,275)	-	156,512
Saipan Power Plant Improvements	15.875	1,733,956	3,505,887	(1,009)	2,098,738	325,798
As Matusi Water Well Interconnection and Waterline	15.875	144,212	144,212	-	-	-
		2,108,955	3,650,099	(75,284)	2,098,738	482,310
Waste and Wastewater Master Plan	CNMI Water/ Wastewater 2010-1	-	13,089	-	13,089	-
Waste and Wastewater funding	CNMI Water/ Wastewater 2009-1	-	148,600	-	162,653	14,053
Sadog Tasi Wastewater Treatment Plant Rehabilitation	CNMI-CIP-2009-1	-	169,418	-	371,723	202,305
Sadog Tasi Wastewater Treatment Plant Rehabilitation	CNMI-CIP-2009-2	-	48,740	-	183,028	134,288
Stipulated Order No. 2	CNMI-CIP-2009-3	-	578,029	-	718,335	140,306
Rehabilitation of Agingan Wastewater Treatment Facilities	CNMI-CIP-2009-4	-	24,480	-	19,040	(5,440)
Backup Pumps for Wastewater Lift Station	CNMI-CIP-2008	-	150,000	-	150,000	-
Subtotal Passed through		2,108,955	4,782,455	(75,284)	3,716,606	967,822
Total U.S. Department of the Interior		2,095,788	4,917,735	(75,284)	3,744,584	847,353
Total		\$ 2,372,503	\$ 6,355,125	\$ (76,289)	\$ 5,810,247	\$ 1,751,336

See accompanying notes to schedule of expenditures of federal awards.

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

Schedule of Programs Selected for Audit
In Accordance with OMB Circular A-133

Year Ended September 30, 2010

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

<u>Original Grantor</u>	<u>CFDA No.</u>	<u>Description</u>	<u>Amount of Expenditures</u>
U.S. Department of the Interior	15.875	Capital Development Projects	\$ 3,744,584
U.S. Environmental Protection Agency	66.418A	ARRA - Wastewater Treatment Construction Programs	970,124
U.S. Environmental Protection Agency	66.468A	ARRA - Capitalization Grants for Drinking Water	693,740
U.S. Environmental Protection Agency	66.468	Capitalization Grants for Drinking Water	<u>350,137</u>
		Total federal program expenditures	<u>\$ 5,758,585</u>
		% of total federal program expenditures tested	<u>99%</u>

Dollar threshold used to distinguish between

Type A and Type B programs: \$ 300,000

Auditee qualified as low-risk auditee yes X no

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

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2010

(1) Scope of Audit

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

A. Programs Subject to Single Audit

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

(2) Summary of Significant Accounting Policies

A. Basis of Accounting

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

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

B. Indirect Cost Allocation

For fiscal year 2010, CUC had no indirect cost agreement with grantor agencies.

C. Matching Requirements

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

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION I – SUMMARY OF AUDITOR’S RESULTS

Financial Statements

Type of auditor’s report issued: Unqualified

Internal control over financial reporting:

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

Noncompliance material to financial statements noted? X yes no

Federal Awards

Internal control over major programs:

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

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

66.418 - Reporting
- Equipment and Real Property

66.418 ARRA - Reporting
- Equipment and Real Property

66.468 ARRA - Reporting
- Equipment and Real Property

15.875 - Reporting
- Equipment and Real Property

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

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS

Cash and Cash Equivalents – Uninsured and Uncollateralized Bank Balances

Finding No. 2010-1

Criteria:

Pursuant to Title 4 Division 8 of the Commonwealth Code §8155, all funds received by CUC must be deposited into federally insured or fully collateralized accounts.

Condition:

Bank deposits in the amount of \$10,212,255 and \$9,538,178 were in excess of FDIC insurable limits insured as of September 30, 2010 and 2009, respectively. CUC also has deposits of \$3,847 in 2010 and \$18,293 in 2009 maintained in an federally uninsured financial institution.

Cause:

CUC maintains an account with this non-insured financial institution since this financial institution also acts as one of the collecting agents of CUC. Furthermore, CUC does not have an existing collateralization policy for its deposits in excess of insured limits.

Effect:

CUC is in violation of the Title 4 Division 8 of the Commonwealth Code §8155. Furthermore, the amount of cash in this institution has high custodial risk.

Recommendation:

CUC should obtain collateralization from the financial institution to comply with the requirements of 4 CMC §8155.

Auditee response:

Beginning February 14, 2011, CUC's accounts with Bank of Guam are insured or collateralized by the bank.

Prior Year Status:

The same condition was noted as Finding Nos. 2009-01, 2008-3 and 2007-5 in prior year audits.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Bank Reconciliation

Finding No. 2010-2

Criteria:

Generally accepted accounting principles requires that the general ledger balances of cash accounts be reconciled with the bank balances.

Condition:

- a. The general fund bank account has unaccounted difference of \$1,877.
- b. The bank reconciliations do not have the signatures of reviewing and approving officer.
- c. Bank reconciliation was not prepared for the Bank of Guam Visa Checking Account.

Cause:

- a. The bank reconciliations were not prepared timely, thus the identification of certain reconciling items are difficult to determine.
- b. There are no formal procedures in place for the review and approval of the bank reconciliations.
- c. The Bank of Guam Visa Checking Account was opened during fiscal 2010 and minimal transactions occurred during the year.

Effect:

Errors and misstatement could occur and not be detected in a timely manner if monthly bank reconciliations are not prepared.

Recommendation:

CUC should reconcile bank accounts timely. CUC should also require responsible official to review and approve bank reconciliations prepared by the accountant.

Auditee response:

An additional accountant has been hired to focus on reconciliation of bank accounts, detect errors and apply appropriate corrections timely. The FY 2010 bank reconciliations were amended to include signatures of reviewing and approving officers.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Customer Deposits – Liability

Finding No. 2010-3

Criteria:

Pursuant to Public Law 16-02, deposits shall be placed in an interest-earning trust fund to be established by the Executive Director of the Corporation. Such funds shall not be used for any other purpose; except that CUC may use up to fifty percent (50%) of the security deposit funds to pay for its fuel expenses during fiscal year 2010 with the condition that CUC return such funds within a three-year period. Residential security deposit refunds shall be paid within 30 days after disconnection of such utilities and with earned interest.

Condition:

The following were noted during the audit of customer deposits:

- a. Although annual interest owed on deposits received from customers are calculated annually, CUC did not recognize the liability for such interest in its financial statements.
- b. Of the customer deposits received, \$7,500,000 placed in various time certificates of deposit are held as security pursuant to a letter of credit obtained from a financial institution to secure a \$7,500,000 credit line for fuel purchases.
- c. A portion of the customer deposits received was co-mingled in CUC's general fund and may have already been expended for purposes not allowed by law.

	<u>2010</u>	<u>2009</u>
Restricted cash	\$ 7,709,149	\$ 8,148,586
Total customer deposits (including accumulated accrued interest)	<u>(10,511,904)</u>	<u>(10,634,511)</u>
Restricted net asset deficiency	<u>\$(2,802,755)</u>	<u>\$(2,485,925)</u>

- d. Upon disconnection of customer accounts, customer deposits are refunded or applied to the customer's outstanding balance without regard to accrued interest earned.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Customer Deposits – Liability, Continued

Finding No. 2009-3, Continued

Cause:

CUC has not established and implemented internal control procedures to allocate interest earned to individual customer deposits. Additionally, the above condition may be due to confusion caused by several amendments made to the statutes affecting CUC regulations.

Effect:

CUC is in violation of its enabling legislation and Public Laws regarding its customer deposits.

Recommendation:

CUC should comply with statutes pertaining to customer deposits.

CUC should ensure that all customer deposits are placed in a restricted interest earning account and the related interest earned on that account be rolled-over in the account instead of the current practice of transferring interest to the general fund.

Auditee response:

CUC concurs with this finding, however, CUC has not established a corrective action plan to restore the restricted cash balance because of the financial condition of CUC.

Prior Year Status:

The same condition was cited as Finding Nos. 2009-03, 2008-5, 2007-7 and 2006-15 in prior year audits.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Revenue/Receipts

Finding No. 2010-4

Criteria:

All recorded revenues and receivables should reflect collectible balances.

Condition:

There were twenty (20) long outstanding disputed accounts totaling \$2,540,906 that were not disconnected. Management asserts that these delinquent customers represent landowners which CUC placed water wells, utility poles, pumps, etc., on their property. In-lieu of CUC making rental payments for use of the property, customers are not paying for utility usage; however, no formal contractual agreement exists between these customers and CUC. Correspondingly, no cost analysis study has been performed to determine the fair value of the property rental versus the property owner's utility consumption.

Cause:

CUC has not implemented its formal policy for its use of private property in-lieu of payment to CUC for utility usage. A formal policy was drafted in fiscal year 2007 and approved by management but it has not been implemented.

Effect:

The above delinquent accounts may be uncollectible. Additionally, there could be inequalities in the amount paid for certain parcels of land depending on the value of utilities consumed.

Recommendation:

CUC should consider conducting cost analysis to determine the fair value of the property rental versus the property owner's utility consumption for which CUC has placed its water wells, utility poles, pumps and related equipment.

CUC should execute formal contractual agreements with all landowners for the use of land and ensure compliance with established policies and procedures. Furthermore, depending on the agreed monthly rate to recognize as rental expense, it may be necessary for CUC to make prior period adjustments to record rent expense and reduce the related outstanding receivable.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Revenue/Receipts

Finding No. 2010-4, Continued

Auditee response:

All disputed customer accounts involving easements have been referred to outside legal counsel and will proceed through an administrative hearing process, with litigation to follow, if necessary. All legal attempts will be made to collect the amounts due. All affected customers have been notified to begin paying current charges or they will be subject to disconnection.

Prior Year Status:

Lack of formal contractual agreements with landowners for the use of land was reported as a finding in the audits of CUC for fiscal years 1996 through 2009. During 2007, CUC adopted a policy requiring all agreements to be prepared prior to using private properties. CUC also established procedures for easement claims.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Accounts Receivable/Disconnection

Finding No. 2010-5

Criteria:

Pursuant to CUC Electric Service Regulation, Part 17, CUC may disconnect past due accounts 14 calendar days after second disconnection notice, which is sent 45 days after the first disconnection notice. The customer may seek remedy against disconnection by filing a formal dispute or execute a promissory note subject to CUC approval.

Condition:

The active accounts with overdue amounts from the aging of receivables were summarized. The listing of active accounts with overdue amounts was compared with the listing of accounts with disputes and accounts with promissory notes. There were 513 customer accounts whose aggregate overdue balance was \$963,850, and none of which had disputes or promissory notes and were not disconnected.

Also, since CUC may not disconnect customers who are disputing their account balances, as of September 30, 2009, total customers with disputed accounts totaled 765 with an aggregate balance of \$9,572,983.

Cause:

There is a lack of internal control monitoring to ensure that all accounts 90-days past due are disconnected pursuant to Part 17 of CUC's Electric Service Regulation.

Effect:

The collectibility of the above-mentioned past due customer accounts are doubtful and may represent bad debts. Furthermore fraud could be committed on these accounts and not be detected in a timely manner.

Recommendation:

The above-mentioned past due customer accounts should be investigated pursuant to Part 17 of CUC's Electric Service Regulation and evaluated for collectability. CUC should adhere to its established policies and procedures for termination/disconnection of service. Furthermore, internal control monitoring should be performed to ensure that all accounts 90-days past due are timely disconnected, unless supported by promissory notes or formal customer dispute.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Accounts Receivable/Disconnection

Finding No. 2010-5, Continued

Auditee response:

All legal attempts will be made to collect the amounts due. All affected customers have been notified to begin paying current charges or they will be subject to disconnection.

Prior Year Status:

Similar conditions were cited as Findings 2009-04, 2008-07, 2007-9 and 2006-5 in prior year audits.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Negative Balances in the Aging of Accounts Receivable

Finding No. 2010-6

Criteria:

Collections received should be applied to specific billings.

Condition:

The aged listing of accounts receivable as of September 30, 2010 included negative balances totaling \$1,299,624 as of September 30, 2010.

Cause:

The negative balances pertain to advance payments of customers.

Effect:

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

Recommendation:

Accounts receivable with credit balance should be reviewed periodically. Management should ensure that a separate listing of such credit balances be generated, reviewed and adjusted on monthly basis. For month-end and year-end financial statement reporting, these negative balances should be reclassified and reported as deferred revenue.

Auditee response:

CUC is in the process of upgrading its accounting software pursuant to the Stipulated Order. This concern, among others, will be addressed by the new accounting software which is to be completed in fiscal year 2011.

Prior Year Status:

Similar condition was cited as Finding No. 2009-14 in prior year audit.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Prepayments

Finding No. 2010-7

Criteria:

Recorded prepayments should represent valid assets of an entity. Additionally, a good internal control provides for timely identification and reversal of prepayments upon receipt of goods and or when services are performed.

Condition:

An aggregate amount of \$705,850 or 90% of the prepayment balance was from prior periods.

Cause:

There is the lack of established policies and procedures on monitoring prepayments.

Effect:

The potential misstatement exists for prepayments and expenses. Goods or services could have been paid for but not received. Due to lack internal control, fraud could exist and not be prevented or detected in a timely manner.

Recommendation:

CUC should investigate its prepaid expense accounts and determine whether the goods were received or services were performed, then adjust the prepaid asset and related expense accounts accordingly. Internal control should be strengthened to properly monitor all prepayments.

Auditee response:

The Accounts Payable Supervisor is investigating the prepayment account. Receiving reports, completion of service and other necessary documentations will be required from the Divisions involved to close prior years prepayments. The prepayment accounts reconciliation is now prepared monthly and reviewed by the Chief Accountant.

Prior Year Status:

Similar conditions were cited as Finding Nos. 2009-14 and 2008-19 in prior year audits.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory

Finding No. 2010-8

Criteria:

Perpetual inventory records should, at all times, reflect the total inventory quantity on-hand.

Condition:

The inventory valuation report as of September 30, 2010 included several inventory items with negative quantities on-hand. Although the ending inventory was adjusted to the actual physical count, the adjustment may be overstated by these items with credit balances (See Finding No. 2010-9).

Cause:

CUC's automated system records inventory when Accounts Payable personnel post vendor invoices into the system. Receiving reports prepared and posted by CUC's Warehouse personnel are matched by the system with the corresponding vendor invoices posted. Consequently, if corresponding invoices have not been posted by the Accounting Department or cannot be identified, the inventory subsidiary ledger is not adjusted for warehouse receipts. As a result, the inventory subsidiary ledger account may be zero even though there may be actual inventory on-hand. Since the computer system allows for issuance even when there is insufficient inventory quantities on-hand per the subsidiary ledger, inventory issuances by Warehouse personnel may result in negative inventory quantities per book.

Effect:

There is a potential for material misstatement of inventory balances, and if such is not adjusted, could result in an opinion qualification on the account balance and related expenses. There is also the potential for theft and misappropriation of assets due to a lack of internal control and inventory variances may simply be written off without adequate investigation and resolution. Furthermore, an inaccurate inventory valuation report is not useful to management in making inventory purchase decisions.

Recommendation:

CUC should ensure that all inventory transactions are properly posted and performed in a timely manner. A properly functioning perpetual inventory system will help generate more accurate interim financial statements and minimize the likelihood of large physical inventory adjustments.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory

Finding No. 2010-8, Continued

Auditee response:

Reports for uninvoiced receipts, unreceived invoices and negative quantities are now being generated regularly to clear all pending transactions that result in inventory negative balances. Coordination between the Warehouse Manager, Inventory Accountant and Accounts Payable Accountant is maintained to resolve negative quantities timely. Stacking sheet or an authorization to withdraw materials is required to properly monitor the withdrawal of materials.

Prior Year Status:

Similar condition was cited as Finding Nos. 2009-5, 2008-8, 2007-10 and 2006-6 in prior year audits.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory Reconciliation

Finding No. 2010-9

Criteria:

A reconciliation of inventory balances between the general ledger and subsidiary ledgers should be performed regularly and discrepancies, if any, should be investigated.

Condition:

For fiscal year ending September 30, 2010, CUC adjusted \$168,381 as additional production fuel expenses, for the net overstatement of the inventory general ledger balance control account against the adjusted inventory valuation report. The variance was not investigated and there no analysis of the loss pertaining to normal operations (such as flushing loss), costing or pricing variance and extraordinary loss.

Cause:

Existing internal control is ineffective for safeguarding CUC's inventories to prevent and detect discrepancies and potential waste, fraud and abuse. CUC has not implemented a plan of corrective action for the above condition as this control deficiency has existed since fiscal year 2002. There is a lack of responsible personnel assigned to perform the established inventory control and there are no monitoring procedures in place to ensure that established policies and procedures are adhered.

Effect:

There is a potential for material misstatement of inventory balances and thus resulting in an opinion qualification on the account balance and related expenses. The potential exist for theft and misappropriation of assets due to a lack of internal control and inventory variances may simply be written off without adequate investigation and resolution.

Recommendation:

The adjustment should only be made by a responsible person after a thorough investigation and a reasonable explanation for the discrepancies have been obtained and approved by the Chief Accountant. Thus, before making the adjustment, someone with no access to the inventory should investigate the discrepancies between the inventory valuation report (subsidiary ledger) and physical count and attempt to determine whether such variances are due to clerical or counting errors, improper purchase and issuance cutoff procedures during the physical count, theft, intentional misstatement of the records or count, etc. Steps should then be taken to address the causes to detect and prevent recurrence.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory Reconciliation, Continued

Finding No. 2010-9, Continued

Recommendation, Continued:

To ensure that purchase and issuance cutoffs are proper, a responsible person should control purchase and sales invoices issued/received shortly before and after the physical count. This person should determine that the subsidiary ledger as of the physical inventory date include purchase invoices for all goods received before, not after, the physical count and should exclude issuances for all goods used/transferred before the count.

Monthly inventory reconciliations should be prepared in a timely manner to identify reconciling items between the general ledger and subsidiary ledgers in order to test the accuracy of both systems and, therefore provide more accurate financial information.

CUC should also consider performing periodic cycle counts of the fast moving inventory items and compare the results with the perpetual records. This will enable CUC to identify inventory shortages and errors on a timely basis.

Auditee response:

Monthly inventory reconciliation is now prepared by the Inventory Accountant and reviewed by the Chief Accountant to identify discrepancies between the general ledger and the subsidiary ledgers. Any variance is thoroughly reviewed by the Chief Accountant before adjustments are posted.

Prior Year Status:

Lack of established policies and procedures over inventory reconciliations was reported as a finding in the audits of CUC for fiscal years 2002 through 2009.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory Valuation

Finding No. 2010-10

Criteria:

When the moving average unit cost method of inventory costing is utilized, unit cost is updated for new purchases and issuances are valued based on the most recent average unit cost.

Condition:

Certain inventory items have negative unit costs and related issuances have negative values as of September 30, 2010. This resulted to significant year-end inventory adjustments.

Cause:

CUC has not implemented a plan of corrective action for the above condition as this control deficiency has existed since fiscal year 2002. The cause of the above condition is attributable to the following:

- Untimely posting of inventory purchases, receipts and issuances;
- Lack of coordination between accounts payable and warehouse personnel for input of purchases and issuances; and
- Lack of monitoring and review of inventory adjustments.

Effect:

The effect of the above condition is a possible misstatement of inventory that could have resulted in an opinion qualification on the account balance and related expenses.

Recommendation:

CUC should establish policies and procedures to ensure timely posting of inventory purchases, receipts and issuances; establish a formal review process and monitoring procedures for inventory adjustments; ensure coordination between responsible personnel; and ensure that these policies and procedures are strictly adhered. Even with CUC's planned implementation of a bar-coding, coordination between Warehouse and Accounting personnel is necessary. Although the bar-coding system may facilitate the warehouse receiving and issuance functions, if the Accounts Payable section does not timely record the purchases, issuances will still result in credit balances in the inventory valuation report.

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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Inventory Valuation

Finding No. 2010-10, Continued

Auditee response:

The Inventory Accountant has been assigned to monitor inventory balances by analyzing negative quantity reports and uninvoiced receipts reports. These reports are downloaded weekly and/or as often as necessary. Any discrepancies are resolved with the coordination of the Inventory Accountant, Accounts Payable Supervisor and Warehouse Manager.

Prior Year Status:

Similar findings were cited in the audit of CUC for fiscal years 2002 through 2009.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Utility Plant

Finding No. 2010-11

Criteria:

OMB Circular A-133 requires that capital assets be physically accounted for at bi-annually.

Condition:

CUC has not conducted physical count of capital assets in over 5 years. Since a physical count has not been conducted, the asset listing may still include assets that have been retired, broken, destroyed or stolen.

Cause:

There is a lack of management oversight on the significance of accounting for and conducting physical count of capital assets and monitoring controls to ensure that asset listing is updated not only for additions but also for deletions. CUC has not implemented a plan of corrective action for the above condition as this control deficiency has existed since fiscal year 1988.

Effect:

CUC is not in compliance with OMB Circular A-133. The effect of the above condition is a possible misstatement of capital assets. Additionally, a control deficiency exists over the safeguarding of capital assets. Capital assets may be misappropriated and not be detected in a timely manner.

Recommendation:

CUC should perform a physical inventory of all fixed assets on-hand, agree the count with its records and make necessary adjustments. CUC should consider evaluating its capital assets for impairments and recoverability of carrying values. An asset should be tested for recoverability if events or changes in circumstances, such as the following among others, indicate that its carrying amount may not be fully recoverable:

- a. Significant adverse change in the asset's use or in its physical condition;
- b. Significant adverse changes in legal factors or business climate, including an adverse action or assessment by a regulator; and

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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Utility Plant, Continued

Finding No. 2010-11, Continued

Recommendation, Continued:

- c. Costs to acquire or construct an asset that significantly exceed original expectations.

When long-lived assets are tested for recoverability, a review of depreciation or amortization estimates may be required. Any revision to the remaining useful life should then be considered in developing estimates of future cash flows used to test the asset's recoverability.

Auditee response:

CUC's Comptroller and Chief Accountant in coordination with the Division Heads will review its Utility Plant policies and procedures and develop a cycle physical inventory counting procedures.

Prior Year Status:

The lack of control over capital assets was reported as a finding in the audits of CUC for fiscal years 1988 through 2009.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Travel

Finding No. 2010-12

Criteria:

Pursuant to CUC's Travel policy:

- a. Liquidation of travel advances with supporting documents should be filed within ten days from completion of travel.
- b. Travel advance is limited to 80% of the total estimated per diem and other expenses as shown on the travel authorization.

Condition:

- a. For 8 or 32% of 25 travel authorizations selected for testing, the travel vouchers were not provided during the audit.

For 1 or 4% of 25 travel authorizations selected for testing, the liquidation was received more than 10 days after the end of travel as follows:

End of Trip	August 29, 2010
Due date of liquidation	September 8, 2010
Date liquidated	September 14, 2010

- b. For 4 or 16% of 25 travel authorization selected for testing, the amount advanced were more than 80% of the estimated per diem and other expenses as follows:

<u>TA No.</u>	<u>Amount</u>
10-094	\$ 225
10-111	750
10-113	240
10-119	<u>240</u>
	<u>\$1,455</u>

Cause:

- a. The turnover in and shortage of accounting personnel did not allow for CUC's Accounting Department to properly monitor and make timely follow up on outstanding travel advances.
- b. The authorization for the travel advance in excess of 80% of estimated per diem and other expenses was approved by management due to increased lodging expenses for the travel destination.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION II – FINANCIAL STATEMENT FINDINGS, CONTINUED

Travel, Continued

Finding No. 2010-12, Continued

Effect:

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

Recommendation:

CUC should ensure that policies and procedures are complied with. CUC may also review its travel policy to address the changes in the current travel conditions.

Auditee response:

CUC will review its travel policies and procedures and ensure that all travel will be in compliance with the policies and procedures.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Reporting – Interim Financial Status Report

Finding No. 2010-13

<u>CFDA No.</u>	<u>Findings/Noncompliance</u>	<u>Questioned Costs</u>
66.418		
66.468		\$ -

Criteria:

Pursuant to the Grant agreement, an interim Financial Status Report is to be submitted to the appropriate U.S. Environmental Protection Agency (EPA) Grants Management Office 90 days after the anniversary of the project period start date.

Condition:

The interim Financial Status Reports were submitted late for the following grants:

<u>Grant Award No.</u>	<u>Due Date</u>	<u>Date Submitted</u>	<u>No. Of Days Late</u>
2C-69926301-0	11/12/2010	12/15/2010	33
2C-69926201-0	11/18/2010	12/15/2010	27
2F-00T26101-0	11/12/2010	12/15/2010	33

Cause:

With the turnover of personnel handling the federal programs certain documentation were not properly endorsed.

Effect:

CUC is not in compliance with the Grant Award reporting requirements.

Recommendation:

CUC should establish and implement internal controls and monitoring procedures to ensure that federal award reporting requirements are strictly adhered.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Reporting – Interim Financial Status Report

Finding No. 2010-13, continued

<u>CFDA No.</u>	<u>Findings/Noncompliance</u>	<u>Questioned Costs</u>
66.418		
66.468		\$ -

Auditee response:

CUC established a formal Federal Compliance Section in FY 2010. The Section Head will establish monitoring controls and procedures to ensure CUC's compliance with the requirements of federal grants received.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS, CONTINUED

Reporting

Finding No. 2010-14

<u>CFDA No.</u>	<u>Findings/Noncompliance</u>	<u>Questioned Costs</u>
15.875	<p><u>Criteria:</u></p> <p>Pursuant to the Grant Terms and Conditions, Financial Status Reports must be submitted semi-annually for periods beginning January 1 and ending June 30, and beginning July 1 and ending December 31.</p> <p>Reports are due within 30 days of the end of the period.</p> <p>Final reports are due 90 days after the expiration or term of award.</p> <p><u>Condition:</u></p> <p>a. Financial Status Reports were submitted late for 5 or 46% of 11 grant awards with semi-annual reports due on January 30, 2010, for the following grants:</p>	\$ -

<u>Grant Award No.</u>	<u>Date Submitted</u>	<u>No. Of Days Late</u>
CNMI-CIP-2005/GR 570134	5/1/2010	91
CNMI-CIP-2005/GR 570136	5/1/2010	91
CNMI-CIP-2007-1/GR 770070	5/1/2010	91
CNMI-CIP-2007-2/GR 770098	5/1/2010	91
CNMI-CIP-2008-3/GR 879104	5/1/2010	91

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS, CONTINUED

Reporting

Finding No. 2010-14, continued

<u>CFDA No.</u>	<u>Findings/Noncompliance</u>	<u>Questioned Costs</u>
15.875	<u>Condition, continued:</u>	\$ -

- b. Financial Status Reports for 7 or 73% of 11 grant awards with semi-annual reports due on July 30, 2010 were not provided during the audit for the following grants:

<u>Grant Award No.</u>
CNMI-CIP-2008-5/GR 870176
CNMI-CIP-2009-1/GR 970092
CNMI-CIP-2010-3/GRX0115
CNMI-CIP-2009-4/BU#5648
CNMI Water/ Wastewater 2009-1/ GR 970179
CNMI Water/ Wastewater 2010-1/ GR X0109
CNMI-CIP-2010-2/ GR X0082

- c. The Final Report for 6 or 100% of the grant awards that ended in fiscal year 2010 were submitted late for the following:

<u>Grant Award No.</u>	<u>End of Term</u>	<u>Due Date</u>	<u>Date Submitted</u>	<u>No. Of Days Late</u>
CNMI-CIP-2001-1/GR 100011	09/30/09	12/29/09	05/01/10	123
CNMI-CIP-2002-1/GR 270027	09/30/09	12/29/09	05/01/10	123
CNMI-CIP-2003/GR 470058	09/30/09	12/29/09	05/01/10	123
CNMI-CIP-2005/GR 570134	02/01/10	05/02/10	05/20/10	18
CNMI-CIP-2005/GR 570136	02/01/10	05/02/10	05/20/10	18
CNMI-CIP-2008-3/GR 870067	09/30/09	12/29/09	05/01/10	123

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS, CONTINUED

Reporting

Finding No. 2010-14, continued

<u>CFDA No.</u>	<u>Findings/Noncompliance</u>	<u>Questioned Costs</u>
15.875	<p><u>Effect:</u></p> <p>CUC is in non-compliance with grant reporting condition and certain expenditure reported on these forms may be disallowed by the grantor due to non-compliance with the grant condition.</p> <p><u>Cause:</u></p> <p>There is a lack of monitoring of compliance with grant requirements.</p> <p>Since the majority of CUC awards prior to fiscal year 2010 were passed-through the CNMI Government and CUC's management did not have spending authority, CUC is unable to obtain, in a timely manner, information and has not formally established monitoring controls over federal award.</p> <p><u>Recommendation:</u></p> <p>CUC should establish and implement internal controls and monitoring procedures to ensure that federal award reporting requirements are strictly adhered.</p> <p><u>Auditee response:</u></p> <p>CUC established a formal Federal Compliance Section in FY 2010. The Section Head will establish monitoring controls and procedures to ensure CUC's compliance with the requirements of federal grants received. Grants received prior to FY 2010 were passed through from the CNMI central government and the reporting requirement lies with the CNMI central government.</p>	\$ -

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS, CONTINUED

Reporting

Finding No. 2010-15

<u>CFDA No.</u>	<u>Findings/Noncompliance</u>	<u>Questioned Costs</u>																																	
15.875	<p><u>Criteria:</u></p> <p>Pursuant to the Grant Terms and Conditions, Narrative Status Reports must be submitted semi-annually for periods beginning January 1 and ending June 30, and beginning July 1 and ending December 31.</p> <p>Reports are due within 30 days of the end of the period.</p> <p>Final reports are due 90 days after the expiration or term of award.</p> <p><u>Condition:</u></p> <p>a. The following Narrative Reports for 9 or 64% of 14 grant awards with semi-annual reports due on January 30, 2010 were submitted late.</p> <table style="margin-left: 40px; border-collapse: collapse;"> <thead> <tr> <th style="text-align: left;"><u>Grant Award No.</u></th> <th style="text-align: left;"><u>Date Submitted</u></th> <th style="text-align: left;"><u>No. Of Days Late</u></th> </tr> </thead> <tbody> <tr><td>CNMI-CIP-2001-1/GR 100011</td><td>04/30/10</td><td>90</td></tr> <tr><td>CNMI-CIP-2002-1/GR 270027</td><td>04/30/10</td><td>90</td></tr> <tr><td>CNMI-CIP-2003/GR 470058</td><td>04/30/10</td><td>90</td></tr> <tr><td>CNMI-CIP-2005/GR 570134</td><td>04/30/10</td><td>90</td></tr> <tr><td>CNMI-CIP-2005/GR 570136</td><td>04/30/10</td><td>90</td></tr> <tr><td>CNMI-CIP-2007-1/GR 770070</td><td>04/30/10</td><td>90</td></tr> <tr><td>CNMI-CIP-2007-2/GR 770098</td><td>04/30/10</td><td>90</td></tr> <tr><td>CNMI-CIP-2008-3/GR 870067</td><td>04/30/10</td><td>90</td></tr> <tr><td>CNMI-CIP-2008-3/GR 879104</td><td>04/30/10</td><td>90</td></tr> </tbody> </table> <p>b. The following Narrative Reports for 2 or 14% of 14 grant awards with semi-annual reports due on January 30, 2010 were not provided for audit.</p> <table style="margin-left: 40px; border-collapse: collapse;"> <thead> <tr> <th style="text-align: left;"><u>Grant Award No.</u></th> </tr> </thead> <tbody> <tr><td>CNMI Water/ Wastewater 2009-1/ GR 970179</td></tr> <tr><td>CNMI-CIP-2010-2/ GR X0082</td></tr> </tbody> </table>	<u>Grant Award No.</u>	<u>Date Submitted</u>	<u>No. Of Days Late</u>	CNMI-CIP-2001-1/GR 100011	04/30/10	90	CNMI-CIP-2002-1/GR 270027	04/30/10	90	CNMI-CIP-2003/GR 470058	04/30/10	90	CNMI-CIP-2005/GR 570134	04/30/10	90	CNMI-CIP-2005/GR 570136	04/30/10	90	CNMI-CIP-2007-1/GR 770070	04/30/10	90	CNMI-CIP-2007-2/GR 770098	04/30/10	90	CNMI-CIP-2008-3/GR 870067	04/30/10	90	CNMI-CIP-2008-3/GR 879104	04/30/10	90	<u>Grant Award No.</u>	CNMI Water/ Wastewater 2009-1/ GR 970179	CNMI-CIP-2010-2/ GR X0082	\$ -
<u>Grant Award No.</u>	<u>Date Submitted</u>	<u>No. Of Days Late</u>																																	
CNMI-CIP-2001-1/GR 100011	04/30/10	90																																	
CNMI-CIP-2002-1/GR 270027	04/30/10	90																																	
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COMMONWEALTH UTILITIES CORPORATION
 (A Component Unit of the CNMI Government)

Schedule of Findings and Questioned Costs
 Year Ended September 30, 2010

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS, CONTINUED

Reporting

Finding No. 2010-15, Condition, continued

<u>CFDA No.</u>	<u>Findings/Noncompliance</u>	<u>Questioned Costs</u>
15.875		\$ -

Condition, continued:

c. The Final Report for 2 or 33% of the 6 awards that ended in fiscal year 2010 were submitted late as follows:

<u>Grant Award No.</u>	<u>End of Term</u>	<u>Due Date</u>	<u>Date Submitted</u>	<u>No. Of Days Late</u>
CNMI-CIP-2005/GR 570134	02/01/10	05/02/10	05/26/10	24
CNMI-CIP-2005/GR 570136	02/01/10	05/02/10	05/26/10	24

d. The Final Report for 4 or 67% of the 6 awards that ended in fiscal year 2010 were not provided for audit as follows:

<u>Grant Award No.</u>
CNMI-CIP-2001-1/GR 100011
CNMI-CIP-2002-1/GR 270027
CNMI-CIP-2003/GR 470058
CNMI-CIP-2008-3/GR 870067

Cause:

There is lack of monitoring of compliance with grant requirements.

Effect:

CUC is in non-compliance with grant reporting requirements and certain expenditure reported on these forms may be disallowed by the grantor due to non-compliance with the grant condition.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS, CONTINUED

Reporting

Finding No. 2010-15, Continued

<u>CFDA No.</u>	<u>Findings/Noncompliance</u>	<u>Questioned Costs</u>
		\$ -

Recommendation:

CUC should establish and implement internal controls and monitoring procedures to ensure that federal award reporting requirements are strictly adhered.

Auditee response:

CUC established a formal Federal Compliance Section in FY 2010. The Section Head will establish monitoring controls and procedures to ensure CUC's compliance with the requirements of federal grants received. Grants received prior to FY 2010, were passed through from the CNMI central government and the reporting requirement lies with the CNMI central government.

COMMONWEALTH UTILITIES CORPORATION
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS, CONTINUED

Equipment and Real Property Management

Finding No. 2010-16

<u>CFDA No.</u>	<u>Findings/Noncompliance</u>	<u>Questioned Costs</u>
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all

-

Criteria:

Pursuant to 40 CFR Part 31.32 (2), a physical inventory of the property must be taken and results reconciled with the property records at least once every two years. In accordance with generally accepted accounting principles in the United States of America, long-lived assets should be evaluated for impairment.

Condition:

CUC has not conducted physical count of capital assets in over 5 years.

Cause:

There is a lack of management oversight on the significance of accounting for and conducting physical count of capital assets and monitoring controls to ensure that the asset listing is updated for both additions and deletions.

Effect:

CUC is in non-compliance with grant equipment and real property internal control requirements. Since a physical count has not been conducted, the asset listing may still include assets that have been retired, broken, destroyed or stolen.

Recommendation:

CUC should conduct physical inventory of its capital assets and update its asset listing in accordance with 40 CFR Part 31.

Auditee response:

CUC will review its Utility Plant policies and procedures and develop a cycle physical inventory counting procedures.

Total Questioned Costs

\$ -

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

SECTION IV – PRIOR YEAR FINDINGS AND QUESTIONED COSTS

Unresolved Findings

Status of prior year findings are discussed in the Schedule of Findings and Questioned Costs section of this report (pages 60 through 88).

Questioned Costs

The prior year Single Audit report on compliance with the laws and regulations noted the following costs and comments that were unresolved at September 30, 2010:

Questioned cost as previously reported	\$1,245,922
Questioned costs of fiscal year 2010 Single Audit	<u> -</u>
Unresolved questioned costs at September 30, 2008	<u><u>\$1,245,922</u></u>

In accordance with OMB Circular A-133 subpart C Section 315, CUC's management believes that these questioned costs may no longer be valid since these have been reported prior to fiscal year 2006 and the grantors or pass-through entity are not currently following up with CUC on these audit questioned costs.



Commonwealth Utilities Corporation
Chief Financial Officer



March 15, 2011

J SCOTT MAGLIARI & COMPANY
PMB 297 BOX 10000
Saipan, MP 96950

Dear Mr. Magliari:

We are transmitting herewith our responses to the audit findings and recommendations per your audit report for fiscal year 2010.

We hope that the attached plan of corrective action responses is sufficient to address the audit findings and recommendations.

Sincerely,

/Charles Warren/

Charles Warren
Chief Financial Officer

Finding No. 2010-1

Beginning February 14, 2011, CUC's accounts with Bank of Guam are insured or collateralized by the bank.

Finding No. 2010-2

An additional accountant has been hired to focus on reconciliation of bank accounts, detect errors and apply appropriate corrections timely. The FY 2010 bank reconciliations were amended to include signatures of reviewing and approving officers.

Finding No. 2010-3

CUC concurs with this finding, however, CUC has not established a corrective action plan to restore the restricted cash balance because of the financial condition of CUC.

Finding No. 2010-4

All disputed customer accounts involving easements have been referred to outside legal counsel and will proceed through an administrative hearing process, with litigation to follow, if necessary. All legal attempts will be made to collect the amounts due. All affected customers have been notified to begin paying current charges or they will be subject to disconnection.

Finding No. 2010-5

All legal attempts will be made to collect the amounts due. All affected customers have been notified to begin paying current charges or they will be subject to disconnection.

Finding No. 2010-6

CUC is in the process of upgrading its accounting software pursuant to the Stipulated Order. This concern, among others, will be addressed by the new accounting software which is to be completed in fiscal year 2011.

Finding No. 2010-7

The Accounts Payable Supervisor is investigating the prepayment account. Receiving reports, completion of service and other necessary documentations will be required from the Divisions involved to close prior years prepayments. The prepayment accounts reconciliation is now prepared monthly and reviewed by the Chief Accountant.

Finding No. 2010-8

Reports for uninvoiced receipts, unreceived invoices and negative quantities are now being generated regularly to clear all pending transactions that result in inventory negative balances. Coordination between the Warehouse Manager, Inventory Accountant and Accounts Payable Accountant is maintained to resolve negative quantities timely. Stacking sheet or an authorization to withdraw materials is required to properly monitor the withdrawal of materials.

Finding No. 2010-9

Monthly inventory reconciliation is now prepared by the Inventory Accountant and reviewed by the Chief Accountant to identify discrepancies between the general ledger and the subsidiary ledgers. Any variance is thoroughly reviewed by the Chief Accountant before adjustments are posted.

Finding No. 2010-10

The Inventory Accountant has been assigned to monitor inventory balances by analyzing negative quantity reports and uninvoiced receipts reports. These reports are downloaded weekly and/or as often as necessary. Any discrepancies are resolved with the coordination of the Inventory Accountant, Accounts Payable Supervisor and Warehouse Manager.

Finding No. 2010-11

CUC's Comptroller and Chief Accountant in coordination with the Division Heads will review its Utility Plant policies and procedures and develop a cycle physical inventory counting procedures.

Finding No. 2010-12

CUC will review its travel policies and procedures and ensure that all travel will be in compliance with the policies and procedures.

Finding No. 2010-13

CUC established a formal Federal Compliance Section in FY 2010. The Section Head will establish monitoring controls and procedures to ensure CUC's compliance with the requirements of federal grants received.

Finding No. 2010-14

CUC established a formal Federal Compliance Section in FY 2010. The Section Head will establish monitoring controls and procedures to ensure CUC's compliance with the requirements of federal grants received. Grants received prior to FY 2010 were passed through from the CNMI central government and the reporting requirement lies with the CNMI central government.

Finding No. 2010-15

CUC established a formal Federal Compliance Section in FY 2010. The Section Head will establish monitoring controls and procedures to ensure CUC's compliance with the requirements of federal grants received. Grants received prior to FY 2010, were passed through from the CNMI central government and the reporting requirement lies with the CNMI central government.

Finding No. 2010-16

CUC will review its Utility Plant policies and procedures and develop a cycle physical inventory counting procedures.