



COMMONWEALTH DEVELOPMENT AUTHORITY

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

YEAR ENDED SEPTEMBER 30, 2003

COMMONWEALTH DEVELOPMENT AUTHORITY

FINANCIAL STATEMENTS  
AND  
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2003 AND 2002



## INDEPENDENT AUDITORS' REPORT

Board of Directors  
Commonwealth Development Authority:

We have audited the accompanying combined statements of net assets of the Commonwealth Development Authority (CDA), a component unit of the Commonwealth of the Northern Mariana Islands, as of September 30, 2003 and 2002, and the related combined statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of CDA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of CDA as of September 30, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 11 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Combining Statement of Net Assets, Combining Statement of Revenues, Expenses and Changes in Net Assets and Combining Statement of Cash Flows as of and for the year ended September 30, 2003 (pages 32 through 34) are presented for the purpose of additional analysis and are not a required part of the basic financial statements of CDA. These combining statements are also the responsibility of the management of CDA. Such additional information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 21, 2003, on our consideration of CDA's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

*Deloitte & Touche*

November 21, 2003



# COMMONWEALTH DEVELOPMENT AUTHORITY

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## *Commonwealth Development Authority*

### **Management's Discussion and Analysis For Fiscal Year Ending September 30, 2003**

Our discussion and analysis of the Commonwealth Development Authority's financial performance provides an overview of the Authority's financial activity for the fiscal year ended September 30, 2003. It should be read in conjunction with the audited financial statements.

This discussion will enable the reader to understand the Authority's structure and programs. Additionally it will provide financial information for CDA as a whole and its major divisions.

**The Commonwealth Development Authority (CDA)**, formerly known as the Economic Development Loan Fund, was established as an autonomous public agency in 1985 through Public Law 4-49. The Authority's functions are carried out through the Development Banking Division (DBD) and the Development Corporation Division (DCD). Additionally in 1994 the Northern Marianas Housing Corporation (NMHC) was consolidated into CDA. CDA has a Board of Directors composed of seven individuals that are appointed to staggered four-year terms by the Governor of the Commonwealth.

The Banking Division (DBD) generally engages in government and public sector activities while the Corporation Division (DCD) engages in private sector activities. Additionally, on December 1, 2000, CDA was given administrative authority for the Qualifying Certificate Program (QC). The QC is a tax incentive program to encourage new investment within the CNMI. The Housing Division (NMHC) provides low cost housing and rentals and housing loans to qualifying residents of the CNMI. CDA's overall purpose is to stimulate economic development in the CNMI. CDA maintains three offices, its main office in Saipan and branch offices in Tinian and Rota.

## Financial Highlights

As shown on the Combined Statements of Revenue, Expenses and Changes in Net Assets and the Related Combined Statements of Net Assets, CDA as a whole experienced the following results of operations.

- Operating revenue for the year decreased by \$1,271,344, a 12% decrease primarily because of the decrease by 64% in the activities for the CDBG Program and 100% decrease of the HPG Program Grant and net increase in the fair value of investments respectively.
- Operating expenses, omitting the provision of doubtful accounts, decreased by \$711,868 or 10%. This decrease is related primarily to the decreased activities of the CDBG Grant Program (\$716,371) and other Grant Programs decreased by (\$403,656). Professional fees decreased by 30% with Repair and Maintenance decreased by 16%.
- The Provision for Doubtful Accounts decreased dramatically by (\$10,340,778). Since the Provision for Doubtful Accounts was made current with its ratio from last year's loan portfolio, this year's allocation was strictly based on the existing loan portfolio and the continual charge-off loans.
- The total assets of CDA decreased by (\$6,207,177) to \$89,615,304, primarily due to the effects of the transfer of funds to ongoing construction in progress (CIP) programs because of the interim financing by CDA for the Prison Facility while the \$40 Million Bond was in progress of its floatation.
- Transfers (payment) of CIP related programs totaled \$4,795,111 an increase of \$2,960,325 or 161%. These payments continue to erode the assets of the Development Banking Division. The Legislature has the authority to appropriate DBD's funds and any related earnings for CIP projects. In reality DBD is a little more than an administrative custodian of the CIP local matching funds. With the enactment of P.L.12-64, P.L. 13-13, P.L. 13-14, P.L. 13-27 and P.L. 13-56, the construction for these projects will continue to escalate, while DBD's balances will continue to decline.
- With the enactment of P.L. 11-72, CDA was authorized to borrow up to \$2,000,000 from Marianas Public Land Trust (MPLT) for the beautification and development of the American Memorial Park. Therefore, CDA passed a Resolution #CDA-99-01 on April 22, 1999. On May 28, 2003, CDA received the Loan Proceed from MPLT and deposited it in the Savings CIP Project Account. The fund was expended as of the end of this fiscal year for the project.

## **Division Analysis of the Development Corporation Division (DCD)**

DCD's mission is to initiate, stimulate, and facilitate development of the economy of the Commonwealth for the economic and social advancement of the people of the Commonwealth by making loans, loan guarantees and providing financial, technical, and advisory assistance in its discretion to the private sector in the Northern Marianas.

DCD's primary activity relates to the servicing of its direct loan portfolio. As of year-end, CDA's portfolio consisted of 223 loans with an outstanding balance of \$34,828,639, a decrease of \$1,598,867 or 4%. The additional 9 loans were mainly from the activities of the Small Business Loan Fund Division. The vast majority of the outstanding balance relates to loans that were initiated during the late 1980's and the early 1990's.

Unfortunately, with the original Japanese crisis in the early 1990's many of the projects financed by these loans have greatly diminished in value both as commercial enterprises and in the carrying value that DCD places on them. This was further exacerbated by the Asian currency in the late 1990's, the events of the twin tower terrorist attack in the United States and the war in Iraq. For the current year, the net value of the portfolio, after provision for doubtful accounts totaled \$18,529,681, an increase of \$133,787. As shown on Exhibit A, the provision for doubtful accounts for the current year was \$1,151,240. This figure represents CDA's estimated potential of the loss of value of the loans and accrued interest for the current year. The ultimate collection of the earned interest and the principal value of loans is without doubt DCD's biggest financial concern. The inability of borrowers to repay their commitments has not allowed funds to be accumulated and re-loaned to new borrowers.

CDA has recognized this concern and continued the moratorium during the current year. The Board of Directors continuously emphasized to management that the collection of delinquent loans is its number one priority. The trend of the collection for the last quarter of the current year has gradually increased. This is an indication that CDA is moving in a positive direction with its collection effort.



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## *Commonwealth Development Authority* Management Discussion and Analysis For Fiscal Year Ending September 30, 2003

### Division Analysis of the Northern Marianas Housing Corporation (NMHC)

Exhibit B shows the results of operations for NMHC and compares it to the prior year. NMHC is a multifaceted organization, that offers direct housing loans, housing loan guarantees, rental properties, housing development and where necessary, infrastructure development.

In fiscal year 2003, NMHC all but finalized four units at Tottotville. These units are occupied however, financing has not yet been finalized for the sale. With closure of the Expansion Project, NMHC needs to transfer infrastructure values to CUC and DPW.

U.S. Department of Housing and Urban Development (HUD), through NMHC, assisted the victims of Typhoon Pongsona with an award of fifty vouchers for the island of Rota exclusively and an annual budget of \$520,000. As of September 30, 2003, all fifty vouchers had been occupied.

NMHC's revenues decreased 17% from prior year but expenses were only reduced by 8%. The Vouchers awarded to the victims of Typhoon Pongsona would not be reimbursed to NMHC from HUD until fiscal year 2004.

#### Short-Term Goals: NMHC - 2003

The Mortgage & Credit Division works diligently to close the purchases of the Sugar King II units as well. Many of these loans however, are being serviced at NMHC as our loan purchasing program with the private partners, has come to standstill.

NMHC did not renew the Agreement with BankPacific as the requirements became too stringent. Bank of Hawaii has also changed their requirements and as such, loans that have already been done, can not be transferred. The resulting affect will not avail NMHC with more funds for these Programs.

NMHC now services a total of 357 loans and has reopened the MPLT Loans Program. NMHC has started updates of application, commitments and loan closings for the island of Rota & Tinian. NMHC intends to exhaust \$1.6M still available for the Program. We have performed two judicial foreclosures with three pending.



The Partnership Program with Rural Development (RD) is underway and NMHC has received 9 loan commitments. This is a leveraging program between NMHC and RD so that more loans can be made with budgeted funds.

With the additional 50 Housing Choice Vouchers, received for Rota victims, NMHC now administers 215 units in this Program which at present are at a 99% occupancy. The New Construction, Project-Based Program is at 98% occupancy. As much as NMHC receives its revenues for its operations from the rental of housing units, repairs and maintenance of these units require the majority of the revenues collected. With each passing year and because of the age of these units, costs to maintain the units become greater, however, HUD's Housing Quality Standards (HQS) must be met.

HUD's inspector has made critical issues of our Section 8 units and thus costs to bring up to standards will be great through March 2004. Replacement of appliances and smoke alarms will be the most costly. An anticipated total cost for repairs and maintenance will take us close to \$800,000 through the next fiscal year 2004 of which at least \$150,000 fell into FY2003.

NMHC works to account for the real estate properties which had been originally turned over to us from Public Lands. These assets have never been shown on our financials and should enhance the NMHC's financial standing.

**COMMONWEALTH DEVELOPMENT AUTHORITY**  
**Combined Statement of Net Assets**  
**September 30, 2003**

	<u>2003</u>	<u>2002</u>
Current assets	\$ 12,704,135	\$ 11,378,997
Other assets	13,513,889	17,867,790
Noncurrent assets	<u>63,397,280</u>	<u>66,575,694</u>
<b><i>Total assets</i></b>	<b><u>\$ 89,615,304</u></b>	<b><u>\$ 95,822,481</u></b>
Current liabilities	\$ 2,964,684	\$ 3,436,236
Noncurrent liabilities	<u>22,199,343</u>	<u>23,008,166</u>
<b><i>Total liabilities</i></b>	<b><u>25,164,027</u></b>	<b><u>26,444,402</u></b>
Investment in capital assets	18,067,965	18,943,194
Restricted	<u>46,383,312</u>	<u>50,434,885</u>
<b><i>Total net assets</i></b>	<b><u>64,451,277</u></b>	<b><u>69,378,079</u></b>
<b><i>Total liabilities and net assets</i></b>	<b><u>\$ 89,615,304</u></b>	<b><u>\$ 95,822,481</u></b>

Commonwealth Development Authority  
Development Banking Division  
Condense, Comparative Statement of Income and Expense  
For the Fiscal Years Ending September 30, 1998, 1999, 2000, 2001, 2002 and 2003

	1998	%	1999	%	2000	%	2001	%	2002	%	2003	%
<b>Operating Revenue:</b>												
Interest on loans	\$ 1,363,608	55%	\$ 652,472	44%	\$ 339,038	22%	\$ 280,869	27%	\$ 262,909	49%	\$ 240,955	59%
Interest on investment	1,132,127	45%	830,221	56%	1,219,235	78%	744,073	73%	275,731	51%	164,870	41%
Total	\$ 2,495,735	100%	\$ 1,482,693	100%	\$ 1,558,273	100%	\$ 1,024,942	100%	\$ 538,640	100%	\$ 405,825	100%
<b>Operating Expenses:</b>												
Salaries & wages	\$ 85,139	48%	\$ -	0%	\$ -	0%	\$ -	0%	\$ -	0%	\$ -	0%
Provision for bad-debt	-	0%	-	0%	-	0%	-	0%	4,590,350	95%	-	0%
Depreciation	-	0%	-	0%	-	0%	-	0%	-	0%	-	0%
Employee benefits	21,273	12%	-	0%	-	0%	-	0%	-	0%	-	0%
Repairs & maintenance	-	0%	-	0%	-	0%	-	0%	-	0%	-	0%
Professional fees	26,962	15%	-	0%	-	0%	19,764	9%	-	0%	-	0%
Rents	27,001	15%	-	0%	-	0%	-	0%	-	0%	-	0%
Travel	-	0%	-	0%	-	0%	-	0%	-	0%	-	0%
Other Operating Expenses	18,377	10%	286,113	100%	321,989	100%	204,988	91%	235,687	5%	214,745	100%
Total	\$ 178,752	100%	\$ 286,113	100%	\$ 321,989	100%	\$ 224,752	100%	\$ 4,826,037	100%	\$ 214,745	100%
Operating Income or (loss)	\$ 2,316,983		\$ 1,196,580		\$ 1,236,284		\$ 800,190		\$ (4,287,397)		\$ 191,080	
<b>Nonoperating revenue and (expenses):</b>												
CIP Transfers	\$ -		\$ -		\$ (1,716,438)		\$ (5,255,033)		\$ (1,834,786)		\$ (4,795,111)	
Forgiveness of Debt	(9,428,932)		-		(974,108)		-		-		-	
Total	\$ (9,428,932)		\$ -		\$ (2,690,546)		\$ (5,255,033)		\$ (1,834,786)		\$ (4,795,111)	
Net Income/ (loss)	\$ (7,111,949)		\$ 1,196,580		\$ (1,454,262)		\$ (4,454,843)		\$ (6,122,183)		\$ (4,604,031)	

**Commonwealth Development Authority  
Development Corporation Division  
Condense, Comparative Statement of Income and Expense**

**Exhibit A**

**For the Fiscal Years Ending September 30, 2002 and 2003**

	<u>2002</u>	<u>%</u>	<u>2003</u>	<u>%</u>	<u>Increase (Decrease) Between Yrs.</u>	<u>%</u>
<b><u>Operating Revenue:</u></b>						
Interest on loans	\$ 3,247,558	88%	\$ 3,299,192	92%	\$ 51,634	2%
Interest on investment	\$ 204,166	6%	\$ 116,837	3%	(87,329)	-43%
Other Income	234,041	6%	185,870	5%	(48,171)	-21%
Total	<u>\$ 3,685,765</u>	<u>100%</u>	<u>\$ 3,601,899</u>	<u>100%</u>	<u>\$ (83,866)</u>	<u>-2%</u>
<b><u>Operating Expenses:</u></b>						
Salaries & wages	\$ 597,551	41%	\$ 583,535	38%	\$ (14,016)	-2%
Depreciation	97,517	7%	97,249	6%	(268)	0%
Employee benefits	187,661	13%	282,163	18%	94,502	50%
Repairs & maintenance		0%		0%		
Professional fees	100,313	7%	127,944	8%	27,631	28%
Rents	136,544	9%	134,521	9%	(2,023)	-1%
Travel	21,744	1%	34,936	2%	13,192	61%
Other Operating Expenses	328,578	22%	295,482	19%	(33,096)	-10%
Total Expenses	<u>\$ 1,469,908</u>	<u>100%</u>	<u>\$ 1,555,830</u>	<u>100%</u>	<u>\$ 85,922</u>	<u>6%</u>
Subtotal-Operating						
Income before Bad-debt	\$ 2,215,857		\$ 2,046,069		\$ (169,788)	-8%
Provision for bad-debt	<u>(7,302,305)</u>		<u>(1,151,240)</u>		<u>6,151,065</u>	<u>-84%</u>
Operating Income or (loss)	\$ (5,086,448)		\$ 894,829		\$ 5,981,277	-118%
<b><u>Nonoperating revenue and (expenses):</u></b>						
Other Income	\$ -		\$ -		\$ -	
Interest expense	<u>(34,051)</u>		<u>(22,953)</u>		<u>11,098</u>	<u>-33%</u>
Total	<u>\$ (34,051)</u>		<u>\$ (22,953)</u>		<u>\$ 11,098</u>	<u>-33%</u>
<b>Net Income/ (loss)</b>	<u><u>\$ (5,120,499)</u></u>		<u><u>\$ 871,876</u></u>		<u><u>\$ 5,992,375</u></u>	<u><u>-117%</u></u>

**Commonwealth Development Authority  
Northern Mariana Housing Corporation  
Condense, Comparative Statement of Income and Expense**

Exhibit B

**For the Fiscal Years Ending September 30, 2002 and 2003**

	<u>2002</u>	<u>%</u>	<u>2003</u>	<u>%</u>	<u>Increase (Decrease) Between Yrs.</u>	<u>%</u>
<b><u>Operating Revenue:</u></b>						
Interest on loans	\$ 1,200,338	19%	\$ 1,356,814	26%	\$ 156,476	13%
Section 8 grant	3,069,314	49%	3,127,675	61%	\$ 58,361	2%
CDBG grant	1,111,367	18%	394,736	8%	\$ (716,631)	-64%
Other grants	527,049	9%	122,179	2%	(404,870)	-77%
Other Income	<u>281,909</u>	<u>5%</u>	<u>133,910</u>	<u>3%</u>	<u>(147,999)</u>	<u>-52%</u>
Total	<u>\$ 6,189,977</u>	<u>100%</u>	<u>\$ 5,135,314</u>	<u>100%</u>	<u>\$ (1,054,663)</u>	<u>-17%</u>
<b><u>Operating Expenses:</u></b>						
Salaries & wages	\$ 553,380	10%	\$ 679,184	14%	\$ 125,804	23%
CDBG grant projects	1,111,107	20%	394,736	8%	\$ (716,371)	-64%
Section 8 program	1,505,609	27%	1,595,239	33%	\$ 89,630	6%
Other Grant programs	526,136	9%	122,480	3%	\$ (403,656)	-77%
Depreciation	474,901	8%	597,669	12%	122,768	26%
Employee benefits	169,440	3%	205,897	4%	36,457	22%
Repairs & maintenance	710,221	13%	594,479	12%	(115,742)	-16%
Professional fees	155,419	3%	50,668	1%	(104,751)	-67%
Rents	9,600	0%	9,600	0%	-	0%
Travel	36,711	1%	45,037	1%	8,326	23%
Other Operating Expenses	<u>373,616</u>	<u>6%</u>	<u>554,303</u>	<u>12%</u>	<u>180,687</u>	<u>48%</u>
Total Expenses	<u>\$ 5,626,140</u>	<u>100%</u>	<u>\$ 4,849,292</u>	<u>100%</u>	<u>\$ (776,848)</u>	<u>-14%</u>
Subtotal-Operating						
Income before Bad-debt	\$ 563,837		\$ 286,022		\$ (277,815)	-49%
Provision for bad-debt	<u>(475,723)</u>		<u>(876,360)</u>		<u>(400,637)</u>	84%
Operating Income or (loss)	\$ 88,114		\$ (590,338)		\$ (678,452)	-770%
<b><u>Nonoperating revenue and (expenses):</u></b>						
Other transfers	\$ -		\$ 70,475		\$ 70,475	
Interest expense	<u>(906,952)</u>		<u>(795,473)</u>		<u>111,479</u>	<u>-12%</u>
Total	<u>\$ (906,952)</u>		<u>\$ (724,998)</u>		<u>\$ 181,954</u>	<u>-20%</u>
<b>Net Income/ (loss)</b>	<u><b>\$ (818,838)</b></u>		<u><b>\$ (1,315,336)</b></u>		<u><b>\$ (496,498)</b></u>	<u><b>61%</b></u>

COMMONWEALTH DEVELOPMENT AUTHORITY

Combined Statements of Net Assets  
September 30, 2003 and 2002

<u>ASSETS</u>	<u>2003</u>	<u>2002</u> <u>(As Restated)</u>
Current assets:		
Cash and cash equivalents	\$ 2,669,440	\$ 1,541,422
Time certificates of deposit	6,220,865	5,797,334
Receivables:		
Current portion of loan receivable, net	1,577,092	1,561,809
Current portion capital development loans, net	603,648	592,461
Rent, net	35,226	56,506
Accrued interest, net of allowance for doubtful loans of \$8,740,467 and \$6,273,369 as of September 30, 2003 and 2002, respectively	1,252,720	1,256,529
Other	29,636	19,797
Inventory	264,879	534,728
Prepaid expenses	50,629	18,411
Total current assets	<u>12,704,135</u>	<u>11,378,997</u>
Other assets:		
Cash and cash equivalents, restricted	6,446,559	8,353,783
Investments, restricted	7,067,330	9,514,007
Total other assets	<u>13,513,889</u>	<u>17,867,790</u>
Noncurrent assets:		
Loans receivable, net	30,286,057	30,958,389
Capital development loans receivable, net	3,543,384	3,997,888
Due from other funds	10,309,157	12,407,882
Property and equipment, net	7,115,283	7,990,512
Land	10,409,682	10,409,682
Foreclosed real estate	1,522,923	543,000
Other assets	210,794	268,341
Total noncurrent assets	<u>63,397,280</u>	<u>66,575,694</u>
	<u>\$ 89,615,304</u>	<u>\$ 95,822,481</u>
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Current installment of notes payable	\$ 109,814	\$ 864,255
Accounts payable and accrued expenses	818,122	1,298,889
Interest payable	2,036,748	1,273,092
Total current liabilities	<u>2,964,684</u>	<u>3,436,236</u>
Notes payable, net of current installments	11,890,186	10,600,284
Due to other funds	10,309,157	12,407,882
Total liabilities	<u>25,164,027</u>	<u>26,444,402</u>
Contingencies		
Net assets:		
Investment in capital assets	18,067,965	18,943,194
Restricted	46,383,312	50,434,885
Total net assets	<u>64,451,277</u>	<u>69,378,079</u>
	<u>\$ 89,615,304</u>	<u>\$ 95,822,481</u>

See accompanying notes to financial statements.

COMMONWEALTH DEVELOPMENT AUTHORITY

Combined Statements of Revenues, Expenses and Changes in Net Assets  
Years Ended September 30, 2003 and 2002

	2003	2002 (As Restated)
Operating revenues:		
Interest and fees on loans	\$ 4,896,961	\$ 4,710,805
Section 8 income:		
Federal housing assistance rentals	3,048,227	2,961,973
Tenant share	79,448	107,341
Interest on investments	281,707	377,177
HOME Investment Partnership Program grants	113,466	412,416
CDBG Program Grant	394,736	1,111,367
ESG Program Grant	8,713	75,133
HPG Program Grant	-	39,500
Net increase in the fair value of investments	-	102,720
Housing rental	5,102	4,910
Other	314,678	511,040
	<u>9,143,038</u>	<u>10,414,382</u>
Total operating revenues		
Operating expenses:		
Provision for doubtful accounts	2,027,600	12,368,378
Section 8 rental	1,595,239	1,505,609
Salaries and wages	1,262,719	1,150,931
Depreciation	694,918	572,418
Repairs and maintenance	594,479	710,221
Employee benefits	488,060	357,101
CDBG Program Grant	394,736	1,111,107
Professional fees	178,612	255,732
Office rent	144,121	146,144
HOME Investment Partnership Program grants	113,466	412,416
Travel	79,973	58,455
ESG Program Grant	9,014	74,778
HPG Program Grant	-	38,942
Other	1,064,530	937,881
	<u>8,647,467</u>	<u>19,700,113</u>
Total operating expenses		
Operating income (loss)	<u>495,571</u>	<u>(9,285,731)</u>
Nonoperating revenues (expenses):		
Interest income	70,475	86,117
Interest expense	(818,426)	(1,027,120)
	<u>(747,951)</u>	<u>(941,003)</u>
Total nonoperating revenues (expenses), net		
Loss before contributions and transfers	(252,380)	(10,226,734)
Contributed capital	120,689	193,456
Transfers out for capital development grants	(4,795,111)	(1,834,786)
Change in net assets	(4,926,802)	(11,868,064)
Net assets - beginning	<u>69,378,079</u>	<u>81,246,143</u>
Net assets - ending	<u>\$ 64,451,277</u>	<u>\$ 69,378,079</u>

See accompanying notes to financial statements.

COMMONWEALTH DEVELOPMENT AUTHORITY

Combined Statements of Cash Flows  
Years Ended September 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Cash flows from operating activities:		
Cash received from interest and fees on loans receivable	\$ 2,150,112	\$ 2,755,407
Cash received from interest and fees on capital development loans	279,249	558,042
Interest and dividends on investments	281,707	479,897
Cash payments to suppliers for goods and services	(2,529,469)	(1,393,347)
Cash received from customers	367,216	427,801
Cash payments to employees for services	(1,468,616)	(1,508,032)
Cash received from federal grant awards	3,614,984	4,600,389
Cash payments from federal grant awards	(2,142,500)	(3,142,852)
Net cash provided by operating activities	<u>552,683</u>	<u>2,777,305</u>
Cash flows from noncapital financing activities:		
Net (repayment) proceeds of line of credit	(789,799)	998,554
Net cash (used for) provided by noncapital financing activities	<u>(789,799)</u>	<u>998,554</u>
Cash flows from capital and related financing activities:		
Acquisition of property and equipment	(41,452)	(940,680)
Proceeds from sale of property and equipment	221,763	738,386
Contributed capital	120,689	193,456
Net proceeds (disbursements) of loans receivable	144,593	(1,248,606)
Payments received on capital development loans	443,317	178,457
Capital development grants	(4,795,111)	(1,834,786)
Proceeds from notes payable	2,000,000	95,000
Principal paid on notes payable	(674,740)	(1,006,079)
Interest paid on notes payable	(54,770)	(1,027,120)
Net cash used for capital and related financing activities	<u>(2,635,711)</u>	<u>(4,851,972)</u>
Cash flows from investing activities:		
Net proceeds from sale and maturities of restricted cash and cash equivalents, time certificates of deposit and investments	4,396,341	1,195,302
Net purchase of restricted cash and cash equivalents, time certificates of deposit and investments	(465,971)	(132,507)
Interest income	70,475	86,117
Net cash provided by investing activities	<u>4,000,845</u>	<u>1,148,912</u>
Net increase in cash and cash equivalents	1,128,018	72,799
Cash and cash equivalents at beginning of year	1,541,422	1,468,623
Cash and cash equivalents at end of year	<u>\$ 2,669,440</u>	<u>\$ 1,541,422</u>
Reconciliation of operating income (loss) to net cash provided by operating activities:		
Operating income (loss)	\$ 495,571	\$ (9,285,731)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Provision for doubtful accounts	2,027,600	12,368,378
Depreciation	694,918	572,418
(Increase) decrease in assets:		
Receivables:		
Rent	(2,376)	(25,648)
Other	(9,839)	(19,797)
Accrued interest	(2,467,600)	(1,602,220)
Inventory	269,849	(534,728)
Prepaid expenses	(32,219)	(398)
Other assets	57,547	(127,012)
Increase (decrease) in liabilities:		
Accounts payable and accrued expenses	(480,768)	584,898
Interest payable	-	847,145
Net cash provided by operating activities	<u>\$ 552,683</u>	<u>\$ 2,777,305</u>
Supplemental disclosures of noncash capital and related financing activities:		
Recording of value of property received at incorporation date:		
Noncash increase in land	\$ -	\$ 10,409,682
Noncash increase in net assets-investment in capital assets	-	(10,409,682)
	<u>\$ -</u>	<u>\$ -</u>
Completion and sale of Koblerville Expansion Project Housing units:		
Noncash increase in notes receivable	\$ -	\$ 548,845
Noncash increase in contractors payable	-	(170,110)
Noncash decrease in notes payable	-	2,674,694
Noncash decrease in property and equipment	-	(3,053,429)
	<u>\$ -</u>	<u>\$ -</u>
Supplemental disclosure of noncash investing activities:		
Write-off of property and equipment:		
Noncash decrease in property and equipment	\$ -	\$ (4,104)
Noncash decrease in accumulated depreciation	-	4,104
	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to financial statements.



# COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2003 and 2002

## (1) Reporting Entity

The Commonwealth Development Authority (CDA), a component unit of the Commonwealth of the Northern Mariana Islands (CNMI), was created as an autonomous public agency of the CNMI pursuant to Public Law 4-49 as amended by Public Laws 4-63 and 5-27. CDA's existence is to be perpetual and it shall have all the rights and privileges of a corporation. The purpose of CDA is to stimulate the economic development of the CNMI.

The functions of CDA are carried out through a Development Banking Division (DBD, government and public sector activities), a Development Corporation Division (DCD, private sector activities), and a discretely presented component unit, the Northern Marianas Housing Corporation (NMHC). NMHC, formerly the Mariana Islands Housing Authority (MIHA), was established under Public Law 5-37 to assist in the development and administration of low cost residential housing in the Northern Mariana Islands. In 1977, Public Law 5-37 was succeeded by Public Law 5-67, which empowered MIHA to provide low cost residential housing and employment through the construction, maintenance, and repair of such housing. On October 20, 1994, Executive Order 94-3 became effective which abolished MIHA and all of its functions, assets and liabilities were transferred to CDA. CDA established a subsidiary corporation (i.e., NMHC) to account for the operations, assets and liabilities of MIHA. NMHC is governed by a five member Board of Directors appointed by the Board of Directors of CDA. The purpose and functions of the two divisions and NMHC are as follows:

### Development Banking Division:

- To receive and hold United States economic assistance for economic development loans provided under Section 702(c) of the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America (the Covenant);
- To aid in the financing of capital improvement projects and other projects undertaken by the CNMI and its autonomous public agencies;
- To achieve the greatest possible return, in terms of economic development, on the funds made available to the CNMI by the United States in accordance with the Covenant; and on such other funds as may be made available to CDA as capital contributions;
- To disseminate modern practices and techniques of financing, management and business administration in order to raise the levels of efficiency and productivity in all sectors; and
- To serve as the Northern Marianas development bank identified in Article IX, Section 6(c) of the Constitution.

As such, DBD considers all its net assets restricted for such purposes.

### Development Corporation Division:

- To identify, formulate, initiate, stimulate and facilitate business and commercial enterprises, with special emphasis on agricultural and marine resources, manufacturing and processing activities, import substitution, export development and responsible use of indigenous raw materials;

# COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2003 and 2002

## (1) Reporting Entity, Continued

Development Corporation Division, Continued:

- To identify, formulate, initiate, stimulate and facilitate business and commercial enterprises where a service necessary and vital to economic development is required, or where profit incentives are not sufficient to attract private sector investors; and
- To serve as the economic development loan fund agency for qualified private sector enterprises.
- During the year ended September 30, 2002, served as an intermediary lender for the Microloan Program, administered by the U.S. Small Business Administration (SBA), the objective of which was to assist small business concerns in those areas suffering from a lack of credit due to economic downturns. Under the program, SBA made loans to CDA, who used the loan funds to make short-term microloans in amounts up to \$35,000 to start-up newly established and growing small business concerns. This program was terminated in 2003.

As such, DCD considers all its net assets, except net assets invested in capital assets, to be restricted for such purposes.

Northern Marianas Housing Corporation:

- To administer direct loans to qualified individuals for housing construction;
- To participate as guarantor or trustee in housing loan programs;
- To develop and construct rental housing;
- To construct and/or administer various other Federal and local residential and housing projects; and
- To participate in projects subsidized by the U.S. Department of Housing and Urban Development (HUD). Upon completion of the projects, the residential units are rented to qualifying families and individuals.

As such, NMHC considers all its net assets, except net assets invested in capital assets, to be restricted for such purposes.

## (2) Summary of Significant Accounting Policies

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

# COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2003 and 2002

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

### Basis of Accounting

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

### Budgets

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

### Cash and Cash Equivalents

For purposes of the statements of net assets and cash flows, cash and cash equivalents is defined as cash held in demand deposits, savings and unrestricted time certificates of deposit with a maturity date within three months of the date acquired. Deposits maintained in time certificates of deposit with original maturity dates greater than ninety days are separately classified. At September 30, 2003 and 2002, total unrestricted cash and cash equivalents were \$2,669,440 and \$1,541,422, respectively, and the corresponding bank balances were \$2,762,005 and \$1,623,691, respectively. Of the bank balance amounts, \$2,762,005 and \$1,623,691 are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance as of September 30, 2003 and 2002, respectively. Bank deposits in the amount of \$400,000 and \$300,000 were FDIC insured as of September 30, 2003 and 2002, respectively. CNMI law does not require component units to collateralize their bank accounts and thus CDA's deposits in excess of FDIC insurance are uncollateralized.

### Time Certificates of Deposit

Unrestricted investments are held in time certificates of deposit (TCDs) with maturities of more than three months when purchased, and fair value approximated cost as of September 30, 2003 and 2002. At September 30, 2003 and 2002, approximately \$6,220,865 and \$5,797,334, respectively, of CDA's TCDs are with financial institutions subject to FDIC. As of September 30, 2003 and 2002, TCDs in the amount of \$300,000 were FDIC insured. CNMI law does not require component units to collateralize their bank accounts and thus CDA's deposits in excess of FDIC insurance are uncollateralized.

### Prepaid Expenses

Payments made to vendors for services that will benefit future periods are recorded as prepaid expenses.

### Property and Equipment

Property and equipment, set forth in note 7, are recorded at cost. Depreciation is provided by using the straight-line method over the estimated useful lives of the assets.

# COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2003 and 2002

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

### Property and Equipment, Continued

Long-lived assets for which management has committed to a plan to dispose of the assets, whether by sale or abandonment, are reported at the lower of carrying amount or fair value less costs to sell.

### Foreclosed Real Estate

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value at the date of foreclosure less estimated selling costs establishing a new cost basis. Valuations are periodically performed by management and adjustments are made to reflect the real estate at the lower of the carrying amount or fair value less estimated costs to sell. Operating expenses or income, reductions in estimated values, and gains or losses on disposition of such properties are charged to current operations.

### Loans Receivable, Interest Receivable and Allowance for Loan Losses

Loans and interest receivable are stated at the amount of unpaid principal and interest, reduced by an allowance for loan losses. Interest on loans is calculated by using the simple interest method on daily balances of the principal amount outstanding. The allowance for loan losses is established through a provision for doubtful accounts charged to expense. Loans are charged against the allowance for loan losses when management believes that the collection of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may be uncollectible, based on evaluations of the collectibility of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans and current economic conditions that may affect the borrowers' ability to pay.

### Restricted Cash and Cash Equivalents and Investments

As described in note 1, DBD receives and holds United States economic assistance for economic development loans provided under Section 702(c) of the Covenant. The *Agreement of the Special Representatives on Future United States Financial Assistance for the Northern Mariana Islands* requires that a revolving fund be established into which repayments of principal and interest from revenue-producing projects shall be deposited for financing of additional revenue-producing capital development projects. From its inception on October 1, 1985, DBD has exclusively accounted for Covenant 702(c) funding and thus represents the required revolving fund.

As described in note 1, DCD serves as the economic development loan fund agency for qualified private sector enterprises. DCD accounts for all funds received by the former Northern Mariana Islands Economic Development Loan Fund pursuant to Article VII, Section 702(c) of the Covenant from February 15, 1975 through September 30, 1985. In addition to the aforementioned financial resources, DCD has been designated as the administrative agency for economic development loans transferred from the Trust Territory of the Pacific Islands government to the CNMI. DCD represents a revolving fund to account for economic development loans to qualified private sector enterprises.

# COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2003 and 2002

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

### Restricted Cash and Cash Equivalents and Investments, Continued

As described in note 1, NMHC administers various Federal and local residential and housing projects. In administering these programs, NMHC is required to maintain certain funds as collateral or in accounts which are restricted for specific purposes.

### Retirement Plan

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

Plan members are required to contribute 6.5% and 9.0% of their annual covered salary for Class I and Class II members, respectively, and CDA is required to contribute at an actuarially determined rate. The current rate is 26.4% of annual covered payroll. The contribution requirements of plan members and CDA are established and may be amended by the Fund's Board of Trustees. CDA's contributions to the Fund for the years ended September 30, 2003, 2002 and 2001 were \$328,153, \$274,518 and \$279,301, respectively, equal to the required contributions for each year.

### Net Assets

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, has required CDA to establish net asset categories as follows:

- Investment in capital assets; capital assets, net of accumulated depreciation.
- Restricted:

Nonexpendable - Net assets subject to externally imposed stipulations that CDA maintain them permanently. At September 30, 2003 and 2002, CDA does not have nonexpendable net assets.

Expendable - Net assets whose use by CDA is subject to externally imposed stipulations that can be fulfilled by actions of CDA pursuant to those stipulations or that expire by the passage of time. As described in note 1, CDA considers all assets, except investments in capital assets, to be restricted for economic development.

- Unrestricted; net assets that are not subject to externally imposed stipulations. As CDA considers all assets, except investments in capital assets, to be restricted for economic development, CDA does not have unrestricted net assets of September 30, 2003 and 2002.

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2003 and 2002

(2) Summary of Significant Accounting Policies, Continued

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.

Reclassification

Certain 2002 balances in the accompanying financial statements have been reclassified to conform to the 2003 presentation.

(3) Restricted Cash and Cash Equivalents and Investments

Development Banking Division

Restricted cash and cash equivalents and investments represent the proceeds of Covenant funding and liquidated revenue bonds derived from pledged Covenant funding, and are restricted for capital development purposes. Proceeds are deposited with commercial lending institutions and the securities are held in the name of CDA.

At September 30, 2003 and 2002, restricted cash and cash equivalents and investments consist of U.S. Government agency bonds, U.S. Government-secured money market funds, time certificates of deposit and amounts held in demand deposit accounts. These investments are presented at fair value in the accompanying financial statements, in accordance with GASB Statement No. 31. At September 30, 2003 and 2002, total restricted cash and cash equivalents and investments were \$9,849,702 and \$12,104,153, respectively, with \$9,801,455 and \$12,741,531, respectively, maintained in financial institutions subject to FDIC insurance. Restricted cash and cash equivalents and investments in the amount of \$200,000 and \$600,000 were FDIC insured as of September 30, 2003 and 2002, respectively. CNMI law does not require component units to collateralize their bank accounts and thus CDA's restricted cash and cash equivalents and investments in excess of FDIC insurance are uncollateralized.

Restricted cash and cash equivalents and investments of DBD as of September 30, 2003 and 2002, are summarized below:

	<u>Fair Value</u>	
	<u>2003</u>	<u>2002</u>
<u>Restricted cash and cash equivalents:</u>		
Demand deposit accounts	\$ 4,077,759	\$ 3,179,419
U.S. Government-secured money market funds	<u>-</u>	<u>663,674</u>
	<u>\$ 4,077,759</u>	<u>\$ 3,843,093</u>
<u>Restricted investments:</u>		
U.S. Government agency bonds	\$ -	\$ 3,269,112
Time certificates of deposit	<u>5,771,943</u>	<u>4,991,948</u>
	<u>\$ 5,771,943</u>	<u>\$ 8,261,060</u>

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2003 and 2002

(3) Restricted Cash and Cash Equivalents and Investments, Continued

Development Corporation Division

Restricted investments amounted to \$1,295,387 and \$1,252,947 at September 30, 2003 and 2002, respectively, and comprise time certificates of deposit, maintained at a non-FDIC insured bank, as a guarantee against loans issued by the bank.

Northern Marianas Housing Corporation

NMHC maintains depository accounts with financial institutions in the CNMI which are restricted for various purposes, as detailed below. Of the amounts detailed below, \$300,000 and \$400,000 at September 30, 2003 and 2002, respectively, were FDIC insured.

	<u>2003</u>	<u>2002</u>
<u>Restricted cash and cash equivalents:</u>		
Savings account restricted for the loan program established pursuant to Covenant Section 702(c)	\$ -	\$ 2,027
Savings account which acts as collateral against a bank line of credit	-	1,223,358
Escrow account maintained as a guarantee for any deficiency in foreclosure proceeds related to U.S. Farmers Home Administration loans	251,666	175,511
Savings account restricted for Koblerville Section 8 project repairs and maintenance expenses, per contract with the U.S. Department of Housing and Urban Development	194,730	193,649
Savings account maintained as a guarantee of housing loans made by a savings and loan in the CNMI	120,134	119,546
MPLT collateral account	626,677	213,593
Time certificates of deposit for MPLT loan program	1,015,428	2,365,062
Other depository accounts reserved for various purposes	<u>160,165</u>	<u>217,944</u>
	<u>\$ 2,368,800</u>	<u>\$ 4,510,690</u>

CDA's investments are categorized as either (1) insured or registered or for which the securities are held by CDA or its agent in CDA's name, (2) uninsured and unregistered for which the securities are held by the broker's or dealer's trust department or agent in CDA's name or (3) uninsured and unregistered for which the securities are held by the broker or dealer or by its trust department or agent but not in CDA's name. All of CDA's investments in U.S. Government agency bonds are classified in category (2).

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2003 and 2002

(4) Loans Receivable

Development Corporation Division

As described in note 1, DCD was established to serve as the economic development loan fund agency for qualified private sector enterprises pursuant to Public Law 4-49. In this capacity all functions, powers, duties, funds, contracts, obligations and liabilities managed and administered by the Northern Marianas Islands Economic Development Loan Fund (EDLF) were transferred to DCD. EDLF was established pursuant to Article VII, Section 702(c) of the Covenant, dated February 15, 1975, to administer financial resources received under the Covenant which were specifically set aside for a loan program to assist the general economic development of the Northern Marianas Islands. Additionally, the Trust Territory of the Pacific Islands Government contributed to the economic development loan portfolio. During the year ended September 30, 2002, DCD also served as an intermediary lender in the Microloan Program, administered by SBA, in which DCD received loan funds from SBA and, in turn, made short-term, fixed rate microloans to small business concerns in the Northern Mariana Islands. This program was terminated in 2003.

Outstanding loans are due within various periods not to exceed twenty (20) years. The interest rates charged are based on the economic purpose of the loan. Production development loans bear interest at 9%, marine and agriculture loans bear interest at 5%, commercial development loans bear interest at 9%, and microloans bear interest at 9% to 12%.

Northern Marianas Housing Corporation

NMHC makes loans for the specific purpose of providing residents of the Northern Mariana Islands with approved low-cost housing. The loans have terms from ten to thirty-three years in duration at interest rates of 4.5% to 12%. Loans are restricted to ninety percent (90%) of the appraised value of the property or the purchase price, whichever is lower. For construction loans, the purchase price of the property is defined as the value of the land plus the estimated cost of construction.

Major classifications of economic development loans as of September 30, 2003 and 2002 (with combining information as of September 30, 2003), are as follows:

	<u>Development Corporation Division</u>	<u>Northern Marianas Housing Corporation</u>	<u>2003</u>	<u>2002</u>
General	\$ 26,421,747	\$ 1,156,009	\$ 27,577,756	\$ 31,022,374
Direct family home loans	-	11,502,349	11,502,349	8,759,322
Marine	5,872,700	-	5,872,700	5,643,583
Agriculture	2,793,299	-	2,793,299	2,836,038
HOME Investment Partnerships Act grant	-	1,125,613	1,125,613	1,118,077
Housing construction	-	598,825	598,825	597,380
Tinian turnkey	-	520,056	520,056	521,844
Microloan	-	-	-	416,631
Home revenue bond	-	125,757	125,757	142,668
Section 8	-	173,656	173,656	183,163
Housing preservation grant	-	63,074	63,074	68,381
Trust Territory Guaranteed	10,493	-	10,493	11,636
Loan principal receivable	35,098,239	15,265,339	50,363,578	51,321,097
Less allowance for doubtful loans	<u>(17,548,481)</u>	<u>(951,948)</u>	<u>(18,500,429)</u>	<u>(18,800,899)</u>
Net loans receivable	<u>\$ 17,549,758</u>	<u>\$ 14,313,391</u>	<u>\$ 31,863,149</u>	<u>\$ 32,520,198</u>



COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2003 and 2002

(5) Due from/to Other Funds

Due from/to balances between NMHC and DBD result from loans made by CDA to the former Marianas Islands Housing Authority (MIHA) prior to that entity being established as a subsidiary corporation of CDA. The year end balances are summarized as follows:

	<u>2003</u>	<u>2002</u>
Economic development loan, bearing interest at 5% per annum, payable in monthly installments of \$17,898, including interest, through September 1, 2005, collateralized by mortgage of Koblerville Section 8 project, receivables and inventories. The loan was paid in full in 2003.	\$ -	\$ 593,347
Housing construction loan. On February 3, 1999, CNMI Public Law 11-57 authorized CDA to write off the portion of this loan not considered recoverable through sale of housing construction units. Interest has therefore been suspended pending sales of the units.	<u>2,367,411</u>	<u>2,757,412</u>
Loan principal balance	2,367,411	3,350,759
Operating expenses	<u>54,046</u>	<u>54,045</u>
	\$ <u>2,421,457</u>	\$ <u>3,404,804</u>

Due from/to balances between DBD and DCD result from the use of restricted funding between the two divisions. The year end balances are summarized as follows:

	<u>2003</u>	<u>2002</u>
Principal and interest payments made by DCD on a note payable to Bank of America-Asia Limited.	\$ 13,747,096	\$ 13,747,096
Principal and interest payments made by NMHC on the note payable to DBD.	(6,012,937)	(4,932,734)
Operating expenses	<u>153,541</u>	<u>188,716</u>
	\$ <u>7,887,700</u>	\$ <u>9,003,078</u>

NMHC is obligated to repay CDA for the construction cost of housing units at Sugar King II.

(6) Capital Development Loans Receivable

As described in note 2, DBD is required to establish a revolving fund into which repayments of principal and interest from revenue-producing projects shall be deposited. The revolving fund consists of the following notes receivable as of September 30, 2003 and 2002:

	<u>2003</u>	<u>2002</u>
Note receivable from the Commonwealth Utilities Corporation (CUC), bearing interest at 7% per annum, with quarterly principal and interest payments due February 17, 1992 in the amount of \$658,469, with a maturity date of February 17, 2013. Proceeds are to be used for certain power generation and distribution projects within the CNMI.	\$ 30,000,000	\$ 30,000,000

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2003 and 2002

(6) Capital Development Loans Receivable, Continued

	<u>2003</u>	<u>2002</u>
Note receivable from CUC, bearing interest at 5% per annum, with quarterly principal and interest payments due January 12, 1994 in the amount of \$359,514, with a maturity date of January 12, 2014. Proceeds are to be used for certain water projects within the CNMI.	16,068,750	16,068,750
Due from CUC, bearing interest at 7% per annum, with monthly principal and interest payments of \$58,509. No promissory agreement related to this note has been signed.	10,000,000	10,000,000
Note receivable from CUC, bearing interest at 7% per annum, with quarterly principal and interest payments due two years after January 30, 1990 in the amount of \$276,471, with a maturity date of January 30, 2000. Proceeds are to be used for Saipan Power Plant expansion.	5,500,000	5,500,000
Note receivable from the Commonwealth Ports Authority (CPA), bearing interest at 2.5% per annum, with quarterly principal and interest payments in the amount of \$204,113, with maturity date of November 16, 2014. Proceeds are to be used for the Saipan Harbor Project.	<u>8,737,382</u>	<u>9,180,699</u>
Total capital development loans receivable	70,306,132	70,749,449
Less allowance for loan losses	<u>(66,159,100)</u>	<u>(66,159,100)</u>
Net capital development loans receivable	\$ <u>4,147,032</u>	\$ <u>4,590,349</u>

At September 30, 2003, estimated proceeds from principal and interest repayments of loans receivable (excluding all CUC loans) for the following years ending September 30, are as follows:

<u>Year ending September 30,</u>	<u>Principal Amount</u>	<u>Interest</u>
2004	\$ 603,648	\$ 212,805
2005	618,882	197,571
2006	634,499	181,954
2007	650,511	165,942
2008	666,927	149,526
Subsequent years	<u>5,562,915</u>	<u>535,932</u>
	\$ <u>8,737,382</u>	\$ <u>1,443,730</u>

As of September 30, 2002, CPA was three quarters delinquent in loan payments. On February 4, 2003, CDA authorized the deferral of 50% of CPA's current outstanding loan payment amounts, the reduction of quarterly loan payments for one year ending September 30, 2003, and extension of terms of the loan to accommodate the deferral. An amendment to the loan agreement has not been signed by both CPA and CDA. Management provided an allowance of \$4,590,350 representing 53% and 50% of the outstanding principal balance at September 30, 2003 and 2002, respectively.

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2003 and 2002

(6) Capital Development Loans Receivable, Continued

The most recent audited financial statements of CUC are as of September 30, 1999, and reflect a deficit of \$32,053,662 and a working capital deficiency of \$84,495,626. Management of CDA has determined that collection of the principal of the above described loans to CUC is unlikely and has included 100% of the loan balances in its allowance for loan losses. CDA has also suspended accrual of interest income on the loans from CUC since collection of the principal has become doubtful. Unrecorded accrued interest receivable amounted to \$76,689,015 and \$68,363,758 at September 30, 2003 and 2002, respectively.

On November 21, 2002, a Memorandum of Agreement (MOA) was established between CDA and CUC to waive a portion of the capital development loans receivable and the conversion into equity ownership of the balance. Public Law 13-35 effectuated terms of the MOA requiring CDA to waive \$16,068,750 and waive certain specified interest payments and for other purposes. Public Law 13-36 effectuated terms of the MOA by authorizing CUC to issue shares to CDA of cumulative nonconvertible non-transferable preferred stock valued at \$45,500,000. The terms of the settlement are still under negotiation between CDA and CUC.

(7) Property and Equipment

Property and equipment consist of the following at September 30, 2003 and 2002:

	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2002</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at September 30, 2003</u>
<u>Development Corporation Division</u>					
Structure and improvements	7 years	\$ 468,456	\$ -	\$ -	\$ 468,456
Vehicles/office equipment	3 - 5 years	139,394	26,000	(29,400)	135,994
Computer equipment	3 - 5 years	114,210	14,055	-	128,265
Furniture and fixtures	7 years	<u>123,704</u>	<u>1,399</u>	<u>-</u>	<u>125,103</u>
		845,764	41,454	(29,400)	857,818
Less accumulated depreciation		<u>(518,942)</u>	<u>(97,251)</u>	<u>29,400</u>	<u>(586,793)</u>
		<u>\$ 326,822</u>	<u>\$ (55,797)</u>	<u>\$ -</u>	<u>\$ 271,025</u>
	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2001</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at September 30, 2002</u>
Structure and improvements	7 years	\$ 468,456	\$ -	\$ -	\$ 468,456
Vehicles/office equipment	3 - 5 years	136,314	3,080	-	139,394
Computer equipment	3 - 5 years	112,262	1,948	-	114,210
Furniture and fixtures	7 years	<u>123,704</u>	<u>-</u>	<u>-</u>	<u>123,704</u>
		840,736	5,028	-	845,764
Less accumulated depreciation		<u>(421,426)</u>	<u>(97,516)</u>	<u>-</u>	<u>(518,942)</u>
		<u>\$ 419,310</u>	<u>\$ (92,488)</u>	<u>\$ -</u>	<u>\$ 326,822</u>

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2003 and 2002

(7) Property and Equipment, Continued

	Estimated Useful Lives	Balance at October 1, 2002	Additions	Deletions	Balance at September 30, 2003
<u>Northern Marianas Housing Corporation</u>					
Residential Housing Development Projects:					
Section 8 Mihaville Housing	30 years	\$ 2,424,982	\$ 3,672	\$ -	\$ 2,428,654
Section 8 Koblerville Housing	30 years	1,912,380	1,039	-	1,913,419
Section 8 Rota Housing	30 years	1,161,243	700	(8,905)	1,153,038
Section 8 Tinian Housing	30 years	1,078,334	4,170	(23,436)	1,059,068
Section 8 Housing Phase II	30 years	634,544	685	-	635,229
Section 8 Housing Phase I	30 years	600,515	-	-	600,515
		<u>7,811,998</u>	<u>10,266</u>	<u>(32,341)</u>	<u>7,789,923</u>
Other:					
Koblerville infrastructure	30 years	2,214,991	-	-	2,214,991
Tinian infrastructure	30 years	608,500	-	-	608,500
Building and improvements	20 years	424,586	-	-	424,586
Equipment and computers	3 - 8 years	259,619	40,301	(760)	299,160
Vehicles	3 years	104,319	7,500	(34,425)	77,394
		<u>3,612,015</u>	<u>47,801</u>	<u>(35,185)</u>	<u>3,624,631</u>
		11,424,013	58,067	(67,526)	11,414,554
Less accumulated depreciation		<u>(7,353,685)</u>	<u>(597,669)</u>	<u>67,072</u>	<u>(7,884,282)</u>
		4,070,328	(539,602)	(454)	3,530,272
Koblerville Expansion Project Infrastructure					
to be transferred out to CUC		2,508,362	-	(220,376)	2,287,986
Sugar King Housing to be disposed of		<u>1,085,000</u>	<u>-</u>	<u>(59,000)</u>	<u>1,026,000</u>
		<u>\$ 7,663,690</u>	<u>\$ (539,602)</u>	<u>\$ (279,830)</u>	<u>\$ 6,844,258</u>
	Estimated Useful Lives	Balance at October 1, 2001	Additions	Deletions	Balance at September 30, 2002
Residential Housing Development Projects:					
Section 8 Mihaville Housing	30 years	\$ 2,419,828	\$ 6,299	\$ (1,145)	\$ 2,424,982
Section 8 Koblerville Housing	30 years	1,910,443	2,656	(719)	1,912,380
Section 8 Rota Housing	30 years	1,159,845	1,398	-	1,161,243
Section 8 Tinian Housing	30 years	1,075,283	3,051	-	1,078,334
Section 8 Housing Phase II	30 years	631,243	3,301	-	634,544
Section 8 Housing Phase I	30 years	600,515	-	-	600,515
		<u>7,797,157</u>	<u>16,705</u>	<u>(1,864)</u>	<u>7,811,998</u>
Other:					
Koblerville infrastructure	30 years	2,214,991	-	-	2,214,991
Tinian infrastructure	30 years	608,500	-	-	608,500
Building and improvements	20 years	424,586	-	-	424,586
Equipment and computers	3 - 8 years	231,438	30,421	(2,240)	259,619
Vehicles	3 years	90,319	14,000	-	104,319
		<u>3,569,834</u>	<u>44,421</u>	<u>(2,240)</u>	<u>3,612,015</u>
		11,366,991	61,126	(4,104)	11,424,013
Less accumulated depreciation		<u>(6,882,888)</u>	<u>(474,901)</u>	<u>4,104</u>	<u>(7,353,685)</u>
		4,484,103	(413,775)	-	4,070,328
Koblerville Expansion Project Infrastructure					
to be transferred out to CUC		-	2,508,362	-	2,508,362
Sugar King Housing to be disposed of		1,411,000	-	(326,000)	1,085,000
Koblerville Expansion Project in progress		<u>5,269,762</u>	<u>-</u>	<u>(5,269,762)</u>	<u>-</u>
		<u>\$ 11,164,865</u>	<u>\$ 2,094,587</u>	<u>\$ (5,595,762)</u>	<u>\$ 7,663,690</u>

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2003 and 2002

(7) Property and Equipment, Continued

NMHC also holds title to approximately 339,000 square meters of land acquired at no cost which was originally held for development of low income rental housing or resale to low income families for construction of housing. The land is recorded on NMHC's financial statements at estimated fair value of \$10,409,682 at September 30, 2003 and 2002. Public Law 6-34 provides NMHC, subject to certain terms and conditions, the authority to lease for commercial development certain land situated in the North Garapan Subdivision Annex No. 2. NMHC is currently in the process of promoting the development of the abovementioned land to allow NMHC to meet its future commitments.

Pursuant to Public Law 11-57, NMHC shall have the duty to pay CDA approximately \$3,364,412 for the cost of constructing fifty-two housing units located at the Sugar King II. Repayment of the loan shall come from the sale of the fifty-two units at Sugar King Part II. As of September 30, 2003, NMHC has sold thirty-six units amounting to \$2,349,000 with a total value of \$1,026,000 remaining to be disposed.

NMHC has entered into a construction agreement to have forty-five housing units built in Koblerville, Saipan. The Koblerville Expansion Project will provide forty-five single-family houses for very low, low and moderate-income families at a cost of \$6,377,130. On January 11, 2002, the project was turned over to the buyers. As of September 30, 2003 and 2002, the total amount remaining to be paid to the contractor is \$-0- and \$170,110, respectively. Of the total forty-five units, three and six units were unsold as of September 30, 2003 and 2002, respectively, valued at \$264,879 and \$534,728, respectively. These units are recorded as inventory. Sales of the units amounted to \$269,849 and \$3,640,925 in 2003 and 2002, respectively, of which \$269,849 and \$548,845, respectively, was purchased under NMHC's loan program.

(8) Notes Payable

Development Banking Division

Note payable at September 30, 2003 and 2002, is as follows:

	<u>2003</u>	<u>2002</u>
Note payable to Marianas Public Land Trust (MPLT), bearing interest at 6.5% per annum, due over a fifteen-year term, beginning June, 2003. The note is collateralized by the full faith and credit of the CNMI Government held in trust by MPLT, for the purpose of development and maintenance of the American Memorial Park, and is being repaid from earnings of the investments pursuant to CNMI Public Law 11-72.	\$ <u>2,000,000</u>	\$ <u>          -</u>

Principal maturities for subsequent fiscal years are as follows (estimated as repayments depend on earnings on the investments):

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2003 and 2002

(8) Notes Payable, Continued

Development Banking Division, Continued

<u>Year ending September 30,</u>	<u>Principal Balance</u>	<u>Interest</u>
2004	\$ 109,814	\$ 168,940
2005	88,819	120,247
2006	94,767	114,299
2007	101,114	107,952
2008	107,886	101,180
2009 - 2013	657,985	387,344
2014 - 2018	<u>839,615</u>	<u>136,024</u>
	<u>\$ 2,000,000</u>	<u>\$ 1,135,986</u>

Development Corporation Division

Notes payable at September 30, 2003 and 2002, is as follows:

	<u>2003</u>	<u>2002</u>
<p>Note payable to SBA, due on October 28, 2009, collateralized by all funds held in CDA's Microloan Revolving Fund and Loan Loss Reserve Fund accounts at a local commercial bank and by all Microloan notes made with the proceeds from this note payable under the Microloan Program. The interest rate on the note is adjusted annually to either 3.75% or 4.5%, based on the current average size of the microloans made by CDA (4.5% at September 30, 2002) and is payable in monthly installments of \$4,037, including interest. The note was paid in full in 2003.</p>	\$ -	\$ 275,711
<p>Note payable to SBA, due on November 15, 2010, collateralized by all funds held in CDA's Microloan Revolving Fund and Loan Loss Reserve Fund accounts at a local commercial bank and by all Microloan notes made with the proceeds from this note payable under the Microloan Program. The interest rate on the note is adjusted annually to either 4.25% or 5%, based on the current average size of the microloans made by CDA (5% at September 30, 2002) and is payable in monthly installments of \$5,261, including interest. The note was paid in full in 2003.</p>	<u>-</u>	<u>399,029</u>
	<u>\$ -</u>	<u>\$ 674,740</u>

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2003 and 2002

(8) Notes Payable, Continued

Northern Marianas Housing Corporation

Notes payable at September 30, 2003 and 2002, are as follows:

	<u>2003</u>	<u>2002</u>
Note payable to MPLT, bearing interest at 8.5% per annum, due on March 1, 2016, collateralized by the full faith and credit of the CNMI Government. CNMI Public Law 12-17 approved the repayment of the loan through legislative appropriation of operating transfers to the general fund of the CNMI Government from investment income of MPLT. Repayment of the loan is deferred for a period of ten years.	\$ 8,996,623	\$ 8,996,623
Note payable to the CNMI Government for the operating transfers to the general fund of the CNMI Government from investment income of MPLT pursuant to the approved repayment of the MPLT loan through legislative appropriation as provided for in Public Law 12-27. Operating transfers in the general fund reduces NMHC's payable to MPLT but recognizes a payable to the CNMI Government deferred for ten years.	1,003,377	1,003,377
Short-term bank note, drawn against a bank line of credit of the lesser of 95% of savings account balance or \$6,000,000, interest at savings account interest rate plus 3% (5.5% at September 30, 2002), collateralized by savings account balance. The note was fully retired in 2003.	<u>-</u>	<u>789,799</u>
	<u>\$ 10,000,000</u>	<u>\$ 10,789,799</u>

Principal maturities for subsequent fiscal years are as follows:

<u>Year ending September 30,</u>	<u>Principal Balance</u>	<u>Interest</u>
2004	\$ -	\$ -
2005	-	-
2006	-	-
2007	-	-
2008	-	-
2009 - 2013	-	-
2014 - 2016	<u>10,000,000</u>	<u>7,725,311</u>
	<u>\$ 10,000,000</u>	<u>\$ 7,725,311</u>

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Financial Statements  
September 30, 2003 and 2002

(9) Transfer Out for Capital Development Grants

As described in note 2, DBD receives and holds U.S. economic assistance provided in the Covenant. Terms and conditions of this assistance are contained in the *Agreement of the Special Representatives on Future United States Financial Assistance for the Northern Mariana Islands* (the Agreement). In accordance with the Agreement, DBD uses the proceeds, and accumulated earnings, by issuing either grants or loans to subrecipients, and acts in a pass through capacity. Revenues and expenditures related to grant agreements are recognized by the subrecipient with DBD recording expense under the caption "transfer out for capital development grants".

Transfers out for capital development grants consist of the following for the years ended September 30, 2003 and 2002:

	<u>2003</u>	<u>2002</u>
Transfer to CNMI Office of the Governor for matching funds for grants from the U.S. Department of the Interior	\$ 2,795,111	\$ 1,834,786
Transfer to CNMI Office of the Governor for improvements to the American Memorial Park, pursuant to CNMI Public Law No. 12-58	<u>2,000,000</u>	<u>-</u>
	<u>\$ 4,795,111</u>	<u>\$ 1,834,786</u>

(10) Restatement

NMHC holds title to several land lots, acquired after incorporation, at zero cost. In fiscal year 2003, in accordance with GASB Statement No. 33, *Accounting and Financial Reporting for Non-Exchange Transactions*, as amended by GASB Statement No. 36, management elected to estimate and record fair value of these lots at acquisition date, reduced for impairment in value at September 30, 2003. Management is of the opinion that the fair value of the properties were not materially different at October 1, 2001, and, accordingly, has elected to retroactively restate net assets at October 1, 2001 based on this current value as follows:

	<u>NMHC</u>
Net assets - October 1, 2001, as previously stated	\$ <u>11,841,169</u>
Estimated land value at acquisition	14,533,118
Adjustment for impairment in fair value	<u>(4,123,436)</u>
Adjusted land value	<u>10,409,682</u>
Net assets - October 1, 2001, as restated	\$ <u>22,250,851</u>

(11) Contingencies

CDA is authorized to guarantee up to 90% of the principal of loans and lines of credit made by financial institutions to qualified borrowers, in addition to approving direct loans. The amount for which CDA was contingently liable under this arrangement at September 30, 2003 and 2002, was \$16,546,839 and \$16,596,865, respectively. Unutilized line of credit facilities guaranteed by CDA amounted to \$-0- and \$54,593 at September 30, 2003 and 2002, respectively.



# COMMONWEALTH DEVELOPMENT AUTHORITY

## Notes to Financial Statements September 30, 2003 and 2002

### (11) Contingencies, Continued

CDA has time certificates of deposit in a non-FDIC bank institution amounting to \$1,295,387 as of September 30, 2003. The bank institution went into receivership on April 30, 2002. It is uncertain when CDA will realize the abovementioned deposits. CDA has determined that due to the receivership of the bank institution, interest on the time certificates of deposit will only be accrued through the maturity date. CDA has also determined that any future loss on the time certificates of deposit will be offset against CDA's underlying contingent liability for loan guarantees with the bank.

NMHC has entered into an agreement with the U.S. Farmers Home Administration (FmHA) whereby NMHC assists borrowers in obtaining FmHA financing for housing construction. The agreement requires NMHC to guarantee any deficiency in foreclosure proceeds should borrowers default on the FmHA loans. As security under the agreement, NMHC is required to maintain an escrow account of \$286,436. Beginning September 30, 1993, the amount in the escrow account will be reduced each year by the product of \$1,500 multiplied by the number of loans paid in full for that particular year, or 4% of the total outstanding balance, whichever is less. As of September 30, 2003 and 2002, NMHC has guaranteed outstanding loans of approximately \$8,900,000 and \$14,800,000, respectively. As of September 30, 2003 and 2002, the balance in the escrow account was \$251,666 and \$175,511, respectively. These amounts are included in "restricted cash and cash equivalents and investments" in the accompanying statements of net assets. NMHC was advised by FmHA to increase the account's minimum balance from \$100,000 to \$250,000 in 2003.

NMHC entered into a loan agreement and related loan purchase agreement with a savings and loan in the CNMI whereby the savings and loan will make available up to \$6,000,000 for housing loans. Under the agreements, NMHC is responsible for administering the loan purchase program and the savings and loan agrees to purchase qualified loans from NMHC. NMHC guarantees the first 25% of the principal balance plus interest on each loan sold to the savings and loan. As of September 30, 2003 and 2002, NMHC was contingently liable for \$1,980,899 and \$3,017,815, respectively, of the balance of loans purchased by the savings and loan. In addition, NMHC is required to maintain an account at the savings and loan equal to the lesser of 5% of all loans sold to the savings and loan or \$100,000. The balance in the account at September 30, 2003 and 2002 was \$120,134 and \$119,546, respectively, which is included in "restricted cash and cash equivalents" in the accompanying balance sheet.

NMHC also has similar arrangements with other bank institutions whereby NMHC guarantees a varying percentage of loans issued by the banks for housing construction. At September 30, 2003, NMHC was contingently liable to these institutions for \$3,462,636.

### (12) Risk Management

CDA 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. CDA has elected to purchase commercial insurance from independent third parties for the risks of loss to which it is exposed. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

## COMMONWEALTH DEVELOPMENT AUTHORITY

Combining Statement of Net Assets  
September 30, 2003

ASSETS	Development Banking Division	Development Corporation Division	Component Unit	Total
			Northern Marianas Housing Corporation	
Current assets:				
Cash and cash equivalents	\$ -	\$ 1,554,879	\$ 1,114,561	\$ 2,669,440
Time certificates of deposit	-	6,220,865	-	6,220,865
Receivables:				
Loans, net	-	926,484	650,608	1,577,092
Capital development loans, net	603,648	-	-	603,648
Rent, net	-	-	35,226	35,226
Accrued interest, net	73,172	834,285	345,263	1,252,720
Other	-	29,636	-	29,636
Inventory	-	-	264,879	264,879
Prepaid expenses	-	50,629	-	50,629
Total current assets	676,820	9,616,778	2,410,537	12,704,135
Other assets:				
Cash and cash equivalents, restricted	4,077,759	-	2,368,800	6,446,559
Investments, restricted	5,771,943	1,295,387	-	7,067,330
Total other assets	9,849,702	1,295,387	2,368,800	13,513,889
Noncurrent assets:				
Loans receivable, net	-	16,623,274	13,662,783	30,286,057
Capital development loans receivable, net	3,543,384	-	-	3,543,384
Due from other funds	2,421,457	7,887,700	-	10,309,157
Property and equipment, net	-	271,025	6,844,258	7,115,283
Land	-	-	10,409,682	10,409,682
Foreclosed real estate	-	1,522,923	-	1,522,923
Other assets	-	-	210,794	210,794
Total noncurrent assets	5,964,841	26,304,922	31,127,517	63,397,280
	\$ 16,491,363	\$ 37,217,087	\$ 35,906,854	\$ 89,615,304
<u>LIABILITIES AND NET ASSETS</u>				
Current liabilities:				
Current installment of notes payable	\$ 109,814	\$ -	\$ -	\$ 109,814
Accounts payable and accrued expenses	-	425,677	392,445	818,122
Interest payable	-	-	2,036,748	2,036,748
Total current liabilities	109,814	425,677	2,429,193	2,964,684
Notes payable, net of current installments	1,890,186	-	10,000,000	11,890,186
Due to other funds	7,887,700	-	2,421,457	10,309,157
Total liabilities	9,887,700	425,677	14,850,650	25,164,027
Net assets:				
Investment in capital assets	-	814,025	17,253,940	18,067,965
Restricted	6,603,663	35,977,385	3,802,264	46,383,312
Total net assets	6,603,663	36,791,410	21,056,204	64,451,277
	\$ 16,491,363	\$ 37,217,087	\$ 35,906,854	\$ 89,615,304

See Accompanying Independent Auditors' Report.

COMMONWEALTH DEVELOPMENT AUTHORITY

Combining Statement of Revenues, Expenses and Changes in Net Assets  
Year Ended September 30, 2003

	Development Banking Division	Development Corporation Division	Component Unit Northern Marianas Housing Corporation	Total
Operating revenues:				
Interest and fees on loans	\$ 240,955	\$ 3,299,192	\$ 1,356,814	\$ 4,896,961
Section 8 income:				
Federal housing assistance rentals	-	-	3,048,227	3,048,227
Tenant share	-	-	79,448	79,448
Interest on investments	164,870	116,837	-	281,707
HOME Investment Partnership Program grants	-	-	113,466	113,466
CDBG Program Grant	-	-	394,736	394,736
ESG Program Grant	-	-	8,713	8,713
Housing rental	-	-	5,102	5,102
Other	-	185,870	128,808	314,678
<b>Total operating revenues</b>	<b>405,825</b>	<b>3,601,899</b>	<b>5,135,314</b>	<b>9,143,038</b>
Operating expenses:				
Provision for doubtful accounts	-	1,151,240	876,360	2,027,600
Section 8 rental	-	-	1,595,239	1,595,239
Salaries and wages	-	583,535	679,184	1,262,719
Depreciation	-	97,249	597,669	694,918
Repairs and maintenance	-	-	594,479	594,479
Employee benefits	-	282,163	205,897	488,060
CDBG Program Grant	-	-	394,736	394,736
Professional fees	-	127,944	50,668	178,612
Office rent	-	134,521	9,600	144,121
HOME Investment Partnership Program grants	-	-	113,466	113,466
Travel	-	34,936	45,037	79,973
ESG Program Grant	-	-	9,014	9,014
Other	214,745	295,482	554,303	1,064,530
<b>Total operating expenses</b>	<b>214,745</b>	<b>2,707,070</b>	<b>5,725,652</b>	<b>8,647,467</b>
<b>Operating (loss) income</b>	<b>191,080</b>	<b>894,829</b>	<b>(590,338)</b>	<b>495,571</b>
Nonoperating revenues (expenses):				
Interest income	-	-	70,475	70,475
Interest expense	-	(22,953)	(795,473)	(818,426)
<b>Total nonoperating revenues (expenses), net</b>	<b>-</b>	<b>(22,953)</b>	<b>(724,998)</b>	<b>(747,951)</b>
<b>Loss before contributions and transfers</b>	<b>191,080</b>	<b>871,876</b>	<b>(1,315,336)</b>	<b>(252,380)</b>
Contributed capital	-	-	120,689	120,689
Transfers out for capital development grants	(4,795,111)	-	-	(4,795,111)
<b>Change in net assets</b>	<b>(4,604,031)</b>	<b>871,876</b>	<b>(1,194,647)</b>	<b>(4,926,802)</b>
Net assets - beginning	11,207,694	35,919,534	22,250,851	69,378,079
<b>Net assets - ending</b>	<b>\$ 6,603,663</b>	<b>\$ 36,791,410</b>	<b>\$ 21,056,204</b>	<b>\$ 64,451,277</b>

See Accompanying Independent Auditors' Report.

COMMONWEALTH DEVELOPMENT AUTHORITY

Combining Statement of Cash Flows  
Year Ended September 30, 2003

	Development Banking Division	Development Corporation Division	Component Unit Northern Marianas Housing Corporation	Total
<b>Cash flows from operating activities:</b>				
Cash received from interest and fees on loans receivable	\$ -	\$ 1,053,941	\$ 1,096,171	\$ 2,150,112
Cash received from interest and fees on capital development loans	279,249	-	-	279,249
Interest and dividends on investments	164,870	116,837	-	281,707
Cash payments to suppliers for goods and services	(214,745)	(940,418)	(1,374,306)	(2,529,469)
Cash received from customers	-	156,234	210,982	367,216
Cash payments to employees for services	-	(583,535)	(885,081)	(1,468,616)
Cash received from federal grant awards	-	-	3,614,984	3,614,984
Cash payments from federal grant awards	-	-	(2,142,500)	(2,142,500)
Net cash provided by (used for) operating activities	229,374	(196,941)	520,250	552,683
<b>Cash flows from noncapital financing activities:</b>				
Net repayment under line of credit	-	-	(789,799)	(789,799)
Net cash used for noncapital financing activities	-	-	(789,799)	(789,799)
<b>Cash flows from capital and related financing activities:</b>				
Net interdivisional transactions	(132,031)	1,115,378	(983,347)	-
Acquisition of property and equipment	-	(41,452)	-	(41,452)
Proceeds from sale of property and equipment	-	-	221,763	221,763
Contributed capital	-	-	120,689	120,689
Net proceeds (disbursements) of loans receivable	-	580,757	(436,164)	144,593
Payments received on capital development loans	443,317	-	-	443,317
Capital development grants	(4,795,111)	-	-	(4,795,111)
Proceeds from notes payable	2,000,000	-	-	2,000,000
Principal paid on notes payable	-	(674,740)	-	(674,740)
Interest paid on notes payable	-	(22,953)	(31,817)	(54,770)
Net cash (used for) provided by capital and related financing activities	(2,483,825)	956,990	(1,108,876)	(2,635,711)
<b>Cash flows from investing activities:</b>				
Net proceeds from sale and maturities of restricted cash and cash equivalents, time certificates of deposit and investments	2,254,451	-	2,141,890	4,396,341
Net purchase of restricted cash and cash equivalents, time certificates of deposit and investments	-	(465,971)	-	(465,971)
Interest income	-	-	70,475	70,475
Net cash provided by (used for) investing activities	2,254,451	(465,971)	2,212,365	4,000,845
Net increase in cash and cash equivalents	-	294,078	833,940	1,128,018
Cash and cash equivalents at beginning of year	-	1,260,801	280,621	1,541,422
Cash and cash equivalents at end of year	\$ -	\$ 1,554,879	\$ 1,114,561	\$ 2,669,440
<b>Reconciliation of operating (loss) income to net cash provided by (used for) operating activities:</b>				
Operating income (loss)	\$ 191,080	\$ 894,829	\$ (590,338)	\$ 495,571
Adjustments to reconcile operating income (loss) to net cash provided by (used for) operating activities:				
Provision for doubtful accounts	-	1,151,240	876,360	2,027,600
Depreciation	-	97,249	597,669	694,918
(Increase) decrease in assets:				
Receivables:				
Rent	-	-	(2,376)	(2,376)
Other	-	(29,636)	19,797	(9,839)
Accrued interest	38,294	(2,245,251)	(260,643)	(2,467,600)
Inventory	-	-	269,849	269,849
Prepaid expenses	-	(33,019)	800	(32,219)
Other assets	-	57,997	(450)	57,547
Increase (decrease) in liabilities:				
Accounts payable and accrued expenses	-	(90,350)	(390,418)	(480,768)
Net cash provided by (used for) operating activities	\$ 229,374	\$ (196,941)	\$ 520,250	\$ 552,683

See Accompanying Independent Auditors' Report.

COMMONWEALTH DEVELOPMENT AUTHORITY

INDEPENDENT AUDITORS' REPORTS ON  
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2003

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

Board of Directors  
Commonwealth Development Authority:

We have audited the financial statements of the Commonwealth Development Authority (CDA), as of and for the year ended September 30, 2003, and have issued our report thereon dated November 21, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered CDA's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect CDA's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs (pages 9 through 13) as items 2003-1 through 2003-3.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider item 2003-3 to be a material weakness. We also noted other matters involving the internal control over financial reporting that we have reported to management in a separate letter dated November 21, 2003.

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

*Deloitte & Touche*

November 21, 2003



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

Board of Directors  
Commonwealth Development Authority:

Compliance

We have audited the compliance of the Commonwealth Development Authority (CDA) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2003. CDA's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 9 through 13). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of CDA's management. Our responsibility is to express an opinion on CDA's compliance based on our audit.

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 CDA's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on CDA's compliance with those requirements.

As described in item 2003-4 in the accompanying Schedule of Findings and Questioned Costs, CDA did not comply with requirements regarding reporting related to U.S. Department Housing and Urban Development programs, that are applicable to its major programs. Compliance with such requirements is necessary, in our opinion, for CDA to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, CDA complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2003.



### Internal Control Over Compliance

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

We noted one matter involving the internal control over compliance and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect CDA's ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts, and grants. The reportable condition is described in the accompanying Schedule of Findings and Questioned Costs as item 2003-4.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions described above to be material weaknesses. However, we do not consider the reportable condition described above to be a material weakness.

### Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of CDA as of and for the year ended September 30, 2003, and have issued our report thereon dated November 21, 2003. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards (page 5) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of CDA. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

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

*Deloitte & Touche*

November 21, 2003

COMMONWEALTH DEVELOPMENT AUTHORITY

Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2003

Federal Grantor/ Program Title	Federal CFDA Number	Federal Cumulative Amount of Grant Award	Federal Funds Received in Fiscal Year 2003	Federal Funds Expended in Fiscal Year 2003 (see note 2a)
Direct Programs:				
U.S. Department of the Interior /Covenant Capital Development Fund	15.875	\$ 3,036,935	\$ 3,036,935	\$ 3,036,935
U.S. Department of Housing and Urban Development /Section 8 Housing Choice Voucher Program	14.871	1,887,348	1,887,348	1,887,348
U.S. Department of Housing and Urban Development /Lower Income Housing Assistance Program	14.856	461,085	461,085	461,085
	14.856	255,292	255,292	255,292
	14.856	265,179	265,179	265,179
	14.856	179,323	179,323	179,323
Subtotal CFDA #14.856		1,160,879	1,160,879	1,160,879
U.S. Department of Housing and Urban Development /Community Development Block Grant	14.225	100,000	33,248	33,248
	14.225	152,190	108,604	78,807
	14.225	107,272	4,522	4,522
	14.225	155,247	74,740	74,740
	14.225	25,000	25,000	25,000
	14.225	91,345	39,768	39,768
	14.225	57,848	7,407	7,321
	14.225	40,000	2,577	2,577
	14.225	128,753	128,753	128,753
Subtotal CFDA #14.225		857,655	424,619	394,736
U.S. Department of Housing and Urban Development /Emergency Shelter	14.231	40,000	10,068	10,068
U.S. Department of Housing and Urban Development /HOME Investment Partnerships Program	14.239	61,950	187	-
	14.239	351,050	131,883	131,883
Subtotal CFDA #14.239		413,000	132,070	131,883
U.S. Department of Agriculture /Rural Development/ Home Preservation Grant	10.417	39,500	-	-
		<u>\$ 7,435,317</u>	<u>\$ 6,651,919</u>	<u>\$ 6,621,849</u>
Reconciliation of expenditures to Statement of Revenues, Expenses and Changes in Net Assets:				
Federal award expenditures per above:				
U.S. Department of the Interior/Covenant Capital Development Fund				\$ 3,036,935
U.S. Department of Housing and Urban Development/Emergency Shelter				10,068
U.S. Department of Housing and Urban Development/HOME Investment Partnerships Program				131,883
				<u>\$ 3,178,886</u>
Federal award expenditures per Statement of Revenues, Expenses and Changes in Net Assets:				
Transfers out for capital development grants				\$ 4,795,111
U.S. Department of Housing and Urban Development/Emergency Shelter				9,014
U.S. Department of Housing and Urban Development/HOME Investment Partnerships Program				113,466
Total federal award expenditures per Statement of Revenues, Expenses and Changes in Net Assets				4,917,591
Reconciling items:				
Transfer out for capital development grant, not funded by Covenant Funds				(2,000,000)
Administrative expenditures funded by Covenant Funds				241,824
Unidentified difference				19,471
				<u>\$ 3,178,886</u>

See accompanying notes to schedule of expenditures of federal awards.

# COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2003

## (1) Scope of Review

The Commonwealth Development Authority (CDA) was created as an autonomous public agency of the Commonwealth of the Northern Mariana Islands (CNMI) pursuant to Public Law 4-49 as amended by Public Law 4-63 and 5-27. CDA's existence is to be perpetual and it shall have all the rights and privileges of a corporation. The purpose of CDA is to stimulate the economic development of the CNMI. The Northern Marianas Housing Corporation (NMHC), a component unit and subsidiary corporation of CDA, was established under Public Law 5-37 as amended by Public Law 5-67. The purpose of NMHC is to develop and administer low cost residential housing in the CNMI. All significant operations of CDA and NMHC 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 CDA's cognizant agency for 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 award received. Disbursements made to subrecipients related to grant agreements are reported as expenditures. Disbursements made to subrecipients related to loan agreements are reported within applicable loan portfolios, and are subject to the Single Audit.

### b. Subgrantees

Certain program funds are passed through CDA to subgrantee organizations. The Schedule of Expenditures of Federal Awards does not contain separate schedules disclosing how the subgrantees outside of CDA's control utilized the funds.

### c. Funds Received

*United States Department of the Interior, Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America (the Covenant)*

- *Covenant Capital Development Funds obtained pursuant to the Agreement of the Special Representatives on Future United States Financial Assistance for the Northern Mariana Islands (the Agreement).*

## COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2003

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

#### c. Funds Received, Continued

CDA is a subrecipient of funding obtained in Part II, Section 3 of the Agreement, from the Government of the CNMI. These funds are to be disbursed in accordance with a seven-year strategic plan for capital improvement projects of which a minimum of eighty percent (80%) shall be obligated and expended in accordance with such plan for essential infrastructure and no more than twenty percent (20%) shall be obligated and expended in accordance with such plan to provide for economic development activities. Additionally, CDA is required to establish a revolving fund, into which repayments of principal and interest from revenue producing projects shall be deposited for financing of additional revenue producing capital development projects.

- Covenant Funds Obtained Pursuant to Article VII, Section 702(c) of the Covenant.

CDA accounts for all funds received by the former Northern Mariana Islands Economic Development Loan Fund pursuant to Article VII Section 702(c) of the Covenant from February 15, 1975 through September 30, 1985. In addition, CDA has been designated as the administrative agency for economic development loans transferred from the Trust Territory of the Pacific Islands government to the CNMI. In total, these funds are accounted for in a revolving fund for economic development loans which are made to qualified private sector enterprises.

*U.S. Department of HUD - CDBG Grants/HOME Investment Partnerships Program/Emergency Shelter Grants Program/Affordable Housing Program - NMHC* received these funds in a direct capacity in fiscal year 2003 and administers the funds and is responsible for ensuring compliance with laws and regulations.

*U.S. Department of the Interior - NMHC* records federal funds received from Covenant appropriations. Program income is interest income earned on notes receivable and time certificates of deposit. Federal funds disbursed are recorded as notes receivable, cash and time certificates of deposit, and operating transfers.

*U.S. Department of HUD - Lower Income Housing Assistance Program/Section 8 Rental Voucher Program/Section 8 Rental Certificate Program - NMHC* records federal rental assistance as Section 8 income. Program requirements do not entail the reporting of expenditures except for project No. TQ10-0016-004, Koblerville.

*U.S. Department of Agriculture - Rural Development - NMHC* received these funds in a direct capacity in fiscal year 2003 and administers the funds and is responsible for ensuring compliance with laws and regulations.

#### d. Indirect Cost Allocation

CDA does not receive an indirect cost allocation.

COMMONWEALTH DEVELOPMENT AUTHORITY

Notes to Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2003

(3) Loan Funds

a. Development Banking Division

The Development Banking Division of CDA represents the revolving fund required under the *Agreement of the Special Representatives on Future United States Financial Assistance for the Northern Mariana Islands* into which repayments of principal and interest from revenue-producing projects funded under Section 702(c) of the Covenant shall be deposited. These funds will be used for financing additional revenue-producing capital development projects. During the year ended September 30, 2003, such funds amounting to \$2,795,111 were transferred out as capital development grants to CNMI Office of the Governor for matching funds for grants from the U.S. Department of the Interior. As of September 30, 2003, \$4,147,032 (net of the allowance for doubtful accounts of \$66,159,100) of loans made out of this revolving fund were outstanding.

b. Development Corporation Division

The Development Corporation Division (DCD) of CDA represents the revolving fund established to account for funds received by the former Northern Mariana Islands Economic Development Loan Fund pursuant to Section 702(c) of the Covenant from February 15, 1975 through September 30, 1985. In addition to the aforementioned financial resources, DCD has been designated as the administrative agency for economic development loans transferred from the Trust Territory of the Pacific Islands government to the CNMI. DCD also served as an intermediary lender for part of the year, for the SBA Microloan Program and obtained loans from SBA and used the loan funds to issue short-term microloans to qualified newly-established and growing small business concerns in the CNMI. As of September 30, 2003, \$17,549,758 (net of the allowance for doubtful accounts of \$17,548,481) of loans made out of this revolving fund were outstanding.

c. Northern Marianas Housing Corporation

The Northern Marianas Housing Corporation (formerly the Mariana Islands Housing Authority (MIHA)) received economic development loan funds from the former Northern Mariana Islands Economic Development Loan Fund pursuant to a Memorandum of Understanding transferring funds received under Section 702(c) of the Covenant to MIHA. These funds are used for a revolving fund for a special program of low interest housing loans for low income families. As of September 30, 2003, \$4,350,141 (net of the related allowance for doubtful accounts of \$289,317 and out of total NMHC net loans receivable of \$14,313,391) of loans made out of this revolving fund were outstanding.

COMMONWEALTH DEVELOPMENT AUTHORITY

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2003

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

1. The Independent Auditors' Report on the financial statements expressed an unqualified opinion.
2. Reportable conditions in internal control over financial reporting were identified, one of which is considered to be a material weakness.
3. No instances of noncompliance considered material to the financial statements were disclosed by the audit.
4. One reportable condition in internal control over compliance with requirements applicable to major federal awards programs was identified, which is not considered to be a material weakness.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. CDA's major programs were as follows:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
U.S. Department of Housing and Urban Development:	
Lower Income Housing Assistance Program	14.856
Community Development Block Grant	14.225
U.S. Department of the Interior:	
Capital Development Program	15.875
Economic Development Loan Fund	15.875

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

**Section II - Financial Statement Findings**

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>	<u>Refer Page #</u>
2003-1	Cash Receipts	\$ -	10
2003-2	Cash Disbursements	\$ -	11
2003-3	Receivables	\$ -	12

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

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>	<u>Refer Page #</u>
2003-4	Reporting	\$ -	13

COMMONWEALTH DEVELOPMENT AUTHORITY

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2003

**Section II - Financial Statement Findings**

Cash Receipts

Finding No. 2003-1

Criteria: An effective internal control system should include adequate segregation of duties, batch control numbers, and independent review of transactions and recording.

Condition: During the year ended September 30, 2003, the following weaknesses existed within the cash receipt business cycle of the Loan Base System utilized by NMHC to record, summarize and report daily collections:

- a. Receipt numbers generated by the system were susceptible to manual alterations and manual assignment. As such, a break in the sequential numbering of receipts could be forced manually.
- b. A summary of the day's collections by receipt number was not an available option, thereby eliminating the possibility of independent review for completeness of collections.
- c. An option existed that permitted cash receipts to be posted to loan accounts at a later date.
- d. Segregation of duties between cash custody and recording was sometimes compromised due to staff absence.
- e. Monthly loan statements were not circulated.

Cause: The cause of the above condition is deficiencies within the Loan Base System and lack of clearly established policies regulating internal control procedures.

Effect: The effect of the above condition is an increase in the risk of errors and/or irregularities occurring and not being detected in a timely manner.

Recommendation: Shortly after fiscal year end, NMHC implemented the following procedures which address or mitigate the above weaknesses:

- a. Daily collections are now being processed by a different cash receipt system, which is linked with the general ledger. This system prevents manual alterations to the receipt numbering process and provides a summary of day's receipts. Postings to loan accounts are required to reconcile to the summary report.
- b. A monthly statement is now being circulated to borrowers, which serves as a reminder notice for payment and provides the borrower an opportunity to reconcile their accounts with NMHC.

We commend management for their prompt action in addressing the above weaknesses. We also recommend that management define clear internal control policies, which regulate custody and recording of assets.

COMMONWEALTH DEVELOPMENT AUTHORITY

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2003

Cash Disbursement

Finding No. 2003-2

Criteria: A basic element of internal control is independent review of transactions and their recording.

Condition: Our review of the Section 8 Housing Choice Voucher Program noted that disbursements issued under the program are not being reviewed by management. This is because management presumes reliance on the eligibility review process. However, this review process is primarily performed on manual documents and does not include a review of the electronic database, which is the basis for initializing checks. Subsequent alterations to the electronic database after the review of manual documents may not be detected.

Cause: The cause of the above condition is documented above.

Effect: The effect of the above condition is a risk that potential irregularities may not be detected in a timely manner.

Recommendation: We recommend that a review of the check initialization run (a preliminary printout of checks to be printed) be performed by independent, knowledgeable personnel (specifically, the Housing Manager) whose scan of the printout can detect possible unauthorized payments on the list.



COMMONWEALTH DEVELOPMENT AUTHORITY

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2003

Receivables

Finding No. 2003-3

Criteria: An effective system of internal control includes procedures to ensure that loan payments are received on a timely basis.

Condition: Our audit included an analysis of the Development Corporation Division's past due loans to determine the propriety of the allowance for doubtful loans as of September 30, 2003. This analysis revealed that as of September 30, 2003, one hundred twenty-seven loans (57% of the two hundred twenty-three total loans outstanding) were six months or more in arrears. At September 30, 2002, one hundred twenty-seven (55%) of two hundred fourteen loans outstanding were six months or more in arrears. Accrued interest on loans has also increased from \$6,728,186 at September 30, 2002 to \$8,969,125 as of September 30, 2003. As such, the collateral for these loans is becoming smaller as a percentage of the loan and interest.

Cause: The cause of the above condition is the increase in past due loans.

Effect: The effect of the above condition is an increased possibility of loan losses due to non-payment by borrowers.

Recommendation: We recommend that follow-up procedures on past due loans be adhered to. We recommend that evaluations be performed on these loans and a corrective plan be developed and documented. Future results may be compared against this plan and actions taken by management as deemed necessary. Legal action should be considered for those loans which are considered unlikely to be serviceable by the borrower.

Prior Year Status: Past due loans was reported as a finding in the Single Audits of CDA for fiscal years 1994 through 2002.

COMMONWEALTH DEVELOPMENT AUTHORITY

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2003

Reporting - Community Development Block Grant  
CFDA #14.225

Finding No. 2003-4

Criteria: HUD requires that CDBG expenditures be reported on SF-272, Federal Cash Transactions Report.

Condition: NMHC draws funds for use in CDBG expenditures and reports these expenditures on the SF-272. We noted that funds drawn were reprogrammed to other HUD approved projects resulting in variances between project expenditures reported on the SF-272 and the general ledger by individual projects. In addition, a prior year expenditure was reported on the SF-272 as a fiscal year 2003 expenditure creating a variance between SF-272 summaries and the general ledger of \$29,797.

Cause: The cause of the above condition is the failure of management to report the proper amount of expenditures to HUD.

Effect: The effect of the above condition is the improper reporting of CDBG expenditures and possible use of funds for unallowable costs.

Recommendation: We recommend that management ensure proper reporting of expenditures on SF-272's to HUD.

Prior Year Status: Incorrect reporting of expenditures on the SF-272 was reported as a finding in the Single Audit of CDA for fiscal year 2002.

COMMONWEALTH DEVELOPMENT AUTHORITY

Unresolved Prior Year Findings and Questioned Costs  
Year Ended September 30, 2003

The status of unresolved prior year findings is discussed within the Schedule of Findings and Questioned Costs section of this report (pages 9 through 13). There are no unresolved questioned costs from prior year audits of CDA.



# COMMONWEALTH DEVELOPMENT AUTHORITY

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Corrective Action Plans to Questioned Costs and Findings included in the Independent Auditors' Report on Internal Control and Compliance for the Year Ended September 30, 2003

## **Financial Statements Findings**

### Cash Receipts

#### Finding No. 2003-1

Daily collections are now being processed by a different cash receipt system, which is linked with the general ledger. This system prevents manual alterations to the receipt numbering process, and provides a summary of day's receipts. Postings to loan accounts are required to the summary. A monthly statement is now being circulated to borrowers, which serves as a reminder notice for payment and provides the borrower opportunity to reconcile their accounts with NMHC.

### Cash Disbursement

#### Finding No. 2003-2

Action was taken to avoid risk of potential errors on the Housing Choice Voucher disbursement of checks. Prior to printing of checks, the amount from the initialization was reviewed and checked against the Housing Choice Voucher and Utility Reimbursement payment list for the month to ensure no overpayment or cash disbursement is made. The Manager, Program & Housing Division, will be responsible to verify initial check prior to disbursement.

### Receivables

#### Finding No. 2003-3

With the new Loan Manager on board, the Loan Department of CDA has a plan of action to contact all delinquent clients and arrange a Workout on their loans. With these Workouts, they will eventually decrease the delinquency rate. Emphasis was also made to increase collection. Furthermore, emphasis was made in following protocols of legal proceedings. CDA will adhere to its Rules & Regulations and follow-up procedures on past due loans.

## **Federal Award Findings and Questioned Costs**

### Reporting - Community Development Block Grant

#### Finding No. 2003-4

Any reporting to HUD on SF-272s may be only a cut-off difference. Drawdowns made on the Integrated Disbursement & Information System (IDIS) is tied to the SF-272 reports by HUD, Honolulu. We double check the drawdowns compared from the drawdowns report and this would be tied up with disbursement made when we received funds from IDIS. We are very aware of the rules and regulations and in compliance of SF-272s for proper expenditure reporting on the cash transactions.



# COMMONWEALTH DEVELOPMENT AUTHORITY

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## Summary of Schedule of Prior Audit Findings

Status of audit findings included in the schedule of findings and questioned costs for the year ended September 30, 2002:

### **Financial Statement Findings**

Finding No. 2002-1 - Not corrected. See corrective action plan to Finding No. 2003-3.

### **Federal Award Findings and Questioned Costs**

Finding No. 2002-2 - Corrective action has been taken.

Finding No. 2002-3 - Corrective action has been taken.

Finding No. 2002-4 - Not corrected. See corrective action plan to Finding No. 2003-4.