

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

**INDEPENDENT AUDITORS' REPORT
AND
FINANCIAL STATEMENTS**

**Years Ended
September 30, 2015 and 2014**

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

Years Ended September 30, 2015 and 2014

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Commonwealth Utilities Corporation

Report on the Financial Statements

We were engaged to audit the financial statements of the Commonwealth Utilities Corporation, a component unit of the Commonwealth of the Northern Mariana Islands Government, as of and for the years ended September 30, 2015 and 2014, and the related notes to the financial statements, which collectively comprise the Commonwealth Utilities Corporation's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. Except as described in the basis for disclaimer of opinion paragraph, we conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement. However, because of the matter described in the basis for disclaimer of opinion paragraph, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

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Basis for Disclaimer of Opinion

CUC has not conducted a physical count of all fixed assets and inventories as of September 30, 2015 and was not able to quantify the impact of the Typhoon Soudelor damage on its financial statements. We were unable to, and we were unable to obtain sufficient appropriate audit evidence by performing alternative auditing procedures.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements as of September 30, 2015 referred to in the first paragraph.

Going Concern

The accompanying financial statements have been prepared assuming that the Commonwealth Utilities Corporation will continue as a going concern. As discussed in Note 17 to the financial statements, the Commonwealth Utilities Corporation has suffered recurring losses from operations and has a significant negative unrestricted net position, which raises substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters also are described in Note 17. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to that matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 11 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Commonwealth Utilities Corporation's basic financial statements. The Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements.

The Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis and the Schedule of Expenditures of Federal Awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements.

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 26, 2016, on our consideration of the Commonwealth Utilities Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Commonwealth Utilities Corporation's internal control over financial reporting and compliance.



Saipan, Commonwealth of the Northern Mariana Islands
September 26, 2016

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

MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2015

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, 2015 with comparisons to the prior fiscal year ended September 30, 2014. We encourage readers to consider the information presented here in conjunction with the financial statements, related notes and supplementary information (pages 12 through 48).

	2015	2014	\$ Change	% Change
Assets				
Current unrestricted assets	\$ 41,495,593	\$ 37,294,420	\$ 4,201,173	11.3%
Current restricted assets	10,740,855	10,197,517	543,338	5.3%
Noncurrent assets	115,800	105,224	10,576	10.1%
Capital assets, net	84,075,999	84,712,220	(636,221)	-0.8%
	<u>\$ 136,428,247</u>	<u>\$ 132,309,381</u>	<u>4,118,866</u>	<u>3.1%</u>
Current liabilities	66,912,448	57,043,234	9,869,214	17.3%
Noncurrent liabilities	20,554,528	19,813,020	741,508	3.7%
Deferred inflows	1,667,267	2,788,238	(1,120,971)	-40.2%
Net position	47,294,004	52,664,889	(5,370,885)	-10.2%
	<u>\$ 136,428,247</u>	<u>\$ 132,309,381</u>	<u>4,118,866</u>	<u>3.1%</u>
Revenues, Expenses and Changes in Net Position				
Operating revenues	76,585,109	98,931,151	(22,346,042)	-22.6%
Operating expenses	85,147,441	102,949,527	(17,802,086)	-17.3%
Loss from operations	<u>(8,562,332)</u>	<u>(4,018,376)</u>	<u>(4,543,956)</u>	
Capital contributions	7,136,143	6,270,224	865,919	13.8%
Nonoperating revenues (expenses)	(5,136,577)	(5,857,054)	720,477	-12.3%
Change in deferred fuel costs	1,191,883	(456,570)	1,648,453	-361.1%
Total nonoperating revenues (expenses), net	<u>3,191,449</u>	<u>(43,400)</u>	<u>3,234,849</u>	
	<u>(5,370,883)</u>	<u>(4,061,776)</u>	<u>(1,309,107)</u>	<u>32.2%</u>

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.

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

MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2015

Basic Financial Statements

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

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

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

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

Notes to the Financial Statements

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

Other Information

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

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

MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2015

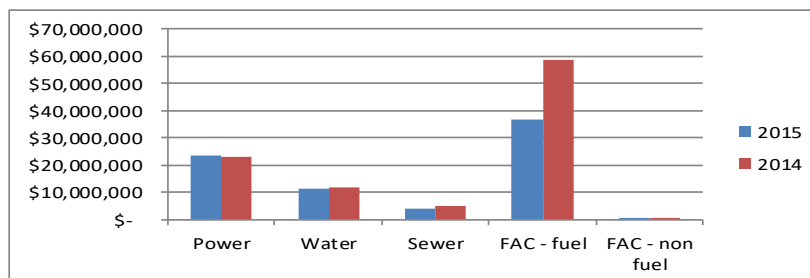
ANALYSIS OF BASIC FINANCIAL STATEMENTS

Condensed Statements of Revenues, Expenses and Change in Net Position

	2015	2014
Operating revenues, net	\$ 69,457,002	\$ 92,024,791
Operating expenses	78,019,334	96,043,167
Loss from operations	(8,562,332)	(4,018,376)
Nonoperating revenues (expenses), net	(5,136,577)	(5,857,054)
Change in recovery of fuel costs	1,191,883	(456,570)
Net loss before capital contributions and federal grants	(12,507,026)	(10,332,000)
Capital contributions and federal grants	7,136,143	6,270,224
Change in net position	(5,370,883)	(4,061,776)
Net position, beginning	52,664,887	56,726,663
Net position, ending	\$ 47,294,004	\$ 52,664,887

Financial Highlights

Operating Revenues	2015	2014	\$ Change	% Change
Power	\$ 23,550,183	\$ 22,876,847	\$ 673,336	3%
Water	11,201,566	11,976,163	(774,597)	-6%
Sewer	4,154,973	4,853,750	(698,777)	-14%
FAC - fuel	36,837,230	58,618,588	(21,781,358)	-37%
FAC - non fuel	232,158	237,824	(5,666)	-2%
Other	608,999	367,979	241,020	65%
	<u>\$ 76,585,109</u>	<u>\$ 98,931,151</u>	<u>\$ (22,346,042)</u>	<u>-23%</u>

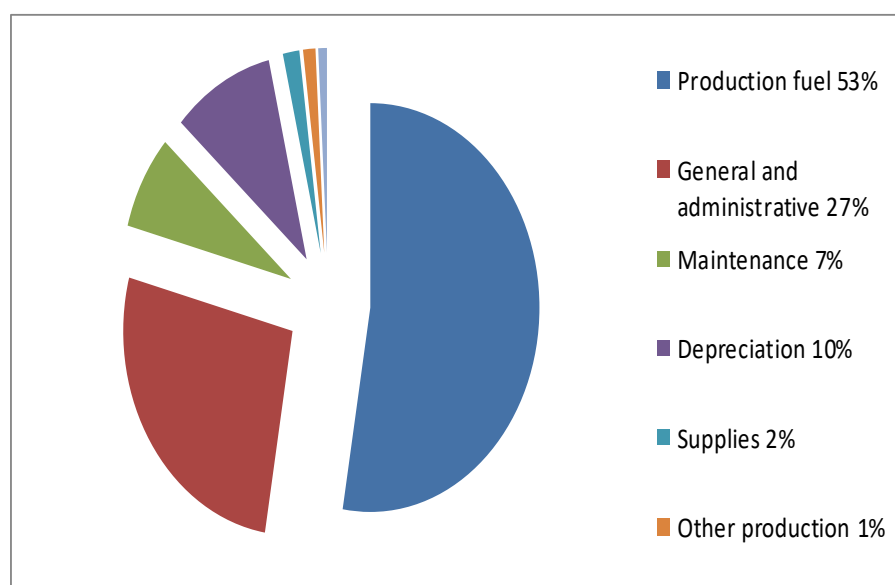


COMMONWEALTH UTILITIES CORPORATION
(A Component Unit of the CNMI Government)

MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2015

Operating Expenses

		<u>2015</u>	<u>2014</u>	<u>\$Change</u>	<u>% Change</u>
Production fuel	53%	\$ 41,046,828	\$ 61,645,777	\$ (20,598,949)	-33.4%
General and administrative	27%	20,753,951	18,313,501	2,440,450	13.3%
Maintenance	7%	5,824,879	5,446,343	378,536	7.0%
Depreciation	10%	7,591,231	7,227,734	363,497	5.0%
Supplies	2%	1,229,146	1,609,566	(380,420)	-23.6%
Other production	1%	926,170	1,000,912	(74,742)	-7.5%
Other	1%	647,129	799,334	(152,205)	-19.0%
		<u>\$ 78,019,334</u>	<u>\$ 96,043,167</u>	<u>\$ (18,023,833)</u>	<u>-18.8%</u>



For the year ended September 30, 2015, CUC has a loss from operations of about \$8.6 million as compared to a loss of about \$4 million for the year ended September 30, 2014.

During the year ended September 30, 2015, CUC operating revenues decreased overall by \$22 million or 23% when compared to revenues for the year ended September 30, 2014. Operating expenses also decreased by \$18 million or 18.8%.

COMMONWEALTH UTILITIES CORPORATION

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MANAGEMENT'S DISCUSSION & ANALYSIS

September 30, 2015

CUC's loss from its operations at the end of fiscal year 2015 is \$8.6 million. CUC is currently not billing or collecting enough revenues to recover the cost of providing service to its customers.

Further complicating the financial woes of the utility, on August 2, 2015, the Commonwealth was struck by a catastrophic CAT IV typhoon that devastated the island of Saipan. Sufficient numbers of power poles were toppled to cause a complete crash of the entire power grid. The main generating plant, Power Plant #1 was badly damaged, causing a complete shutdown of the plant for weeks of repair. Since the water and sewer systems are dependent upon continuous electric supply, these also suffered complete shutdowns.

As a result of this devastating storm, CUC was unable to provide electricity, water or sewer services to its customers for the last two months of the Fiscal Year. This resulted in virtually no revenue collection for the utility, while at the same time required extraordinary expenditures in manpower and resources to work around the clock trying to restore life-saving services to the people of the Islands.

The amount due from grantor agencies increased to \$2,442,567 by end of the fiscal year. President Obama declared the Commonwealth to be a major disaster area due to the devastation resulting from Typhoon Soudelor. The Public Assistance Program through the Department of Homeland Security, Federal Emergency Management Agency (FEMA) made emergency financial assistance available to the Commonwealth with a 90% FEMA / 10% CUC cost-share arrangement. By the end of fiscal year 2015, approximately \$1.3 million in reimbursable restoration costs were incurred by CUC.

CUC cannot determine the full negative impact of the disaster on its financial statements until the typhoon restoration is complete and FEMA reimbursement requests are received. An external company will be contracted to perform a physical count of all fixed assets and inventories and compare these to the accounting records of CUC for completeness and accuracy. Furthermore, an external company needs to perform a full valuation of CUC's fixed assets and inventories.

COMMONWEALTH UTILITIES CORPORATION
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MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2015

Capital Assets

At September 30, 2015, CUC had \$84,075,999 invested in capital assets, net of depreciation where applicable, including electric plant, water plant, sewer plant, administrative equipment and construction in progress.

	2015	2014
Utility plant in service:		
Electric plant	\$ 129,528,547	\$ 129,733,086
Water plant	68,764,005	67,952,180
Sewer plant	50,234,999	48,315,973
Administrative equipment	3,895,897	3,884,430
	252,423,448	249,885,669
Accumulated depreciation	(187,581,639)	(180,835,511)
Depreciable assets, net	64,841,809	69,050,158
Construction work-in progress	19,234,190	15,662,062
Capital assets, net	\$ 84,075,999	\$ 84,712,220

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

Debt

Long-term debt as of September 2015 and 2014 are as follows:

	2015	2014
Pacific Marine Industrial Corporation	3,373,563	3,373,563
Current maturities	(2,619,347)	(2,520,963)
Long-term debt, net of current portion	\$ 754,216	\$ 852,600

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

COMMONWEALTH UTILITIES CORPORATION
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MANAGEMENT'S DISCUSSION & ANALYSIS
September 30, 2015

SUMMARY CONCLUSION REGARDING FY 2015 AND OUTLOOK FOR FY 2016

CUC will achieve fiscal stability if CUC recovers its collectible revenue of amounts at least equal to what it costs to provide services. Most of the capital improvement projects were financed by federal grants, rather than by rate payers. Such reliance on federal financial assistance is not sustainable due to future funding uncertainties. While CUC had some success in improving the overall quality of services, continued emphasis must be placed on reinvestment on maintenance, sustainment and infrastructure improvements.

To be successful, CUC must:

- o Evaluate and adjust its existing rate and fee schedules that is sufficient to meet its financial obligations, operating expenses, debt service and capital improvement needs.
- o Identify and implement programs to increase its revenue and improve its operations to a surplus and provide service to paying customers.
- o Invest in the acquisition of new and replacement structure to generate and meet increasing power demand with an adequate amount of reserve capacity for the new developments in the CNMI.
- o To identify further water and wastewater infrastructure projects, with design and engineering of solutions, and the procurement of contractors to achieve timely completion of such projects. (Funded by US-EPA grant)
- o Complete a Water/Wastewater 20-Year Master Plan to provide long range guidance regarding the infrastructure needs & solutions over the next two decades.
- o Establish a dedicated crew for leak detection and repairs, resulting in conservation of water and subsequent energy savings. (Partially funded by US-EPA and Bureau of Reclamation grants)
- o Continue building on 2015 successes in sewer line and lift station cleaning and rehabilitation to ensure safe and effective collection and transmission of wastewater to treatment plants.
- o Ensure compliance with Stipulated Orders 1 and 2 regarding compliance with the Clean Water Act and Safe Drinking Water Act.
- o Expand policies to encourage individuals to implement energy conservation and use of renewable energy sources at their homes and businesses, reducing dependence on fossil fuels.
- o Maintain the operation of the power generation system in spite of lack of funds, and the challenge of hiring skilled mechanics and engineers caused in part by immigration restrictions.
- o Continue to provide professional and functional training of all employees to deliver outstanding utility services to the CNMI.

COMMONWEALTH UTILITIES CORPORATION

(A Component Unit of the CNMI Government)

MANAGEMENT'S DISCUSSION & ANALYSIS

September 30, 2015

The CUC Board of Directors (BOD) continues to work with the CNMI Government to resolve its past due and delinquent accounts. It has made some progress resolving its receivable issues:

- The CUC BOD and Public School System (PSS) negotiated a settlement agreement in November 2015 to begin full payment of monthly utility bills and regularly pay \$100,000 per month towards its past due amount.
- Although less than the current monthly metered power, water and sewer consumption billings, CUC and the Commonwealth Health Center Corporation (CHCC) entered into a Net Metering Intergovernmental Cooperative Agreement in December 2015 which has resulted in regular monthly payments to CUC.
- The CUC BOD and the Commonwealth Development Authority (CDA) are negotiating a payment agreement to address CUC's outstanding dividend payments. CUC has offered to assign PSS' monthly payments of \$100,000 to satisfy the dividend payments.
- Discussions with The Commonwealth Ports Authority (CPA) have been initiated to address CUC's long-outstanding debt and CPA's past-due utility billings.

REQUESTS FOR INFORMATION

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

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

Or, call (670) 664-4282.

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

Statements of Net Position
September 30, 2015 and 2014

	2015	2014
<u>ASSETS</u>		
Current assets:		
Current unrestricted assets:		
Cash and cash equivalents	\$ 16,684,792	\$ 9,180,020
Accounts receivable - utility, net	5,699,668	10,039,709
Due from grantor agencies	2,442,567	819,393
Inventory, net	9,384,817	11,079,929
Regulatory cost for future recovery - fuel	5,332,794	4,140,910
Notes receivable, net	95,811	86,855
Other assets, net	1,855,144	1,947,604
Total current unrestricted assets	41,495,593	37,294,420
Current restricted assets:		
Cash and cash equivalents	10,740,855	10,197,517
Total current assets	52,236,448	47,491,937
Noncurrent assets:		
Notes receivable, net of current portion	115,800	105,224
Capital assets:		
Utility plant in service		
Electric plant	129,528,547	129,733,086
Water plant	68,764,005	67,952,180
Sewer plant	50,234,999	48,315,972
Administrative equipment	3,895,897	3,884,431
	252,423,448	249,885,669
Accumulated depreciation	(187,581,639)	(180,835,510)
Net utility plant and administrative equipment	64,841,809	69,050,159
Construction in progress	19,234,190	15,662,061
Total capital assets	84,075,999	84,712,220
Total noncurrent assets	84,191,799	84,817,444
TOTAL ASSETS	\$ 136,428,247	\$ 132,309,381

See accompanying notes to financial statements.

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

Statements of Net Position, Continued
September 30, 2015 and 2014

	2015	2014
<u>LIABILITIES</u>		
Current liabilities:		
Unrestricted current liabilities:		
Accounts payable and accrued liabilities	\$ 7,011,387	\$ 5,024,942
Compensated absences	913,633	350,675
Current maturities of long-term debt	2,619,347	2,520,963
Dividends payable	3,420,000	2,340,000
Stipulated order penalties assessed	41,041,000	36,041,000
Interest payable	823,145	668,983
Total unrestricted current liabilities	55,828,512	46,946,563
Restricted current liabilities:		
Security deposits, including accrued interest	11,083,936	10,096,671
Total current liabilities	66,912,448	57,043,234
Noncurrent liabilities:		
Long-term debt, net of current maturities	754,216	852,600
Due to primary government	7,049,078	6,646,790
Retirement contributions payable	3,414,064	3,387,153
Unearned fuel purchase obligation rebate	5,031,316	6,131,316
Unearned revenue	2,218,558	-
Dividends payable	1,980,000	2,160,000
Advances from CNMI Government	107,296	107,296
Compensated absences	-	527,865
Total noncurrent liabilities	20,554,528	19,813,020
TOTAL LIABILITIES	87,466,976	76,856,254
<u>DEFERRED INFLOWS</u>		
Rate stabilization (Public Law 16-7)	1,667,267	2,788,238
TOTAL DEFERRED INFLOWS	1,667,267	2,788,238
<u>NET POSITION</u>		
Net investment in capital assets	84,075,999	84,712,220
Restricted for:		
Regulatory expenses	(591,186)	(489,093)
Preferred stocks	45,000,000	45,000,000
Unrestricted	(81,190,809)	(76,558,238)
NET POSITION	\$ 47,294,004	\$ 52,664,889

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

(A Component Unit of the CNMI Government)

Statements of Revenues, Expenses and Changes in Net Position
For the Years Ended September 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Operating revenues:		
Power	\$ 23,550,183	\$ 22,876,847
Water	11,201,566	11,976,163
Sewer	4,154,973	4,853,750
LEAC - fuel charge	36,837,230	58,618,588
LEAC - non fuel	232,158	237,824
Other	608,999	367,979
	<u>76,585,109</u>	<u>98,931,151</u>
Bad debts	<u>(7,128,107)</u>	<u>(6,906,360)</u>
Net operating revenues	<u>69,457,002</u>	<u>92,024,791</u>
Operating expenses:		
Production fuel	41,046,828	61,645,777
General and administrative	20,753,951	18,313,501
Maintenance	5,824,879	5,446,343
Depreciation	7,591,231	7,227,734
Supplies	1,229,146	1,609,566
Other production	926,170	1,000,912
Other	647,129	799,334
	<u>78,019,334</u>	<u>96,043,167</u>
Loss from operations, carried forward	<u>\$ (8,562,332)</u>	<u>\$ (4,018,376)</u>

See accompanying notes to financial statements.

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

Statements of Revenues, Expenses and Changes in Net Position, Continued
For the Years Ended September 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Loss from operations, brought forward	\$ (8,562,332)	\$ (4,018,376)
Non-operating revenues (expenses):		
Interest income	460,694	574,488
Miscellaneous income	222,340	213,785
Amortization of fuel purchase obligation rebate	1,100,000	468,684
Regulatory assessments	(334,250)	(960,301)
Settlement expense	(26,432)	(6,558)
Stipulated order penalties	(5,000,000)	(4,574,000)
Contribution to the CNMI government	(402,289)	(366,948)
Interest and distribution expense	<u>(1,156,640)</u>	<u>(1,206,204)</u>
Total non-operating revenues (expenses), net	<u>(5,136,577)</u>	<u>(5,857,054)</u>
Loss before change in recovery of fuel costs	(13,698,909)	(9,875,430)
Change in recovery of fuel costs	<u>1,191,883</u>	<u>(456,570)</u>
Net loss before capital contributions and federal grants	(12,507,026)	(10,332,000)
Capital contributions and federal grants	<u>7,136,143</u>	<u>6,270,224</u>
Change in net position	(5,370,883)	(4,061,776)
Net position, beginning	<u>52,664,887</u>	<u>56,726,663</u>
Net position, ending	<u>\$ 47,294,004</u>	<u>\$ 52,664,887</u>

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, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Cash flows from operating activities		
Cash received from customers	\$ 81,174,575	\$ 88,103,440
Cash payments to suppliers for goods and services	(57,499,287)	(72,980,805)
Cash payments to employees for services	<u>(13,680,372)</u>	<u>(10,398,452)</u>
Net cash provided by operating activities	<u>9,994,916</u>	<u>4,724,183</u>
Cash flows from noncapital financing activities		
Interest paid on outstanding debt	(102,477)	(192,857)
Principal repayment of debt	<u>(402,288)</u>	<u>(3,902,581)</u>
Net cash used for noncapital financing activities	<u>(504,765)</u>	<u>(4,095,438)</u>
Cash flows from capital and related financing activities		
Acquisition and construction of capital assets	(6,955,010)	(4,912,409)
Capital contributions received	<u>5,512,969</u>	<u>5,567,178</u>
Net cash provided by capital and related financing activities	<u>(1,442,041)</u>	<u>654,769</u>
Net change in cash and cash equivalents	8,048,110	1,283,514
Cash and cash equivalents at beginning of year	<u>19,377,537</u>	<u>18,094,023</u>
Cash and cash equivalents at end of year	<u>\$ 27,425,647</u>	<u>\$ 19,377,537</u>
Cash and cash equivalents	\$ 16,684,792	\$ 9,180,020
Restricted cash and cash equivalents	<u>10,740,855</u>	<u>10,197,517</u>
	<u>\$ 27,425,647</u>	<u>\$ 19,377,537</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, 2015 and 2014

	2015	2014
Reconciliation of loss from operations to net cash provided by operating activities		
Loss from operations	\$ (8,562,332)	\$ (4,018,376)
Adjustments to reconcile loss from operations to net cash used for operating activities:		
Depreciation	7,591,231	7,227,734
Provision for bad debts	7,128,107	6,906,358
Loss on disposal of property and equipment	-	11,565
Interest income/late charges	460,694	574,488
Miscellaneous income	222,340	213,785
Marketing assistance program	1,100,000	468,684
Regulatory assessments	(334,250)	(960,301)
Settlement expense	(26,432)	(6,558)
(Increase) decrease in assets:		
Accounts receivable - utility	(2,788,216)	(4,495,839)
Inventory	1,695,262	(1,888,372)
Notes receivable	(19,532)	248,518
Other assets	92,460	(545,142)
Increase (decrease) in liabilities		
Accounts payable and accrued liabilities	(183,266)	(2,808,493)
Accrued liabilities:	2,157,784	-
Accrued payroll	414,210	-
Compensated absences	35,093	(50,807)
Security deposits including accrued interest	987,265	(1,671,389)
Unearned revenue - BSI voucher	2,218,558	-
Unearned fuel purchase obligation rebate	(1,100,000)	6,131,316
Rate stabilization	(1,120,971)	(611,762)
Retirement contributions payable	26,911	(1,226)
	<u>\$ 9,994,916</u>	<u>\$ 4,724,183</u>
Net cash provided by operating activities	<u>\$ 9,994,916</u>	<u>\$ 4,724,183</u>

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2015 and 2014

(1) Organization

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

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

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

(2) Summary of Significant Accounting Policies

Measurement Focus, Basis of Accounting and Basis of Presentation

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

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

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

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

Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

Adopted Pronouncements

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

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

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

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

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

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

Recent Pronouncements

In November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to The Measurement Date — An Amendment of GASB Statement No. 68*. The objective of this Statement is to address an issue regarding application of the transition provisions of Statement No. 68, Accounting and Financial Reporting for Pensions. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. The requirements of this Statement will eliminate the source of a potential significant understatement of restated beginning net position and expense in the first year of implementation of Statement 68 in the accrual-basis financial statements of employers and nonemployer contributing entities. This benefit will be achieved without the imposition of significant additional costs. The provisions of this Statement are required to be applied simultaneously with the provisions of Statement 68.

In February 2015 GASB issued Statement No. 72, *Fair Value Measurement and Application*. This Statement addresses accounting and financial reporting issues related to fair value measurements. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. This Statement requires a government to use valuation techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair value. This Statement establishes a hierarchy of inputs to valuation techniques used to measure fair value. This Statement requires additional analysis of fair value if the volume or level of activity for an asset or liability has significantly decreased. It also requires identification of transactions that are not orderly. This Statement requires measurement at acquisition value (an entry price) for donated capital assets, donated works of art, historical treasures, and similar assets and capital assets received in a service concession arrangement. This Statement requires disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques. It also requires additional disclosures regarding investments in certain entities that calculate net asset value per share (or its equivalent). The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015. Earlier application is encouraged. Management does not believe that the implementation of this statement will have a material impact on CUC's financial statements.

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2015 and 2014

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68 and Amendments to Certain Provisions of GASB Statement 67 and 68*. This Statement establishes requirements for defined benefit pensions that are not within the scope of Statement No. 68, Accounting and Financial Reporting for Pensions, as well as for the assets accumulated for purposes of providing those pensions. In addition, it establishes requirements for defined contribution pensions that are not within the scope of Statement 68. The requirements of this Statement will improve financial reporting by establishing a single framework for the presentation of information about pensions, which will enhance the comparability of pension-related information reported by employers and nonemployer contributing entities. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2015, with the exception of the provisions that address employers and governmental non-employer contributing entities for pensions that are not within the scope of Statement 68, which are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this Statement will have a material impact on CUC's financial statements.

In June 2015, GASB Statement No. 74, *Financial Reporting for Postemployment benefits Plans Other Than Pension Plans*. This Statement replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, as amended*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, as amended*, Statement 43, and Statement No. 50, *Pension Disclosures*. This Statement also addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions or OPEB. The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this Statement will have a material impact on CUC's the financial statements.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of *Statements No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, as amended*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and provide guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments.

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2015 and 2014

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

The provisions in Statement No. 75 establish new accounting and financial reporting requirements for OPEB plans. This Statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures.

For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on CUC's financial statements.

In June 2015, GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Government*. The objective of this Statement is to identify—in the context of the current governmental financial reporting environment—the hierarchy of generally accepted accounting principles (GAAP). The “GAAP hierarchy” consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. This Statement supersedes Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015, and should be applied retroactively. Earlier application is permitted. Management does not believe that the implementation of this statement will have a material effect on CUC's financial statements.

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2015 and 2014

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements. Although many governments offer tax abatements and provide information to the public about them, they do not always provide the information necessary to assess how tax abatements affect their financial position and results of operations, including their ability to raise resources in the future. This Statement requires disclosure of tax abatement information about (1) a reporting government's own tax abatement agreements and (2) those that are entered into by other governments and that reduce the reporting government's tax revenues. The provisions in Statement No. 77 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material impact on CUC's financial statements.

Budgets

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

Cash and Cash Equivalents

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

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

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

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

Cash and Cash Equivalents, Continued

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, 2015 and 2014, cash and cash equivalents were \$27,425,647 and \$19,377,537, respectively, and the corresponding bank balances were \$20,641,125 and \$19,745,738, respectively. Of the bank balance amounts, \$28,070,667 and \$19,734,620, respectively, were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. Bank deposits in the amount of \$27,765,276 and \$19,479,529 were in excess of FDIC insurable limits as of September 30, 2015 and 2014, respectively. CUC also has deposits of \$70,458 in 2015 and \$11,118 in 2014 in an uninsured financial institution. CUC's deposits in excess of FDIC insured limits are collateralized by securities in the financial institutions name.

Restricted Cash and Cash Equivalents

The restricted cash and cash equivalents of \$10,740,855 and \$10,197,517 at September 30, 2015 and 2014, respectively, pertain to customer deposits.

Accounts Receivable and Allowance for Uncollectible Accounts

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

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

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

Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

Inventory

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

Inventory balances at September 30, 2015 and 2014 are as follows:

	2015	2014
Fuel and lubes	\$ 1,669,690	\$ 2,944,911
Materials and supplies	8,408,030	8,827,921
 Total	 10,077,720	 11,772,832
Allowance for obsolescence	(692,903)	(692,903)
 Inventory, net	 \$ 9,384,817	 \$ 11,079,929

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 a deferred fuel cost asset or liability, respectively, in the accompanying Statement of Net Position, and is recovered in or deducted from future billings to customers based on the amendments to Part 24 of the Electric Service Regulations of the CUC adopted on July 20, 2006. Electric fuel rates are computed monthly.

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

On April 2, 2009, the Commonwealth Public Utilities Commission (CPUC) adopted a “levelized energy adjustment clause” rate or LEAC . On September 3, 2009, CPUC approved to extend the effective date of the rate structure until ordered otherwise by the CPUC.

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

Fuel Oil Costs, Continued

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

Subsequent approved FAC rates for 2014 and 2015 are as follows:

Effective Dates	Rate
September 1, 2014	\$ 0.28902
November 1, 2014	\$ 0.25168
December 1, 2014	\$ 0.23616
January 1, 2015	\$ 0.19617
February 1, 2015	\$ 0.15959
March 1, 2015	\$ 0.17108
June 1, 2015	\$ 0.19346
August 4, 2015	\$ 0.16699
September 1, 2015	\$ 0.14445

The regulatory cost for future recovery at September 30, 2015 and 2014 is as follows:

	2015	2014
At beginning of year	\$ 4,140,910	\$ 4,597,480
Change in recovery of fuel costs	1,191,883	(456,570)
At end of year	\$ 5,332,794	\$ 4,140,910

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

Capital Assets and Depreciation

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

CUC's current policy is to capitalize items in excess of \$5,000 effective October 1, 2013. The previous limit was \$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 CUC commences recording depreciation expense. CUC capitalizes interest cost on borrowings incurred during the new construction or upgrade of qualifying assets. Capitalized interest is added to the cost of the underlying assets and is amortized over the estimated useful lives of the assets. There was no capitalized interest for the fiscal years ending September 30, 2015 and 2014.

Compensated Absences

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

The liability at September 30, 2015 and 2014 is as follows:

	2015	2014
Total compensated absences, beginning of year	\$ 878,541	\$ 929,348
Vacation earned	701,522	686,584
Vacation used	(666,430)	(737,391)
Total compensated absences, end of year	\$ 913,633	\$ 878,541

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

Compensated Absences, Continued

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

Net Assets (Deficit)

Net assets represent the residual interest in CUC's assets after liabilities while net deficit represents the excess of liabilities over assets. Net assets consist of three sections: invested in capital assets, net of related debt; restricted regulatory expenses and preferred stocks; 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.

CUC's restricted net position as of September 30, 2015 and 2014 are as follows:

	2015	2014
Commonwealth Development Authority equity in CUC (Note 12)	\$ 45,000,000	\$ 45,000,000
Restricted for:		
Regulatory assessments	(591,186)	(489,093)
	\$ 44,408,814	\$ 44,510,907

Prioritization and Use of Available Resources

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

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

Retirement Plan

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

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

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

COMMONWEALTH UTILITIES CORPORATION
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Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

Defined Contribution Plan (DC Plan)

On June 16, 2006, Public Law No. 15-13 was enacted which created the DC Plan, a multi-employer pension plan and is the single retirement program for all employees whose first time CNMI government employment commences on or after January 1, 2007. Each member of the DC Plan is required to contribute to the member's individual account an amount equal to 10% of the member's compensation. CUC is required to contribute to each member's individual account an amount equal to 40% of the member's compensation. The DC Plan by its nature is fully funded on a current basis from employer and member contributions. Members of the DC Plan, who have completed five years of government service, have a vested balance of 100% of both member and employer contribution plus any earnings thereon. With the passage of Public Law 17-82 in September 11, 2013, the membership to the DC Plan became voluntary.

CUC's aggregate contributions to the Retirement Fund for the years ended September 30, 2015, 2014 and 2013 were \$410,346, \$351,044 and \$418,307, respectively.

The amount CUC recognized as payable to the Retirement Fund prior to the creation of the Settlement Fund totaled \$3,414,064 as of September 30, 2015.

Medical and Life Insurance Benefits

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

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Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

Revenue and Expense Recognition

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

Power, water and sewer sales are recorded as billed to customers on a monthly cycle billing basis. At the end of each month, unbilled revenues are accrued for each cycle based on the subsequent cycle billing. Unbilled receivables included in current earnings at September 30, 2015 and 2014 are \$2,483,420 and \$4,392,854, 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.

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(2) Summary of Significant Accounting Policies, Continued

Contingencies, Continued

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

(3) Accounts Receivable – Utility

Account receivable – utility as of September 30, 2015 and 2014 summarized by location and customer classification are as follows:

	<u>2015</u>	<u>2014</u>
By Location		
Saipan		
Commercial	\$ 5,378,767	\$ 7,589,715
Residential	3,878,318	10,576,221
Government	<u>30,925,172</u>	<u>18,973,818</u>
	<u>40,182,257</u>	<u>37,139,754</u>
Tinian		
Commercial	\$ 1,164,803	\$ 663,942
Residential	(291,996)	364,196
Government	<u>2,107,225</u>	<u>755,554</u>
	<u>2,980,032</u>	<u>1,783,692</u>
Rota		
Commercial	\$ 199,072	\$ 202,791
Residential	(420,968)	275,692
Government	<u>3,510,794</u>	<u>2,246,032</u>
	<u>3,288,898</u>	<u>2,724,515</u>
Total billed	46,451,187	41,647,961
Unbilled	<u>2,483,420</u>	<u>4,392,854</u>
	<u>\$ 48,934,607</u>	<u>\$ 46,040,815</u>

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(3) Accounts Receivable – Utility, Continued

By Customer Classification

	<u>2015</u>	<u>2014</u>
Billed		
Commercial	\$ 6,742,641	\$ 8,456,448
Residential	3,165,354	11,216,110
Government	36,543,192	21,975,404
Unbilled	<u>2,483,420</u>	<u>4,392,854</u>
	48,934,607	46,040,816
Allowance for uncollectible accounts	<u>(43,234,939)</u>	<u>(36,001,107)</u>
	<u>\$ 5,699,668</u>	<u>\$ 10,039,709</u>

(4) Allowance for Uncollectible Accounts

Changes in allowance for uncollectible accounts for the years ended September 30, 2015 and 2014 are as follows:

	<u>2015</u>	<u>2014</u>
Total allowance, beginning of year	\$ 36,777,972	\$ 29,871,614
Provision for uncollectible accounts	7,128,107	6,906,358
Bad debts recovery	105,725	-
Accounts written-off	<u>(69,003)</u>	<u>-</u>
Total allowance, end of year	<u>\$ 43,942,801</u>	<u>\$ 36,777,972</u>
Accounts receivable - utility (Note 3)	\$ 43,234,939	\$ 36,001,107
Notes receivable (Note 5)	88,749	157,752
Other assets (Note 6)	<u>619,113</u>	<u>619,113</u>
Total allowance, end of year	<u>\$ 43,942,801</u>	<u>\$ 36,777,972</u>

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Notes to Financial Statements
September 30, 2015 and 2014

(5) Notes Receivable

CUC allows customers to settle their outstanding utilities through issuance of promissory notes with terms ranging from 6 months to 10 years at an interest rate of 12% per annum.

A summary of the outstanding notes receivable as of September 30, 2015 and 2014 is as follows:

	<u>2015</u>	<u>2014</u>
Current portion, net of allowance of \$88,749	\$ 95,811	\$ 86,855
Noncurrent portion	<u>115,800</u>	<u>105,224</u>
	<u>\$ 211,611</u>	<u>\$ 192,079</u>

(6) Other Assets

Other assets as of September 30, 2015 and 2014 consist of the following:

	<u>2015</u>	<u>2014</u>
Prepayments	\$ 1,594,406	\$ 705,653
Temporary facility	77,817	51,240
Employee advances and travel advances	18,372	18,903
Other receivables, net of allowance of \$619,113	<u>164,549</u>	<u>1,171,808</u>
	<u>\$ 1,855,144</u>	<u>\$ 1,947,604</u>

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(7) Due from Grantor Agencies

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

Changes in the due from grantor agencies account for the years ended September 30, 2015 and 2014 are as follows:

	2015	2014
Balance at beginning of year	\$ 819,393	\$ 116,347
Adjustments		
Deductions - cash receipts from grantors	(6,941,061)	(5,054,646)
Additions - program outlays	8,564,235	5,757,692
Balance at end of year	\$ 2,442,567	\$ 819,393

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(8) Capital Assets

A summary of the changes in capital assets activity for the years ended September 30, 2015 and 2014 is as follows:

	Estimated Useful Lives	Balance at October 1, 2014	Acquisitions	Adjustments/ Disposals	Transfers	Balance at September 30, 2015
Utility plant in service						
Electric plant	20 years	\$ 129,733,086	\$ 174,443	\$ (378,982)	\$ -	\$ 129,528,547
Water plant	20 years	67,952,180	26,106	(170,218)	955,937	68,764,005
Sewer plant	20 years	48,315,973	11,416	(2,499,311)	4,406,921	50,234,999
Administrative equipment	3-5 years	<u>3,884,430</u>	<u>320,195</u>	<u>(308,728)</u>	<u>-</u>	<u>3,895,897</u>
		249,885,669	532,160	(3,357,239)	5,362,858	252,423,448
Accumulated depreciation		<u>(180,835,511)</u>	<u>(7,466,274)</u>	<u>720,146</u>	<u>-</u>	<u>(187,581,639)</u>
Depreciable assets, net		69,050,158	(6,934,114)	(2,637,093)	5,362,858	64,841,809
Construction work-in progress		<u>15,662,062</u>	<u>6,855,519</u>	<u>-</u>	<u>(3,283,391)</u>	<u>19,234,190</u>
Capital assets, net		<u>\$ 84,712,220</u>	<u>\$ (78,595)</u>	<u>\$ (2,637,093)</u>	<u>\$ 2,079,467</u>	<u>\$ 84,075,999</u>
	Estimated Useful Lives	Balance at October 1, 2013	Acquisitions	Adjustments/ Disposals	Transfers	Balance at September 30, 2014
Utility plant in service						
Electric plant	20 years	\$ 128,881,452	\$ 854,127	\$ (2,493)	\$ -	\$ 129,733,086
Water plant	20 years	67,805,784	146,396	-	-	67,952,180
Sewer plant	20 years	45,730,511	40,066	-	2,545,396	48,315,973
Administrative equipment	3-5 years	<u>3,667,746</u>	<u>303,814</u>	<u>(87,130)</u>	<u>-</u>	<u>3,884,430</u>
		246,085,493	1,344,403	(89,623)	2,545,396	249,885,669
Accumulated depreciation		<u>(173,685,835)</u>	<u>(7,227,734)</u>	<u>78,058</u>	<u>-</u>	<u>(180,835,511)</u>
Depreciable assets, net		72,399,658	(5,883,331)	(11,565)	2,545,396	69,050,158
Construction work-in progress		<u>14,639,453</u>	<u>4,470,373</u>	<u>-</u>	<u>(3,447,764)</u>	<u>15,662,062</u>
Capital assets, net		<u>\$ 87,039,111</u>	<u>\$ (1,412,958)</u>	<u>\$ (11,565)</u>	<u>\$ (902,368)</u>	<u>\$ 84,712,220</u>

Included in utility plant in service adjustments/transfers for fiscal years ended September 30, 2015 and 2014 are completed projects transferred from construction work-in-progress to utility plant in service of \$3,283,392, and \$3,447,764, respectively.

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Notes to Financial Statements
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(8) Capital Assets, Continued

Depreciation expense for the years ended September 30, 2015 and 2014 is \$7,591,231 and \$7,227,734, respectively.

CUC entered into several construction contracts during fiscal years 2015 and 2014 for improvements, rehabilitation and replacement of facilities, and other capital projects. As of September 30, 2015, CUC had outstanding construction contracts totaling \$7,108,420 that will be financed from operating funds and federal awards.

(9) Security Deposits

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

Summarized below is the summary of security deposits including accrued interest as of September 30, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
Electric	\$ 9,710,468	\$ 8,828,718
Water	176,624	593,130
Sewer	<u>663,942</u>	<u>157,740</u>
Total security deposits	10,551,034	9,579,588
Accrued interest on security deposits	<u>532,902</u>	<u>517,083</u>
Security deposits, including interest	<u><u>11,083,936</u></u>	<u><u>10,096,671</u></u>
Security deposits, including interest	11,083,936	10,096,671
Restricted cash	<u>10,740,855</u>	<u>10,197,517</u>
Accumulated security deposits used to purchase fuel (Excess restricted cash over liability)	<u><u>\$ 343,081</u></u>	<u><u>\$ (100,846)</u></u>

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(10) Long-term Debt

Long-term debt at September 30, 2015 and 2014 is as follows:

	2015	2014
Commonwealth Ports Authority	\$ 3,373,563	\$ 3,373,563
Current maturities	(2,619,347)	(2,520,963)
Long-term debt, net of current portion	\$ 754,216	\$ 852,600

Interest expense on long-term debt for the years ended September 30, 2015 and 2014 was \$256,640 and \$306,204, respectively, and is presented as a component of interest and distribution expense in the accompanying Statements of Revenues, Expenses and Changes in Net Position.

Changes in long-term debt for the fiscal years ended September 30, 2015 and 2014 are as follows:

	Balance at October 1, 2014	Acquisitions	Transfers	Balance at September 30, 2015
Commonwealth Ports Authority	\$ 3,373,563	\$ -	\$ -	\$ 3,373,563
	Balance at October 1, 2013	Acquisitions	Transfers	Balance at September 30, 2014
Commonwealth Ports Authority	\$ 3,373,563	\$ -	\$ -	\$ 3,373,563
Pacific Marine Industrial Corporation	3,902,581	-	(3,902,581)	-
Total	\$ 7,276,144	\$ -	\$ (3,902,581)	\$ 3,373,563

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Notes to Financial Statements
September 30, 2015 and 2014

(10) Long-term Debt, continued

A summary of CUC's loans payable to CPA at September 30, 2015 and 2014 is as follows:

	<u>2015</u>	<u>2014</u>
Loan payable to Commonwealth Ports Authority, a component unit of the CNMI Government, principal of \$3,385,131, interest at 6.25% per annum, with a maturity date of October 31, 2017. Principal and interest is due in monthly payments of \$38,008.	\$ 3,373,563	\$ 3,373,563
Current maturities	(2,619,347)	(2,520,963)
Long-term debt, net of current portion	\$ 754,216	\$ 852,600

Future repayment commitments of principal and interest are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending September 30:			
2016	\$ 2,916,409	\$ 700,841	\$ 3,617,250
2017	420,882	35,217	456,099
2018	36,272	1,736	38,008
	\$ 3,373,563	\$ 737,794	\$ 4,111,357

(11) Due to Primary Government

Public Law 9-68, enacted on October 19, 1995, requires government agencies to pay the CNMI Treasurer an amount not less than the greater of 1% of its total operations budget from sources other than legislative appropriations or pursuant to any other formula, which the CNMI Office of the Public Auditor (OPA) and the agency may agree, to fund the OPA.

At September 30, 2015 and 2014, CUC recognized an outstanding payable to the CNMI Government in the amount of \$7,049,078 and \$6,646,790, respectively. CUC accrued OPA fees of \$402,288 in 2015 and \$366,947 in 2014. OPA asserts that CUC owes the CNMI government OPA fees of approximately \$9 million as of September 30, 2014 based on 1% of CUC's operations budget including fuel costs. CUC's management and OPA have initiated negotiations to reconcile CUC's payable to the CNMI Government for OPA fees; however, no settlement agreement has been formalized as of September 30, 2015.

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(11) Due to Primary Government, continued

CUC and OPA have differing opinions whether fuel costs should be included in the operations budget which should be used as the basis for the OPA Fee. CUC intends to seek assistance from the CNMI Legislature to resolve this issue. CUC has not made any remittance for OPA fees since fiscal year 2003.

On September 26, 2011, the Appropriations and Budget Authority Act of 2012 (Public Law 17-55) was signed into law. Section 601 of Public Law 17-55 authorizes the CNMI Secretary of Finance to deduct the 1% due to the OPA from CUC from the monthly utility costs of the government. No application of payments were made as of September 30, 2015.

(12) Preferred Stocks Issued to Commonwealth Development Authority

On October 2, 2008, Public Law 16-17 or the Commonwealth Utilities Corporation Act of 2008 authorized CUC to issue shares of cumulative, non-convertible, non-transferable preferred stock valued at \$45,000,000 to CDA.

CUC and CDA may provide by written agreement, subject to the terms and conditions of a Memorandum of Agreement (MOA), such terms and conditions being incorporated herein by reference, for the following:

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

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

Pursuant to the terms of the MOA, the dividend payments for the first three years after issuance of the stocks are to be amortized and interest free over a 15-year period. Although the preferred stock certificates have not been physically issued, CUC is of the opinion that CDA has constructive receipt of the preferred shares through the execution of the MOA. Dividends payable as of September 30, 2015 and 2014 amounted to \$5,400,000 and \$4,500,000, respectively. CUC is in default of its \$900,000 dividend payment for 2015 and its \$900,000 dividend payment for 2014 and the \$180,000 amortization of deferred dividends.

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(12) Preferred Stocks Issued to Commonwealth Development Authority, continued

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

Years ending September 30:	
2016	\$ 3,420,000
2017	180,000
2018	180,000
2019	180,000
2020 to 2024	900,000
2025 to 2027	<u>540,000</u>
	<u>\$ 5,400,000</u>

(13) Risk Management

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

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

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

(14) Commitments and Contingencies

Commitments

At September 30, 2015, CUC had commitments of \$7,108,420 for construction, purchases of inventory, and acquisition of property and equipment, all of which are expected to be incurred in 2015.

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(14) Commitments and Contingencies, continued

Lease Commitments

CUC entered into a lease agreement for office space in Joeten Dandan Building for a term of five years commencing in December 2011 and expiring in December 2016 with an option for one additional five year lease term renewal. The annual lease payment is \$155,889.

CUC also entered into a lease agreement for lease of office/warehouse space for Power Division in Saipan for a term of two years commencing in December 2013 and expiring in December 2015 with an option for six months renewal. The annual lease payment is \$64,022.

CUC also entered into a lease agreement for office space in Rota for a term of four years commencing in December 2012 and expiring in December 2016 with an option for an additional two year lease term extension. The annual lease payment is \$15,600.

Future lease payments are as follows:

Year ended September 30, 2016	\$ 235,512
2017	<u>85,579</u>
	<u>\$ 321,091</u>

Rent expense totaled \$241,102 in 2015 and \$246,327 in 2014.

Contingencies

Federal Questioned Costs

CUC participates in a number of federally assisted grant programs funded by the United States of America Federal government. These programs are subject to financial and compliance audits to ascertain if federal laws and regulations have been followed. There were no accumulated questioned costs as of September 30, 2015 and 2014.

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

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

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Notes to Financial Statements
September 30, 2015 and 2014

(14) Commitments and Contingencies, continued

Contingencies, Continued

Public Law 18-19 Public School System Water and Waste Water Rate, Continued

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

On September 30, 2014, the CNMI Attorney General issued Legal Opinion Number 2014-02 which concluded that Public Law 18-19 does not require the review and approval of the Commonwealth Public Utilities Commission prior to CUC putting the commercial rate for PSS into effect. CUC intends to comply with this Opinion.

On November 30, 2015, CUC signed a settlement agreement with CNMI Public School System to pay \$100,000 per month until the unpaid principal amount of \$3,841,202.09 as of October 1, 2015 has been paid in full and to pay its current utility charges.

CHCC Settlement Agreement

On December 23, 2015, CUC entered into a Net Metering Intergovernmental Cooperative Agreement (NMICA) with Commonwealth Health Care Corporation (CHCC). The NMICA establishes the relationship between them regarding the metering and planning and development of photovoltaic renewable energy for CHCC in accordance with Public Law 18-75. Public Law 18-75 prioritizes net metering for public health and education agencies, enables any credits from renewable energy to be kept as a credit for two years by the public agency, requires CUC to adopt any rules and procedures necessary to implement the net metering priority for the public health entity, and mandates completion of such net metering agreement and the full implementation of such net metering request within a year.

CHCC has remitted to CUC an initial amount of \$250,000 in June 2015. CHCC needs to complete the PV system within two years and make minimum monthly payment of \$150,000 to CUC starting in July 2015. In the event that the CHCC is unable to complete the PV system in two years, CHCC will increase the payment to \$300,000 until such time as the project is completed and generating an excess of capacity, which includes any appropriations earmarked by the CNMI government for CUC payments.

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Notes to Financial Statements
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(14) Commitments and Contingencies, Continued

Contingencies, Continued

CDA

A Settlement Agreement was signed by the CUC Board of Directors and will be presented to the CDA Board of Directors, which indicated that CUC's unpaid dividend as of October 1, 2016 is \$4,320,000. CUC shall pay this amount over a period of time, without the accrual of interest as follows:

- By assigning PSS' monthly payment to CUC as described in the November 30, 2015 Agreement in the amount of at least \$100,000 per month and continuing monthly until the total principal amount owed under that agreement, or \$3,841,202.09, is paid by PSS.
- By paying the difference between the amount owed by CUC to CDA as of October 1, 2016, and the amount to be received from PSS by CUC, or \$478,798.00, through monthly payments to CDA at the rate of \$40,000.00 per month, payable on the 1st of every month, beginning the month after the final payment from PSS to CUC on its principal debt. CUC also agrees to begin and continue making the annual dividend payments on a quarterly basis as required in the Preferred Stock Agreement; \$270,000.00 quarterly.

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

CUC is a defendant in a class action lawsuit, Superior Court Civil Case No. 09-0410, wherein CUC is alleged to have overcharged its customers from July 22, 2006 to October 24, 2006. The damages sought include a refund of approximately \$4.2 million, in addition to related punitive damages and attorney fees. This matter has now been settled and the case has been dismissed against CUC.

Litigation and Potential Claims

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

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

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Notes to Financial Statements
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(14) Commitments and Contingencies, Continued

Contingencies, Continued

Stipulated Orders

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

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

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

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

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

Fines and penalties related to these Stipulated Orders have accumulated to over \$76 million. However the fines and penalties have never been assessed and billed to or paid for by CUC 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. This accrued amount is subject to mitigation and objections. On September 26, 2014, another Stipulated Order concerning the appointment of an EEMC was entered into under which the United States and EPA waived all Stipulated Order Two penalties which have accumulated as of September 25, 2014. The amount waived was calculated to be approximately \$40 million of potential liability though no official numerical value was given to the provision.

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Notes to Financial Statements
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(14) Commitments and Contingencies, Continued

Contingencies, Continued

Stipulated Orders, Continued

The parties appeared for status conferences and signed further stipulations dated August 12, 2010, in which CUC has agreed to specific performance dates for required projects. On the status conference on December 9, 2010, CUC had met its deadlines on 31 out of 33 discrete deliverables, and had made substantial progress on the balance. Pursuant to the March 22, 2011 status conference stipulation, the parties agreed to further deadlines for meter change-outs and the pipeline project. The Federal District Court has expressed its satisfaction with CUC's progress on the water metering project.

There have been three major projects of the highest priority to the Federal District Court: the Pipeline, Tank 102, and the Rota Tanks. CUC completed the Rota Tanks in late December 2012. Construction of Tank 102 was completed in June 2016. Construction of the oil pipeline is completed. In March 2016, a Task Order (#5) was issued by the Northern Mariana Islands District Court ordering initiation of work on Tank 103 (Clean, Inspect, Repair. Tank 103).

The project will resume under the direction of an Engineering and Environmental Management Company (EEMC) pursuant to the provisions of the Stipulated Order entered on September 26, 2014. Any further penalties and fines which may be assessed are related to CUC's performance under both Stipulated Orders One and Two. To date CUC has not been assessed any penalties and fines under the stipulated orders by EPA. CUC has accrued a liability under Stipulated Order one as described in note 17 below.

Other Matters

In August 2012, the then CNMI Governor and Attorney General signed a 25-year power purchase agreement (PPA) with a private company granting exclusive right to develop a diesel-generated electric power plant on Saipan for a total guaranteed price of \$190 million. A taxpayer lawsuit was filed in the Superior Court for the purpose of challenging the PPA. CUC is a named Defendant in the case. CUC filed a motion detailing the problems and illegalities with the agreement arguing that the PPA is void ab initio, per a CNMI Attorney General's Opinion. On February 4, 2014 the CNMI Superior Court entered a decision declaring the PPA void ab initio. Since then the case has been dismissed. There are no further proceedings pending in this matter.

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

Notes to Financial Statements
September 30, 2015 and 2014

(14) Commitments and Contingencies, Continued

Contingencies, Continued

Other Matters, Continued

SDLLC sued CUC in the US District Court for breach of contract and equitable reimbursement for the PPA at issue in the Superior Court action above. CUC brought a motion to dismiss which was granted by an Order of June 24, 2014, wherein the District Court found exceptional circumstances weighed in favor of abstention and dismissed the complaint with prejudice. SDLLC has appealed this decision to the Ninth Circuit Court of Appeals. That appeal has been dismissed. There are no further proceedings pending in this matter.

(15) Liability for Estimated Environmental Remediation Costs

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

On March 10, 2011, CUC received an order from the U.S. EPA, which requires CUC to perform cleanup activities of Power Plants 1 and 2, pursuant to the National Oil and Hazardous Substances Pollution Contingency Plan, which appears at Title 40, CFR Part 300 and paragraphs 12 and 14 of Stipulated Order Two for Preliminary Injunctive Relief. CUC and EPA estimate the cost of remedial activities to range from \$1 million to \$2 million. The accompanying financial statements have not been restated to include accrual of these remedial activities. Since then, CUC has been assessed \$2,131,696.40. In addition to this amount the U.S. Coast Guard has assessed CUC a total of \$7,553,341.38. These assessments are still outstanding.

(16) Economic Dependency

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

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

Notes to Financial Statements
September 30, 2015 and 2014

(17) Going Concern

Historically the Corporation has had operating losses, negative cash flows from operations and working capital deficiencies. The unrestricted net deficit as of September 30, 2015 is \$81,190,809 and the net loss for the year ended September 30, 2015 was \$5,370,883. Whether, and when, the Corporation can attain a net surplus and positive cash flows from operations is uncertain.

The Corporation will need to increase revenue and improve the collection of revenue in order to fund its operations. This need may be adversely impacted by: continued non-payment of current and past due debts from the CNMI Government and its component units, non-approval of requested rate increases by the Commonwealth Public Utilities Commission (CPUC), legislative decisions, emergency maintenance of power, water and wastewater systems, which are in desperate need of replacement and/or repairs, and debts being called by the Commonwealth Development Authority (CDA), the Commonwealth Ports Authority (CPA) and/or the Environmental Protection Agency (EPA).

Management has concluded that the combination of the above circumstances represents a material uncertainty that casts significant doubt upon the Corporation's ability to continue as a going concern and that, therefore, the Corporation may not be able to realize its assets and discharge its liabilities in the normal course of business. Nevertheless, after making inquiries and considering the uncertainties described above, Management has a reasonable expectation that the Corporation will have adequate resources to continue in some form for the foreseeable future, but the above circumstances could have a significant impact on operational stability. For these reasons, Management continues to adopt the going concern basis of accounting in preparing the annual financial statements.

(18) Reclassifications

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

COMMONWEALTH UTILITIES CORPORATION

(A Component Unit of the CNMI Government)

Supplementary Information
Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis
For the Year Ended September 30, 2015

	Power	Water	Sewer	Administrative and General	Internal Revenues and Expenses	Total
Operating revenues:						
Governmental	\$ 6,905,282	\$ 3,741,449	\$ 1,977,713	\$ -	\$ (1,972,147)	\$ 10,652,297
Commercial	12,495,452	2,660,027	1,594,999	-	-	16,750,478
Residential	6,013,182	4,896,298	594,467	-	-	11,503,947
Subtotal	25,413,916	11,297,774	4,167,179	-	(1,972,147)	38,906,722
LEAC - Fuel charge	39,854,944	-	-	-	(3,017,714)	36,837,230
LEAC - Non fuel	232,158	-	-	-	-	232,158
Other	493,603	54,935	60,461	-	-	608,999
	65,994,621	11,352,709	4,227,640	-	(4,989,861)	76,585,109
Bad debts	(4,969,600)	(1,423,592)	(734,915)	-	-	(7,128,107)
Net operating revenues:	61,025,021	9,929,117	3,492,725	-	(4,989,861)	69,457,002
Operating expenses						
Production fuel	41,046,828	-	-	-	-	41,046,828
General and administrative	10,573,186	2,914,171	1,045,939	6,220,655	-	20,753,951
Maintenance	3,849,407	939,500	921,989	113,983	-	5,824,879
Depreciation	2,492,685	2,568,757	2,072,688	457,101	-	7,591,231
Supplies	451,733	483,353	86,352	207,708	-	1,229,146
Other production	996,686	3,759,028	935,741	224,576	(4,989,861)	926,170
Other	-	-	-	647,129	-	647,129
Total operating expenses	59,410,525	10,664,809	5,062,709	7,871,152	(4,989,861)	78,019,334
Earnings (loss) from operations before allocation of common cos	1,614,496	(735,692)	(1,569,984)	(7,871,152)	-	(8,562,332)
Allocation of common cost:	(5,010,127)	(1,825,590)	(1,035,435)	7,871,152	-	-
Earnings (loss) from operations	\$ (3,395,631)	\$ (2,561,282)	\$ (2,605,419)	\$ -	\$ -	\$ (8,562,332)

See accompanying notes to financial statements.

COMMONWEALTH UTILITIES CORPORATION

(A Component Unit of the CNMI Government)

Supplementary Information
Schedule of Revenues, Expenses and Changes in Net Position on a Divisional Basis
For the Year Ended September 30, 2015

	Power	Water	Sewer	Administrative and General	Internal Revenues and Expenses	Total
Earnings (loss) from operations	\$ (3,395,631)	\$ (2,561,282)	\$ (2,605,419)	\$ -	\$ -	\$ (8,562,332)
Non-operating revenues (expenses)						
Interest income	302,195	101,780	56,719	-	-	460,694
Miscellaneous income	154,105	20,950	47,285	-	-	222,340
Amortization of marketing assistance	1,100,000	-	-	-	-	1,100,000
Regulatory assessments	(289,250)	(22,500)	(22,500)	-	-	(334,250)
Settlement expenses	(21,170)	(4,681)	(581)	-	-	(26,432)
Contribution to the CNMI government	(209,177)	(137,469)	(55,643)	-	-	(402,289)
Stipulated order penalties	(2,518,333)	(2,163,334)	(318,333)	-	-	(5,000,000)
Interest expense	(1,156,640)	-	-	-	-	(1,156,640)
Total non-operating revenues (expenses), net	<u>(2,638,270)</u>	<u>(2,205,254)</u>	<u>(293,053)</u>	-	-	<u>(5,136,577)</u>
Loss before change in recovery of fuel cost	(6,033,901)	(4,766,536)	(2,898,472)	-	-	(13,698,909)
Change in recovery of fuel costs	<u>1,191,883</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,191,883</u>
Net loss before capital contributions and federal grants	(4,842,018)	(4,766,536)	(2,898,472)	-	-	(12,507,026)
Capital contributions and federal grants	<u>2,222,597</u>	<u>2,898,665</u>	<u>2,014,881</u>	<u>-</u>	<u>-</u>	<u>7,136,143</u>
Change in net position	<u>\$ (2,619,421)</u>	<u>\$ (1,867,871)</u>	<u>\$ (883,591)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (5,370,883)</u>

See accompanying notes to financial statements.

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

**INDEPENDENT AUDITORS' REPORTS
ON INTERNAL CONTROL
AND ON COMPLIANCE**

**Years Ended
September 30, 2015 and 2014**

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

To the Board of Directors
Commonwealth Utilities Corporation

We were engaged to audit, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Commonwealth Utilities Corporation (CUC), as of and for the year ended September 30, 2015, and the related notes to the financial statements, which collectively comprise CUC's basic financial statements and have issued our report thereon dated September 26, 2016. Our report disclaims an opinion on such financial statements because of CUC's inability to perform a physical count of all its fixed assets and inventories at September 30, 2015 and to quantify and record on its financial statements the impact of Typhoon Soudelor damage.

Internal Control Over Financial Reporting

In connection with our engagement to audit the financial statements of CUC, we considered CUC's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of CUC's internal control. Accordingly, we do not express an opinion on the effectiveness of CUC's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in Finding No. 2015-006 in the accompanying schedule of findings and questioned costs to be a material weakness.

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. We consider the deficiencies described in Finding Nos. 2015-001 and 2015-003 in the accompanying schedule of findings and questioned costs to be significant deficiencies.

Compliance and Other Matters

In connection with our engagement to audit the financial statements of CUC, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as Finding Nos. 2015-004 to 2015-007. Additionally, if the scope of our work had been sufficient to enable us to express opinions on the basic financial statements, other instances of noncompliance or other matters may have been identified and reported herein.

CUC's Response to Findings

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

Purpose of this Report

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



Saipan, Commonwealth of the Northern Mariana Islands
September 26, 2016



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

To the Board of Directors
Commonwealth Utilities Corporation

Report on Compliance for Each Major Federal Program

We have audited Commonwealth Utilities Corporation (CUC's) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of CUC's major federal programs for the year ended September 30, 2015. CUC's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

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

Auditors' Responsibility

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

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

Basis for Qualified Opinion

As described in Finding No. 2015-008 in the accompanying Schedule of Findings and Questioned Costs, CUC did not comply with requirements regarding equipment and real property that is applicable to its Economic, Social, and Political Development of the Territories Grant (CFDA 15.875), Environmental Protection Consolidated Grants Support (CFDA 66.600) and the FEMA-DR-4235-MP. Compliance with such requirements is necessary, in our opinion, for CUC to comply with the requirements applicable to that program.

Qualified Opinion

In our opinion, except for the noncompliance described in the Basis for Qualified Opinion paragraph, CUC complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2015.

Other Matters

The results of our auditing procedures disclosed one instance of noncompliance, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying Schedule of Findings and Questioned Costs as Finding No. 2015-008. Our opinion on CUC's major federal programs is not modified with respect to this matter.

CUC's response to the noncompliance finding identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. CUC's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be a material weakness and a significant deficiency.

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 deficiency in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as Finding No. 2015-008 to be a material weakness.

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.

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



Saipan, Commonwealth of the Northern Mariana Islands
September 26, 2016

**Commonwealth Utilities Corporation
Schedule of Expenditures of Federal Awards
Year Ended September 30, 2015**

Federal Grantor/ Pass Through Grantor/ Program Title	Federal CFDA Number/ Grantor ID No./ Pass Through Grantor's Number	Program or Award Amount	Receivable from Grantor (Deferred) Revenue) at September 30, 2014	Cash Receipts	Expenditures	Receivable from Grantor (Deferred) Revenue) at September 30, 2015
<u>U.S. Environmental Protection Agency</u>						
Direct Program:						
Consolidated Environmental Program		\$ 39,412,704	\$ 496,274	\$ 4,939,281	\$ 4,816,457	\$ 373,450
Consolidated Environmental Program	M-00T33715	8,219,700	-	43,243	43,243	-
Subtotal		<u>47,632,404</u>	<u>496,274</u>	<u>4,982,524</u>	<u>4,859,700</u>	<u>373,450</u>
<u>U.S. Department of the Interior</u>						
<u>Direct Program</u>						
USGS	OMIP CUC 2006 -1	12,500	(12,500)	-	-	(12,500)
Bureau of Reclamation:						
Water Loss Reduction and Energy Savings	R13AP80017	294,967	-	35,329	35,329	-
Passed through the Government of the CNMI:						
<u>Federal Portion</u>						
Geothermal Energy	CNMI-CIP-2011-3	1,260,000	-	121,578	121,578	-
Geothermal Energy	CNMI-EIC-2011-1	500,000	-	-	-	-
Sadog Tasi Wastewater Treatment Plant Rehabilitation	CNMI-CIP-2010-2	1,000,000	-	25,946	25,946	-
Stipulated Order #2	CNMI-CIP-2010-3	4,050,000	(9,880)	386,033	596,272	200,359
New Fuel Tank at PP1 (Tank 102)	CNMI-CIP-2013-1	350,000	-	14,191	37,232	23,041
Tank System Integrity and Cleanou Plan-(Rota Tanks, SpnTank103)	CNMI-CIP-2012-8	232,000	-	-	-	-
Replacement of 8" Petroleum Pipeline	CNMI-CIP-2011-2	2,154,000	160,310	160,310	56,010	56,010
Add'l Funding for Replacement of 8" Petroleum Pipeline	CNMI-CIP-2012-7	800,000	-	-	-	-
Add'l Funding for Replacement of 8" Petroleum Pipeline	CNMI-CIP-2013-3	1,025,000	-	464,111	707,000	242,889
Add'l Funding for Replacement of 8" Petroleum Pipeline	CNMI-CIP-2013-6	725,000	185,189	185,189	-	-
Add'l Funding for Replacement of 8" Petroleum Pipeline	CNMI-CIP-2014-2	733,253	-	327,750	365,581	37,831
Integrated Resource Plan	CNMI-EIC-2013-1	500,000	-	238,100	348,800	110,700
Prepaid Meters	CNMI-EIC-2013-2	622,000	-	-	-	-
Economic Development Administration:						
Design of Lower Base Sewer System - EDA Share	EDA -07-79-07008	200,000	-	-	90,144	90,144
Design of Lower Base Sewer System - CNMI/OIA Share		-	-	-	30,048	30,048
Subtotal Federal Portion		<u>14,458,720</u>	<u>323,119</u>	<u>1,958,537</u>	<u>2,413,940</u>	<u>778,522</u>
Federal Emergency Management Administration						
Typhoon Soudelor Claims	FEMA-DR-4235-MP	-	-	-	1,290,595	1,290,595
		<u>\$ 62,091,124</u>	<u>\$ 819,393</u>	<u>\$ 6,941,061</u>	<u>\$ 8,564,235</u>	<u>\$ 2,442,567</u>

See accompanying notes to Schedule of Expenditures of Federal Awards

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

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2015

(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 2015, CUC had no indirect cost agreement with grantor agencies.

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

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2015

(2) Summary of Significant Accounting Policies

C. Matching Requirements

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

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

In February 2009, the Federal Government enacted the American Recovery and Reinvestment Act of 2009 (ARRA). During the year ended September 30, 2015 CUC's grant award notification and expenditures did not include any ARRA funded programs.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2015

SECTION I – SUMMARY OF AUDITORS RESULTS

Financial Statements

Type of auditors' report issued: Disclaimer

Internal control over financial reporting:

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

Noncompliance material to financial statements noted? yes no

Federal Awards

Internal control over major programs:

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

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

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

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

Schedule of Findings and Questioned Costs
 Year Ended September 30, 2015

Identification of Major Programs:

<u>CFDA No.</u>	<u>Description</u>	
15.875	Economic, Social, and Political Development of the Territories	\$ 2,258,419
66.600	Environmental Protection Consolidated Grants Support	4,859,700
	FEMA-DR-4235-MP	<u>1,290,595</u>
	Total major program expenditures	\$ <u>8,408,714</u>
	Total federal expenditures	\$ <u>8,564,235</u>
	Percentage of federal expenditures tested as major programs	<u>98%</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)

Schedule of Findings and Questioned Costs
Year Ended September 30, 2015

INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No. 2015-001 Purchases/Disbursements

Criteria:

Pursuant to § 50-50-210 of the CUC Procurement Regulations, purchase orders may be utilized for small purchases below \$25,000. Disbursements should be properly supported with an approved purchase order as evidence that the purchase of goods or performance of services is authorized.

Condition:

- a. For 5 or 6% of the 90 purchase order files tested, the vendor invoices show dates that were prior to the date of the purchase order as follows:

No.	Purchase Order Number	Purchase Order Date	Invoice Number	Invoice Date	Invoice Amount	Purchase Order Amount
1	15-0846	4/20/2015	PGS 15-230	3/30/2015	\$ 450.00	\$ 2,949.00
2	15-1227	7/23/2015	AA42679	6/15/2015	\$ 3,752.16	\$ 3,752.16
3	15-0452	12/18/2014	P15-0452-01	12/17/2014	\$ 325.00	\$ 9,500.00
4	15-0540	1/26/2015	2015-0113	1/23/2015	\$ 358.00	\$ 10,000.00
5	15-1501	9/15/2015	SPN1331	8/20/2015	\$ 36.00	\$ 345.49
			31708385	8/20/2015	\$ 20.00	
			E6WE1X	9/10/2015	\$ 289.49	

The following purchase order files were not provided during the audit.

1. P.O. No 15-1039
2. P.O. No.15-1528

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2015

INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No. 2015-001 Purchases/Disbursements, Continued

Cause:

There is a lack of internal control monitoring to ensure compliance with established procurement policies and procedures. CUC failed to ensure the completeness of relevant supporting documentation prior to processing its purchase orders and to ensure that such completed purchase orders are systematically filed for retrieval.

Effect:

The potential exists for unauthorized/invalid expenditures and waste, fraud and abuse that might not be prevented or detected in a timely manner.

Recommendation:

CUC should establish monitoring procedures to ensure that all small purchases below \$25,000 are approved and documented pursuant to § 50-50-210 of the CUC Procurement Regulations. Payments should only be made on vendor invoices with reference to an approved purchase order, contract, or other justification as allowed by the procurement policies of CUC. Administrative procedures should be implemented to ensure all procurements are properly filed for easy retrieval and independent inspection.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2015

INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No. 2015-002 Reconciliation of Customer Accounts Subsidiary Ledgers to the General Ledger Accounts

Criteria:

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

Condition:

For every customer account in the Billings and Collections software, general ledger accounts were assigned to each transaction such as billing, customer adjustments and collection. The software provider designed an interface to upload the transactions to the general ledger. This procedure aims to seamlessly record the transactions from the subsidiary ledgers (which are maintained in the Billings and Collections software) to the general ledger accounts in the Financial Accounting Software.

Having this computerized internal control in place, CUC did not conduct monthly reconciliations of the subsidiary ledgers to the general ledger balances. Account reconciliation was only prepared at year-end and such reconciliation disclosed several discrepancies.

Cause:

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

Effect:

Although the accounts receivable balances as of September 30, 2015 were reconciled, interim financial reports may have been misstated for the effects of the unreconciled balances. Financial decisions involving receivables, such as provision for uncollectible accounts, could be based on inaccurate information and may have negative consequences. Furthermore, fraud, theft and errors could exist and not be detected.

Prior Year Status:

A similar condition was reported in the prior year audit as Finding 2013-02 and 2014-003.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2015

INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No. 2015-002 Reconciliation of Customer Accounts Subsidiary Ledgers to the General Ledger Accounts, Continued

Recommendation:

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

Finding No. 2015-003 Negative Balances in the Aging of Accounts Receivable

Criteria:

Collections received should be applied to specific billings.

Condition:

The aged listing of accounts receivable as of September 30, 2015 included negative balances totaling more than \$1 million.

Cause:

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

Effect:

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

Prior Year Status:

A similar condition was reported in the prior year audits as Finding 2014-004, 2013-06, 2012-02, 2011-03, 2010-06 and 2009-14.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2015

INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No. 2015-003 Negative Balances in the Aging of Accounts Receivable, Continued

Recommendation:

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

Finding No. 2015-004 Travel

Criteria:

Pursuant to CUC's Travel policy:

- a. All approved travel requests must be submitted to Travel Section at least three days prior to the planned departure for processing of corresponding Travel Authorization form. Only approved travel requests for emergency cases shall be processed immediately.
- b. Per diem rate is calculated based on federal guidelines, as per GSA and DoD websites. Per diem entitlement starts at the time the traveler departs from his official station (municipal limits of the island he/she is stationed) and ends on the day of his return to his official station.
- c. The traveler is responsible to prepare and submit a travel voucher within 15 working days after the completion of travel.
- d. Trip reports should be as detailed as possible to provide information as to the actual activities covered by the trip.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2015

INTERNAL CONTROL OVER FINANCIAL REPORTING

Finding No. 2015-004 Travel, Continued

Condition:

- a. 20 or 27% of 75 travel authorizations selected for testing were submitted less than three days prior to the planned departure.
- b. 13 or 17% of travel authorizations selected for testing were not recalculated properly upon liquidation.
- c. For 6 or 8% of 75 travel authorizations selected, the Travel Voucher (TV) was submitted late; 27 or 36% were not dated; 20 or 27% were missing boarding passes and without justification; and 2 or 3% were not provided during the audit.
- d. For 63 or 84% of 75 travel authorizations selected, the trip reports were not submitted together with the TV.

Cause:

The turnover in and shortage of accounting personnel did not allow for CUC's Accounting Department to make timely follow up and properly monitor implementation of travel policies and procedures, particularly with liquidation.

Effect:

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

Recommendation:

CUC should ensure that policies and procedures are complied with.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2015

COMPLIANCE AND OTHER MATTERS

Finding 2015-005 Payroll Processing

Criteria:

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

Condition:

The rate used in calculating the following payroll was not supported by an approved Notice of Personnel Action (NOPA):

Employee Number	Pay period	Payment Date	Rate Used	NOPA Rate	Effectivity	Remarks
10013	3/22/15-4/4/15	4/17/2015	10.01	8.308	9/5/2015	
10123	3/22/15-4/4/15	4/17/2015	36.00	36.489	2/8/2015	
10202	3/22/15-4/4/15	4/17/2015	10.01	8.308	1/28/2013	
10266	3/22/15-4/4/15	4/17/2015	10.01	7.693	11/4/2012	
10381	3/22/15-4/4/15	4/17/2015	10.01	8.308	12/15/2011	
149	3/22/15-4/4/15	4/17/2015	17.21	27.134	2/12/2016	Previous NOPA not provided
283	3/22/15-4/4/15	4/17/2015	32.79	58.075	2/5/2016	Previous NOPA not provided
4701	3/22/15-4/4/15	4/17/2015	26.44	28.846	1/25/2016	Previous NOPA not provided
10167	8/23/15-9/5/15	9/18/2015	11.58	10.178	3/26/2012	
10201	8/23/15-9/5/15	9/18/2015	10.09	10.096	7/15/2015	
10392	8/23/15-9/5/15	9/18/2015	10.01	8.308	2/1/2012	
10425	8/23/15-9/5/15	9/18/2015	10.01	8.309	10/16/2012	
10462	8/23/15-9/5/15	9/18/2015	8.24	8.049	1/26/2015	
32582	8/23/15-9/5/15	9/18/2015	9.61	7.692	9/15/2014	

Cause:

Not all the NOPA effective for the fiscal year ended September 30, 2015 were provided to the auditor.

Effect:

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

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2015

COMPLIANCE AND OTHER MATTERS

Finding 2015-005 Payroll Processing

Prior Year Status:

A similar condition was reported in the prior year audit as Finding 2013-10 and 2014-009.

Recommendation:

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

Finding 2015-006 Fixed assets

Criteria:

Capital assets should be physically accounted for at least bi-annually. Adequate presentation and control of capital assets are essential in preparing accurate financial statements. Unless all capital assets are accounted for, the depreciation in determining utility rates could be misstated.

Condition:

CUC has not conducted a physical count of capital assets at September 30, 2015. Since a physical count has not been conducted, the asset listing may still include assets that have been retired, broken, idle, destroyed or stolen.

Cause:

On August 2, 2015, Saipan was struck by typhoon Soudelor. Saipan had no power for two months. CUC has provided extraordinary expenses in manpower and resources to work around the clock to restore utility services. This has resulted in CUC's inability to count all of its physical assets and inventories and record the typhoon damage on its financial statements.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2015

COMPLIANCE AND OTHER MATTERS

Finding 2015-006 Fixed assets

Effect:

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 errors or misstatements may exist 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. With the financial constraints, CUC may conduct cycle counts per division/location to minimize overtime.

CUC should also consider evaluating 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
- 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.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2015

Finding No. 2015-007 Procurement

Criteria:

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

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

Condition:

The Executive Director issued a memorandum authorizing the procurement of materials and parts utilizing a request for quotation instead of competitive sealed bidding. The following contracts were procured using a request for quotation:

Contract Number	Amount
CUC-PG-15-C002	\$ 110,000

Effect:

CUC did not comply with its Procurement Regulations.

Cause:

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

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2015

COMPLIANCE AND OTHER MATTERS

Finding No. 2015-007 Procurement, Continued

Recommendation:

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

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

Prior year status:

Similar findings were noted in prior year audit reported as Finding 2013-08 and 2014-07.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2015

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

**Federal Agencies: U.S. Environmental Protection Agency,
U.S. Department of the Interior
Federal Emergency Management Administration**

Area: Equipment and Real Property Management

Finding No. 2015-008

<u>CFDA No.</u>	<u>Findings/Noncompliance</u>	<u>Questioned Costs</u>
All Major Programs	<p><u>Criteria:</u> 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.</p> <p><u>Condition:</u> CUC has not conducted a physical count of capital assets at September 30, 2015 and has no basis to determine if the carrying value of its capital assets is accurate. Since a physical count has not been conducted, the asset listing may include assets that have been retired, broken, idled, destroyed or stolen.</p> <p><u>Cause:</u> On August 2, 2015, Saipan was struck by typhoon Soudelor. Saipan had no power for two months. CUC has provided extraordinary expenses in manpower and resources to work around the clock to restore utility services. This has resulted in CUC's inability to count all of its physical assets and inventories and record the typhoon damage on its financial statements.</p> <p><u>Effect:</u> CUC is in non-compliance with grant equipment and real property internal control requirements.</p>	\$ -

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2015

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Finding No. 2015-008, Continued

Recommendation:

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

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2015

PRIOR YEAR FINDINGS AND QUESTIONED COSTS

<u>Finding</u>	<u>Subject Matter</u>	<u>Current Year Status</u>
2013-01	Bank Reconciliations	Corrective action taken.
2013-02	Reconciliation of Customer Accounts Receivable Subsidiary Ledger to the General Ledger Account	Unresolved. Refer to Finding 2014-003, 2015-002
2013-06	Negative Accounts Receivable	Unresolved. Refer to Finding 2014-004, 2015-003
2013-08	Procurement	Unresolved. Refer to Finding 2014-007, 2015-007
2013-09	Memorandum of Agreement (MOA) with CDA	Corrective action taken.
2013-10	Payroll processing	Unresolved. Refer to Finding 2014-009, 2015-005
2013-11	Interest on Security Deposit Refunds	Corrective action taken.
2014-001	Bank Reconciliation	Corrective action taken.
2014-002	Purchases/Disbursements	Unresolved. Refer to Finding 2015-001
2014-003	Reconciliation of Customer Accounts Receivable Subsidiary Ledger to the General Ledger Account	Unresolved. Refer to Finding 2015-002
2014-004	Negative Accounts Receivable	Unresolved. Refer to Finding 2015-003
2014-005	Provision for Uncollectible Accounts	Corrective action taken.
2014-006	Recalculation of Security Deposits	Corrective action taken.
2014-007	Procurement	Unresolved. Refer to Finding 2015-007

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2015

PRIOR YEAR FINDINGS AND QUESTIONED COSTS

<u>Finding</u>	<u>Subject Matter</u>	<u>Current Year Status</u>
2014-008	Memorandum of Agreement (MOA) with CDA	Corrective action taken.
2014-009	Payroll processing	Unresolved. Refer to Finding 2015-005
2014-010	Interest on Security Deposit Refunds	Corrective action taken.

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

Schedule of Findings and Questioned Costs
Year Ended September 30, 2015

SECTION IV – PRIOR YEAR FINDINGS AND QUESTIONED COSTS

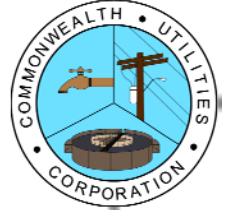
Questioned Costs

The prior year Single Audit report on compliance with the laws and regulations noted the following costs and comments that were unresolved at September 30, 2015:

Questioned costs as previously reported	\$ -
Questioned costs for fiscal year 2015 Single Audit	<u>-</u>
Unresolved questioned costs at September 30, 2015	<u>\$ -</u>



Commonwealth Utilities Corporation



November 30, 2016

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

Subject: Schedule of Findings and Questioned Costs for the year ended September 30, 2015

Dear Mr. Burger:

Please see below CUC's responses to the findings regarding CUC FY 2015 Audit:

Finding 2015-001 Purchases/Disbursements

Condition:

For 5 or 6% of the 90 purchase order files tested, the vendor invoices show dates that were prior to the date of the purchase order.

Recommendation:

CUC should establish monitoring procedures to ensure that all small purchases below \$25,000 are approved and documented pursuant to § 50-50-210 of the CUC Procurement Regulations. Payments should only be made on vendor invoices with reference to an approved purchase order, contract, or other justification as allowed by the procurement policies of CUC. Administrative procedures should be implemented to ensure all procurements are properly filed for easy retrieval and independent inspection.

CUC Response:

CUC agrees with the finding.

Management's Plan of Corrective Action:

CUC ensures that purchase orders are properly executed and sent to vendors before the purchase transactions are completed. Furthermore, Accounts Payable staff will notify vendors that CUC will not pay goods/ services procured by CUC employees without the proper authorization and a valid purchase order.

Finding No. 2015-002 Reconciliation of Customer Accounts Subsidiary Ledgers to the General Ledger Accounts

Condition:

For every customer account in the Billings and Collections software, general ledger accounts were assigned to each transaction such as billing, customer adjustments and collection. The software provider designed an interface to upload the transactions to the general ledger. This procedure aims to seamlessly record the transactions from the subsidiary ledgers (which are maintained in the Billings and Collections software) to the general ledger accounts in the Financial Accounting Software.

Having this computerized internal control in place; CUC did not conduct monthly reconciliations of the subsidiary ledgers to the general ledger balances. Account reconciliation was only prepared at year-end and such reconciliation disclosed several discrepancies.

Recommendation:

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

CUC Response:

CUC agrees with the finding.

Management's Plan of Corrective Action:

CUC Accounting staff conducts monthly review of customer account balances and transactions posted in the general ledger. Financial Accounts Management Section review customer account balances. Adjustments are posted as soon as errors are discovered. Upon completion of all backlogs, CUC staff will be able to fully resolve this finding.

Finding No. 2015-003 Negative Balances in the Aging of Accounts Receivable

Condition:

The aged listing of accounts receivable as of September 30, 2015 included negative balances totaling more than \$1 million.

Recommendation:

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

CUC Response:

CUC agrees with the finding.

Management's Plan of Corrective Action:

Billing and Financial Accounts Management Section continue to analyze accounts and issue refunds to customers. Target completion date is March 31, 2016.

Finding 2015-004 Travel

Condition:

- a. 20 or 27% of 75 travel authorizations selected for testing were submitted less than three days prior to the planned departure.
- b. 13 or 17% of travel authorizations selected for testing were not recalculated properly upon liquidation.

- c. For 6 or 8% of 75 travel authorizations selected, the Travel Voucher (TV) was submitted late; 27 or 36% were not dated; 20 or 27% were missing boarding passes and without justification; and 2 or 3% were not provided during the audit.
- d. For 63 or 84% of 75 travel authorizations selected, the trip reports were not submitted together with the TV.

Recommendation:

CUC should ensure that policies and procedures are complied with.

CUC Response:

CUC agrees with the finding.

Management's Plan of Corrective Action:

CUC will review and update its existing travel policies and procedures. An Administration Office staff will be trained and assigned to monitor employee submission of completed travel documents and Travel Vouchers for liquidation.

Finding 2015-005 Payroll Processing

Condition:

The rate used in calculating the following payroll was not supported by an approved Notice of Personnel Action (NOPA).

Recommendation:

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

CUC Response:

CUC agrees with the finding.

Management's Plan of Corrective Action:

CUC Human Resources Department will ensure that Notice of Personnel Actions and other pertinent documents are kept current in the employee file and in the software payroll system. Payroll Office will keep abreast all CUC employees on any laws and mandates affecting payroll.

Finding 2015-006 Fixed assets

Condition:

CUC has not conducted a physical count of capital assets at September 30, 2015. Since a physical count has not been conducted, the asset listing may still include assets that have been retired, broken, idle, destroyed or stolen.

Recommendation:

CUC should perform a physical inventory of all fixed assets on-hand, agree the count with its records and make necessary adjustments. With the financial constraints, CUC may conduct cycle counts per division/location to minimize overtime.

CUC should also consider evaluating 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
- 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.

CUC Response:

CUC agrees with the finding.

Management's Plan of Corrective Action:

CUC will implement a cycle physical inventory counting procedure of its fixed assets and reconcile with its financial records for inclusion in the asset status report.

Finding 2015-007 Procurement

Condition:

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

Recommendation:

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

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

CUC Response:

CUC agrees with the finding.

Management's Plan of Corrective Action:

CUC has implemented directives regarding procurement of materials and parts utilizing request for quotation instead of competitive sealed bidding but have not updated its written policies. CUC is in the process of procuring a professional service to assist in updating its policies and procedures.

Finding 2015-008

Condition:

CUC has not conducted a physical count of capital assets at September 30, 2015 and has no basis to determine if the carrying value of its capital assets is accurate. Since a physical count has not been conducted, the asset listing may include assets that have been retired, broken, idled, destroyed or stolen.

Recommendation:

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

CUC Response:

CUC agrees with the finding.

Management's Plan of Corrective Action:

CUC will implement a cycle physical inventory counting procedure of its fixed assets and reconcile with its financial records for inclusion in the asset status report.

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

Sincerely,


ANTONIO B. CASTRO
Chief Financial Officer